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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 Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases.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).
- Index.

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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 Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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T.D. 8895, *304*

Section 6103. – Confidentiality and Disclosure of Returns and Return Information
T.D. 8908, *585*

Section 6104. – Publicity of Information Required From Certain Exempt Organizations and Certain Trusts
Rev. Rul. 2000–49, *430*

Section 6111. – Registration of Tax Shelters
T.D. 8896, *249*

Section 6302. – Mode or Time of Collection
T.D. 8909, *596*

Section 6501. – Limitations on Assessment and Collection
Rev. Proc. 2000–34, *186*

Section 6621. – Determination of Rate of Interest
Rev. Rul. 2000–42, *297*
Rev. Rul. 2000–57, *579*

Section 6652. – Failure to File Certain Information Returns, Registration Statements, etc.
Rev. Rul. 2000–49, *430*

Section 6695. – Other Assessable Penalties With Respect to the Preparation of Income Tax Returns for Other Persons
T.D. 8893, *143*
T.D. 8905, *435*

Section 7520. – Valuation Tables
Rev. Rul. 2000–32, *1* T.D. 8886, *3*
Rev. Rul. 2000–38, *157*
Rev. Rul. 2000–41, *248*
Rev. Rul. 2000–45, *337*
Rev. Rul. 2000–50, *462*
Rev. Rul. 2000–54, *566*

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

Rev. Rul. 2000–32, *1*
Rev. Rul. 2000–38, *157*
Rev. Rul. 2000–41, *248*
Rev. Rul. 2000–45, *337*
Rev. Rul. 2000–50, *462*
Rev. Rul. 2000–54, *566*
Rev. Rul. 2000–56, *597*

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 decision:

Kathy A. King v. Commissioner,[1]
115 T.C. No. 8

Weisbart v. United States Department of Treasury and Internal Revenue Service,[2]
222 F. 3d 93 (2d Cir. 2000), **rev'g** 99–1 USTC (CCH) ¶ 50,549 (E.D.N.Y. 1999)

The Commissioner does NOT ACQUIESCE in the following decision:

John D. Shea v. Commissioner,[3]
112 T.C. 183 (1999)

[1] Acquiescence relating to whether a nonpetitioning spouse (or former spouse) is entitled to notice and an opportunity to become a party within the meaning of I.R.C. section 6015(e)(4) in a deficiency case where the petitioning spouse (or former spouse) is claiming relief from joint and several liability under section 6015.

[2] Acquiescence relating to whether the "timely mailing/timely filing" rule of I.R.C. section 7502 applies to a claim for refund included on a tax return mailed after the due date of the return.

[3] Nonacquiescence relating to whether the burden of proof will be placed on the Commissioner for any issue where the statutory notice of deficiency fails to meet the standards set forth in I.R.C. section 7522.

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Stoppenhagen, Larry	Ft. Wayne, IN	CPA	April 14, 2000 to April 13, 2001
Chon, James	N. Hollywood, CA	CPA	May 22, 2000 to May 21, 2003
Bleyer, Stephen A.	Bala Cynwyd, PA	CPA	June 26, 2000 to December 25, 2000
Knutson, Owen	Ouray, CO	CPA	July 3, 2000 to January 2, 2003
Silverman, Richard E.	Fayetteville, NY	CPA	August 1, 2000 to March 31, 2004
Holt, Jeffrey	Little Rock, AR	Enrolled Agent	October 1, 2000 to March 31, 2003
Barbagallo, Joseph	Newton, PA	CPA	October 15, 2000 to October 14, 2004

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents, or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Luebben, William	Hot Springs, AR	CPA	February 11, 2000

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 2000. See Rev. Rul. 2000–32, on this page.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2000. See Rev. Rul. 2000–32, 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 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000. See Rev. Rul. 2000–32, 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 July 2000.

Rev. Rul. 2000–32

This revenue ruling provides various prescribed rates for federal income tax purposes for July 2000 (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 purposes of section 7872.

REV. RUL. 2000–32 TABLE 1
Applicable Federal Rates (AFR) for July 2000
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	6.60%	6.49%	6.44%	6.40%
110% AFR	7.27%	7.14%	7.08%	7.04%
120% AFR	7.94%	7.79%	7.72%	7.67%
130% AFR	8.62%	8.44%	8.35%	8.30%
Mid-Term				
AFR	6.62%	6.51%	6.46%	6.42%
110% AFR	7.29%	7.16%	7.10%	7.06%
120% AFR	7.96%	7.81%	7.74%	7.69%
130% AFR	8.64%	8.46%	8.37%	8.31%
150% AFR	10.01%	9.77%	9.65%	9.58%
175% AFR	11.71%	11.39%	11.23%	11.13%
Long-Term				
AFR	6.40%	6.30%	6.25%	6.22%
110% AFR	7.05%	6.93%	6.87%	6.83%
120% AFR	7.70%	7.56%	7.49%	7.44%
130% AFR	8.36%	8.19%	8.11%	8.05%

REV. RUL. 2000–32 TABLE 2
Adjusted AFR for July 2000
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.88%	4.82%	4.79%	4.77%
Mid-term adjusted AFR	5.12%	5.06%	5.03%	5.01%
Long-term adjusted AFR	5.79%	5.71%	5.67%	5.64%

REV. RUL. 2000–32 TABLE 3
Rates Under Section 382 for July 2000

Adjusted federal long-term rate for the current month	5.79%
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.)	5.79%

REV. RUL. 2000–32 TABLE 4
Appropriate Percentages Under Section 42(b)(2)
for July 2000

Appropriate percentage for the 70% present value low-income housing credit	8.53%
Appropriate percentage for the 30% present value low-income housing credit	3.66%

REV. RUL. 2000–32 TABLE 5 Rate Under Section 7520 for July 2000	
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	8.0%

REV. RUL. 2000–32 TABLE 6 Blended Annual Rate for 2000	
Section 7872(e)(2) blended annual rate for 2000	6.24%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2000. See Rev. Rul. 2000–32, page 1.

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049–7: Returns of information with respect to REMIC regular interests and collateralized debt obligations.

T.D. 8888

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Real Estate Mortgage Investment Conduits; Reporting Requirements and Other Administrative Matters

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document eliminates the regulatory requirement that the issuer of a collateralized debt obligation (CDO) or regular interest in a real estate mortgage investment conduit (REMIC) set forth certain information on the face of the CDO or regular interest. This action eliminates a reporting burden imposed on issuers of CDOs and regular interests.

EFFECTIVE DATE: These regulations are effective June 16, 2000.

FOR FURTHER INFORMATION CONTACT: Kenneth Christman, (202) 622-3950 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On May 19, 1999, the IRS published in the Federal Register a notice of proposed rulemaking (REG–100905–97, 1999–22 I.R.B. 10 [64 F.R. 27221]) intending to eliminate the regulatory requirement that certain information be set forth on the face of a certificate representing a CDO or REMIC regular interest.

The public hearing scheduled for September 13, 1999, was canceled because no one requested to speak, and the only written comment received supports finalizing the regulations in the form proposed. This Treasury decision, therefore, adopts the proposed regulations with no change.

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 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, 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 Kenneth Christman, 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 continues to read in part as follows:

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

§1.6049–7 [Amended]

Par. 2. In §1.6049–7, paragraph (g) is removed.

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

Approved June 1, 2000.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 15, 2000, 8:45 a.m., and published in the issue of the Federal Register for June 16, 2000, 65 F.R. 37701)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2000. See Rev. Rul. 2000–32, page 1.

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26 CFR Section 20.7520–1.—Valuation of annuities, unitrust interests, interests for life or terms of years, and remainder or reversionary interests.

T.D. 8886

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 20, and 25

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests. These regulations will effect the valuation of inter vivos and testamentary transfers of interests dependent on one or more measuring lives. Section 7520 of the Internal Revenue Code of 1986 (Code) was enacted by section 5031 of the Technical and Miscellaneous Revenue Act of 1988 and was effective on May 1, 1989. These regulations are necessary because section 7520(c)(3) directs the Secretary to revise the actuarial tables used in valuing interests dependent on mortality experience not less frequently than once each 10 years to take into account the most recent mortality experience available as of the time of the revision. This document contains amendments to the regulations revising certain tables used for the valuation of partial interests in property under section 7520 to reflect the most recent mortality experience available.

DATES: These regulations are effective June 12, 2000.

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

SUPPLEMENTARY INFORMATION:

Background

On April 30, 1999, the IRS published in the **Federal Register** (T.D. 8819, 1999-20 I.R.B. 5 [64 F.R. 23187 and 64 F.R. 23245]) temporary regulations and a notice of proposed rulemaking by cross reference to temporary regulations (REG-103851-99, 1999-20, I.R.B. 93) under sections 642, 664, 2031, 2512, and 7520 relating to the use of actuarial tables in valuing annuities, interests for life or terms of years, and remainder or reversionary interests. No written comments responding to the notice of proposed rulemaking by cross reference to temporary regulations were received and, thus, no hearing was held. This document adopts, with no substantive changes, final regulations with respect to this notice of proposed rulemaking by cross reference to temporary regulations.

The following chart summarizes the applicable interest rates and the citations to textual materials and tables for the various periods covered under the regulations:

Cross Reference to Regulation Sections

Valuation *Period*	Interest *Rate*	Regulation *Section*	*Table*
Section 642:			
Valuation, in general	-	1.642(c)-6	
before 01/01/52	4%	1.642(c)-6A(a)	
01/01/52 - 12/31/70	3.5%	1.642(c)-6A(b)	
01/01/71 - 11/30/83	6%	1.642(c)-6A(c)	
12/01/83 - 04/30/89	10%	1.642(c)-6A(d)	Table G
05/01/89 - 04/30/99	§7520	1.642(c)-6A(e)	Table S (05/01/89 - 4/30/99)
after 04/30/99	§7520	1.642(c)-6(e)	Table S (after 04/30/99)
Section 664:			
Valuation, in general	-	1.664-4	
before 01/01/52	4%	1.664-4A(a)	
01/01/52 - 12/31/70	3.5%	1.664-4A(b)	
01/01/71 - 11/30/83	6%	1.664-4A(c)	
12/01/83 - 04/30/89	10%	1.664-4A(d)	Table E, Table F(1)
05/01/89 - 04/30/99	§7520	1.664-4A(e)	Table U(1) (05/01/89 - 4/30/99)
after 04/30/99	§7520	1.664-4(e)(6)	Table D and Tables F(4.2) – F(14.0)
		1.664-4(e)(7)	Table U(1) (after 04/30/99)
Section 2031:			
Valuation, in general	-	20.2031-7	
before 01/01/52	4%	20.2031-7A(a)	
01/01/52 - 12/31/70	3.5%	20.2031-7A(b)	
01/01/71 - 11/30/83	6%	20.2031-7A(c)	
12/01/83 - 04/30/89	10%	20.2031-7A(d)	Table A, Table B, Table LN
05/01/89 - 04/30/99	§7520	20.2031-7A(e)	Table S (05/01/89 - 4/30/99) Life Table 80CNSMT

after 04/30/99	§7520	20.2031–7(d)(6) 20.2031–7(d)(7)	Table B, Table J, Table K Table S (after 04/30/99) and Life Table 90CM
Section 2512:			
Valuation, in general	-	25.2512–5	
before 01/01/52	4%	25.2512–5A(a)	
01/01/52 - 12/31/70	3.5%	25.2512–5A(b)	
01/01/71 - 11/30/83	6%	25.2512–5A(c)	
12/01/83 - 04/30/89	10%	25.2512–5A(d)	
05/01/89 - 04/30/99	§7520	25.2512–5A(e)	
after 04/30/99	§7520	25.2512–5(d)	

Effective Dates

These regulations are applicable in the case of annuities, interests for life or terms of years, and remainder or reversionary interests created after April 30, 1999.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking by cross reference to temporary 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 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 1, 20, and 25 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for 1.642(c)–6T, 1.664–4T and 1.7520–1T to read in part as follows:

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

Par. 2. Section 1.170A–12 is amended by revising paragraphs (b)(2) and (b)(3) to read as follows:

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

* * * * *

(b) * * *

(2) *Computation of depreciation factor.* If the valuation of the remainder interest in depreciable property is dependent upon the continuation of one life, a special factor must be used. The factor determined under this paragraph (b)(2) is carried to the fifth decimal place. The special factor is to be computed on the basis of the interest rate and life contingencies prescribed in §20.2031–7 of this chapter (or for periods before May 1, 1999, §20.2031–7A) and on the assumption that the property depreciates on a straight-line basis over its estimated useful life. For transfers for which the valuation date is after April 30, 1999, special factors for determining the present value of a remainder interest following one life and an example describing the computation is contained in Internal Revenue Service Publication 1459, "Actuarial Values, Book Gimel," (7-1999). A copy of this publication is available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. For transfers for which the valuation date is after April 30, 1989, and before May 1, 1999, special factors for determining the present value of a remainder interest following one life and an example describing the computation is contained in Internal Revenue Service Publication 1459, "Actuarial Values, Gamma Volume," (8-89). This publication is no longer available for purchase from the Superintendent of Documents. However, it may be obtained by requesting a copy from: CC:DOM:CORP:R (IRS Publication 1459), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. See, however, §1.7520–3(b) (relating to exceptions to the use of prescribed tables under certain circumstances). Otherwise, in the case of the valuation of a remainder interest following one life, the special factor may be obtained through use of the following formula:

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

Where:

n=the estimated number of years of useful life,

i=the applicable interest rate under section 7520 of the Internal Revenue Code,

v=1 divided by the sum of 1 plus the applicable interest rate under section 7520 of the Internal Revenue Code,

x=the age of the life tenant, and

lx=number of persons living at age x as set forth in Table 90CM of §20.2031–7 (or, for periods before May 1, 1999, the tables set forth under §20.2031–7A) of this chapter.

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

Example. A, who is 62, donates to Y University a remainder interest in a personal residence, consist-

ing of a house and land, subject to a reserved life estate in A. At the time of the gift, the land has a value of $30,000 and the house has a value of $100,000 with an estimated useful life of 45 years, at the end of which the value of the house is expected to be $20,000. The portion of the property considered to be depreciable is $80,000 (the value of the house ($100,000) less its expected value at the end of 45 years ($20,000)). The portion of the property considered to be nondepreciable is $50,000 (the value of the land at the time of the gift ($30,000) plus the expected value of the house at the end of 45 years ($20,000)). At the time of the gift, the interest rate prescribed under section 7520 is 8.4 percent. Based on an interest rate of 8.4 percent, the remainder factor for $1.00 prescribed in §20.2031–7(d) of this chapter for a person age 62 is 0.27925. The value of the nondepreciable remainder interest is $13,962.50 (0.27925 times $50,000). The value of the depreciable remainder interest is $16,148.80 (0.20186, computed under the formula described in paragraph (b)(2) of this section, times $80,000). Therefore, the value of the remainder interest is $30,111.30.

* * * * *

§1.170A–12T [Removed]

Par. 3. Section 1.170A–12T is removed.

Par. 4. -5. Section 1.642(c)–6 is amended by revising paragraphs (d), (e) and (f) to read as follows:

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

* * * * *

(d) *Valuation.* The present value of the remainder interest in property transferred to a pooled income fund after April 30, 1999, is determined under paragraph (e) of this section. The present value of the remainder interest in property transferred to a pooled income fund for which the valuation date is before May 1, 1999, is determined under the following sections:

Valuation Dates		Applicable
After	*Before*	*Regulations*
	01-01-52	1.642(c)–6A(a)
12-31-51	01-01-71	1.642(c)–6A(b)
12-31-70	12-01-83	1.642(c)–6A(c)
11-30-83	05-01-89	1.642(c)–6A(d)
04-30-89	05-01-99	1.642(c)–6A(e)

(e) *Present value of the remainder interest in the case of transfers to pooled income funds for which the valuation date is after April 30, 1999*—(1) *In general.* In the case of transfers to pooled income funds for which the valuation date is after April 30, 1999, the present value of a remainder interest is determined under this section. See, however, §1.7520–3(b) (relating to exceptions to the use of prescribed tables under certain circumstances). The present value of a remainder interest that is dependent on the termination of the life of one individual is computed by the use of Table S in paragraph (e)(6) of this section. For purposes of the computations under this section, the age of an individual is the age at the individual's nearest birthday.

(2) *Transitional rules for valuation of transfers to pooled income funds.* (i) For purposes of sections 2055, 2106, or 2624, if on May 1, 1999, the decedent was mentally incompetent so that the disposition of the property could not be changed, and the decedent died after April 30, 1999, without having regained competency to dispose of the decedent's property, or the decedent died within 90 days of the date that the decedent first regained competency after April 30, 1999, the present value of a remainder interest is determined as if the valuation date with respect to the decedent's gross estate is either before May 1, 1999, or after April 30, 1999, at the option of the decedent's executor.

(ii) For purposes of sections 170, 2055, 2106, 2522, or 2624, in the case of transfers to a pooled income fund for which the valuation date is after April 30, 1999, and before July 1, 1999, the present value of the remainder interest under this section is determined by use of the section 7520 interest rate for the month in which the valuation date occurs (see §§1.7520–1(b) and 1.7520–2(a)(2)) and the appropriate actuarial tables under either paragraph (e)(6) of this section or §1.642(c)–6A(e)(5), at the option of the donor or the decedent's executor, as the case may be.

(iii) For purposes of paragraphs (e)(2)(i) and (ii) of this section, where the donor or decedent's executor is given the option to use the appropriate actuarial tables under either paragraph (e)(6) of this section or §1.642(c)–6A(e)(5), the donor or decedent's executor must use the same actuarial table with respect to each individual transaction and with respect to all transfers occurring on the valuation date (for example, gift and income tax charitable deductions with respect to the same transfer must be determined based on the same tables, and all assets includible in the gross estate and/or estate tax deductions claimed must be valued based on the same tables).

(3) *Present value of a remainder interest.* The present value of a remainder interest in property transferred to a pooled income fund is computed on the basis of—

(i) Life contingencies determined from the values of *lx* that are set forth in Table 90CM in §20.2031–7(d)(7) of this chapter (see § 20.2031–7A of this chapter for certain prior periods); and

(ii) Discount at a rate of interest, compounded annually, equal to the highest yearly rate of return of the pooled income fund for the 3 taxable years immediately preceding its taxable year in which the transfer of property to the fund is made. For purposes of this paragraph (e), the yearly rate of return of a pooled income fund is determined as provided in paragraph (c) of this section unless the highest rate of return is deemed to be the rate described in paragraph (e)(4) of this section for funds in existence less than 3 taxable years. For purposes of this paragraph (e)(3)(ii), the first taxable year of a pooled income fund is considered a taxable year even though the taxable year consists of less than 12 months. However, appropri-

ate adjustments must be made to annualize the rate of return earned by the fund for that period. Where it appears from the facts and circumstances that the highest yearly rate of return of the fund for the 3 taxable years immediately preceding the taxable year in which the transfer of property is made has been purposely manipulated to be substantially less than the rate of return that would otherwise be reasonably anticipated with the purpose of obtaining an excessive charitable deduction, that rate of return may not be used. In that case, the highest yearly rate of return of the fund is determined by treating the fund as a pooled income fund that has been in existence for less than 3 preceding taxable years.

(4) *Pooled income funds in existence less than 3 taxable years.* If a pooled income fund has been in existence less than 3 taxable years immediately preceding the taxable year in which the transfer is made to the fund and the transfer to the fund is made after April 30, 1989, the highest rate of return is deemed to be the interest rate (rounded to the nearest two-tenths of one percent) that is 1 percent less than the highest annual average of the monthly section 7520 rates for the 3 calendar years immediately preceding the calendar year in which the transfer to the pooled income fund is made. The deemed rate of return for transfers to new pooled income funds is recomputed each calendar year using the monthly section 7520 rates for the 3-year period immediately preceding the calendar year in which each transfer to the fund is made until the fund has been in existence for 3 taxable years and can compute its highest rate of return for the 3 taxable years immediately preceding the taxable year in which the transfer of property to the fund is made in accordance with the rules set forth in the first sentence of paragraph (e)(3)(ii) of this section.

(5) *Computation of value of remainder interest.* The factor that is used in determining the present value of a remainder interest that is dependent on the termination of the life of one individual is the factor from Table S in paragraph (e)(6) of this section under the appropriate yearly rate of return opposite the number that corresponds to the age of the individual upon whose life the value of the remainder interest is based (see §1.642(c)–6A for certain prior periods). The tables in paragraph (e)(6) of this section include factors for yearly rates of return from 4.2 to 14 percent. Many actuarial factors not contained in the tables in paragraph (e)(6) of this section are contained in Table S in Internal Revenue Service Publication 1457, "Actuarial Values, Book Aleph," (7-1999). A copy of this publication is available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. For other situations, see paragraph (b) of this section. If the yearly rate of return is a percentage that is between the yearly rates of return for which factors are provided, a linear interpolation must be made. The present value of the remainder interest is determined by multiplying the fair market value of the property on the valuation date by the appropriate remainder factor. This paragraph (e)(5) may be illustrated by the following example:

Example. A, who is 54 years and 8 months, transfers $100,000 to a pooled income fund, and retains a life income interest in the property. The highest yearly rate of return earned by the fund for its 3 preceding taxable years is 9.47 percent. In Table S, the remainder factor opposite 55 years under 9.4 percent is .17449 and under 9.6 percent is .17001. The present value of the remainder interest is $17,292.00, computed as follows:

Factor at 9.4 percent for age 55	.17449
Factor at 9.6 percent for age 55	.17001
Difference	.00448

Interpolation adjustment:

$$\frac{9.47\% - 9.4\%}{0.2\%} = \frac{x}{.00448}$$

$$x = .00157$$

Factor at 9.4 percent for age 55	.17449
Less: Interpolation adjustment	.00157
Interpolated factor	.17292

Present value of remainder interest:
($100,000 X .17292) $17,292.00

(6) *Actuarial tables.* In the case of transfers for which the valuation date is after April 30, 1999, the present value of a remainder interest dependent on the termination of one life in the case of a transfer to a pooled income fund is determined by use of the following Table S:

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
0	.06752	.06130	.05586	.05109	.04691	.04322	.03998	.03711	.03458	.03233
1	.06137	.05495	.04932	.04438	.04003	.03620	.03283	.02985	.02721	.02487
2	.06325	.05667	.05088	.04580	.04132	.03737	.03388	.03079	.02806	.02563
3	.06545	.05869	.05275	.04752	.04291	.03883	.03523	.03203	.02920	.02668
4	.06784	.06092	.05482	.04944	.04469	.04048	.03676	.03346	.03052	.02791
5	.07040	.06331	.05705	.05152	.04662	.04229	.03845	.03503	.03199	.02928
6	.07310	.06583	.05941	.05372	.04869	.04422	.04025	.03672	.03357	.03076
7	.07594	.06849	.06191	.05607	.05089	.04628	.04219	.03854	.03528	.03236
8	.07891	.07129	.06453	.05853	.05321	.04846	.04424	.04046	.03709	.03407
9	.08203	.07423	.06731	.06115	.05567	.05079	.04643	.04253	.03904	.03592

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
10	.08532	.07734	.07024	.06392	.05829	.05326	.04877	.04474	.04114	.03790
11	.08875	.08059	.07331	.06683	.06104	.05587	.05124	.04709	.04336	.04002
12	.09233	.08398	.07653	.06989	.06394	.05862	.05385	.04957	.04572	.04226
13	.09601	.08748	.07985	.07304	.06693	.06146	.05655	.05214	.04816	.04458
14	.09974	.09102	.08322	.07624	.06997	.06435	.05929	.05474	.05064	.04694
15	.10350	.09460	.08661	.07946	.07303	.06725	.06204	.05735	.05312	.04930
16	.10728	.09818	.09001	.08268	.07608	.07014	.06479	.05996	.05559	.05164
17	.11108	.10179	.09344	.08592	.07916	.07306	.06755	.06257	.05807	.05399
18	.11494	.10545	.09691	.08921	.08227	.07601	.07034	.06521	.06057	.05636
19	.11889	.10921	.10047	.09259	.08548	.07904	.07322	.06794	.06315	.05880
20	.12298	.11310	.10417	.09610	.08881	.08220	.07622	.07078	.06584	.06135
21	.12722	.11713	.10801	.09976	.09228	.08550	.07935	.07375	.06866	.06403
22	.13159	.12130	.11199	.10354	.09588	.08893	.08260	.07685	.07160	.06682
23	.13613	.12563	.11612	.10748	.09964	.09250	.08601	.08009	.07468	.06975
24	.14084	.13014	.12043	.11160	.10357	.09625	.08958	.08349	.07793	.07284
25	.14574	.13484	.12493	.11591	.10768	.10018	.09334	.08708	.08135	.07611
26	.15084	.13974	.12963	.12041	.11199	.10431	.09728	.09085	.08496	.07956
27	.15615	.14485	.13454	.12513	.11652	.10865	.10144	.09484	.08878	.08322
28	.16166	.15016	.13965	.13004	.12124	.11319	.10580	.09901	.09279	.08706
29	.16737	.15567	.14497	.13516	.12617	.11792	.11035	.10339	.09699	.09109
30	.17328	.16138	.15048	.14047	.13129	.12286	.11510	.10796	.10138	.09532
31	.17938	.16728	.15618	.14599	.13661	.12799	.12004	.11272	.10597	.09974
32	.18568	.17339	.16210	.15171	.14214	.13333	.12520	.11769	.11076	.10435
33	.19220	.17972	.16824	.15766	.14790	.13889	.13058	.12289	.11578	.10920
34	.19894	.18627	.17460	.16383	.15388	.14468	.13618	.12831	.12102	.11426
35	.20592	.19307	.18121	.17025	.16011	.15073	.14204	.13399	.12652	.11958
36	.21312	.20010	.18805	.17691	.16658	.15701	.14814	.13990	.13225	.12514
37	.22057	.20737	.19514	.18382	.17331	.16356	.15450	.14608	.13825	.13096
38	.22827	.21490	.20251	.19100	.18031	.17038	.16113	.15253	.14452	.13705
39	.23623	.22270	.21013	.19845	.18759	.17747	.16805	.15927	.15108	.14344
40	.24446	.23078	.21805	.20620	.19516	.18487	.17527	.16631	.15795	.15013
41	.25298	.23915	.22626	.21425	.20305	.19259	.18282	.17368	.16514	.15715
42	.26178	.24782	.23478	.22262	.21125	.20062	.19069	.18138	.17267	.16450
43	.27087	.25678	.24360	.23129	.21977	.20898	.19888	.18941	.18053	.17220
44	.28025	.26603	.25273	.24027	.22860	.21766	.20740	.19777	.18873	.18023
45	.28987	.27555	.26212	.24953	.23772	.22664	.21622	.20644	.19724	.18858
46	.29976	.28533	.27179	.25908	.24714	.23591	.22536	.21542	.20606	.19725
47	.30987	.29535	.28171	.26889	.25682	.24546	.23476	.22468	.21518	.20621
48	.32023	.30563	.29190	.27897	.26678	.25530	.24447	.23425	.22460	.21549
49	.33082	.31615	.30234	.28931	.27702	.26543	.25447	.24412	.23434	.22509
50	.34166	.32694	.31306	.29995	.28756	.27586	.26479	.25432	.24441	.23502
51	.35274	.33798	.32404	.31085	.29838	.28658	.27541	.26482	.25479	.24528
52	.36402	.34924	.33525	.32200	.30946	.29757	.28630	.27561	.26547	.25584
53	.37550	.36070	.34668	.33339	.32078	.30882	.29746	.28667	.27643	.26669
54	.38717	.37237	.35833	.34500	.33234	.32031	.30888	.29801	.28766	.27782

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
55	.39903	.38424	.37019	.35683	.34413	.33205	.32056	.30961	.29918	.28925
56	.41108	.39631	.38227	.36890	.35617	.34405	.33250	.32149	.31099	.30097
57	.42330	.40857	.39455	.38118	.36844	.35629	.34469	.33363	.32306	.31297
58	.43566	.42098	.40699	.39364	.38089	.36873	.35710	.34600	.33538	.32522
59	.44811	.43351	.41956	.40623	.39350	.38133	.36968	.35855	.34789	.33768
60	.46066	.44613	.43224	.41896	.40624	.39408	.38243	.37127	.36058	.35033
61	.47330	.45887	.44505	.43182	.41914	.40699	.39535	.38418	.37347	.36318
62	.48608	.47175	.45802	.44485	.43223	.42011	.40848	.39732	.38660	.37629
63	.49898	.48478	.47115	.45807	.44550	.43343	.42184	.41069	.39997	.38966
64	.51200	.49793	.48442	.47143	.45895	.44694	.43539	.42427	.41357	.40326
65	.52512	.51121	.49782	.48495	.47255	.46062	.44912	.43805	.42738	.41709
66	.53835	.52461	.51137	.49862	.48634	.47449	.46307	.45206	.44143	.43118
67	.55174	.53818	.52511	.51250	.50034	.48860	.47727	.46633	.45576	.44556
68	.56524	.55188	.53899	.52654	.51452	.50291	.49168	.48083	.47034	.46020
69	.57882	.56568	.55299	.54071	.52885	.51737	.50627	.49552	.48513	.47506
70	.59242	.57951	.56703	.55495	.54325	.53193	.52096	.51034	.50004	.49007
71	.60598	.59332	.58106	.56918	.55767	.54651	.53569	.52520	.51503	.50516
72	.61948	.60707	.59504	.58338	.57206	.56108	.55043	.54009	.53004	.52029
73	.63287	.62073	.60895	.59751	.58640	.57561	.56513	.55495	.54505	.53543
74	.64621	.63435	.62282	.61162	.60073	.59015	.57985	.56984	.56009	.55061
75	.65953	.64796	.63671	.62575	.61510	.60473	.59463	.58480	.57523	.56591
76	.67287	.66160	.65063	.63995	.62954	.61940	.60952	.59989	.59050	.58135
77	.68622	.67526	.66459	.65419	.64404	.63415	.62450	.61509	.60590	.59694
78	.69954	.68892	.67856	.66845	.65858	.64895	.63955	.63036	.62140	.61264
79	.71278	.70250	.69246	.68265	.67308	.66372	.65457	.64563	.63690	.62836
80	.72581	.71588	.70618	.69668	.68740	.67833	.66945	.66077	.65227	.64396
81	.73857	.72899	.71962	.71045	.70147	.69268	.68408	.67566	.66741	.65933
82	.75101	.74178	.73274	.72389	.71522	.70672	.69840	.69024	.68225	.67441
83	.76311	.75423	.74553	.73700	.72864	.72044	.71240	.70451	.69678	.68919
84	.77497	.76645	.75809	.74988	.74183	.73393	.72618	.71857	.71110	.70377
85	.78665	.77848	.77047	.76260	.75487	.74728	.73982	.73250	.72530	.71823
86	.79805	.79025	.78258	.77504	.76764	.76036	.75320	.74617	.73925	.73245
87	.80904	.80159	.79427	.78706	.77998	.77301	.76615	.75940	.75277	.74624
88	.81962	.81251	.80552	.79865	.79188	.78521	.77865	.77220	.76584	.75958
89	.82978	.82302	.81636	.80980	.80335	.79699	.79072	.78455	.77847	.77248
90	.83952	.83309	.82676	.82052	.81437	.80831	.80234	.79645	.79064	.78492
91	.84870	.84260	.83658	.83064	.82479	.81902	.81332	.80771	.80217	.79671
92	.85716	.85136	.84563	.83998	.83441	.82891	.82348	.81812	.81283	.80761
93	.86494	.85942	.85396	.84858	.84326	.83801	.83283	.82771	.82266	.81767
94	.87216	.86690	.86170	.85657	.85149	.84648	.84153	.83664	.83181	.82704
95	.87898	.87397	.86902	.86412	.85928	.85450	.84977	.84510	.84049	.83592
96	.88537	.88060	.87587	.87121	.86659	.86203	.85751	.85305	.84864	.84427
97	.89127	.88672	.88221	.87775	.87335	.86898	.86467	.86040	.85618	.85200
98	.89680	.89245	.88815	.88389	.87968	.87551	.87138	.86730	.86326	.85926
99	.90217	.89803	.89393	.88987	.88585	.88187	.87793	.87402	.87016	.86633

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

AGE	INTEREST RATE									
	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
100	.90738	.90344	.89953	.89567	.89183	.88804	.88428	.88056	.87687	.87322
101	.91250	.90876	.90504	.90137	.89772	.89412	.89054	.88699	.88348	.88000
102	.91751	.91396	.91045	.90696	.90350	.90007	.89668	.89331	.88997	.88666
103	.92247	.91912	.91579	.91249	.90922	.90598	.90276	.89957	.89640	.89326
104	.92775	.92460	.92148	.91839	.91532	.91227	.90924	.90624	.90326	.90031
105	.93290	.92996	.92704	.92415	.92127	.91841	.91558	.91276	.90997	.90719
106	.93948	.93680	.93415	.93151	.92889	.92628	.92370	.92113	.91857	.91604
107	.94739	.94504	.94271	.94039	.93808	.93579	.93351	.93124	.92899	.92675
108	.95950	.95767	.95585	.95404	.95224	.95045	.94867	.94689	.94512	.94336
109	.97985	.97893	.97801	.97710	.97619	.97529	.97438	.97348	.97259	.97170

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

AGE	INTEREST RATE									
	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
0	.03034	.02857	.02700	.02559	.02433	.02321	.02220	.02129	.02047	.01973
1	.02279	.02094	.01929	.01782	.01650	.01533	.01427	.01331	.01246	.01168
2	.02347	.02155	.01983	.01829	.01692	.01569	.01458	.01358	.01268	.01187
3	.02444	.02243	.02065	.01905	.01761	.01632	.01516	.01412	.01317	.01232
4	.02558	.02349	.02163	.01996	.01846	.01712	.01590	.01481	.01382	.01292
5	.02686	.02469	.02275	.02101	.01945	.01804	.01677	.01562	.01458	.01364
6	.02825	.02600	.02398	.02217	.02053	.01906	.01773	.01653	.01544	.01445
7	.02976	.02742	.02532	.02343	.02172	.02019	.01880	.01754	.01640	.01536
8	.03137	.02894	.02675	.02479	.02301	.02140	.01995	.01864	.01744	.01635
9	.03311	.03059	.02832	.02627	.02442	.02274	.02122	.01985	.01859	.01745
10	.03499	.03237	.03001	.02788	.02595	.02420	.02262	.02118	.01987	.01867
11	.03700	.03428	.03183	.02961	.02760	.02578	.02413	.02262	.02125	.02000
12	.03913	.03632	.03377	.03146	.02937	.02748	.02575	.02418	.02275	.02144
13	.04135	.03843	.03579	.03339	.03122	.02924	.02744	.02580	.02431	.02294
14	.04359	.04057	.03783	.03534	.03308	.03102	.02915	.02744	.02587	.02444
15	.04584	.04270	.03986	.03728	.03493	.03279	.03083	.02905	.02742	.02593
16	.04806	.04482	.04187	.03919	.03674	.03452	.03248	.03063	.02892	.02736
17	.05029	.04692	.04387	.04108	.03855	.03623	.03411	.03218	.03040	.02877
18	.05253	.04905	.04588	.04299	.04036	.03795	.03574	.03373	.03187	.03017
19	.05484	.05124	.04796	.04496	.04222	.03972	.03742	.03532	.03339	.03161
20	.05726	.05354	.05013	.04702	.04418	.04158	.03919	.03700	.03498	.03313
21	.05980	.05595	.05242	.04920	.04625	.04354	.04105	.03877	.03667	.03473
22	.06246	.05847	.05482	.05147	.04841	.04559	.04301	.04063	.03844	.03642
23	.06524	.06112	.05734	.05387	.05069	.04777	.04508	.04260	.04032	.03821
24	.06819	.06392	.06001	.05642	.05312	.05008	.04728	.04470	.04232	.04012

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

AGE	INTEREST RATE									
	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
25	.07131	.06690	.06285	.05913	.05570	.05255	.04964	.04695	.04447	.04218
26	.07460	.07005	.06586	.06200	.05845	.05518	.05215	.04936	.04677	.04438
27	.07810	.07340	.06907	.06508	.06140	.05800	.05485	.05195	.04925	.04676
28	.08179	.07693	.07246	.06833	.06451	.06098	.05772	.05469	.05189	.04929
29	.08566	.08065	.07603	.07176	.06780	.06414	.06075	.05761	.05469	.05198
30	.08973	.08456	.07978	.07536	.07127	.06748	.06396	.06069	.05766	.05483
31	.09398	.08865	.08372	.07915	.07491	.07098	.06733	.06394	.06078	.05785
32	.09843	.09294	.08785	.08313	.07875	.07468	.07089	.06737	.06409	.06103
33	.10310	.09745	.09220	.08732	.08279	.07858	.07466	.07100	.06759	.06441
34	.10799	.10217	.09676	.09173	.08705	.08269	.07862	.07483	.07129	.06798
35	.11314	.10715	.10157	.09638	.09155	.08704	.08283	.07890	.07522	.07179
36	.11852	.11236	.10662	.10127	.09628	.09162	.08726	.08319	.07938	.07581
37	.12416	.11783	.11193	.10641	.10126	.09645	.09194	.08772	.08377	.08006
38	.13009	.12359	.11751	.11183	.10652	.10155	.09689	.09253	.08843	.08459
39	.13629	.12962	.12338	.11753	.11206	.10693	.10212	.09761	.09337	.08938
40	.14281	.13597	.12955	.12355	.11791	.11262	.10766	.10299	.09860	.09447
41	.14966	.14264	.13606	.12989	.12409	.11864	.11352	.10870	.10417	.09989
42	.15685	.14966	.14291	.13657	.13061	.12500	.11972	.11475	.11006	.10564
43	.16437	.15702	.15010	.14360	.13747	.13171	.12627	.12115	.11631	.11174
44	.17224	.16472	.15764	.15098	.14469	.13876	.13317	.12789	.12290	.11819
45	.18042	.17274	.16550	.15867	.15223	.14615	.14040	.13496	.12982	.12496
46	.18893	.18110	.17370	.16671	.16011	.15387	.14796	.14238	.13708	.13207
47	.19775	.18975	.18220	.17505	.16830	.16190	.15584	.15010	.14466	.13950
48	.20688	.19873	.19102	.18373	.17682	.17027	.16406	.15817	.15258	.14727
49	.21633	.20804	.20018	.19274	.18568	.17898	.17262	.16658	.16084	.15539
50	.22612	.21769	.20969	.20210	.19490	.18805	.18155	.17536	.16948	.16388
51	.23625	.22769	.21955	.21182	.20448	.19749	.19084	.18452	.17849	.17275
52	.24669	.23799	.22973	.22186	.21438	.20726	.20047	.19400	.18784	.18196
53	.25742	.24861	.24022	.23222	.22461	.21735	.21043	.20383	.19753	.19151
54	.26845	.25952	.25101	.24290	.23516	.22777	.22072	.21399	.20756	.20140
55	.27978	.27074	.26212	.25389	.24604	.23853	.23136	.22450	.21793	.21166
56	.29140	.28227	.27355	.26522	.25725	.24963	.24233	.23535	.22867	.22227
57	.30333	.29411	.28529	.27686	.26879	.26106	.25365	.24656	.23976	.23324
58	.31551	.30621	.29731	.28878	.28061	.27278	.26528	.25807	.25116	.24453
59	.32790	.31854	.30956	.30095	.29269	.28477	.27716	.26986	.26284	.25610
60	.34050	.33107	.32202	.31334	.30500	.29699	.28929	.28190	.27478	.26794
61	.35331	.34384	.33473	.32598	.31757	.30948	.30170	.29422	.28701	.28007
62	.36639	.35688	.34772	.33892	.33044	.32229	.31443	.30687	.29958	.29255
63	.37974	.37020	.36101	.35216	.34363	.33542	.32750	.31986	.31250	.30539
64	.39334	.38378	.37456	.36568	.35711	.34884	.34087	.33317	.32574	.31857
65	.40718	.39761	.38838	.37947	.37087	.36257	.35455	.34681	.33932	.33208
66	.42128	.41172	.40249	.39357	.38496	.37663	.36858	.36079	.35326	.34597
67	.43569	.42616	.41694	.40803	.39941	.39107	.38299	.37518	.36761	.36028
68	.45038	.44089	.43170	.42281	.41419	.40585	.39777	.38994	.38235	.37499
69	.46531	.45587	.44672	.43786	.42927	.42094	.41286	.40503	.39743	.39006

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
70	.48040	.47103	.46194	.45312	.44456	.43626	.42820	.42038	.41278	.40540
71	.49558	.48629	.47727	.46851	.46000	.45174	.44371	.43591	.42832	.42095
72	.51082	.50162	.49268	.48399	.47554	.46733	.45934	.45157	.44401	.43666
73	.52607	.51697	.50813	.49952	.49114	.48299	.47506	.46733	.45981	.45249
74	.54139	.53241	.52367	.51515	.50686	.49879	.49092	.48325	.47578	.46849
75	.55683	.54798	.53936	.53095	.52276	.51477	.50698	.49938	.49197	.48474
76	.57243	.56373	.55524	.54696	.53888	.53100	.52330	.51579	.50846	.50130
77	.58819	.57965	.57132	.56318	.55523	.54747	.53988	.53247	.52523	.51815
78	.60408	.59572	.58755	.57957	.57177	.56414	.55668	.54939	.54225	.53527
79	.62001	.61184	.60385	.59604	.58840	.58092	.57360	.56644	.55943	.55256
80	.63582	.62786	.62007	.61244	.60497	.59765	.59048	.58347	.57659	.56985
81	.65142	.64367	.63608	.62864	.62135	.61421	.60721	.60034	.59361	.58701
82	.66673	.65920	.65182	.64458	.63748	.63052	.62368	.61698	.61041	.60395
83	.68175	.67444	.66728	.66024	.65334	.64656	.63991	.63338	.62696	.62066
84	.69657	.68950	.68256	.67574	.66904	.66246	.65599	.64964	.64340	.63727
85	.71128	.70446	.69775	.69116	.68467	.67830	.67204	.66587	.65982	.65386
86	.72576	.71919	.71272	.70636	.70010	.69394	.68789	.68193	.67606	.67029
87	.73981	.73349	.72726	.72114	.71511	.70917	.70333	.69757	.69190	.68632
88	.75342	.74735	.74137	.73548	.72968	.72396	.71833	.71279	.70732	.70194
89	.76658	.76076	.75503	.74938	.74381	.73832	.73290	.72757	.72231	.71712
90	.77928	.77371	.76823	.76281	.75748	.75221	.74702	.74190	.73684	.73186
91	.79131	.78600	.78075	.77557	.77046	.76542	.76044	.75553	.75068	.74589
92	.80246	.79737	.79235	.78740	.78250	.77767	.77290	.76818	.76353	.75893
93	.81274	.80788	.80307	.79832	.79363	.78899	.78441	.77989	.77542	.77100
94	.82232	.81766	.81306	.80850	.80401	.79956	.79517	.79082	.78653	.78228
95	.83141	.82695	.82254	.81818	.81387	.80961	.80539	.80122	.79710	.79302
96	.83996	.83569	.83147	.82729	.82316	.81907	.81503	.81103	.80707	.80315
97	.84787	.84378	.83973	.83573	.83176	.82784	.82396	.82012	.81632	.81255
98	.85530	.85138	.84750	.84366	.83985	.83609	.83236	.82867	.82502	.82140
99	.86255	.85880	.85508	.85140	.84776	.84415	.84057	.83703	.83353	.83005
100	.86960	.86601	.86246	.85894	.85546	.85200	.84858	.84519	.84183	.83849
101	.87655	.87313	.86974	.86638	.86305	.85975	.85648	.85324	.85003	.84684
102	.88338	.88012	.87689	.87369	.87052	.86738	.86426	.86116	.85809	.85505
103	.89015	.88706	.88399	.88095	.87793	.87494	.87197	.86903	.86611	.86321
104	.89737	.89446	.89157	.88871	.88586	.88304	.88024	.87745	.87469	.87195
105	.90443	.90170	.89898	.89628	.89360	.89094	.88830	.88568	.88307	.88049
106	.91351	.91101	.90852	.90605	.90359	.90115	.89873	.89632	.89392	.89154
107	.92452	.92230	.92010	.91791	.91573	.91356	.91141	.90927	.90714	.90502
108	.94161	.93987	.93814	.93641	.93469	.93298	.93128	.92958	.92790	.92622
109	.97081	.96992	.96904	.96816	.96729	.96642	.96555	.96468	.96382	.96296

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
0	.01906	.01845	.01790	.01740	.01694	.01652	.01613	.01578	.01546	.01516
1	.01098	.01034	.00977	.00924	.00876	.00833	.00793	.00756	.00722	.00691
2	.01113	.01046	.00986	.00930	.00880	.00834	.00791	.00753	.00717	.00684
3	.01155	.01084	.01020	.00962	.00909	.00860	.00816	.00775	.00737	.00702
4	.01211	.01137	.01069	.01008	.00952	.00900	.00853	.00810	.00770	.00733
5	.01279	.01201	.01130	.01065	.01006	.00952	.00902	.00856	.00814	.00775
6	.01356	.01274	.01199	.01131	.01068	.01011	.00959	.00910	.00865	.00824
7	.01442	.01356	.01277	.01205	.01140	.01079	.01023	.00972	.00925	.00881
8	.01536	.01446	.01363	.01287	.01218	.01154	.01096	.01041	.00991	.00945
9	.01641	.01546	.01460	.01380	.01307	.01240	.01178	.01120	.01068	.01019
10	.01758	.01659	.01567	.01484	.01407	.01336	.01270	.01210	.01154	.01103
11	.01886	.01781	.01686	.01598	.01517	.01442	.01373	.01310	.01251	.01196
12	.02024	.01915	.01814	.01721	.01636	.01558	.01485	.01419	.01357	.01299
13	.02168	.02054	.01948	.01851	.01762	.01679	.01603	.01533	.01467	.01407
14	.02313	.02193	.02083	.01981	.01887	.01801	.01721	.01646	.01578	.01514
15	.02456	.02330	.02214	.02107	.02009	.01918	.01834	.01756	.01684	.01617
16	.02593	.02462	.02340	.02229	.02126	.02030	.01942	.01860	.01785	.01714
17	.02728	.02590	.02463	.02346	.02238	.02138	.02046	.01960	.01880	.01806
18	.02861	.02717	.02584	.02462	.02348	.02243	.02146	.02056	.01972	.01894
19	.02998	.02847	.02708	.02580	.02461	.02351	.02249	.02154	.02066	.01984
20	.03142	.02984	.02839	.02704	.02580	.02465	.02357	.02258	.02165	.02079
21	.03295	.03130	.02978	.02837	.02706	.02585	.02473	.02368	.02271	.02180
22	.03455	.03283	.03124	.02976	.02839	.02712	.02594	.02484	.02382	.02286
23	.03626	.03446	.03279	.03124	.02981	.02847	.02723	.02608	.02500	.02400
24	.03809	.03620	.03446	.03283	.03133	.02993	.02863	.02741	.02628	.02522
25	.04005	.03808	.03625	.03456	.03298	.03151	.03014	.02887	.02768	.02656
26	.04216	.04010	.03819	.03641	.03476	.03322	.03178	.03044	.02919	.02802
27	.04444	.04229	.04029	.03843	.03670	.03508	.03357	.03217	.03085	.02962
28	.04687	.04463	.04254	.04059	.03877	.03708	.03550	.03402	.03263	.03133
29	.04946	.04712	.04493	.04289	.04099	.03922	.03756	.03600	.03455	.03318
30	.05221	.04976	.04748	.04534	.04335	.04149	.03975	.03812	.03659	.03515
31	.05511	.05255	.05017	.04794	.04585	.04390	.04208	.04037	.03876	.03725
32	.05818	.05551	.05302	.05069	.04851	.04647	.04455	.04276	.04107	.03948
33	.06144	.05866	.05606	.05363	.05135	.04921	.04720	.04532	.04355	.04188
34	.06489	.06200	.05928	.05674	.05436	.05212	.05002	.04805	.04619	.04444
35	.06857	.06555	.06273	.06007	.05758	.05524	.05304	.05097	.04902	.04718
36	.07246	.06932	.06638	.06361	.06101	.05856	.05626	.05409	.05205	.05012
37	.07659	.07332	.07025	.06737	.06466	.06210	.05969	.05742	.05528	.05325
38	.08098	.07758	.07439	.07138	.06855	.06588	.06336	.06099	.05874	.05662
39	.08563	.08210	.07878	.07565	.07270	.06992	.06729	.06480	.06245	.06023
40	.09059	.08692	.08347	.08021	.07714	.07423	.07149	.06889	.06643	.06411
41	.09586	.09206	.08848	.08509	.08189	.07886	.07600	.07329	.07072	.06828
42	.10147	.09753	.09381	.09029	.08696	.08381	.08083	.07800	.07531	.07277
43	.10742	.10334	.09948	.09583	.09237	.08909	.08598	.08304	.08024	.07758
44	.11373	.10950	.10551	.10172	.09813	.09472	.09148	.08841	.08549	.08272

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
45	.12035	.11599	.11185	.10792	.10420	.10066	.09730	.09410	.09106	.08817
46	.12732	.12281	.11853	.11447	.11061	.10694	.10345	.10013	.09696	.09395
47	.13460	.12995	.12553	.12133	.11733	.11353	.10991	.10646	.10317	.10004
48	.14223	.13743	.13287	.12853	.12439	.12046	.11671	.11313	.10972	.10646
49	.15020	.14526	.14056	.13608	.13181	.12774	.12385	.12015	.11661	.11322
50	.15855	.15347	.14862	.14401	.13960	.13540	.13138	.12754	.12388	.12037
51	.16727	.16205	.15707	.15232	.14777	.14344	.13929	.13532	.13153	.12789
52	.17634	.17098	.16587	.16097	.15630	.15183	.14755	.14345	.13953	.13577
53	.18576	.18027	.17501	.16999	.16518	.16057	.15616	.15194	.14789	.14400
54	.19552	.18990	.18451	.17935	.17441	.16968	.16514	.16078	.15661	.15260
55	.20564	.19989	.19437	.18908	.18402	.17915	.17449	.17001	.16571	.16157
56	.21613	.21025	.20461	.19919	.19400	.18901	.18422	.17962	.17519	.17093
57	.22698	.22098	.21522	.20968	.20436	.19925	.19434	.18961	.18507	.18069
58	.23816	.23204	.22616	.22051	.21507	.20984	.20481	.19996	.19530	.19080
59	.24962	.24339	.23740	.23163	.22608	.22073	.21558	.21062	.20584	.20123
60	.26136	.25502	.24892	.24304	.23738	.23192	.22666	.22158	.21669	.21196
61	.27339	.26695	.26075	.25477	.24900	.24343	.23806	.23288	.22787	.22304
62	.28578	.27925	.27295	.26687	.26100	.25533	.24985	.24456	.23945	.23451
63	.29854	.29192	.28553	.27935	.27339	.26762	.26205	.25666	.25145	.24641
64	.31164	.30494	.29846	.29221	.28615	.28030	.27463	.26915	.26384	.25870
65	.32508	.31831	.31177	.30543	.29930	.29336	.28761	.28203	.27663	.27140
66	.33891	.33208	.32547	.31906	.31285	.30684	.30101	.29536	.28987	.28456
67	.35318	.34630	.33963	.33316	.32689	.32081	.31491	.30918	.30363	.29823
68	.36785	.36093	.35422	.34770	.34138	.33524	.32928	.32349	.31787	.31240
69	.38290	.37595	.36920	.36265	.35628	.35009	.34408	.33824	.33256	.32703
70	.39823	.39127	.38450	.37791	.37151	.36529	.35924	.35335	.34762	.34204
71	.41378	.40681	.40003	.39343	.38701	.38076	.37467	.36875	.36298	.35736
72	.42950	.42253	.41575	.40914	.40271	.39644	.39034	.38438	.37858	.37293
73	.44535	.43840	.43162	.42502	.41858	.41231	.40619	.40022	.39440	.38872
74	.46139	.45446	.44771	.44112	.43469	.42842	.42230	.41632	.41049	.40479
75	.47769	.47080	.46408	.45752	.45111	.44485	.43874	.43277	.42693	.42123
76	.49430	.48747	.48079	.47427	.46790	.46167	.45558	.44963	.44380	.43811
77	.51123	.50447	.49786	.49139	.48506	.47888	.47282	.46690	.46111	.45543
78	.52845	.52177	.51523	.50884	.50257	.49645	.49044	.48457	.47881	.47317
79	.54584	.53926	.53282	.52650	.52032	.51426	.50833	.50251	.49681	.49122
80	.56325	.55678	.55044	.54423	.53813	.53216	.52630	.52056	.51492	.50939
81	.58054	.57419	.56797	.56186	.55587	.54999	.54422	.53856	.53300	.52754
82	.59762	.59140	.58530	.57931	.57343	.56766	.56198	.55641	.55094	.54557
83	.61448	.60840	.60243	.59657	.59081	.58515	.57958	.57411	.56874	.56346
84	.63124	.62531	.61949	.61376	.60813	.60259	.59715	.59179	.58652	.58134
85	.64800	.64224	.63657	.63099	.62550	.62010	.61478	.60955	.60441	.59934
86	.66461	.65902	.65351	.64810	.64276	.63751	.63233	.62724	.62222	.61728
87	.68083	.67541	.67008	.66483	.65965	.65455	.64953	.64458	.63970	.63489
88	.69663	.69140	.68624	.68116	.67615	.67121	.66634	.66154	.65680	.65213
89	.71201	.70696	.70199	.69708	.69224	.68747	.68276	.67811	.67353	.66900

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
90	.72694	.72209	.71730	.71257	.70791	.70330	.69876	.69427	.68984	.68547
91	.74117	.73650	.73190	.72735	.72286	.71842	.71404	.70972	.70545	.70123
92	.75439	.74991	.74548	.74110	.73678	.73251	.72829	.72412	.72000	.71593
93	.76664	.76233	.75806	.75385	.74969	.74557	.74150	.73748	.73350	.72957
94	.77809	.77394	.76983	.76578	.76177	.75780	.75388	.75000	.74616	.74237
95	.78899	.78500	.78106	.77715	.77329	.76947	.76569	.76195	.75826	.75460
96	.79928	.79544	.79165	.78790	.78418	.78050	.77686	.77326	.76970	.76617
97	.80883	.80514	.80149	.79787	.79430	.79075	.78725	.78377	.78033	.77693
98	.81781	.81427	.81075	.80727	.80382	.80041	.79703	.79368	.79036	.78708
99	.82661	.82320	.81982	.81648	.81316	.80988	.80662	.80340	.80020	.79704
100	.83519	.83192	.82868	.82547	.82228	.81913	.81600	.81290	.80982	.80678
101	.84368	.84055	.83744	.83437	.83131	.82829	.82529	.82231	.81936	.81643
102	.85203	.84904	.84607	.84313	.84021	.83731	.83444	.83159	.82876	.82596
103	.86034	.85748	.85465	.85184	.84906	.84629	.84355	.84082	.83812	.83544
104	.86923	.86653	.86385	.86119	.85855	.85593	.85333	.85074	.84818	.84563
105	.87792	.87537	.87283	.87032	.86782	.86534	.86287	.86042	.85799	.85557
106	.88918	.88683	.88450	.88218	.87987	.87758	.87530	.87304	.87079	.86855
107	.90291	.90082	.89873	.89666	.89460	.89255	.89051	.88849	.88647	.88447
108	.92455	.92288	.92123	.91958	.91794	.91630	.91468	.91306	.91145	.90984
109	.96211	.96125	.96041	.95956	.95872	.95788	.95704	.95620	.95537	.95455

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
0	.01488	.01463	.01439	.01417	.01396	.01377	.01359	.01343	.01327	.01312
1	.00662	.00636	.00612	.00589	.00568	.00548	.00530	.00513	.00497	.00482
2	.00654	.00626	.00600	.00576	.00554	.00533	.00514	.00496	.00479	.00463
3	.00670	.00641	.00613	.00588	.00564	.00542	.00522	.00502	.00484	.00468
4	.00699	.00668	.00639	.00612	.00587	.00563	.00542	.00521	.00502	.00484
5	.00739	.00706	.00675	.00646	.00620	.00595	.00571	.00550	.00529	.00510
6	.00786	.00751	.00718	.00687	.00659	.00633	.00608	.00585	.00563	.00543
7	.00841	.00803	.00769	.00736	.00706	.00678	.00652	.00627	.00604	.00582
8	.00902	.00863	.00826	.00791	.00759	.00730	.00702	.00675	.00651	.00628
9	.00973	.00931	.00892	.00856	.00822	.00790	.00760	.00733	.00706	.00682
10	.01055	.01010	.00969	.00930	.00894	.00861	.00829	.00799	.00772	.00746
11	.01146	.01099	.01055	.01014	.00976	.00940	.00907	.00875	.00846	.00818
12	.01246	.01196	.01150	.01106	.01066	.01028	.00993	.00960	.00928	.00899
13	.01351	.01298	.01249	.01204	.01161	.01121	.01084	.01049	.01016	.00985
14	.01455	.01400	.01348	.01300	.01255	.01213	.01173	.01136	.01102	.01069

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
15	.01555	.01497	.01443	.01392	.01345	.01300	.01259	.01220	.01183	.01148
16	.01648	.01587	.01530	.01477	.01427	.01380	.01336	.01295	.01257	.01220
17	.01737	.01673	.01612	.01556	.01504	.01455	.01408	.01365	.01324	.01286
18	.01822	.01754	.01691	.01632	.01576	.01525	.01476	.01430	.01387	.01347
19	.01908	.01837	.01770	.01708	.01650	.01595	.01544	.01495	.01450	.01407
20	.01999	.01924	.01854	.01788	.01726	.01669	.01615	.01564	.01516	.01471
21	.02096	.02017	.01943	.01874	.01809	.01748	.01691	.01637	.01586	.01539
22	.02197	.02114	.02036	.01963	.01895	.01830	.01770	.01713	.01660	.01610
23	.02306	.02218	.02136	.02059	.01987	.01919	.01855	.01795	.01739	.01686
24	.02424	.02331	.02245	.02163	.02087	.02016	.01948	.01885	.01825	.01769
25	.02552	.02455	.02364	.02278	.02197	.02122	.02051	.01984	.01920	.01861
26	.02692	.02589	.02493	.02403	.02318	.02238	.02162	.02091	.02025	.01961
27	.02846	.02738	.02636	.02541	.02451	.02367	.02287	.02212	.02141	.02074
28	.03012	.02898	.02791	.02690	.02595	.02506	.02422	.02342	.02267	.02196
29	.03190	.03070	.02957	.02851	.02751	.02656	.02567	.02483	.02404	.02329
30	.03381	.03254	.03135	.03023	.02917	.02817	.02723	.02634	.02551	.02471
31	.03583	.03450	.03324	.03206	.03094	.02989	.02890	.02796	.02707	.02623
32	.03799	.03659	.03527	.03402	.03284	.03173	.03068	.02968	.02874	.02785
33	.04031	.03883	.03744	.03612	.03488	.03371	.03260	.03155	.03055	.02961
34	.04279	.04123	.03976	.03838	.03707	.03583	.03465	.03354	.03249	.03149
35	.04545	.04382	.04227	.04081	.03943	.03812	.03688	.03571	.03459	.03354
36	.04830	.04658	.04495	.04341	.04196	.04058	.03927	.03803	.03685	.03573
37	.05134	.04953	.04782	.04620	.04467	.04321	.04183	.04052	.03928	.03809
38	.05462	.05272	.05092	.04921	.04760	.04606	.04461	.04322	.04191	.04066
39	.05812	.05613	.05424	.05245	.05075	.04913	.04760	.04614	.04475	.04343
40	.06190	.05981	.05782	.05594	.05415	.05245	.05083	.04929	.04783	.04643
41	.06597	.06378	.06170	.05972	.05784	.05605	.05435	.05272	.05118	.04970
42	.07035	.06806	.06587	.06380	.06182	.05994	.05815	.05644	.05481	.05326
43	.07505	.07265	.07036	.06818	.06611	.06414	.06225	.06045	.05874	.05710
44	.08008	.07757	.07518	.07290	.07072	.06865	.06667	.06478	.06298	.06125
45	.08542	.08279	.08029	.07791	.07563	.07346	.07138	.06940	.06750	.06569
46	.09108	.08834	.08573	.08324	.08085	.07858	.07640	.07432	.07233	.07043
47	.09705	.09419	.09147	.08886	.08637	.08399	.08172	.07954	.07745	.07545
48	.10335	.10038	.09754	.09482	.09222	.08973	.08735	.08507	.08288	.08078
49	.10999	.10690	.10394	.10111	.09840	.09581	.09332	.09093	.08864	.08644
50	.11701	.11380	.11073	.10778	.10496	.10225	.09965	.09716	.09477	.09247
51	.12441	.12108	.11789	.11482	.11189	.10907	.10636	.10376	.10126	.09886
52	.13217	.12871	.12540	.12222	.11916	.11623	.11341	.11071	.10810	.10560
53	.14028	.13670	.13327	.12997	.12680	.12375	.12082	.11801	.11529	.11268
54	.14875	.14505	.14150	.13808	.13480	.13163	.12859	.12566	.12284	.12012
55	.15760	.15378	.15011	.14657	.14317	.13989	.13674	.13370	.13077	.12794
56	.16684	.16290	.15911	.15546	.15194	.14855	.14528	.14213	.13909	.13615
57	.17648	.17242	.16851	.16474	.16111	.15760	.15422	.15096	.14781	.14477
58	.18647	.18229	.17827	.17438	.17064	.16702	.16353	.16015	.15689	.15374
59	.19678	.19249	.18835	.18435	.18049	.17676	.17316	.16968	.16631	.16305

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
60	.20740	.20300	.19875	.19464	.19066	.18682	.18311	.17952	.17604	.17268
61	.21837	.21385	.20949	.20527	.20119	.19724	.19341	.18971	.18613	.18266
62	.22973	.22511	.22064	.21631	.21212	.20807	.20414	.20033	.19664	.19306
63	.24152	.23680	.23222	.22779	.22350	.21934	.21530	.21139	.20760	.20392
64	.25372	.24890	.24422	.23969	.23529	.23103	.22690	.22289	.21899	.21521
65	.26633	.26141	.25664	.25201	.24752	.24316	.23893	.23482	.23083	.22695
66	.27940	.27439	.26953	.26481	.26023	.25577	.25145	.24724	.24316	.23918
67	.29299	.28790	.28296	.27815	.27348	.26894	.26453	.26024	.25606	.25200
68	.30709	.30193	.29691	.29202	.28728	.28265	.27816	.27378	.26952	.26537
69	.32166	.31643	.31134	.30639	.30157	.29687	.29230	.28785	.28351	.27928
70	.33661	.33133	.32618	.32116	.31628	.31152	.30688	.30235	.29794	.29364
71	.35188	.34654	.34134	.33627	.33133	.32651	.32181	.31722	.31275	.30838
72	.36742	.36204	.35679	.35168	.34668	.34181	.33706	.33241	.32788	.32345
73	.38317	.37776	.37248	.36733	.36229	.35738	.35257	.34788	.34330	.33882
74	.39923	.39380	.38849	.38330	.37823	.37328	.36844	.36370	.35908	.35455
75	.41566	.41021	.40489	.39968	.39459	.38961	.38474	.37997	.37531	.37074
76	.43254	.42709	.42176	.41655	.41144	.40645	.40156	.39677	.39208	.38749
77	.44988	.44444	.43912	.43391	.42880	.42380	.41891	.41411	.40940	.40479
78	.46765	.46224	.45694	.45174	.44665	.44166	.43677	.43197	.42726	.42265
79	.48574	.48037	.47510	.46993	.46487	.45990	.45502	.45024	.44554	.44094
80	.50397	.49865	.49343	.48830	.48327	.47834	.47349	.46873	.46406	.45947
81	.52219	.51693	.51176	.50669	.50171	.49682	.49201	.48729	.48265	.47809
82	.54029	.53510	.53000	.52499	.52007	.51523	.51047	.50580	.50120	.49667
83	.55826	.55315	.54813	.54319	.53834	.53356	.52886	.52424	.51969	.51522
84	.57624	.57123	.56629	.56144	.55666	.55195	.54732	.54277	.53828	.53386
85	.59435	.58944	.58460	.57984	.57516	.57054	.56599	.56151	.55710	.55275
86	.61241	.60762	.60289	.59824	.59365	.58913	.58468	.58029	.57596	.57170
87	.63015	.62548	.62087	.61633	.61185	.60744	.60309	.59880	.59456	.59039
88	.64753	.64299	.63851	.63409	.62973	.62543	.62118	.61700	.61287	.60879
89	.66454	.66013	.65579	.65150	.64726	.64308	.63895	.63488	.63086	.62689
90	.68115	.67689	.67268	.66853	.66442	.66037	.65637	.65241	.64851	.64465
91	.69706	.69294	.68887	.68486	.68089	.67696	.67309	.66925	.66547	.66173
92	.71190	.70792	.70399	.70011	.69627	.69247	.68872	.68501	.68134	.67771
93	.72569	.72184	.71804	.71429	.71057	.70689	.70326	.69967	.69611	.69259
94	.73861	.73490	.73123	.72759	.72400	.72044	.71692	.71344	.71000	.70659
95	.75097	.74739	.74384	.74033	.73686	.73342	.73002	.72665	.72331	.72001
96	.76267	.75922	.75579	.75240	.74905	.74572	.74243	.73917	.73595	.73275
97	.77356	.77022	.76691	.76363	.76039	.75718	.75399	.75084	.74772	.74463
98	.78382	.78059	.77740	.77423	.77110	.76799	.76491	.76186	.75884	.75584
99	.79390	.79079	.78771	.78465	.78162	.77862	.77565	.77270	.76978	.76688
100	.80376	.80076	.79779	.79485	.79193	.78904	.78617	.78333	.78051	.77771
101	.81353	.81066	.80780	.80497	.80217	.79938	.79662	.79388	.79117	.78847
102	.82318	.82042	.81768	.81496	.81227	.80960	.80694	.80431	.80170	.79911
103	.83278	.83014	.82752	.82491	.82233	.81977	.81723	.81470	.81220	.80971
104	.84310	.84059	.83810	.83563	.83317	.83073	.82831	.82591	.82352	.82115

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
105	.85318	.85079	.84843	.84607	.84374	.84142	.83911	.83682	.83455	.83229
106	.86633	.86413	.86193	.85975	.85758	.85543	.85329	.85116	.84904	.84694
107	.88247	.88049	.87852	.87656	.87460	.87266	.87073	.86881	.86690	.86500
108	.90825	.90666	.90507	.90350	.90193	.90037	.89881	.89727	.89572	.89419
109	.95372	.95290	.95208	.95126	.95045	.94964	.94883	.94803	.94723	.94643

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
0	.01298	.01285	.01273	.01261	.01250	.01240	.01230	.01221	.01212	.01203
1	.00468	.00455	.00443	.00431	.00420	.00410	.00400	.00391	.00382	.00374
2	.00448	.00435	.00421	.00409	.00398	.00387	.00376	.00366	.00357	.00348
3	.00452	.00437	.00423	.00410	.00398	.00386	.00375	.00365	.00355	.00345
4	.00468	.00452	.00437	.00423	.00410	.00397	.00386	.00375	.00364	.00354
5	.00493	.00476	.00460	.00445	.00431	.00418	.00405	.00393	.00382	.00371
6	.00524	.00506	.00489	.00473	.00458	.00444	.00430	.00418	.00406	.00394
7	.00562	.00543	.00525	.00508	.00492	.00477	.00462	.00449	.00436	.00423
8	.00606	.00586	.00566	.00548	.00531	.00515	.00499	.00485	.00471	.00458
9	.00659	.00637	.00616	.00597	.00579	.00561	.00545	.00529	.00514	.00500
10	.00721	.00698	.00676	.00655	.00636	.00617	.00600	.00583	.00567	.00552
11	.00792	.00767	.00744	.00722	.00701	.00682	.00663	.00645	.00628	.00612
12	.00871	.00845	.00821	.00797	.00775	.00754	.00735	.00716	.00698	.00681
13	.00955	.00928	.00902	.00877	.00854	.00831	.00810	.00790	.00771	.00753
14	.01038	.01009	.00981	.00955	.00930	.00907	.00885	.00864	.00843	.00824
15	.01116	.01085	.01056	.01028	.01002	.00977	.00954	.00932	.00910	.00890
16	.01186	.01153	.01123	.01094	.01066	.01040	.01015	.00992	.00969	.00948
17	.01250	.01215	.01183	.01152	.01124	.01096	.01070	.01045	.01022	.00999
18	.01308	.01272	.01238	.01206	.01175	.01147	.01119	.01093	.01068	.01044
19	.01367	.01329	.01293	.01259	.01227	.01196	.01167	.01140	.01113	.01088
20	.01428	.01388	.01350	.01314	.01280	.01248	.01217	.01188	.01161	.01134
21	.01494	.01451	.01411	.01373	.01337	.01303	.01271	.01240	.01211	.01183
22	.01562	.01517	.01475	.01435	.01397	.01361	.01326	.01294	.01263	.01233
23	.01635	.01588	.01543	.01501	.01460	.01422	.01386	.01351	.01319	.01287
24	.01716	.01665	.01618	.01573	.01530	.01489	.01451	.01415	.01380	.01347
25	.01804	.01751	.01701	.01653	.01608	.01565	.01524	.01485	.01448	.01413
26	.01902	.01845	.01792	.01741	.01693	.01648	.01604	.01563	.01524	.01487
27	.02011	.01951	.01895	.01841	.01790	.01742	.01696	.01652	.01610	.01571
28	.02129	.02066	.02006	.01949	.01895	.01844	.01795	.01748	.01704	.01662
29	.02258	.02191	.02127	.02067	.02009	.01955	.01903	.01853	.01806	.01762

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
30	.02396	.02325	.02257	.02193	.02132	.02074	.02019	.01966	.01916	.01869
31	.02543	.02467	.02396	.02328	.02263	.02201	.02143	.02087	.02034	.01983
32	.02701	.02621	.02545	.02472	.02404	.02338	.02276	.02217	.02160	.02106
33	.02871	.02786	.02706	.02629	.02556	.02487	.02420	.02357	.02297	.02240
34	.03054	.02964	.02879	.02797	.02720	.02646	.02576	.02509	.02445	.02383
35	.03253	.03158	.03067	.02981	.02898	.02820	.02745	.02674	.02606	.02541
36	.03467	.03366	.03269	.03178	.03090	.03007	.02928	.02852	.02779	.02710
37	.03697	.03590	.03488	.03391	.03298	.03209	.03125	.03044	.02967	.02893
38	.03947	.03833	.03725	.03622	.03524	.03430	.03340	.03254	.03172	.03094
39	.04217	.04096	.03982	.03873	.03768	.03669	.03573	.03482	.03395	.03312
40	.04510	.04383	.04262	.04146	.04035	.03930	.03828	.03732	.03639	.03550
41	.04830	.04695	.04567	.04445	.04327	.04215	.04108	.04005	.03907	.03812
42	.05177	.05035	.04900	.04770	.04646	.04527	.04413	.04304	.04200	.04100
43	.05553	.05404	.05261	.05123	.04992	.04866	.04746	.04630	.04520	.04413
44	.05960	.05802	.05651	.05506	.05368	.05235	.05107	.04985	.04867	.04754
45	.06395	.06229	.06069	.05917	.05770	.05630	.05495	.05365	.05241	.05121
46	.06860	.06685	.06517	.06356	.06202	.06053	.05911	.05774	.05643	.05516
47	.07353	.07169	.06992	.06823	.06660	.06504	.06353	.06209	.06070	.05936
48	.07877	.07684	.07498	.07320	.07149	.06984	.06826	.06673	.06527	.06385
49	.08433	.08231	.08036	.07849	.07669	.07495	.07329	.07168	.07013	.06864
50	.09026	.08814	.08609	.08413	.08224	.08042	.07867	.07698	.07535	.07378
51	.09655	.09433	.09219	.09013	.08815	.08624	.08440	.08262	.08091	.07926
52	.10318	.10086	.09863	.09647	.09439	.09239	.09046	.08860	.08680	.08506
53	.11017	.10774	.10541	.10315	.10098	.09888	.09686	.09491	.09302	.09120
54	.11750	.11498	.11254	.11019	.10792	.10572	.10361	.10156	.09958	.09767
55	.12522	.12258	.12005	.11759	.11522	.11294	.11072	.10859	.10652	.10451
56	.13332	.13059	.12794	.12539	.12292	.12054	.11823	.11599	.11383	.11174
57	.14183	.13899	.13624	.13359	.13102	.12853	.12613	.12380	.12154	.11936
58	.15070	.14775	.14490	.14215	.13948	.13689	.13439	.13197	.12962	.12734
59	.15990	.15685	.15389	.15103	.14826	.14558	.14298	.14046	.13801	.13564
60	.16942	.16626	.16321	.16024	.15737	.15459	.15189	.14927	.14673	.14426
61	.17929	.17603	.17287	.16981	.16684	.16395	.16115	.15844	.15580	.15324
62	.18960	.18623	.18297	.17980	.17673	.17375	.17085	.16803	.16530	.16264
63	.20035	.19688	.19352	.19025	.18708	.18400	.18100	.17809	.17525	.17250
64	.21154	.20797	.20451	.20114	.19787	.19469	.19159	.18859	.18566	.18281
65	.22318	.21951	.21595	.21249	.20912	.20584	.20265	.19955	.19652	.19358
66	.23532	.23156	.22790	.22434	.22088	.21751	.21422	.21102	.20791	.20487
67	.24804	.24419	.24044	.23679	.23324	.22977	.22640	.22311	.21990	.21678
68	.26133	.25740	.25356	.24983	.24618	.24263	.23917	.23579	.23250	.22929
69	.27516	.27114	.26723	.26341	.25969	.25605	.25251	.24905	.24567	.24237
70	.28945	.28536	.28137	.27747	.27367	.26996	.26633	.26279	.25934	.25596
71	.30412	.29996	.29590	.29193	.28806	.28427	.28057	.27696	.27343	.26998
72	.31913	.31491	.31078	.30675	.30281	.29895	.29519	.29150	.28790	.28438
73	.33444	.33016	.32597	.32188	.31788	.31396	.31013	.30638	.30271	.29913
74	.35012	.34579	.34155	.33741	.33335	.32938	.32549	.32168	.31795	.31430

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
75	.36628	.36190	.35762	.35343	.34932	.34530	.34136	.33750	.33372	.33001
76	.38299	.37858	.37427	.37004	.36589	.36183	.35784	.35394	.35011	.34636
77	.40028	.39585	.39151	.38725	.38307	.37898	.37496	.37103	.36716	.36337
78	.41812	.41368	.40933	.40506	.40086	.39675	.39271	.38874	.38485	.38103
79	.43641	.43198	.42762	.42334	.41914	.41502	.41096	.40698	.40308	.39924
80	.45496	.45054	.44619	.44192	.43772	.43360	.42954	.42556	.42164	.41779
81	.47360	.46920	.46487	.46061	.45643	.45231	.44827	.44429	.44038	.43653
82	.49223	.48785	.48355	.47932	.47516	.47106	.46703	.46307	.45916	.45532
83	.51081	.50648	.50221	.49802	.49388	.48982	.48581	.48187	.47799	.47416
84	.52951	.52523	.52101	.51686	.51277	.50874	.50477	.50086	.49701	.49321
85	.54847	.54425	.54009	.53600	.53196	.52798	.52406	.52019	.51638	.51262
86	.56749	.56335	.55926	.55523	.55126	.54734	.54348	.53966	.53591	.53220
87	.58627	.58221	.57820	.57425	.57035	.56650	.56270	.55895	.55526	.55161
88	.60477	.60079	.59688	.59301	.58919	.58542	.58170	.57802	.57439	.57081
89	.62297	.61909	.61527	.61149	.60776	.60408	.60044	.59685	.59330	.58979
90	.64084	.63707	.63335	.62968	.62604	.62246	.61891	.61540	.61194	.60851
91	.65803	.65437	.65076	.64719	.64366	.64017	.63672	.63330	.62993	.62659
92	.67412	.67058	.66707	.66360	.66017	.65678	.65342	.65010	.64682	.64357
93	.68911	.68567	.68227	.67890	.67557	.67227	.66901	.66578	.66258	.65942
94	.70321	.69988	.69657	.69330	.69006	.68686	.68369	.68055	.67744	.67437
95	.71674	.71351	.71031	.70713	.70399	.70088	.69781	.69476	.69174	.68875
96	.72959	.72646	.72335	.72028	.71724	.71422	.71123	.70828	.70534	.70244
97	.74156	.73853	.73552	.73254	.72959	.72666	.72376	.72089	.71804	.71522
98	.75287	.74993	.74702	.74413	.74126	.73842	.73561	.73282	.73006	.72732
99	.76401	.76117	.75834	.75555	.75277	.75002	.74730	.74459	.74191	.73926
100	.77494	.77219	.76946	.76676	.76408	.76142	.75878	.75616	.75357	.75099
101	.78580	.78315	.78052	.77791	.77532	.77275	.77021	.76768	.76517	.76268
102	.79654	.79399	.79146	.78894	.78645	.78397	.78152	.77908	.77666	.77426
103	.80724	.80479	.80236	.79994	.79755	.79517	.79280	.79046	.78813	.78582
104	.81879	.81646	.81413	.81183	.80954	.80726	.80501	.80276	.80054	.79832
105	.83005	.82782	.82560	.82340	.82121	.81904	.81688	.81474	.81260	.81049
106	.84485	.84277	.84071	.83866	.83662	.83459	.83257	.83057	.82857	.82659
107	.86311	.86124	.85937	.85751	.85566	.85382	.85199	.85017	.84835	.84655
108	.89266	.89114	.88963	.88812	.88662	.88513	.88364	.88216	.88068	.87922
109	.94563	.94484	.94405	.94326	.94248	.94170	.94092	.94014	.93937	.93860

(f) *Effective dates.* This section applies after April 30, 1999.

§1.642(c)–6T [Removed]

Par. 6. Section 1.642(c)–6T is removed.

Par. 7. Section 1.664–4 is amended by:

1. Revising paragraphs (a)(1).

2. Removing existing paragraphs (d) through (e)(5).

3. Adding paragraphs (d), (e) heading and (e)(1) through (e)(5).

4. Adding paragraph (e)(7).

5. Revising paragraph (f).

The revisions and additions read as follows:

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

(a) * * *

(1) Life contingencies determined as to each life involved, from the values of l_x set forth in Table 90CM contained in §20.2031–7(d)(7) of this chapter in the case of transfers for which the valuation date is after April 30, 1999; or from Table 80CNSMT contained §20.2031–7A(e)(4) of this chapter in the case of transfer for which the valuation date is after April 30, 1989, and before May 1, 1999. See §20.2031–7A(a)

through (d) of this chapter, whichever is applicable, for transfers for which the valuation date is before May 1, 1989;

* * * * *

(d) *Valuation.* The fair market value of a remainder interest in a charitable remainder unitrust (as described in §1.664–3) for transfers for which the valuation date is after April 30, 1999, is its present value determined under paragraph (e) of this section. The fair market value of a remainder interest in a charitable remainder unitrust (as described in §1.664–3) for transfers for which the valuation date is before May 1, 1999, is its present value determined under the following sections:

Valuation Dates		*Applicable*
After	*Before*	*Regulations*
	01-01-52	1.664–4A(a)
12-31-51	01-01-71	1.664–4A(b)
12-31-70	12-01-83	1.664–4A(c)
11-30-83	05-01-89	1.664–4A(d)
04-30-89	05-01-99	1.664–4A(e)

(e) *Valuation of charitable remainder unitrusts having certain payout sequences for transfers for which the valuation date is after April 30, 1999*—(1) *In general.* Except as otherwise provided in paragraph (e)(2) of this section, in the case of transfers for which the valuation date is after April 30, 1999, the present value of a remainder interest is determined under paragraphs (e)(3) through (e)(7) of this section, provided that the amount of the payout as of any payout date during any taxable year of the trust is not larger than the amount that the trust could distribute on such date under §1.664–3(a)(1)(v) if the taxable year of the trust were to end on such date. See, however, §1.7520–3(b) (relating to exceptions to the use of the prescribed tables under certain circumstances).

(2) *Transitional rules for valuation of charitable remainder unitrusts.* (i) For purposes of sections 2055, 2106, or 2624, if on May 1, 1999, the decedent was mentally incompetent so that the disposition of the property could not be changed, and the decedent died after April 30, 1999, without having regained competency to dispose of the decedent's property, or the decedent died within 90 days of the date that the decedent first regained competency after April 30, 1999, the present value of a remainder interest under this section is determined as if the valuation date with respect to the decedent's gross estate is either before May 1, 1999, or after April 30, 1999, at the option of the decedent's executor.

(ii) For purposes of sections 170, 2055, 2106, 2522, or 2624, in the case of transfers to a charitable remainder unitrust for which the valuation date is after April 30, 1999, and before July 1, 1999, the present value of a remainder interest based on one or more measuring lives is determined under this section by use of the section 7520 interest rate for the month in which the valuation date occurs (see §§1.7520–1(b) and 1.7520–2(a)(2)) and the appropriate actuarial tables under either paragraph (e)(7) of this section or §1.664–4A(e)(6), at the option of the donor or the decedent's executor, as the case may be.

(iii) For purposes of paragraphs (e)(2)(i) and (ii) of this section, where the donor or decedent's executor is given the option to use the appropriate actuarial tables under either paragraph (e)(7) of this section or §1.664–4A(e)(6), the donor or decedent's executor must use the same actuarial table with respect to each individual transaction and with respect to all transfers occurring on the valuation date (for example, gift and income tax charitable deductions with respect to the same transfer must be determined based on the same tables, and all assets includible in the gross estate and/or estate tax deductions claimed must be valued based on the same tables).

(3) *Adjusted payout rate.* For transfers for which the valuation date is after April 30, 1989, the adjusted payout rate is determined by using the appropriate Table F in paragraph (e)(6) of this section, for the section 7520 interest rate applicable to the transfer. If the interest rate is between 4.2 and 14 percent, see paragraph (e)(6) of this section. If the interest rate is below 4.2 percent or greater than 14 percent, see paragraph (b) of this section. The adjusted payout rate is determined by multiplying the fixed percentage described in §1.664–3(a)(1)(i)(*a*) by the factor describing the payout sequence of the trust and the number of months by which the valuation date for the first full taxable year of the trust precedes the first payout date for such taxable year. If the governing instrument does not prescribe when the distribution or distributions shall be made during the taxable year of the trust, see paragraph (a) of this section. In the case of a trust having a payout sequence for which no figures have been provided by the appropriate table, and in the case of a trust that determines the fair market value of the trust assets by taking the average of valuations on more than one date during the taxable year, see paragraph (b) of this section.

(4) *Period is a term of years.* If the period described in §1.664–3(a)(5) is a term of years, the factor that is used in determining the present value of the remainder interest for transfers for which the valuation date is after November 30, 1983, is the factor under the appropriate adjusted payout rate in Table D of paragraph (e)(6) of this section corresponding to the number of years in the term. If the adjusted payout rate is an amount that is between adjusted payout rates for which factors are provided in Table D, a linear interpolation must be made. The present value of the remainder interest is determined by multiplying the net fair market value (as of the appropriate valuation date) of the property placed in trust by the factor determined under this paragraph. For purposes of this section, the valuation date is, in the case of an inter vivos transfer, the date on which the property is transferred to the trust by the donor. However, if an election is made under section 7520 and §1.7520–2(b) to compute the present value of the charitable interest by use of the interest rate component for either of the 2 months preced-

ing the month in which the date of transfer falls, the month so elected is the valuation date for purposes of determining the interest rate and mortality tables. In the case of a testamentary transfer under section 2055, 2106, or 2624, the valuation date is the date of death, unless the alternate valuation date is elected under section 2032, in which event, and within the limitations set forth in section 2032 and the regulations thereunder, the valuation date is the alternate valuation date. If the decedent's estate elects the alternate valuation date under section 2032 and also elects, under section 7520 and §1.7520–2(b), to use the interest rate component for one of the 2 months preceding the alternate valuation date, the month so elected is the valuation date for purposes of determining the interest rate and mortality tables. The application of this paragraph (e)(4) may be illustrated by the following example:

Example. D transfers $100,000 to a charitable remainder unitrust on January 1. The trust instrument requires that the trust pay 8 percent of the fair market value of the trust assets as of January 1st for a term of 12 years to D in quarterly payments (March 31, June 30, September 30, and December 31). The section 7520 rate for January (the month that the transfer occurred) is 9.6 percent. Under Table F(9.6) in paragraph(e)(6) of this section, the appropriate adjustment factor is .944628 for quarterly payments payable at the end of each quarter. The adjusted payout rate is 7.557 (8% X .944628). Based on the remainder factors in Table D in paragraph(e)(6) of this section, the present value of the remainder interest is $38,950.30, computed as follows:

Factor at 7.4 percent for 12 years	.397495
Factor at 7.6 percent for 12 years	.387314
Difference	.010181

Interpolation adjustment:

$$\frac{7.557\% - 7.4\%}{0.2\%} = \frac{x}{.010181}$$

$$x = .007992$$

Factor at 7.4 percent for 12 years	.397495
Less: Interpolation adjustment	.007992
Interpolated factor	.389503

Present value of remainder interest:
($100,000 X .389503) $38,950.30

(5) *Period is the life of one individual.* If the period described in §1.664–3(a)(5) is the life of one individual, the factor that is used in determining the present value of the remainder interest for transfers for which the valuation date is after April 30, 1999, is the factor in Table U(1) in paragraph (e)(7) of this section under the appropriate adjusted payout. For purposes of the computations described in this paragraph, the age of an individual is the age of that individual at the individual's nearest birthday. If the adjusted payout rate is an amount that is between adjusted payout rates for which factors are provided in the appropriate table, a linear interpolation must be made. The present value of the remainder interest is determined by multiplying the net fair market value (as of the valuation date as determined in paragraph (e)(4) of this section) of the property placed in trust by the factor determined under this paragraph (e)(5). If the adjusted payout rate is between 4.2 and 14 percent, see paragraph (e)(7) of this section. If the adjusted payout rate is below 4.2 percent or greater than 14 percent, see paragraph (b) of this section. The application of this paragraph (e)(5) may be illustrated by the following example:

Example. A, who is 44 years and 11 months old, transfers $100,000 to a charitable remainder unitrust on January 1st. The trust instrument requires that the trust pay to A semiannually (on June 30 and December 31) 9 percent of the fair market value of the trust assets as of January 1st during A's life. The section 7520 rate for January is 9.6 percent. Under Table F(9.6) in paragraph (e)(6) of this section, the appropriate adjustment factor is .933805 for semiannual payments payable at the end of the semiannual period. The adjusted payout rate is 8.404 (9% X .933805). Based on the remainder factors in Table U(1) in paragraph (e)(7) of this section, the present value of the remainder interest is $10,109.00, computed as follows:

Factor at 8.4 percent at age 45	.10117
Factor at 8.6 percent at age 45	.09715
Difference	.00402

Interpolation adjustment:

$$\frac{8.404\% - 8.4\%}{0.2\%} = \frac{x}{.00402}$$

$$x = .00008$$

Factor at 8.4 percent at age 45	.10117
Less: Interpolation adjustment	.00008
Interpolated Factor	.10109

Present value of remainder interest:
($100,000 X .10109) $10,109.00

* * * * *

(7) *Actuarial Table U(1) for transfers for which the valuation date is after April 30, 1999.* For transfers for which the valuation date is after April 30, 1999, the present value of a charitable remainder unitrust interest that is dependent on the termination of a life interest is determined by using the section 7520 rate, Table U(1) in this paragraph (e)(7), and Table F(4.2) through (14.0) in paragraph (e)(6) of this section. See, however, §1.7520–3(b) (relating to exceptions to the use of prescribed tables under certain circumstances). Many actuarial factors not contained in the following tables are contained in Internal Revenue Service Publication 1458, "Actuarial Values, Book Beth," (7-1999). A copy of this publication is available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402.

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
0	.06177	.05580	.05061	.04609	.04215	.03871	.03570	.03307	.03075	.02872
1	.05543	.04925	.04388	.03919	.03509	.03151	.02838	.02563	.02321	.02109
2	.05716	.05081	.04528	.04045	.03622	.03252	.02927	.02642	.02391	.02170
3	.05920	.05268	.04699	.04201	.03765	.03382	.03046	.02750	.02490	.02260
4	.06143	.05475	.04889	.04376	.03926	.03530	.03182	.02876	.02605	.02366
5	.06384	.05697	.05095	.04567	.04103	.03694	.03334	.03016	.02735	.02487
6	.06637	.05933	.05315	.04771	.04292	.03870	.03497	.03168	.02876	.02618
7	.06905	.06183	.05547	.04987	.04494	.04058	.03673	.03332	.03029	.02761
8	.07186	.06445	.05792	.05216	.04708	.04258	.03859	.03506	.03192	.02914
9	.07482	.06722	.06052	.05460	.04936	.04471	.04060	.03694	.03369	.03079
10	.07793	.07015	.06327	.05718	.05179	.04700	.04274	.03896	.03559	.03259
11	.08120	.07323	.06617	.05991	.05435	.04942	.04502	.04111	.03762	.03450
12	.08461	.07645	.06920	.06277	.05706	.05197	.04744	.04339	.03978	.03655
13	.08812	.07976	.07234	.06574	.05985	.05461	.04993	.04576	.04202	.03867
14	.09168	.08313	.07552	.06874	.06269	.05729	.05247	.04815	.04428	.04081
15	.09527	.08652	.07872	.07176	.06554	.05999	.05501	.05055	.04655	.04296
16	.09886	.08991	.08192	.07478	.06839	.06267	.05754	.05294	.04880	.04508
17	.10249	.09334	.08515	.07782	.07126	.06537	.06008	.05533	.05105	.04720
18	.10616	.09680	.08842	.08090	.07415	.06809	.06264	.05774	.05332	.04933
19	.10994	.10037	.09178	.08407	.07714	.07091	.06529	.06023	.05566	.05153
20	.11384	.10406	.09527	.08737	.08025	.07383	.06805	.06283	.05811	.05384
21	.11790	.10790	.09891	.09080	.08349	.07690	.07094	.06555	.06068	.05626
22	.12208	.11188	.10267	.09436	.08686	.08008	.07395	.06839	.06336	.05879
23	.12643	.11601	.10659	.09808	.09038	.08342	.07710	.07138	.06618	.06146
24	.13095	.12031	.11069	.10197	.09408	.08692	.08042	.07452	.06915	.06427
25	.13567	.12481	.11497	.10605	.09795	.09060	.08392	.07784	.07230	.06726
26	.14058	.12950	.11945	.11032	.10202	.09447	.08760	.08134	.07563	.07042
27	.14571	.13442	.12415	.11481	.10631	.09856	.09149	.08505	.07916	.07379
28	.15104	.13953	.12904	.11949	.11078	.10284	.09558	.08895	.08288	.07733
29	.15656	.14484	.13414	.12438	.11546	.10731	.09986	.09304	.08679	.08106
30	.16229	.15034	.13943	.12946	.12034	.11198	.10433	.09732	.09089	.08498
31	.16821	.15605	.14493	.13474	.12541	.11685	.10900	.10179	.09517	.08909
32	.17433	.16196	.15063	.14023	.13069	.12193	.11387	.10647	.09966	.09339
33	.18068	.16810	.15655	.14595	.13620	.12723	.11897	.11137	.10437	.09791
34	.18724	.17446	.16270	.15189	.14193	.13275	.12430	.11650	.10930	.10265
35	.19405	.18107	.16910	.15808	.14791	.13853	.12987	.12187	.11448	.10764
36	.20109	.18791	.17574	.16451	.15414	.14456	.13569	.12749	.11990	.11287
37	.20838	.19500	.18263	.17120	.16062	.15083	.14177	.13337	.12558	.11835
38	.21593	.20236	.18979	.17816	.16739	.15739	.14813	.13953	.13154	.12412
39	.22374	.20998	.19723	.18540	.17443	.16423	.15477	.14597	.13779	.13017
40	.23183	.21789	.20496	.19294	.18177	.17138	.16172	.15272	.14434	.13653
41	.24021	.22611	.21299	.20079	.18943	.17885	.16899	.15980	.15123	.14322
42	.24889	.23463	.22134	.20896	.19741	.18665	.17660	.16721	.15845	.15025
43	.25786	.24344	.23000	.21744	.20572	.19477	.18453	.17496	.16601	.15762
44	.26712	.25257	.23896	.22625	.21435	.20322	.19281	.18305	.17391	.16534

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

AGE	ADJUSTED PAYOUT RATE									
	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
45	.27665	.26196	.24821	.23534	.22328	.21198	.20139	.19145	.18213	.17338
46	.28644	.27163	.25774	.24472	.23251	.22105	.21028	.20018	.19068	.18174
47	.29647	.28155	.26754	.25438	.24201	.23040	.21947	.20919	.19952	.19041
48	.30676	.29173	.27760	.26431	.25181	.24004	.22896	.21852	.20868	.19941
49	.31729	.30217	.28794	.27453	.26190	.24999	.23876	.22817	.21817	.20873
50	.32808	.31289	.29856	.28505	.27229	.26026	.24889	.23814	.22799	.21839
51	.33912	.32387	.30946	.29585	.28299	.27083	.25933	.24845	.23815	.22840
52	.35038	.33507	.32060	.30691	.29395	.28168	.27005	.25904	.24861	.23872
53	.36185	.34651	.33198	.31821	.30517	.29280	.28106	.26993	.25937	.24934
54	.37352	.35815	.34358	.32976	.31664	.30418	.29234	.28110	.27042	.26026
55	.38539	.37002	.35542	.34155	.32836	.31583	.30390	.29256	.28177	.27149
56	.39746	.38209	.36748	.35358	.34034	.32774	.31574	.30431	.29342	.28303
57	.40971	.39437	.37976	.36584	.35257	.33992	.32785	.31634	.30536	.29488
58	.42212	.40682	.39222	.37829	.36500	.35231	.34019	.32862	.31756	.30699
59	.43464	.41939	.40482	.39090	.37759	.36488	.35272	.34109	.32996	.31932
60	.44726	.43207	.41754	.40364	.39034	.37761	.36542	.35375	.34257	.33186
61	.45999	.44488	.43041	.41655	.40326	.39053	.37833	.36662	.35540	.34463
62	.47286	.45785	.44345	.42964	.41639	.40367	.39146	.37974	.36848	.35767
63	.48589	.47098	.45667	.44293	.42972	.41703	.40484	.39311	.38184	.37100
64	.49903	.48426	.47005	.45638	.44324	.43060	.41843	.40671	.39544	.38458
65	.51229	.49766	.48357	.47001	.45694	.44435	.43223	.42054	.40927	.39841
66	.52568	.51121	.49726	.48381	.47084	.45833	.44626	.43461	.42337	.41252
67	.53924	.52495	.51115	.49784	.48498	.47256	.46056	.44898	.43778	.42696
68	.55293	.53883	.52521	.51205	.49932	.48701	.47511	.46360	.45246	.44169
69	.56671	.55283	.53940	.52640	.51382	.50165	.48985	.47844	.46738	.45666
70	.58052	.56687	.55365	.54084	.52843	.51639	.50473	.49342	.48245	.47181
71	.59431	.58091	.56791	.55529	.54306	.53118	.51966	.50847	.49761	.48707
72	.60804	.59490	.58213	.56973	.55768	.54598	.53461	.52357	.51283	.50239
73	.62168	.60881	.59629	.58411	.57227	.56076	.54955	.53866	.52806	.51774
74	.63528	.62268	.61042	.59848	.58686	.57555	.56453	.55380	.54335	.53316
75	.64887	.63657	.62458	.61290	.60151	.59041	.57959	.56904	.55875	.54872
76	.66249	.65049	.63880	.62739	.61625	.60538	.59478	.58443	.57432	.56446
77	.67612	.66446	.65307	.64194	.63108	.62046	.61009	.59995	.59005	.58037
78	.68975	.67843	.66736	.65654	.64596	.63561	.62548	.61558	.60590	.59643
79	.70330	.69233	.68160	.67109	.66081	.65074	.64088	.63123	.62178	.61253
80	.71666	.70605	.69566	.68548	.67550	.66573	.65615	.64676	.63755	.62853
81	.72975	.71950	.70946	.69961	.68995	.68047	.67117	.66205	.65310	.64433
82	.74250	.73263	.72293	.71342	.70407	.69490	.68589	.67705	.66837	.65984
83	.75493	.74542	.73608	.72690	.71788	.70902	.70031	.69175	.68333	.67506
84	.76712	.75798	.74900	.74016	.73147	.72292	.71451	.70624	.69810	.69010
85	.77913	.77037	.76175	.75326	.74491	.73668	.72859	.72061	.71276	.70503
86	.79086	.78248	.77423	.76610	.75808	.75019	.74241	.73474	.72719	.71974
87	.80218	.79418	.78628	.77850	.77083	.76326	.75580	.74844	.74118	.73402
88	.81307	.80544	.79790	.79047	.78313	.77589	.76874	.76169	.75473	.74786
89	.82355	.81628	.80909	.80200	.79500	.78808	.78125	.77450	.76783	.76125

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
90	.83360	.82668	.81985	.81309	.80642	.79982	.79330	.78685	.78048	.77418
91	.84308	.83650	.83000	.82357	.81721	.81092	.80470	.79855	.79246	.78645
92	.85182	.84556	.83937	.83325	.82718	.82119	.81525	.80937	.80356	.79780
93	.85985	.85390	.84800	.84215	.83637	.83064	.82497	.81936	.81379	.80829
94	.86732	.86164	.85601	.85044	.84491	.83944	.83402	.82865	.82333	.81806
95	.87437	.86895	.86359	.85827	.85300	.84778	.84260	.83746	.83237	.82733
96	.88097	.87582	.87070	.86563	.86060	.85561	.85066	.84575	.84088	.83605
97	.88708	.88216	.87727	.87243	.86762	.86285	.85811	.85341	.84875	.84413
98	.89280	.88810	.88343	.87880	.87420	.86964	.86511	.86061	.85614	.85171
99	.89836	.89388	.88943	.88501	.88062	.87626	.87193	.86763	.86336	.85911
100	.90375	.89948	.89525	.89103	.88685	.88269	.87856	.87445	.87037	.86632
101	.90905	.90500	.90097	.89696	.89298	.88902	.88509	.88118	.87729	.87342
102	.91424	.91040	.90658	.90278	.89900	.89524	.89150	.88778	.88408	.88040
103	.91939	.91575	.91214	.90854	.90496	.90139	.89785	.89432	.89081	.88732
104	.92485	.92144	.91805	.91467	.91131	.90796	.90463	.90131	.89800	.89471
105	.93020	.92701	.92383	.92067	.91751	.91437	.91125	.90813	.90502	.90193
106	.93701	.93411	.93122	.92834	.92546	.92260	.91974	.91689	.91405	.91122
107	.94522	.94268	.94013	.93760	.93507	.93254	.93002	.92750	.92499	.92249
108	.95782	.95583	.95385	.95187	.94989	.94791	.94593	.94396	.94199	.94002
109	.97900	.97800	.97700	.97600	.97500	.97400	.97300	.97200	.97100	.97000

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
0	.02693	.02534	.02395	.02271	.02161	.02063	.01976	.01898	.01828	.01765
1	.01922	.01756	.01610	.01480	.01365	.01263	.01171	.01090	.01017	.00951
2	.01975	.01802	.01650	.01514	.01393	.01286	.01190	.01104	.01028	.00959
3	.02056	.01876	.01717	.01575	.01449	.01336	.01235	.01145	.01064	.00992
4	.02155	.01967	.01800	.01652	.01520	.01401	.01296	.01201	.01116	.01039
5	.02266	.02071	.01896	.01741	.01603	.01479	.01368	.01269	.01179	.01098
6	.02389	.02184	.02003	.01841	.01696	.01566	.01450	.01345	.01251	.01166
7	.02522	.02309	.02120	.01950	.01799	.01663	.01540	.01431	.01332	.01242
8	.02665	.02444	.02246	.02069	.01910	.01768	.01640	.01524	.01420	.01326
9	.02821	.02590	.02384	.02199	.02033	.01884	.01750	.01629	.01520	.01421
10	.02990	.02750	.02535	.02342	.02169	.02013	.01872	.01745	.01631	.01526
11	.03172	.02922	.02698	.02497	.02316	.02153	.02006	.01872	.01752	.01643
12	.03365	.03106	.02872	.02663	.02474	.02303	.02149	.02010	.01884	.01769
13	.03566	.03297	.03054	.02835	.02638	.02460	.02299	.02154	.02021	.01901
14	.03770	.03490	.03237	.03010	.02804	.02619	.02450	.02298	.02159	.02033

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
15	.03973	.03682	.03419	.03182	.02968	.02775	.02599	.02439	.02294	.02162
16	.04173	.03871	.03598	.03352	.03129	.02926	.02743	.02576	.02424	.02286
17	.04372	.04059	.03775	.03519	.03287	.03076	.02884	.02710	.02551	.02406
18	.04573	.04248	.03953	.03686	.03444	.03224	.03024	.02842	.02676	.02524
19	.04780	.04443	.04137	.03859	.03607	.03378	.03169	.02978	.02804	.02646
20	.04997	.04647	.04329	.04040	.03778	.03539	.03321	.03122	.02940	.02773
21	.05226	.04862	.04532	.04232	.03958	.03709	.03481	.03274	.03083	.02909
22	.05465	.05088	.04745	.04432	.04148	.03888	.03650	.03433	.03234	.03052
23	.05716	.05325	.04969	.04645	.04348	.04077	.03830	.03603	.03394	.03203
24	.05983	.05578	.05208	.04871	.04562	.04280	.04021	.03784	.03566	.03367
25	.06266	.05846	.05463	.05112	.04791	.04497	.04227	.03980	.03752	.03543
26	.06566	.06131	.05734	.05369	.05035	.04729	.04448	.04189	.03951	.03732
27	.06887	.06436	.06024	.05646	.05298	.04979	.04686	.04416	.04168	.03939
28	.07225	.06758	.06331	.05938	.05577	.05245	.04940	.04658	.04398	.04159
29	.07581	.07099	.06656	.06248	.05873	.05528	.05210	.04916	.04645	.04394
30	.07956	.07457	.06998	.06575	.06186	.05827	.05495	.05189	.04906	.04644
31	.08348	.07833	.07358	.06920	.06515	.06142	.05797	.05478	.05182	.04908
32	.08761	.08228	.07736	.07282	.06863	.06475	.06116	.05783	.05475	.05189
33	.09195	.08645	.08136	.07666	.07231	.06828	.06454	.06108	.05786	.05488
34	.09651	.09082	.08557	.08070	.07619	.07200	.06812	.06452	.06117	.05805
35	.10131	.09545	.09002	.08498	.08030	.07596	.07193	.06818	.06469	.06144
36	.10635	.10031	.09470	.08949	.08465	.08015	.07596	.07206	.06842	.06503
37	.11165	.10542	.09963	.09424	.08923	.08457	.08022	.07617	.07238	.06885
38	.11722	.11081	.10484	.09927	.09409	.08926	.08475	.08054	.07661	.07293
39	.12308	.11648	.11032	.10458	.09922	.09422	.08955	.08518	.08109	.07726
40	.12925	.12246	.11612	.11020	.10466	.09949	.09465	.09011	.08587	.08189
41	.13575	.12877	.12225	.11614	.11043	.10508	.10007	.09537	.09097	.08683
42	.14259	.13542	.12871	.12243	.11654	.11101	.10583	.10097	.09640	.09210
43	.14977	.14242	.13552	.12905	.12298	.11729	.11193	.10690	.10217	.09771
44	.15731	.14976	.14269	.13604	.12979	.12391	.11838	.11318	.10828	.10367
45	.16516	.15743	.15017	.14334	.13691	.13086	.12516	.11979	.11472	.10994
46	.17334	.16544	.15800	.15099	.14438	.13816	.13228	.12674	.12150	.11656
47	.18184	.17375	.16613	.15895	.15217	.14576	.13972	.13400	.12860	.12349
48	.19066	.18240	.17461	.16724	.16029	.15371	.14749	.14161	.13604	.13077
49	.19981	.19138	.18342	.17588	.16875	.16201	.15562	.14956	.14383	.13839
50	.20931	.20072	.19259	.18489	.17759	.17067	.16412	.15790	.15199	.14639
51	.21917	.21042	.20212	.19426	.18679	.17971	.17299	.16660	.16054	.15477
52	.22933	.22043	.21198	.20395	.19633	.18909	.18220	.17566	.16943	.16350
53	.23981	.23076	.22216	.21399	.20621	.19881	.19176	.18506	.17867	.17258
54	.25060	.24141	.23267	.22434	.21642	.20886	.20166	.19480	.18826	.18201
55	.26171	.25239	.24351	.23504	.22697	.21927	.21192	.20491	.19821	.19182
56	.27313	.26369	.25468	.24608	.23787	.23003	.22254	.21538	.20854	.20199
57	.28487	.27531	.26618	.25746	.24912	.24114	.23351	.22621	.21923	.21254
58	.29688	.28722	.27798	.26914	.26067	.25257	.24481	.23738	.23025	.22343
59	.30913	.29937	.29002	.28107	.27249	.26427	.25639	.24882	.24157	.23461

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
60	.32159	.31175	.30231	.29325	.28457	.27623	.26823	.26055	.25317	.24608
61	.33429	.32437	.31485	.30571	.29692	.28848	.28037	.27257	.26507	.25786
62	.34728	.33730	.32770	.31847	.30960	.30106	.29285	.28495	.27734	.27001
63	.36057	.35053	.34087	.33157	.32262	.31400	.30569	.29769	.28998	.28255
64	.37412	.36404	.35433	.34498	.33596	.32726	.31887	.31078	.30298	.29545
65	.38794	.37783	.36809	.35868	.34961	.34085	.33239	.32422	.31633	.30871
66	.40205	.39193	.38216	.37272	.36361	.35479	.34628	.33804	.33008	.32238
67	.41650	.40639	.39661	.38715	.37800	.36915	.36059	.35230	.34428	.33651
68	.43126	.42117	.41139	.40193	.39277	.38390	.37530	.36697	.35890	.35108
69	.44628	.43622	.42648	.41703	.40787	.39898	.39037	.38201	.37391	.36604
70	.46150	.45149	.44178	.43236	.42321	.41433	.40571	.39735	.38922	.38132
71	.47683	.46689	.45723	.44785	.43873	.42987	.42126	.41290	.40476	.39685
72	.49225	.48238	.47279	.46346	.45439	.44556	.43697	.42862	.42048	.41257
73	.50770	.49793	.48841	.47915	.47013	.46135	.45280	.44447	.43635	.42844
74	.52324	.51358	.50416	.49498	.48603	.47731	.46880	.46051	.45242	.44454
75	.53894	.52939	.52008	.51100	.50214	.49349	.48505	.47681	.46877	.46092
76	.55483	.54543	.53624	.52728	.51852	.50996	.50160	.49344	.48546	.47766
77	.57091	.56167	.55263	.54380	.53516	.52671	.51845	.51038	.50247	.49475
78	.58716	.57809	.56922	.56053	.55203	.54372	.53557	.52760	.51980	.51216
79	.60346	.59459	.58590	.57738	.56904	.56086	.55286	.54501	.53732	.52978
80	.61969	.61102	.60252	.59419	.58601	.57800	.57014	.56243	.55487	.54745
81	.63571	.62726	.61897	.61082	.60283	.59499	.58729	.57974	.57232	.56503
82	.65146	.64324	.63515	.62722	.61942	.61176	.60423	.59683	.58957	.58242
83	.66693	.65893	.65108	.64335	.63575	.62828	.62093	.61371	.60660	.59962
84	.68222	.67447	.66684	.65934	.65195	.64468	.63753	.63049	.62356	.61674
85	.69742	.68993	.68255	.67528	.66812	.66106	.65411	.64727	.64053	.63389
86	.71241	.70517	.69805	.69102	.68410	.67727	.67054	.66390	.65736	.65091
87	.72696	.72000	.71313	.70635	.69967	.69307	.68656	.68014	.67381	.66756
88	.74108	.73438	.72777	.72125	.71480	.70845	.70217	.69597	.68985	.68380
89	.75475	.74832	.74198	.73571	.72951	.72339	.71734	.71137	.70547	.69963
90	.76796	.76180	.75572	.74971	.74376	.73788	.73207	.72633	.72065	.71503
91	.78049	.77460	.76878	.76302	.75732	.75168	.74610	.74058	.73512	.72972
92	.79211	.78647	.78089	.77537	.76990	.76449	.75913	.75383	.74858	.74338
93	.80283	.79743	.79208	.78679	.78154	.77634	.77119	.76610	.76105	.75604
94	.81283	.80765	.80253	.79744	.79240	.78741	.78247	.77756	.77270	.76789
95	.82233	.81737	.81245	.80757	.80274	.79795	.79320	.78849	.78382	.77918
96	.83126	.82651	.82180	.81712	.81248	.80788	.80332	.79880	.79431	.78985
97	.83953	.83498	.83046	.82597	.82152	.81710	.81271	.80836	.80404	.79976
98	.84731	.84294	.83860	.83429	.83002	.82577	.82155	.81737	.81321	.80908
99	.85490	.85071	.84656	.84243	.83832	.83425	.83020	.82618	.82219	.81822
100	.86229	.85828	.85431	.85035	.84642	.84252	.83864	.83478	.83095	.82714
101	.86958	.86575	.86195	.85818	.85442	.85069	.84698	.84329	.83962	.83597
102	.87674	.87310	.86947	.86587	.86229	.85873	.85518	.85166	.84815	.84466
103	.88384	.88038	.87694	.87351	.87010	.86671	.86334	.85998	.85663	.85331
104	.89143	.88817	.88492	.88169	.87847	.87526	.87207	.86889	.86573	.86258

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
105	.89885	.89578	.89272	.88967	.88664	.88361	.88060	.87760	.87461	.87163
106	.90840	.90559	.90278	.89999	.89720	.89442	.89165	.88888	.88613	.88338
107	.91999	.91750	.91501	.91253	.91005	.90758	.90511	.90265	.90019	.89774
108	.93805	.93609	.93412	.93216	.93020	.92824	.92629	.92434	.92239	.92044
109	.96900	.96800	.96700	.96600	.96500	.96400	.96300	.96200	.96100	.96000

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
0	.01709	.01658	.01612	.01570	.01532	.01497	.01466	.01437	.01410	.01386
1	.00892	.00839	.00791	.00747	.00708	.00672	.00639	.00609	.00582	.00557
2	.00896	.00840	.00790	.00744	.00702	.00664	.00629	.00598	.00569	.00542
3	.00926	.00867	.00814	.00765	.00721	.00681	.00644	.00611	.00580	.00552
4	.00970	.00908	.00851	.00800	.00753	.00711	.00672	.00636	.00604	.00574
5	.01026	.00960	.00900	.00846	.00796	.00751	.00710	.00672	.00637	.00606
6	.01089	.01019	.00956	.00899	.00846	.00799	.00755	.00715	.00678	.00644
7	.01161	.01088	.01021	.00960	.00905	.00854	.00808	.00765	.00726	.00690
8	.01241	.01163	.01093	.01029	.00970	.00917	.00867	.00822	.00781	.00743
9	.01331	.01249	.01175	.01107	.01045	.00988	.00936	.00889	.00845	.00804
10	.01432	.01346	.01268	.01196	.01131	.01071	.01016	.00965	.00918	.00875
11	.01543	.01453	.01370	.01295	.01226	.01162	.01104	.01051	.01001	.00956
12	.01664	.01569	.01482	.01403	.01330	.01263	.01202	.01145	.01093	.01045
13	.01791	.01691	.01600	.01516	.01440	.01369	.01304	.01245	.01190	.01139
14	.01918	.01813	.01717	.01629	.01548	.01474	.01406	.01343	.01285	.01231
15	.02041	.01931	.01831	.01738	.01653	.01576	.01504	.01437	.01376	.01320
16	.02160	.02044	.01938	.01841	.01752	.01670	.01595	.01525	.01460	.01401
17	.02274	.02152	.02041	.01940	.01846	.01760	.01680	.01607	.01539	.01476
18	.02386	.02258	.02142	.02035	.01936	.01846	.01762	.01685	.01613	.01547
19	.02500	.02367	.02245	.02132	.02029	.01933	.01845	.01764	.01689	.01619
20	.02621	.02481	.02353	.02235	.02126	.02025	.01933	.01847	.01768	.01694
21	.02749	.02603	.02468	.02344	.02229	.02124	.02026	.01936	.01852	.01774
22	.02884	.02730	.02589	.02458	.02338	.02227	.02124	.02029	.01940	.01859
23	.03028	.02867	.02718	.02581	.02454	.02337	.02229	.02128	.02035	.01949
24	.03183	.03013	.02857	.02713	.02580	.02456	.02342	.02236	.02138	.02047
25	.03350	.03172	.03008	.02857	.02717	.02587	.02467	.02355	.02251	.02155
26	.03530	.03344	.03172	.03013	.02865	.02729	.02602	.02484	.02375	.02273
27	.03727	.03532	.03351	.03183	.03028	.02885	.02751	.02627	.02511	.02404
28	.03937	.03732	.03543	.03367	.03204	.03052	.02911	.02780	.02658	.02545
29	.04162	.03947	.03748	.03564	.03392	.03233	.03084	.02946	.02818	.02698
30	.04401	.04176	.03967	.03773	.03593	.03425	.03269	.03124	.02988	.02861
31	.04654	.04419	.04200	.03996	.03807	.03630	.03466	.03312	.03169	.03035
32	.04923	.04676	.04447	.04233	.04034	.03849	.03676	.03514	.03363	.03221
33	.05210	.04952	.04711	.04487	.04278	.04083	.03901	.03731	.03571	.03422

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
34	.05515	.05245	.04993	.04758	.04538	.04333	.04142	.03962	.03794	.03637
35	.05841	.05558	.05295	.05048	.04818	.04603	.04401	.04212	.04035	.03869
36	.06187	.05892	.05616	.05358	.05116	.04890	.04678	.04480	.04293	.04118
37	.06555	.06247	.05958	.05688	.05435	.05198	.04975	.04766	.04570	.04385
38	.06949	.06627	.06325	.06043	.05777	.05528	.05295	.05075	.04868	.04674
39	.07368	.07032	.06717	.06421	.06143	.05882	.05637	.05406	.05189	.04984
40	.07816	.07465	.07137	.06827	.06537	.06263	.06006	.05764	.05535	.05320
41	.08295	.07930	.07587	.07264	.06960	.06674	.06405	.06150	.05910	.05683
42	.08807	.08427	.08069	.07733	.07415	.07116	.06833	.06567	.06315	.06077
43	.09352	.08957	.08585	.08233	.07902	.07589	.07294	.07014	.06750	.06500
44	.09932	.09521	.09134	.08768	.08423	.08096	.07787	.07495	.07218	.06956
45	.10543	.10117	.09715	.09334	.08974	.08634	.08311	.08005	.07716	.07441
46	.11189	.10747	.10329	.09933	.09559	.09204	.08867	.08548	.08245	.07958
47	.11866	.11408	.10974	.10564	.10174	.09805	.09454	.09121	.08805	.08504
48	.12577	.12103	.11654	.11228	.10823	.10439	.10074	.09727	.09397	.09083
49	.13323	.12833	.12368	.11926	.11506	.11107	.10728	.10366	.10022	.09695
50	.14107	.13601	.13120	.12663	.12228	.11813	.11419	.11043	.10685	.10344
51	.14928	.14407	.13910	.13437	.12987	.12558	.12149	.11758	.11386	.11031
52	.15785	.15248	.14735	.14247	.13781	.13337	.12913	.12508	.12122	.11752
53	.16678	.16124	.15597	.15093	.14612	.14153	.13714	.13294	.12893	.12509
54	.17606	.17037	.16493	.15974	.15478	.15004	.14550	.14116	.13700	.13302
55	.18570	.17986	.17428	.16893	.16382	.15893	.15424	.14976	.14546	.14134
56	.19573	.18974	.18400	.17851	.17325	.16821	.16338	.15875	.15430	.15004
57	.20613	.20000	.19412	.18848	.18307	.17789	.17291	.16814	.16355	.15914
58	.21688	.21060	.20458	.19880	.19325	.18792	.18280	.17788	.17316	.16861
59	.22793	.22151	.21535	.20943	.20374	.19827	.19301	.18795	.18309	.17840
60	.23927	.23272	.22642	.22036	.21454	.20893	.20354	.19834	.19334	.18851
61	.25092	.24425	.23782	.23163	.22567	.21993	.21440	.20907	.20393	.19898
62	.26295	.25616	.24961	.24329	.23721	.23134	.22568	.22021	.21494	.20985
63	.27538	.26847	.26180	.25537	.24916	.24316	.23738	.23179	.22639	.22117
64	.28817	.28116	.27438	.26783	.26150	.25539	.24949	.24377	.23825	.23291
65	.30134	.29423	.28735	.28069	.27426	.26803	.26201	.25618	.25054	.24508
66	.31493	.30772	.30075	.29399	.28746	.28113	.27500	.26906	.26331	.25774
67	.32899	.32170	.31464	.30780	.30118	.29475	.28852	.28248	.27663	.27095
68	.34349	.33614	.32901	.32209	.31538	.30887	.30256	.29643	.29047	.28469
69	.35841	.35100	.34381	.33683	.33005	.32346	.31707	.31085	.30481	.29894
70	.37366	.36620	.35896	.35193	.34509	.33844	.33197	.32568	.31957	.31362
71	.38916	.38167	.37440	.36732	.36043	.35372	.34720	.34084	.33466	.32864
72	.40486	.39736	.39006	.38295	.37602	.36927	.36270	.35629	.35005	.34396
73	.42074	.41323	.40591	.39878	.39182	.38504	.37843	.37198	.36568	.35955
74	.43685	.42934	.42202	.41488	.40791	.40110	.39446	.38798	.38165	.37547
75	.45326	.44577	.43846	.43132	.42435	.41754	.41088	.40438	.39802	.39181
76	.47004	.46259	.45530	.44818	.44122	.43442	.42776	.42125	.41488	.40865
77	.48718	.47979	.47255	.46547	.45853	.45175	.44511	.43861	.43225	.42601
78	.50467	.49735	.49017	.48314	.47626	.46951	.46290	.45643	.45008	.44386
79	.52239	.51515	.50806	.50110	.49427	.48758	.48102	.47459	.46828	.46209

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
80	.54018	.53304	.52603	.51916	.51242	.50580	.49930	.49292	.48666	.48052
81	.55788	.55085	.54396	.53718	.53053	.52399	.51757	.51126	.50507	.49898
82	.57540	.56851	.56173	.55506	.54851	.54207	.53574	.52951	.52339	.51737
83	.59274	.58598	.57933	.57279	.56635	.56001	.55378	.54765	.54161	.53567
84	.61002	.60341	.59690	.59049	.58418	.57796	.57184	.56582	.55988	.55403
85	.62734	.62090	.61454	.60828	.60211	.59603	.59004	.58414	.57832	.57258
86	.64455	.63828	.63210	.62600	.61999	.61406	.60821	.60244	.59675	.59113
87	.66139	.65531	.64930	.64337	.63752	.63175	.62605	.62043	.61488	.60939
88	.67783	.67194	.66612	.66037	.65469	.64908	.64354	.63807	.63267	.62733
89	.69387	.68817	.68254	.67698	.67148	.66605	.66068	.65537	.65012	.64493
90	.70947	.70398	.69855	.69318	.68786	.68261	.67742	.67228	.66719	.66217
91	.72437	.71908	.71385	.70867	.70354	.69847	.69345	.68848	.68357	.67870
92	.73823	.73314	.72810	.72310	.71816	.71326	.70841	.70361	.69886	.69415
93	.75109	.74618	.74132	.73650	.73173	.72700	.72232	.71768	.71308	.70852
94	.76312	.75839	.75370	.74905	.74445	.73988	.73536	.73087	.72643	.72202
95	.77459	.77004	.76552	.76104	.75660	.75220	.74783	.74350	.73920	.73494
96	.78543	.78105	.77670	.77238	.76810	.76386	.75964	.75546	.75131	.74720
97	.79550	.79128	.78709	.78293	.77880	.77470	.77063	.76659	.76258	.75860
98	.80498	.80091	.79687	.79286	.78888	.78492	.78099	.77709	.77322	.76937
99	.81428	.81036	.80647	.80261	.79877	.79496	.79117	.78741	.78367	.77995
100	.82336	.81959	.81586	.81214	.80845	.80478	.80113	.79751	.79390	.79032
101	.83234	.82873	.82515	.82158	.81804	.81451	.81101	.80753	.80406	.80062
102	.84119	.83774	.83431	.83089	.82750	.82412	.82076	.81742	.81409	.81078
103	.84999	.84670	.84342	.84016	.83691	.83368	.83046	.82726	.82408	.82091
104	.85944	.85632	.85321	.85011	.84703	.84396	.84090	.83786	.83483	.83182
105	.86866	.86570	.86276	.85982	.85690	.85399	.85109	.84820	.84532	.84245
106	.88065	.87792	.87520	.87248	.86978	.86708	.86440	.86172	.85905	.85638
107	.89530	.89286	.89042	.88799	.88557	.88315	.88073	.87833	.87592	.87352
108	.91849	.91654	.91460	.91266	.91072	.90879	.90685	.90492	.90299	.90106
109	.95900	.95800	.95700	.95600	.95500	.95400	.95300	.95200	.95100	.95000

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
0	.01363	.01342	.01323	.01305	.01288	.01272	.01258	.01244	.01231	.01219
1	.00534	.00512	.00493	.00474	.00458	.00442	.00427	.00414	.00401	.00389
2	.00518	.00495	.00474	.00455	.00437	.00421	.00405	.00391	.00377	.00365
3	.00526	.00502	.00480	.00459	.00440	.00422	.00406	.00391	.00376	.00363
4	.00546	.00521	.00497	.00475	.00455	.00436	.00419	.00402	.00387	.00373

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
5	.00576	.00549	.00524	.00501	.00479	.00459	.00440	.00423	.00406	.00391
6	.00613	.00584	.00557	.00532	.00509	.00488	.00468	.00449	.00432	.00415
7	.00657	.00626	.00598	.00571	.00547	.00524	.00502	.00482	.00464	.00446
8	.00707	.00675	.00644	.00616	.00590	.00565	.00542	.00521	.00501	.00482
9	.00766	.00732	.00699	.00669	.00641	.00615	.00591	.00568	.00547	.00527
10	.00835	.00798	.00764	.00732	.00702	.00675	.00649	.00624	.00602	.00580
11	.00913	.00874	.00838	.00804	.00772	.00743	.00715	.00689	.00665	.00642
12	.01000	.00959	.00920	.00884	.00851	.00819	.00790	.00762	.00737	.00712
13	.01091	.01048	.01007	.00969	.00933	.00900	.00869	.00840	.00813	.00787
14	.01181	.01135	.01092	.01052	.01014	.00979	.00947	.00916	.00887	.00860
15	.01267	.01218	.01173	.01130	.01091	.01054	.01019	.00987	.00956	.00928
16	.01345	.01294	.01246	.01201	.01160	.01121	.01084	.01050	.01018	.00988
17	.01418	.01364	.01313	.01266	.01222	.01181	.01143	.01107	.01073	.01041
18	.01486	.01429	.01375	.01326	.01279	.01236	.01196	.01158	.01122	.01088
19	.01554	.01494	.01438	.01385	.01336	.01291	.01248	.01208	.01170	.01135
20	.01626	.01562	.01503	.01448	.01396	.01348	.01303	.01260	.01220	.01183
21	.01702	.01635	.01573	.01514	.01460	.01409	.01361	.01316	.01274	.01235
22	.01782	.01711	.01645	.01584	.01526	.01472	.01422	.01374	.01330	.01288
23	.01868	.01793	.01724	.01658	.01597	.01540	.01487	.01437	.01390	.01345
24	.01962	.01883	.01809	.01740	.01675	.01615	.01558	.01505	.01455	.01408
25	.02065	.01981	.01903	.01830	.01762	.01698	.01638	.01581	.01528	.01478
26	.02178	.02089	.02006	.01929	.01856	.01789	.01725	.01665	.01609	.01556
27	.02303	.02209	.02122	.02040	.01963	.01891	.01824	.01760	.01700	.01644
28	.02439	.02339	.02247	.02160	.02079	.02002	.01931	.01863	.01800	.01740
29	.02585	.02480	.02382	.02290	.02204	.02123	.02047	.01976	.01908	.01845
30	.02742	.02631	.02527	.02430	.02339	.02253	.02172	.02096	.02025	.01957
31	.02910	.02793	.02683	.02579	.02482	.02391	.02306	.02225	.02149	.02077
32	.03089	.02965	.02849	.02739	.02636	.02540	.02449	.02363	.02282	.02206
33	.03282	.03151	.03028	.02912	.02803	.02701	.02604	.02513	.02427	.02346
34	.03489	.03350	.03220	.03097	.02982	.02873	.02771	.02674	.02583	.02497
35	.03713	.03567	.03429	.03299	.03177	.03061	.02953	.02850	.02753	.02661
36	.03953	.03798	.03653	.03515	.03386	.03263	.03148	.03039	.02936	.02838
37	.04211	.04048	.03894	.03748	.03611	.03481	.03359	.03243	.03134	.03030
38	.04490	.04318	.04155	.04001	.03856	.03719	.03589	.03466	.03350	.03239
39	.04791	.04609	.04437	.04274	.04120	.03975	.03837	.03707	.03583	.03466
40	.05116	.04924	.04742	.04571	.04408	.04254	.04108	.03970	.03839	.03714
41	.05469	.05267	.05075	.04894	.04722	.04559	.04405	.04258	.04119	.03987
42	.05851	.05638	.05436	.05245	.05063	.04891	.04728	.04573	.04425	.04285
43	.06263	.06039	.05827	.05625	.05433	.05252	.05079	.04915	.04759	.04610
44	.06707	.06472	.06248	.06035	.05834	.05642	.05459	.05286	.05121	.04963
45	.07180	.06933	.06698	.06474	.06262	.06059	.05867	.05684	.05509	.05342
46	.07685	.07425	.07178	.06943	.06720	.06507	.06304	.06110	.05926	.05750
47	.08218	.07946	.07687	.07440	.07205	.06981	.06768	.06564	.06369	.06183
48	.08784	.08499	.08228	.07969	.07722	.07487	.07262	.07047	.06842	.06646
49	.09382	.09085	.08801	.08530	.08271	.08024	.07788	.07562	.07346	.07140

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

	ADJUSTED PAYOUT RATE									
AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
50	.10018	.09707	.09410	.09127	.08856	.08597	.08349	.08112	.07885	.07667
51	.10691	.10367	.10057	.09761	.09477	.09206	.08946	.08697	.08459	.08231
52	.11399	.11061	.10738	.10429	.10132	.09849	.09577	.09316	.09066	.08826
53	.12142	.11791	.11454	.11132	.10823	.10526	.10242	.09969	.09707	.09456
54	.12921	.12556	.12206	.11870	.11548	.11239	.10942	.10657	.10383	.10120
55	.13738	.13359	.12995	.12646	.12311	.11989	.11679	.11382	.11096	.10820
56	.14595	.14202	.13824	.13462	.13113	.12778	.12456	.12146	.11847	.11560
57	.15491	.15084	.14693	.14317	.13955	.13607	.13272	.12949	.12638	.12338
58	.16424	.16004	.15599	.15209	.14834	.14473	.14125	.13789	.13465	.13153
59	.17390	.16955	.16537	.16134	.15746	.15371	.15010	.14662	.14325	.14001
60	.18387	.17939	.17507	.17091	.16689	.16302	.15927	.15566	.15217	.14880
61	.19420	.18958	.18513	.18084	.17669	.17268	.16881	.16506	.16145	.15795
62	.20494	.20020	.19561	.19119	.18691	.18277	.17877	.17490	.17115	.16753
63	.21613	.21126	.20654	.20199	.19758	.19331	.18918	.18518	.18131	.17757
64	.22774	.22274	.21791	.21322	.20869	.20429	.20004	.19592	.19192	.18805
65	.23979	.23467	.22971	.22490	.22025	.21573	.21135	.20710	.20299	.19899
66	.25233	.24709	.24202	.23709	.23231	.22767	.22318	.21881	.21457	.21045
67	.26543	.26009	.25489	.24985	.24496	.24021	.23560	.23111	.22676	.22252
68	.27908	.27363	.26833	.26319	.25819	.25332	.24860	.24400	.23954	.23519
69	.29324	.28769	.28230	.27705	.27195	.26699	.26216	.25746	.25288	.24843
70	.30783	.30219	.29671	.29137	.28618	.28112	.27619	.27139	.26672	.26216
71	.32277	.31706	.31150	.30608	.30079	.29564	.29063	.28573	.28096	.27631
72	.33803	.33225	.32661	.32112	.31575	.31052	.30542	.30044	.29559	.29084
73	.35356	.34772	.34201	.33645	.33101	.32571	.32053	.31547	.31053	.30571
74	.36943	.36354	.35778	.35215	.34666	.34129	.33604	.33091	.32590	.32100
75	.38574	.37980	.37400	.36833	.36278	.35735	.35205	.34686	.34178	.33681
76	.40256	.39660	.39076	.38505	.37947	.37400	.36864	.36340	.35827	.35324
77	.41991	.41394	.40808	.40235	.39674	.39124	.38585	.38056	.37539	.37032
78	.43777	.43180	.42594	.42020	.41457	.40906	.40365	.39834	.39314	.38803
79	.45602	.45007	.44422	.43849	.43287	.42735	.42193	.41661	.41139	.40627
80	.47449	.46856	.46275	.45704	.45143	.44592	.44051	.43519	.42997	.42484
81	.49300	.48712	.48134	.47566	.47008	.46460	.45921	.45391	.44870	.44357
82	.51145	.50563	.49990	.49427	.48873	.48328	.47792	.47265	.46746	.46235
83	.52983	.52407	.51841	.51284	.50735	.50195	.49663	.49139	.48624	.48116
84	.54828	.54261	.53702	.53151	.52609	.52075	.51549	.51030	.50519	.50015
85	.56693	.56135	.55586	.55044	.54510	.53983	.53464	.52952	.52447	.51949
86	.58560	.58013	.57474	.56943	.56418	.55901	.55390	.54886	.54389	.53898
87	.60398	.59864	.59337	.58817	.58303	.57795	.57294	.56799	.56310	.55828
88	.62206	.61685	.61170	.60662	.60159	.59663	.59173	.58688	.58209	.57736
89	.63980	.63474	.62972	.62477	.61987	.61503	.61024	.60551	.60083	.59620
90	.65719	.65227	.64741	.64259	.63783	.63312	.62846	.62385	.61928	.61477
91	.67388	.66912	.66440	.65973	.65511	.65053	.64600	.64152	.63708	.63269
92	.68949	.68487	.68030	.67577	.67129	.66685	.66245	.65809	.65378	.64950
93	.70401	.69954	.69511	.69072	.68637	.68205	.67778	.67355	.66935	.66519
94	.71765	.71332	.70902	.70477	.70055	.69636	.69222	.68810	.68403	.67998

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
95	.73072	.72653	.72237	.71825	.71416	.71010	.70608	.70209	.69813	.69421
96	.74311	.73906	.73504	.73105	.72709	.72316	.71926	.71539	.71155	.70774
97	.75465	.75073	.74684	.74297	.73914	.73533	.73155	.72780	.72407	.72037
98	.76555	.76175	.75798	.75424	.75052	.74683	.74317	.73953	.73591	.73232
99	.77626	.77260	.76895	.76534	.76174	.75817	.75462	.75109	.74759	.74411
100	.78676	.78323	.77971	.77622	.77274	.76929	.76586	.76245	.75906	.75569
101	.79719	.79379	.79040	.78703	.78368	.78035	.77704	.77375	.77048	.76722
102	.80749	.80422	.80096	.79772	.79450	.79130	.78811	.78494	.78178	.77864
103	.81775	.81461	.81149	.80838	.80529	.80221	.79914	.79609	.79306	.79003
104	.82881	.82582	.82284	.81988	.81693	.81399	.81106	.80815	.80525	.80236
105	.83959	.83674	.83391	.83108	.82826	.82546	.82267	.81988	.81711	.81435
106	.85373	.85108	.84844	.84581	.84319	.84058	.83797	.83537	.83278	.83020
107	.87113	.86875	.86636	.86399	.86161	.85925	.85689	.85453	.85218	.84984
108	.89913	.89721	.89529	.89337	.89145	.88953	.88762	.88571	.88380	.88189
109	.94900	.94800	.94700	.94600	.94500	.94400	.94300	.94200	.94100	.94000

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
0	.01208	.01197	.01187	.01177	.01168	.01159	.01151	.01143	.01135	.01128
1	.00378	.00367	.00358	.00348	.00340	.00331	.00323	.00316	.00309	.00302
2	.00353	.00342	.00331	.00322	.00312	.00304	.00295	.00288	.00280	.00273
3	.00350	.00339	.00327	.00317	.00307	.00298	.00289	.00281	.00273	.00265
4	.00359	.00347	.00335	.00324	.00313	.00303	.00294	.00285	.00276	.00268
5	.00377	.00363	.00351	.00339	.00327	.00317	.00306	.00297	.00288	.00279
6	.00400	.00386	.00372	.00359	.00347	.00335	.00325	.00314	.00305	.00295
7	.00430	.00414	.00400	.00386	.00373	.00360	.00349	.00338	.00327	.00317
8	.00465	.00448	.00432	.00417	.00403	.00390	.00378	.00366	.00354	.00344
9	.00508	.00490	.00473	.00457	.00442	.00428	.00414	.00402	.00389	.00378
10	.00560	.00541	.00523	.00506	.00490	.00475	.00460	.00446	.00433	.00421
11	.00620	.00600	.00581	.00563	.00546	.00529	.00514	.00499	.00485	.00472
12	.00689	.00668	.00647	.00628	.00610	.00593	.00576	.00560	.00545	.00531
13	.00763	.00740	.00718	.00698	.00678	.00660	.00642	.00626	.00610	.00595
14	.00834	.00810	.00787	.00766	.00745	.00726	.00707	.00689	.00673	.00657
15	.00901	.00875	.00851	.00828	.00807	.00786	.00767	.00748	.00730	.00714
16	.00959	.00932	.00907	.00883	.00860	.00839	.00818	.00799	.00780	.00762
17	.01011	.00983	.00956	.00930	.00907	.00884	.00862	.00842	.00822	.00804
18	.01057	.01027	.00999	.00972	.00947	.00923	.00900	.00879	.00858	.00839
19	.01101	.01070	.01040	.01012	.00985	.00960	.00936	.00914	.00892	.00871

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
20	.01148	.01115	.01083	.01054	.01026	.00999	.00974	.00950	.00927	.00905
21	.01197	.01162	.01129	.01098	.01068	.01040	.01014	.00988	.00964	.00941
22	.01249	.01211	.01176	.01143	.01112	.01082	.01054	.01027	.01002	.00978
23	.01304	.01264	.01227	.01192	.01159	.01127	.01098	.01069	.01042	.01017
24	.01364	.01322	.01283	.01246	.01210	.01177	.01145	.01115	.01087	.01060
25	.01431	.01387	.01345	.01306	.01268	.01233	.01199	.01168	.01137	.01109
26	.01506	.01459	.01415	.01373	.01333	.01295	.01260	.01226	.01194	.01163
27	.01591	.01541	.01494	.01449	.01407	.01367	.01329	.01293	.01259	.01226
28	.01684	.01631	.01580	.01533	.01488	.01445	.01405	.01367	.01330	.01296
29	.01785	.01728	.01675	.01624	.01577	.01531	.01488	.01447	.01408	.01372
30	.01893	.01833	.01776	.01723	.01672	.01623	.01578	.01534	.01493	.01453
31	.02010	.01946	.01885	.01828	.01773	.01722	.01673	.01627	.01582	.01540
32	.02134	.02066	.02002	.01940	.01883	.01828	.01776	.01726	.01679	.01634
33	.02270	.02197	.02128	.02063	.02002	.01943	.01887	.01835	.01784	.01736
34	.02415	.02338	.02265	.02195	.02130	.02067	.02008	.01951	.01897	.01846
35	.02574	.02492	.02414	.02340	.02270	.02203	.02140	.02080	.02022	.01967
36	.02746	.02658	.02575	.02496	.02422	.02350	.02283	.02218	.02157	.02098
37	.02932	.02838	.02750	.02666	.02586	.02510	.02438	.02369	.02303	.02241
38	.03135	.03035	.02941	.02851	.02766	.02685	.02608	.02534	.02464	.02397
39	.03355	.03249	.03149	.03053	.02962	.02876	.02793	.02715	.02640	.02568
40	.03596	.03484	.03377	.03275	.03178	.03086	.02998	.02914	.02833	.02757
41	.03861	.03742	.03628	.03520	.03416	.03318	.03224	.03134	.03048	.02966
42	.04152	.04025	.03903	.03788	.03678	.03573	.03473	.03377	.03285	.03198
43	.04468	.04333	.04205	.04082	.03965	.03853	.03746	.03644	.03546	.03453
44	.04813	.04670	.04533	.04403	.04278	.04159	.04045	.03936	.03832	.03732
45	.05183	.05032	.04887	.04748	.04616	.04489	.04368	.04252	.04141	.04034
46	.05582	.05421	.05267	.05121	.04980	.04846	.04717	.04593	.04475	.04362
47	.06006	.05836	.05673	.05518	.05369	.05226	.05089	.04958	.04832	.04711
48	.06459	.06279	.06107	.05943	.05785	.05634	.05488	.05349	.05216	.05087
49	.06942	.06752	.06571	.06397	.06230	.06070	.05916	.05768	.05626	.05490
50	.07459	.07259	.07068	.06884	.06708	.06538	.06376	.06219	.06069	.05924
51	.08012	.07801	.07599	.07406	.07220	.07041	.06869	.06703	.06544	.06391
52	.08596	.08375	.08163	.07959	.07763	.07574	.07392	.07218	.07049	.06887
53	.09214	.08982	.08759	.08544	.08338	.08139	.07948	.07763	.07586	.07415
54	.09867	.09623	.09389	.09164	.08946	.08737	.08536	.08342	.08154	.07974
55	.10556	.10301	.10055	.09819	.09591	.09371	.09159	.08955	.08757	.08567
56	.11283	.11016	.10759	.10511	.10272	.10042	.09819	.09605	.09397	.09197
57	.12050	.11771	.11502	.11243	.10993	.10751	.10518	.10293	.10075	.09864
58	.12852	.12562	.12281	.12011	.11749	.11496	.11252	.11016	.10787	.10567
59	.13687	.13385	.13092	.12810	.12537	.12273	.12017	.11770	.11531	.11299
60	.14554	.14240	.13935	.13641	.13356	.13080	.12813	.12555	.12305	.12063
61	.15457	.15130	.14813	.14507	.14210	.13923	.13644	.13375	.13113	.12860
62	.16402	.16063	.15734	.15415	.15107	.14808	.14518	.14237	.13964	.13699
63	.17393	.17042	.16700	.16370	.16049	.15738	.15437	.15144	.14860	.14584
64	.18429	.18065	.17712	.17369	.17036	.16714	.16400	.16096	.15800	.15513

TABLE U(1)
BASED ON LIFE TABLE 90CM
UNITRUST SINGLE LIFE REMAINDER FACTORS
APPLICABLE FOR TRANSFERS AFTER APRIL 30, 1999

ADJUSTED PAYOUT RATE

AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
65	.19511	.19135	.18769	.18415	.18070	.17735	.17410	.17094	.16787	.16488
66	.20645	.20257	.19880	.19513	.19157	.18810	.18473	.18146	.17827	.17517
67	.21841	.21441	.21052	.20673	.20305	.19947	.19599	.19259	.18929	.18608
68	.23096	.22685	.22284	.21895	.21515	.21146	.20786	.20436	.20094	.19762
69	.24409	.23987	.23575	.23175	.22784	.22404	.22033	.21672	.21320	.20976
70	.25772	.25339	.24918	.24507	.24106	.23715	.23333	.22961	.22598	.22244
71	.27178	.26735	.26304	.25882	.25471	.25070	.24679	.24296	.23923	.23559
72	.28622	.28170	.27729	.27298	.26877	.26467	.26065	.25673	.25290	.24915
73	.30100	.29639	.29189	.28749	.28320	.27899	.27489	.27087	.26694	.26310
74	.31621	.31152	.30694	.30246	.29807	.29378	.28959	.28548	.28146	.27753
75	.33195	.32719	.32253	.31797	.31351	.30914	.30486	.30067	.29657	.29255
76	.34832	.34350	.33877	.33415	.32961	.32517	.32082	.31656	.31238	.30828
77	.36535	.36047	.35570	.35101	.34642	.34192	.33750	.33317	.32892	.32475
78	.38302	.37811	.37329	.36856	.36392	.35937	.35490	.35051	.34621	.34198
79	.40124	.39630	.39145	.38669	.38201	.37742	.37291	.36848	.36413	.35985
80	.41980	.41485	.40998	.40520	.40050	.39588	.39134	.38688	.38249	.37818
81	.43854	.43358	.42871	.42392	.41921	.41457	.41001	.40553	.40112	.39678
82	.45733	.45238	.44752	.44273	.43802	.43338	.42881	.42431	.41989	.41553
83	.47616	.47123	.46638	.46161	.45690	.45227	.44770	.44320	.43877	.43441
84	.49519	.49030	.48548	.48073	.47604	.47143	.46688	.46239	.45797	.45361
85	.51458	.50974	.50496	.50025	.49560	.49102	.48650	.48204	.47763	.47329
86	.53413	.52935	.52463	.51998	.51538	.51084	.50636	.50194	.49758	.49327
87	.55351	.54881	.54416	.53957	.53503	.53055	.52613	.52176	.51744	.51317
88	.57268	.56806	.56349	.55898	.55451	.55010	.54574	.54144	.53718	.53296
89	.59162	.58710	.58262	.57819	.57382	.56949	.56520	.56097	.55678	.55263
90	.61030	.60588	.60151	.59718	.59290	.58866	.58447	.58032	.57621	.57214
91	.62834	.62403	.61977	.61554	.61136	.60722	.60312	.59907	.59505	.59107
92	.64527	.64107	.63692	.63280	.62872	.62468	.62068	.61672	.61279	.60890
93	.66107	.65699	.65294	.64893	.64495	.64101	.63711	.63323	.62940	.62559
94	.67597	.67200	.66806	.66415	.66027	.65643	.65262	.64884	.64509	.64138
95	.69031	.68645	.68262	.67881	.67504	.67130	.66759	.66390	.66025	.65662
96	.70396	.70021	.69648	.69279	.68912	.68548	.68186	.67828	.67471	.67118
97	.71670	.71305	.70943	.70584	.70227	.69872	.69520	.69171	.68824	.68480
98	.72875	.72521	.72169	.71819	.71472	.71127	.70784	.70444	.70106	.69770
99	.74065	.73721	.73379	.73040	.72703	.72368	.72035	.71704	.71375	.71048
100	.75234	.74901	.74570	.74241	.73914	.73589	.73265	.72944	.72625	.72307
101	.76399	.76077	.75757	.75438	.75122	.74807	.74494	.74183	.73873	.73565
102	.77552	.77241	.76932	.76625	.76319	.76015	.75712	.75411	.75111	.74813
103	.78703	.78404	.78106	.77809	.77514	.77221	.76929	.76638	.76348	.76060
104	.79948	.79662	.79377	.79093	.78810	.78528	.78248	.77969	.77691	.77414
105	.81159	.80885	.80612	.80340	.80069	.79799	.79530	.79262	.78995	.78729
106	.82763	.82506	.82250	.81995	.81741	.81488	.81235	.80983	.80732	.80482
107	.84749	.84516	.84283	.84051	.83819	.83587	.83356	.83126	.82896	.82666
108	.87999	.87808	.87618	.87428	.87238	.87049	.86859	.86670	.86481	.86293
109	.93900	.93800	.93700	.93600	.93500	.93400	.93300	.93200	.93100	.93000

(f) *Effective dates.* This section applies after April 30, 1999.

§1.664–4T [Removed]

Par. 8. Section 1.664–4T is removed.

Par. 9. Section 1.7520–1 is amended by:

1. Revising paragraph (b)(2).
2. Revising paragraphs (c)(1) and (c)(2).
3. Revising paragraph (d).

The revisions read as follows:

§1.7520–1 Valuation of annuities, unitrust interests, interests for life or terms of years, and remainder or reversionary interests.

* * * * *

(b) * * *

(2) *Mortality component.* The mortality component reflects the mortality data most recently available from the United States census. As new mortality data becomes available after each decennial census, the mortality component described in this section will be revised periodically and the revised mortality component tables will be published in the regulations at that time. For transactions with valuation dates after April 30, 1999, the mortality component table (Table 90CM) is contained in §20.2031–7(d)(7) of this chapter. See §20.2031–7A of this chapter for mortality component tables applicable to transactions for which the valuation date falls before May 1, 1999.

(c) * * *

(1) *Regulation sections containing tables with interest rates between 4.2 and 14 percent for valuation dates after April 30, 1999.* Section 1.642(c)–6(e)(6) contains Table S used for determining the present value of a single life remainder interest in a pooled income fund as defined in §1.642(c)–5. See §1.642(c)–6A for actuarial factors for one life applicable to valuation dates before May 1, 1999. Section 1.664–4(e)(6) contains Table F (payout factors) and Table D (actuarial factors used in determining the present value of a remainder interest postponed for a term of years). Section 1.664–4(e)(7) contains Table U(1) (unitrust single life remainder factors). These tables are used in determining the present value of a remainder interest in a charitable remainder unitrust as defined in §1.664–3. See §1.664–4A for unitrust single life remainder factors applicable to valuation dates before May 1, 1999. Section 20.2031–7(d)(6) of this chapter contains Table B (actuarial factors used in determining the present value of an interest for a term of years), Table K (annuity end-of-interval adjustment factors), and Table J (term certain annuity beginning-of-interval adjustment factors). Section 20.2031–7(d)(7) of this chapter contains Table S (single life remainder factors), and Table 90CM (mortality components). These tables are used in determining the present value of annuities, life estates, remainders, and reversions. See §20.2031–7A of this chapter for single life remainder factors and mortality components applicable to valuation dates before May 1, 1999.

(2) *Internal Revenue Service publications containing tables with interest rates between 2.2 and 22 percent for valuation dates after April 30, 1999.* The following documents are available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402:

(i) Internal Revenue Service Publication 1457, "Actuarial Values, Book Aleph," (7-1999). This publication includes tables of valuation factors, as well as examples that show how to compute other valuation factors, for determining the present value of annuities, life estates, terms of years, remainders, and reversions, measured by one or two lives. These factors may also be used in the valuation of interests in a charitable remainder annuity trust as defined in §1.664–2 and a pooled income fund as defined in §1.642(c)–5. See §20.2031–7A of this chapter for publications containing tables for valuation dates before May 1, 1999.

(ii) Internal Revenue Service Publication 1458, "Actuarial Values, Book Beth," (7-1999). This publication includes term certain tables and tables of one and two life valuation factors for determining the present value of remainder interests in a charitable remainder unitrust as defined in §1.664–3. See §1.664–4A for publications containing tables for valuation dates before May 1, 1999.

(iii) Internal Revenue Service Publication 1459, "Actuarial Values, Book Gimel," (7-1999). This publication includes tables for computing depreciation adjustment factors. See §1.170A–12.

(d) *Effective date.* This section applies after April 30, 1989.

§1.7520–1T [Removed]

Par. 10. Section 1.7520–1T is removed.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 11. The authority citation for part 20 is amended by removing entries for sections 20.2031–7T and 20.7520–1T to read in part as follows:

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

§20.2031–0 [Amended]

Par. 12 Section 20.2031–0 is amended by removing the entry for §20.2031–7T from the contents listing.

Par. 13. Section 20.2031–7 is amended by:

1. Removing existing paragraphs (c) through (d)(5).
2. Adding paragraphs (c), (d) heading, and (d)(1) through (d)(5).
3. Revising the introductory text of paragraph (d)(6).
4. Adding paragraph (d)(7).
5. Revising paragraph (e).

The revisions and additions read as follows:

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

* * * * *

(c) *Actuarial valuations.* The present value of annuities, life estates, terms of years, remainders, and reversions for estates of decedents for which the valuation date of the gross estate is after April 30, 1999, is determined under paragraph (d) of this section. The present value of annuities, life estates, terms of years, remainders, and reversions for estates of decedents for which the valuation date of the gross estate is before May 1, 1999, is determined under the following sections:

Valuation Date		Applicable
After	Before	Regulations
	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)

(d) *Actuarial valuations after April 30, 1999*—(1) *In general.* Except as otherwise provided in paragraph (b) of this section and §20.7520–3(b) (pertaining to certain limitations on the use of prescribed tables), if the valuation date for the gross estate of the decedent is after April 30, 1999, the fair market value of annuities, life estates, terms of years, remainders, and reversionary interests is the present value determined by use of standard or special section 7520 actuarial factors. These factors are derived by using the appropriate section 7520 interest rate and, if applicable, the mortality component for the valuation date of the interest that is being valued. For purposes of the computations described in this section, the age of an individual is the age of that individual at the individual's nearest birthday. See §§20.7520–1 through 20.7520–4.

(2) *Specific interests*—(i) *Charitable remainder trusts.* The fair market value of a remainder interest in a pooled income fund, as defined in §1.642(c)–5 of this chapter, is its value determined under §1.642(c)–6(e) of this chapter. The fair market value of a remainder interest in a charitable remainder annuity trust, as defined in §1.664–2(a) of this chapter, is the present value determined under §1.664–2(c) of this chapter. The fair market value of a remainder interest in a charitable remainder unitrust, as defined in §1.664–3 of this chapter, is its present value determined under §1.664–4(e) of this chapter. The fair market value of a life interest or term of years in a charitable remainder unitrust is the fair market value of the property as of the date of valuation less the fair market value of the remainder interest on that date determined under §1.664–4(e)(4) and (5) of this chapter.

(ii) *Ordinary remainder and reversionary interests.* If the interest to be valued is to take effect after a definite number of years or after the death of one individual, the present value of the interest is computed by multiplying the value of the property by the appropriate remainder interest actuarial factor (that corresponds to the applicable section 7520 interest rate and remainder interest period) in Table B (for a term certain) or the appropriate Table S (for one measuring life), as the case may be. Table B is contained in paragraph (d)(6) of this section and Table S (for one measuring life when the valuation date is after April 30, 1999) is contained in paragraph (d)(7) of this section and in Internal Revenue Service Publication 1457. For information about obtaining actuarial factors for other types of remainder interests, see paragraph (d)(4) of this section.

(iii) *Ordinary term-of-years and life interests.* If the interest to be valued is the right of a person to receive the income of certain property, or to use certain nonincome-producing property, for a term of years or for the life of one individual, the present value of the interest is computed by multiplying the value of the property by the appropriate term-of-years or life interest actuarial factor (that corresponds to the applicable section 7520 interest rate and term-of-years or life interest period). Internal Revenue Service Publication 1457 includes actuarial factors for an interest for a term of years in Table B and for the life of one individual in Table S (for one measuring life when the valuation date is after April 30, 1999). However, term-of-years and life interest actuarial factors are not included in Table B in paragraph (d)(6) of this section or Table S in paragraph (d)(7) of this section. If Internal Revenue Service Publication 1457 (or any other reliable source of term-of-years and life interest actuarial factors) is not conveniently available, an actuarial factor for the interest may be derived mathematically. This actuarial factor may be derived by subtracting the correlative remainder factor (that corresponds to the applicable section 7520 interest rate and the term of years or the life) in Table B (for a term of years) in paragraph (d)(6) of this section or in Table S (for the life of one individual) in paragraph (d)(7) of this section, as the case may be, from 1.000000. For information about obtaining actuarial factors for other types of term-of-years and life interests, see paragraph (d)(4) of this section.

(iv) *Annuities.* (A) If the interest to be valued is the right of a person to receive an annuity that is payable at the end of each year for a term of years or for the life of one individual, the present value of the interest is computed by multiplying the aggregate amount payable annually by the appropriate annuity actuarial factor (that corresponds to the applicable section 7520 interest rate and annuity period). Internal Revenue Publication 1457 includes actuarial factors in Table B (for an annuity payable for a term of years) and in Table S (for an annuity payable for the life of one individual when the valuation date is after April 30, 1999). However, annuity actuarial factors are not included in Table B in paragraph (d)(6) of this section or Table S in paragraph (d)(7) of this section. If Internal Revenue Service Publication 1457 (or any other reliable source of annuity actuarial factors) is not conveniently available, a required annuity factor for a term of years or for one life may be mathematically derived. This annuity factor may be derived by subtracting the applicable remainder factor (that corresponds to the applicable section 7520 interest rate and annuity period) in Table B (in the case of a term-of-years annuity) in paragraph (d)(6) of this section or in Table S (in the case of a one-life annuity when the valuation date is after April 30, 1999) in paragraph (d)(7) of this section, as the case may be, from 1.000000 and then dividing the result by the applicable section 7520 interest rate expressed as a decimal number.

(B) If the annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods, the product obtained by multiplying the annuity factor by the aggregate amount payable annually is then multiplied by the applicable adjustment factor as contained in Table K in paragraph (d)(6) of this section for payments made at the end of the specified periods. The provisions of this paragraph (d)(2)(iv)(B) are illustrated by the following example:

Example. At the time of the decedent's death, the survivor/annuitant, age 72, is entitled to receive an an-

nuity of $15,000 a year for life payable in equal monthly installments at the end of each period. The section 7520 rate for the month in which the decedent died is 9.6 percent. Under Table S in paragraph (d)(7) of this section, the remainder factor at 9.6 percent for an individual aged 72 is .38438. By converting the remainder factor to an annuity factor, as described above, the annuity factor at 9.6 percent for an individual aged 72 is 6.4127 (1.00000 minus .38438, divided by .096). Under Table K in paragraph (d)(6) of this section, the adjustment factor under the column for payments made at the end of each monthly period at the rate of 9.6 percent is 1.0433. The aggregate annual amount, $15,000, is multiplied by the factor 6.4127 and the product multiplied by 1.0433. The present value of the annuity at the date of the decedent's death is, therefore, $100,355.55 ($15,000 x 6.4127 x 1.0433).

(C) If an annuity is payable at the beginning of annual, semiannual, quarterly, monthly, or weekly periods for a term of years, the value of the annuity is computed by multiplying the aggregate amount payable annually by the annuity factor described in paragraph (d)(2)(iv)(A) of this section; and the product so obtained is then multiplied by the adjustment factor in Table J in paragraph (d)(6) of this section at the appropriate interest rate component for payments made at the beginning of specified periods. If an annuity is payable at the beginning of annual, semiannual, quarterly, monthly, or weekly periods for one or more lives, the value of the annuity is the sum of the first payment plus the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in this paragraph (d)(2)(iv).

(v) *Annuity and unitrust interests for a term of years or until the prior death of an individual.* See §25.2512–5(d)(2)(v) of this chapter for examples explaining how to compute the present value of an annuity or unitrust interest that is payable until the earlier of the lapse of a specific number of years or the death of an individual.

(3) *Transitional rule.* (i) If a decedent dies after April 30, 1999, and if on May 1, 1999, the decedent was mentally incompetent so that the disposition of the decedent's property could not be changed, and the decedent dies without having regained competency to dispose of the decedent's property or dies within 90 days of the date on which the decedent first regains competency, the fair market value of annuities, life estates, terms for years, remainders, and reversions included in the gross estate of the decedent is their present value determined either under this section or under the corresponding section applicable at the time the decedent became mentally incompetent, at the option of the decedent's executor. For example, see §20.2031–7A(e)(2).

(ii) If a decedent dies after April 30, 1999, and before July 1, 1999, the fair market value of annuities, life estates, remainders, and reversions based on one or more measuring lives included in the gross estate of the decedent is their present value determined under this section by use of the section 7520 interest rate for the month in which the valuation date occurs (see §§20.7520–1(b) and 20.7520-2(a)(2)) and the appropriate actuarial tables under either paragraph (d)(7) of this section or §20.2031–7A(e)(4), at the option of the decedent's executor.

(iii) For purposes of paragraphs (d)(3)(i) and (ii) of this section, where the decedent's executor is given the option to use the appropriate actuarial tables under either paragraph (d)(7) of this section or §20.2031–7A(e)(4), the decedent's executor must use the same actuarial table with respect to each individual transaction and with respect to all transfers occurring on the valuation date (for example, gift and income tax charitable deductions with respect to the same transfer must be determined based on the same tables, and all assets includible in the gross estate and/or estate tax deductions claimed must be valued based on the same tables).

(4) *Publications and actuarial computations by the Internal Revenue Service.* Many standard actuarial factors not included in paragraphs (d)(6) or (d)(7) of this section are included in Internal Revenue Service Publication 1457, "Actuarial Values, Book Aleph," (7-1999). Publication 1457 also includes examples that illustrate how to compute many special factors for more unusual situations. A copy of this publication is available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. See §20.2031–7A for publications containing actuarial factors for valuing interests for which the valuation date is before May 1, 1999. If a special factor is required in the case of an actual decedent, the Internal Revenue Service may furnish the factor to the executor upon a request for a ruling. The request for a ruling must be accompanied by a recitation of the facts including a statement of the date of birth for each measuring life, the date of the decedent's death, any other applicable dates, and a copy of the will, trust, or other relevant documents. A request for a ruling must comply with the instructions for requesting a ruling published periodically in the Internal Revenue Bulletin (see §§601.201 and 601.601(d)(2)(ii)(*b*) of this chapter) and include payment of the required user fee.

(5) *Examples.* The provisions of this section are illustrated by the following examples:

Example 1. Remainder payable at an individual's death. The decedent, or the decedent's estate, was entitled to receive certain property worth $50,000 upon the death of A, to whom the income was bequeathed for life. At the time of the decedent's death, A was 47 years 5 months old. In the month in which the decedent died, the section 7520 rate was 9.8 percent. Under Table S in paragraph (d)(7) of this section, the remainder factor at 9.8 percent for determining the present value of the remainder interest due at the death of a person aged 47, the number of years nearest A's actual age at the decedent's death, is .10317. The present value of the remainder interest at the date of the decedent's death is, therefore, $5,158.50 ($50,000 X .10317).

Example 2. Income payable for an individual's life. A's parent bequeathed an income interest in property to A for life, with the remainder interest passing to B at A's death. At the time of the parent's death, the value of the property was $50,000 and A was 30 years 10 months old. The section 7520 rate at the time of the parent's death was 10.2 percent. Under Table S in paragraph (d)(7) of this section, the remainder factor at 10.2 percent for determining the present value of the remainder interest due at the death of a person aged 31, the number of years closest to A's age at the decedent's death, is .03583. Converting this remainder factor to an income factor, as described in paragraph (d)(2)(iii) of this section, the factor for determining the present value of an income interest for the life of a person aged 31 is .96417. The present value of A's interest at the time of the parent's death is, therefore, $48,208.50 ($50,000 X .96417).

Example 3. Annuity payable for an individual's life. A purchased an annuity for the benefit of both A and B. Under the terms of the annuity contract, at A's death, a survivor annuity of $10,000 a year payable in equal semiannual installments made at the end of each interval is payable to B for life. At A's death, B was 45 years 7 months old. Also, at A's death, the section 7520 rate was 9.6 percent. Under Table S in paragraph (d)(7) of this section, the factor at 9.6 percent for determining the present value of the remainder interest at the death of a person age 46 (the number of years nearest B's actual age) is .10013. By converting the factor to an annuity factor, as described in paragraph (d)(2)(iv)(A) of this section, the factor for the present value of an annuity payable until the death of a person age 46 is 9.3736 (1.00000 minus .10013, divided by .096). The adjustment factor from Table K in paragraph (d)(6) of this section at an interest rate of 9.6 percent for semiannual annuity payments made at the end of the period is 1.0235. The present value of the annuity at the date of A's death is, therefore,

$95,938.80 ($10,000 X 9.3736 X 1.0235).

Example 4. Annuity payable for a term of years. The decedent, or the decedent's estate, was entitled to receive an annuity of $10,000 a year payable in equal quarterly installments at the end of each quarter throughout a term certain. At the time of the decedent's death, the section 7520 rate was 9.8 percent. A quarterly payment had just been made prior to the decedent's death and payments were to continue for 5 more years. Under Table B in paragraph (d)(6) of this section for the interest rate of 9.8 percent, the factor for the present value of a remainder interest due after a term of 5 years is .626597. Converting the factor to an annuity factor, as described in paragraph (d)(2)(iv)(A) of this section, the factor for the present value of an annuity for a term of 5 years is 3.8102. The adjustment factor from Table K in paragraph (d)(6) of this section at an interest rate of 9.8 percent for quarterly annuity payments made at the end of the period is 1.0360. The present value of the annuity is, therefore, $39,473.67 ($10,000 X 3.8102 X 1.0360).

(6) *Actuarial Table B, Table J, and Table K where the valuation date is after April 30, 1989.* Except as provided in §20.7520–3(b) (pertaining to certain limitations on prescribed tables), for determination of the present value of an interest that is dependent on a term of years, the tables in this paragraph (d)(6) must be used in the application of the provisions of this section when the section 7520 interest rate component is between 4.2 and 14 percent.

* * * * *

(7) *Actuarial Table S and Table 90CM where the valuation date is after April 30, 1999.* Except as provided in §20.7520–2(b) (pertaining to certain limitations on the use of prescribed tables), for determination of the present value of an interest that is dependent on the termination of a life interest, Table 90CM and Table S, single life remainder factors applicable where the valuation date is after April 30, 1999, contained in this paragraph (d)(7) (or Table S and Table 80CNSMT contained in §20.2031–7A(e)(4) for valuation dates after April 30, 1989, and before May 1, 1999) and Table J and Table K contained in paragraph (d)(6) of this section, must be used in the application of the provisions of this section when the section 7520 interest rate component is between 4.2 and 14 percent.

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
0	.06752	.06130	.05586	.05109	.04691	.04322	.03998	.03711	.03458	.03233
1	.06137	.05495	.04932	.04438	.04003	.03620	.03283	.02985	.02721	.02487
2	.06325	.05667	.05088	.04580	.04132	.03737	.03388	.03079	.02806	.02563
3	.06545	.05869	.05275	.04752	.04291	.03883	.03523	.03203	.02920	.02668
4	.06784	.06092	.05482	.04944	.04469	.04048	.03676	.03346	.03052	.02791
5	.07040	.06331	.05705	.05152	.04662	.04229	.03845	.03503	.03199	.02928
6	.07310	.06583	.05941	.05372	.04869	.04422	.04025	.03672	.03357	.03076
7	.07594	.06849	.06191	.05607	.05089	.04628	.04219	.03854	.03528	.03236
8	.07891	.07129	.06453	.05853	.05321	.04846	.04424	.04046	.03709	.03407
9	.08203	.07423	.06731	.06115	.05567	.05079	.04643	.04253	.03904	.03592
10	.08532	.07734	.07024	.06392	.05829	.05326	.04877	.04474	.04114	.03790
11	.08875	.08059	.07331	.06683	.06104	.05587	.05124	.04709	.04336	.04002
12	.09233	.08398	.07653	.06989	.06394	.05862	.05385	.04957	.04572	.04226
13	.09601	.08748	.07985	.07304	.06693	.06146	.05655	.05214	.04816	.04458
14	.09974	.09102	.08322	.07624	.06997	.06435	.05929	.05474	.05064	.04694
15	.10350	.09460	.08661	.07946	.07303	.06725	.06204	.05735	.05312	.04930
16	.10728	.09818	.09001	.08268	.07608	.07014	.06479	.05996	.05559	.05164
17	.11108	.10179	.09344	.08592	.07916	.07306	.06755	.06257	.05807	.05399
18	.11494	.10545	.09691	.08921	.08227	.07601	.07034	.06521	.06057	.05636
19	.11889	.10921	.10047	.09259	.08548	.07904	.07322	.06794	.06315	.05880
20	.12298	.11310	.10417	.09610	.08881	.08220	.07622	.07078	.06584	.06135
21	.12722	.11713	.10801	.09976	.09228	.08550	.07935	.07375	.06866	.06403
22	.13159	.12130	.11199	.10354	.09588	.08893	.08260	.07685	.07160	.06682
23	.13613	.12563	.11612	.10748	.09964	.09250	.08601	.08009	.07468	.06975
24	.14084	.13014	.12043	.11160	.10357	.09625	.08958	.08349	.07793	.07284
25	.14574	.13484	.12493	.11591	.10768	.10018	.09334	.08708	.08135	.07611
26	.15084	.13974	.12963	.12041	.11199	.10431	.09728	.09085	.08496	.07956
27	.15615	.14485	.13454	.12513	.11652	.10865	.10144	.09484	.08878	.08322
28	.16166	.15016	.13965	.13004	.12124	.11319	.10580	.09901	.09279	.08706
29	.16737	.15567	.14497	.13516	.12617	.11792	.11035	.10339	.09699	.09109

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
30	.17328	.16138	.15048	.14047	.13129	.12286	.11510	.10796	.10138	.09532
31	.17938	.16728	.15618	.14599	.13661	.12799	.12004	.11272	.10597	.09974
32	.18568	.17339	.16210	.15171	.14214	.13333	.12520	.11769	.11076	.10435
33	.19220	.17972	.16824	.15766	.14790	.13889	.13058	.12289	.11578	.10920
34	.19894	.18627	.17460	.16383	.15388	.14468	.13618	.12831	.12102	.11426
35	.20592	.19307	.18121	.17025	.16011	.15073	.14204	.13399	.12652	.11958
36	.21312	.20010	.18805	.17691	.16658	.15701	.14814	.13990	.13225	.12514
37	.22057	.20737	.19514	.18382	.17331	.16356	.15450	.14608	.13825	.13096
38	.22827	.21490	.20251	.19100	.18031	.17038	.16113	.15253	.14452	.13705
39	.23623	.22270	.21013	.19845	.18759	.17747	.16805	.15927	.15108	.14344
40	.24446	.23078	.21805	.20620	.19516	.18487	.17527	.16631	.15795	.15013
41	.25298	.23915	.22626	.21425	.20305	.19259	.18282	.17368	.16514	.15715
42	.26178	.24782	.23478	.22262	.21125	.20062	.19069	.18138	.17267	.16450
43	.27087	.25678	.24360	.23129	.21977	.20898	.19888	.18941	.18053	.17220
44	.28025	.26603	.25273	.24027	.22860	.21766	.20740	.19777	.18873	.18023
45	.28987	.27555	.26212	.24953	.23772	.22664	.21622	.20644	.19724	.18858
46	.29976	.28533	.27179	.25908	.24714	.23591	.22536	.21542	.20606	.19725
47	.30987	.29535	.28171	.26889	.25682	.24546	.23476	.22468	.21518	.20621
48	.32023	.30563	.29190	.27897	.26678	.25530	.24447	.23425	.22460	.21549
49	.33082	.31615	.30234	.28931	.27702	.26543	.25447	.24412	.23434	.22509
50	.34166	.32694	.31306	.29995	.28756	.27586	.26479	.25432	.24441	.23502
51	.35274	.33798	.32404	.31085	.29838	.28658	.27541	.26482	.25479	.24528
52	.36402	.34924	.33525	.32200	.30946	.29757	.28630	.27561	.26547	.25584
53	.37550	.36070	.34668	.33339	.32078	.30882	.29746	.28667	.27643	.26669
54	.38717	.37237	.35833	.34500	.33234	.32031	.30888	.29801	.28766	.27782
55	.39903	.38424	.37019	.35683	.34413	.33205	.32056	.30961	.29918	.28925
56	.41108	.39631	.38227	.36890	.35617	.34405	.33250	.32149	.31099	.30097
57	.42330	.40857	.39455	.38118	.36844	.35629	.34469	.33363	.32306	.31297
58	.43566	.42098	.40699	.39364	.38089	.36873	.35710	.34600	.33538	.32522
59	.44811	.43351	.41956	.40623	.39350	.38133	.36968	.35855	.34789	.33768
60	.46066	.44613	.43224	.41896	.40624	.39408	.38243	.37127	.36058	.35033
61	.47330	.45887	.44505	.43182	.41914	.40699	.39535	.38418	.37347	.36318
62	.48608	.47175	.45802	.44485	.43223	.42011	.40848	.39732	.38660	.37629
63	.49898	.48478	.47115	.45807	.44550	.43343	.42184	.41069	.39997	.38966
64	.51200	.49793	.48442	.47143	.45895	.44694	.43539	.42427	.41357	.40326
65	.52512	.51121	.49782	.48495	.47255	.46062	.44912	.43805	.42738	.41709
66	.53835	.52461	.51137	.49862	.48634	.47449	.46307	.45206	.44143	.43118
67	.55174	.53818	.52511	.51250	.50034	.48860	.47727	.46633	.45576	.44556
68	.56524	.55188	.53899	.52654	.51452	.50291	.49168	.48083	.47034	.46020
69	.57882	.56568	.55299	.54071	.52885	.51737	.50627	.49552	.48513	.47506
70	.59242	.57951	.56703	.55495	.54325	.53193	.52096	.51034	.50004	.49007
71	.60598	.59332	.58106	.56918	.55767	.54651	.53569	.52520	.51503	.50516
72	.61948	.60707	.59504	.58338	.57206	.56108	.55043	.54009	.53004	.52029
73	.63287	.62073	.60895	.59751	.58640	.57561	.56513	.55495	.54505	.53543
74	.64621	.63435	.62282	.61162	.60073	.59015	.57985	.56984	.56009	.55061

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	4.2%	4.4%	4.6%	4.8%	5.0%	5.2%	5.4%	5.6%	5.8%	6.0%
75	.65953	.64796	.63671	.62575	.61510	.60473	.59463	.58480	.57523	.56591
76	.67287	.66160	.65063	.63995	.62954	.61940	.60952	.59989	.59050	.58135
77	.68622	.67526	.66459	.65419	.64404	.63415	.62450	.61509	.60590	.59694
78	.69954	.68892	.67856	.66845	.65858	.64895	.63955	.63036	.62140	.61264
79	.71278	.70250	.69246	.68265	.67308	.66372	.65457	.64563	.63690	.62836
80	.72581	.71588	.70618	.69668	.68740	.67833	.66945	.66077	.65227	.64396
81	.73857	.72899	.71962	.71045	.70147	.69268	.68408	.67566	.66741	.65933
82	.75101	.74178	.73274	.72389	.71522	.70672	.69840	.69024	.68225	.67441
83	.76311	.75423	.74553	.73700	.72864	.72044	.71240	.70451	.69678	.68919
84	.77497	.76645	.75809	.74988	.74183	.73393	.72618	.71857	.71110	.70377
85	.78665	.77848	.77047	.76260	.75487	.74728	.73982	.73250	.72530	.71823
86	.79805	.79025	.78258	.77504	.76764	.76036	.75320	.74617	.73925	.73245
87	.80904	.80159	.79427	.78706	.77998	.77301	.76615	.75940	.75277	.74624
88	.81962	.81251	.80552	.79865	.79188	.78521	.77865	.77220	.76584	.75958
89	.82978	.82302	.81636	.80980	.80335	.79699	.79072	.78455	.77847	.77248
90	.83952	.83309	.82676	.82052	.81437	.80831	.80234	.79645	.79064	.78492
91	.84870	.84260	.83658	.83064	.82479	.81902	.81332	.80771	.80217	.79671
92	.85716	.85136	.84563	.83998	.83441	.82891	.82348	.81812	.81283	.80761
93	.86494	.85942	.85396	.84858	.84326	.83801	.83283	.82771	.82266	.81767
94	.87216	.86690	.86170	.85657	.85149	.84648	.84153	.83664	.83181	.82704
95	.87898	.87397	.86902	.86412	.85928	.85450	.84977	.84510	.84049	.83592
96	.88537	.88060	.87587	.87121	.86659	.86203	.85751	.85305	.84864	.84427
97	.89127	.88672	.88221	.87775	.87335	.86898	.86467	.86040	.85618	.85200
98	.89680	.89245	.88815	.88389	.87968	.87551	.87138	.86730	.86326	.85926
99	.90217	.89803	.89393	.88987	.88585	.88187	.87793	.87402	.87016	.86633
100	.90738	.90344	.89953	.89567	.89183	.88804	.88428	.88056	.87687	.87322
101	.91250	.90876	.90504	.90137	.89772	.89412	.89054	.88699	.88348	.88000
102	.91751	.91396	.91045	.90696	.90350	.90007	.89668	.89331	.88997	.88666
103	.92247	.91912	.91579	.91249	.90922	.90598	.90276	.89957	.89640	.89326
104	.92775	.92460	.92148	.91839	.91532	.91227	.90924	.90624	.90326	.90031
105	.93290	.92996	.92704	.92415	.92127	.91841	.91558	.91276	.90997	.90719
106	.93948	.93680	.93415	.93151	.92889	.92628	.92370	.92113	.91857	.91604
107	.94739	.94504	.94271	.94039	.93808	.93579	.93351	.93124	.92899	.92675
108	.95950	.95767	.95585	.95404	.95224	.95045	.94867	.94689	.94512	.94336
109	.97985	.97893	.97801	.97710	.97619	.97529	.97438	.97348	.97259	.97170

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
0	.03034	.02857	.02700	.02559	.02433	.02321	.02220	.02129	.02047	.01973
1	.02279	.02094	.01929	.01782	.01650	.01533	.01427	.01331	.01246	.01168
2	.02347	.02155	.01983	.01829	.01692	.01569	.01458	.01358	.01268	.01187
3	.02444	.02243	.02065	.01905	.01761	.01632	.01516	.01412	.01317	.01232
4	.02558	.02349	.02163	.01996	.01846	.01712	.01590	.01481	.01382	.01292
5	.02686	.02469	.02275	.02101	.01945	.01804	.01677	.01562	.01458	.01364
6	.02825	.02600	.02398	.02217	.02053	.01906	.01773	.01653	.01544	.01445
7	.02976	.02742	.02532	.02343	.02172	.02019	.01880	.01754	.01640	.01536
8	.03137	.02894	.02675	.02479	.02301	.02140	.01995	.01864	.01744	.01635
9	.03311	.03059	.02832	.02627	.02442	.02274	.02122	.01985	.01859	.01745
10	.03499	.03237	.03001	.02788	.02595	.02420	.02262	.02118	.01987	.01867
11	.03700	.03428	.03183	.02961	.02760	.02578	.02413	.02262	.02125	.02000
12	.03913	.03632	.03377	.03146	.02937	.02748	.02575	.02418	.02275	.02144
13	.04135	.03843	.03579	.03339	.03122	.02924	.02744	.02580	.02431	.02294
14	.04359	.04057	.03783	.03534	.03308	.03102	.02915	.02744	.02587	.02444
15	.04584	.04270	.03986	.03728	.03493	.03279	.03083	.02905	.02742	.02593
16	.04806	.04482	.04187	.03919	.03674	.03452	.03248	.03063	.02892	.02736
17	.05029	.04692	.04387	.04108	.03855	.03623	.03411	.03218	.03040	.02877
18	.05253	.04905	.04588	.04299	.04036	.03795	.03574	.03373	.03187	.03017
19	.05484	.05124	.04796	.04496	.04222	.03972	.03742	.03532	.03339	.03161
20	.05726	.05354	.05013	.04702	.04418	.04158	.03919	.03700	.03498	.03313
21	.05980	.05595	.05242	.04920	.04625	.04354	.04105	.03877	.03667	.03473
22	.06246	.05847	.05482	.05147	.04841	.04559	.04301	.04063	.03844	.03642
23	.06524	.06112	.05734	.05387	.05069	.04777	.04508	.04260	.04032	.03821
24	.06819	.06392	.06001	.05642	.05312	.05008	.04728	.04470	.04232	.04012
25	.07131	.06690	.06285	.05913	.05570	.05255	.04964	.04695	.04447	.04218
26	.07460	.07005	.06586	.06200	.05845	.05518	.05215	.04936	.04677	.04438
27	.07810	.07340	.06907	.06508	.06140	.05800	.05485	.05195	.04925	.04676
28	.08179	.07693	.07246	.06833	.06451	.06098	.05772	.05469	.05189	.04929
29	.08566	.08065	.07603	.07176	.06780	.06414	.06075	.05761	.05469	.05198
30	.08973	.08456	.07978	.07536	.07127	.06748	.06396	.06069	.05766	.05483
31	.09398	.08865	.08372	.07915	.07491	.07098	.06733	.06394	.06078	.05785
32	.09843	.09294	.08785	.08313	.07875	.07468	.07089	.06737	.06409	.06103
33	.10310	.09745	.09220	.08732	.08279	.07858	.07466	.07100	.06759	.06441
34	.10799	.10217	.09676	.09173	.08705	.08269	.07862	.07483	.07129	.06798
35	.11314	.10715	.10157	.09638	.09155	.08704	.08283	.07890	.07522	.07179
36	.11852	.11236	.10662	.10127	.09628	.09162	.08726	.08319	.07938	.07581
37	.12416	.11783	.11193	.10641	.10126	.09645	.09194	.08772	.08377	.08006
38	.13009	.12359	.11751	.11183	.10652	.10155	.09689	.09253	.08843	.08459
39	.13629	.12962	.12338	.11753	.11206	.10693	.10212	.09761	.09337	.08938
40	.14281	.13597	.12955	.12355	.11791	.11262	.10766	.10299	.09860	.09447
41	.14966	.14264	.13606	.12989	.12409	.11864	.11352	.10870	.10417	.09989
42	.15685	.14966	.14291	.13657	.13061	.12500	.11972	.11475	.11006	.10564
43	.16437	.15702	.15010	.14360	.13747	.13171	.12627	.12115	.11631	.11174
44	.17224	.16472	.15764	.15098	.14469	.13876	.13317	.12789	.12290	.11819

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
45	.18042	.17274	.16550	.15867	.15223	.14615	.14040	.13496	.12982	.12496
46	.18893	.18110	.17370	.16671	.16011	.15387	.14796	.14238	.13708	.13207
47	.19775	.18975	.18220	.17505	.16830	.16190	.15584	.15010	.14466	.13950
48	.20688	.19873	.19102	.18373	.17682	.17027	.16406	.15817	.15258	.14727
49	.21633	.20804	.20018	.19274	.18568	.17898	.17262	.16658	.16084	.15539
50	.22612	.21769	.20969	.20210	.19490	.18805	.18155	.17536	.16948	.16388
51	.23625	.22769	.21955	.21182	.20448	.19749	.19084	.18452	.17849	.17275
52	.24669	.23799	.22973	.22186	.21438	.20726	.20047	.19400	.18784	.18196
53	.25742	.24861	.24022	.23222	.22461	.21735	.21043	.20383	.19753	.19151
54	.26845	.25952	.25101	.24290	.23516	.22777	.22072	.21399	.20756	.20140
55	.27978	.27074	.26212	.25389	.24604	.23853	.23136	.22450	.21793	.21166
56	.29140	.28227	.27355	.26522	.25725	.24963	.24233	.23535	.22867	.22227
57	.30333	.29411	.28529	.27686	.26879	.26106	.25365	.24656	.23976	.23324
58	.31551	.30621	.29731	.28878	.28061	.27278	.26528	.25807	.25116	.24453
59	.32790	.31854	.30956	.30095	.29269	.28477	.27716	.26986	.26284	.25610
60	.34050	.33107	.32202	.31334	.30500	.29699	.28929	.28190	.27478	.26794
61	.35331	.34384	.33473	.32598	.31757	.30948	.30170	.29422	.28701	.28007
62	.36639	.35688	.34772	.33892	.33044	.32229	.31443	.30687	.29958	.29255
63	.37974	.37020	.36101	.35216	.34363	.33542	.32750	.31986	.31250	.30539
64	.39334	.38378	.37456	.36568	.35711	.34884	.34087	.33317	.32574	.31857
65	.40718	.39761	.38838	.37947	.37087	.36257	.35455	.34681	.33932	.33208
66	.42128	.41172	.40249	.39357	.38496	.37663	.36858	.36079	.35326	.34597
67	.43569	.42616	.41694	.40803	.39941	.39107	.38299	.37518	.36761	.36028
68	.45038	.44089	.43170	.42281	.41419	.40585	.39777	.38994	.38235	.37499
69	.46531	.45587	.44672	.43786	.42927	.42094	.41286	.40503	.39743	.39006
70	.48040	.47103	.46194	.45312	.44456	.43626	.42820	.42038	.41278	.40540
71	.49558	.48629	.47727	.46851	.46000	.45174	.44371	.43591	.42832	.42095
72	.51082	.50162	.49268	.48399	.47554	.46733	.45934	.45157	.44401	.43666
73	.52607	.51697	.50813	.49952	.49114	.48299	.47506	.46733	.45981	.45249
74	.54139	.53241	.52367	.51515	.50686	.49879	.49092	.48325	.47578	.46849
75	.55683	.54798	.53936	.53095	.52276	.51477	.50698	.49938	.49197	.48474
76	.57243	.56373	.55524	.54696	.53888	.53100	.52330	.51579	.50846	.50130
77	.58819	.57965	.57132	.56318	.55523	.54747	.53988	.53247	.52523	.51815
78	.60408	.59572	.58755	.57957	.57177	.56414	.55668	.54939	.54225	.53527
79	.62001	.61184	.60385	.59604	.58840	.58092	.57360	.56644	.55943	.55256
80	.63582	.62786	.62007	.61244	.60497	.59765	.59048	.58347	.57659	.56985
81	.65142	.64367	.63608	.62864	.62135	.61421	.60721	.60034	.59361	.58701
82	.66673	.65920	.65182	.64458	.63748	.63052	.62368	.61698	.61041	.60395
83	.68175	.67444	.66728	.66024	.65334	.64656	.63991	.63338	.62696	.62066
84	.69657	.68950	.68256	.67574	.66904	.66246	.65599	.64964	.64340	.63727
85	.71128	.70446	.69775	.69116	.68467	.67830	.67204	.66587	.65982	.65386
86	.72576	.71919	.71272	.70636	.70010	.69394	.68789	.68193	.67606	.67029
87	.73981	.73349	.72726	.72114	.71511	.70917	.70333	.69757	.69190	.68632
88	.75342	.74735	.74137	.73548	.72968	.72396	.71833	.71279	.70732	.70194
89	.76658	.76076	.75503	.74938	.74381	.73832	.73290	.72757	.72231	.71712

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

AGE	INTEREST RATE									
	6.2%	6.4%	6.6%	6.8%	7.0%	7.2%	7.4%	7.6%	7.8%	8.0%
90	.77928	.77371	.76823	.76281	.75748	.75221	.74702	.74190	.73684	.73186
91	.79131	.78600	.78075	.77557	.77046	.76542	.76044	.75553	.75068	.74589
92	.80246	.79737	.79235	.78740	.78250	.77767	.77290	.76818	.76353	.75893
93	.81274	.80788	.80307	.79832	.79363	.78899	.78441	.77989	.77542	.77100
94	.82232	.81766	.81306	.80850	.80401	.79956	.79517	.79082	.78653	.78228
95	.83141	.82695	.82254	.81818	.81387	.80961	.80539	.80122	.79710	.79302
96	.83996	.83569	.83147	.82729	.82316	.81907	.81503	.81103	.80707	.80315
97	.84787	.84378	.83973	.83573	.83176	.82784	.82396	.82012	.81632	.81255
98	.85530	.85138	.84750	.84366	.83985	.83609	.83236	.82867	.82502	.82140
99	.86255	.85880	.85508	.85140	.84776	.84415	.84057	.83703	.83353	.83005
100	.86960	.86601	.86246	.85894	.85546	.85200	.84858	.84519	.84183	.83849
101	.87655	.87313	.86974	.86638	.86305	.85975	.85648	.85324	.85003	.84684
102	.88338	.88012	.87689	.87369	.87052	.86738	.86426	.86116	.85809	.85505
103	.89015	.88706	.88399	.88095	.87793	.87494	.87197	.86903	.86611	.86321
104	.89737	.89446	.89157	.88871	.88586	.88304	.88024	.87745	.87469	.87195
105	.90443	.90170	.89898	.89628	.89360	.89094	.88830	.88568	.88307	.88049
106	.91351	.91101	.90852	.90605	.90359	.90115	.89873	.89632	.89392	.89154
107	.92452	.92230	.92010	.91791	.91573	.91356	.91141	.90927	.90714	.90502
108	.94161	.93987	.93814	.93641	.93469	.93298	.93128	.92958	.92790	.92622
109	.97081	.96992	.96904	.96816	.96729	.96642	.96555	.96468	.96382	.96296

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

AGE	INTEREST RATE									
	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
0	.01906	.01845	.01790	.01740	.01694	.01652	.01613	.01578	.01546	.01516
1	.01098	.01034	.00977	.00924	.00876	.00833	.00793	.00756	.00722	.00691
2	.01113	.01046	.00986	.00930	.00880	.00834	.00791	.00753	.00717	.00684
3	.01155	.01084	.01020	.00962	.00909	.00860	.00816	.00775	.00737	.00702
4	.01211	.01137	.01069	.01008	.00952	.00900	.00853	.00810	.00770	.00733
5	.01279	.01201	.01130	.01065	.01006	.00952	.00902	.00856	.00814	.00775
6	.01356	.01274	.01199	.01131	.01068	.01011	.00959	.00910	.00865	.00824
7	.01442	.01356	.01277	.01205	.01140	.01079	.01023	.00972	.00925	.00881
8	.01536	.01446	.01363	.01287	.01218	.01154	.01096	.01041	.00991	.00945
9	.01641	.01546	.01460	.01380	.01307	.01240	.01178	.01120	.01068	.01019
10	.01758	.01659	.01567	.01484	.01407	.01336	.01270	.01210	.01154	.01103
11	.01886	.01781	.01686	.01598	.01517	.01442	.01373	.01310	.01251	.01196
12	.02024	.01915	.01814	.01721	.01636	.01558	.01485	.01419	.01357	.01299
13	.02168	.02054	.01948	.01851	.01762	.01679	.01603	.01533	.01467	.01407
14	.02313	.02193	.02083	.01981	.01887	.01801	.01721	.01646	.01578	.01514

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
15	.02456	.02330	.02214	.02107	.02009	.01918	.01834	.01756	.01684	.01617
16	.02593	.02462	.02340	.02229	.02126	.02030	.01942	.01860	.01785	.01714
17	.02728	.02590	.02463	.02346	.02238	.02138	.02046	.01960	.01880	.01806
18	.02861	.02717	.02584	.02462	.02348	.02243	.02146	.02056	.01972	.01894
19	.02998	.02847	.02708	.02580	.02461	.02351	.02249	.02154	.02066	.01984
20	.03142	.02984	.02839	.02704	.02580	.02465	.02357	.02258	.02165	.02079
21	.03295	.03130	.02978	.02837	.02706	.02585	.02473	.02368	.02271	.02180
22	.03455	.03283	.03124	.02976	.02839	.02712	.02594	.02484	.02382	.02286
23	.03626	.03446	.03279	.03124	.02981	.02847	.02723	.02608	.02500	.02400
24	.03809	.03620	.03446	.03283	.03133	.02993	.02863	.02741	.02628	.02522
25	.04005	.03808	.03625	.03456	.03298	.03151	.03014	.02887	.02768	.02656
26	.04216	.04010	.03819	.03641	.03476	.03322	.03178	.03044	.02919	.02802
27	.04444	.04229	.04029	.03843	.03670	.03508	.03357	.03217	.03085	.02962
28	.04687	.04463	.04254	.04059	.03877	.03708	.03550	.03402	.03263	.03133
29	.04946	.04712	.04493	.04289	.04099	.03922	.03756	.03600	.03455	.03318
30	.05221	.04976	.04748	.04534	.04335	.04149	.03975	.03812	.03659	.03515
31	.05511	.05255	.05017	.04794	.04585	.04390	.04208	.04037	.03876	.03725
32	.05818	.05551	.05302	.05069	.04851	.04647	.04455	.04276	.04107	.03948
33	.06144	.05866	.05606	.05363	.05135	.04921	.04720	.04532	.04355	.04188
34	.06489	.06200	.05928	.05674	.05436	.05212	.05002	.04805	.04619	.04444
35	.06857	.06555	.06273	.06007	.05758	.05524	.05304	.05097	.04902	.04718
36	.07246	.06932	.06638	.06361	.06101	.05856	.05626	.05409	.05205	.05012
37	.07659	.07332	.07025	.06737	.06466	.06210	.05969	.05742	.05528	.05325
38	.08098	.07758	.07439	.07138	.06855	.06588	.06336	.06099	.05874	.05662
39	.08563	.08210	.07878	.07565	.07270	.06992	.06729	.06480	.06245	.06023
40	.09059	.08692	.08347	.08021	.07714	.07423	.07149	.06889	.06643	.06411
41	.09586	.09206	.08848	.08509	.08189	.07886	.07600	.07329	.07072	.06828
42	.10147	.09753	.09381	.09029	.08696	.08381	.08083	.07800	.07531	.07277
43	.10742	.10334	.09948	.09583	.09237	.08909	.08598	.08304	.08024	.07758
44	.11373	.10950	.10551	.10172	.09813	.09472	.09148	.08841	.08549	.08272
45	.12035	.11599	.11185	.10792	.10420	.10066	.09730	.09410	.09106	.08817
46	.12732	.12281	.11853	.11447	.11061	.10694	.10345	.10013	.09696	.09395
47	.13460	.12995	.12553	.12133	.11733	.11353	.10991	.10646	.10317	.10004
48	.14223	.13743	.13287	.12853	.12439	.12046	.11671	.11313	.10972	.10646
49	.15020	.14526	.14056	.13608	.13181	.12774	.12385	.12015	.11661	.11322
50	.15855	.15347	.14862	.14401	.13960	.13540	.13138	.12754	.12388	.12037
51	.16727	.16205	.15707	.15232	.14777	.14344	.13929	.13532	.13153	.12789
52	.17634	.17098	.16587	.16097	.15630	.15183	.14755	.14345	.13953	.13577
53	.18576	.18027	.17501	.16999	.16518	.16057	.15616	.15194	.14789	.14400
54	.19552	.18990	.18451	.17935	.17441	.16968	.16514	.16078	.15661	.15260
55	.20564	.19989	.19437	.18908	.18402	.17915	.17449	.17001	.16571	.16157
56	.21613	.21025	.20461	.19919	.19400	.18901	.18422	.17962	.17519	.17093
57	.22698	.22098	.21522	.20968	.20436	.19925	.19434	.18961	.18507	.18069
58	.23816	.23204	.22616	.22051	.21507	.20984	.20481	.19996	.19530	.19080
59	.24962	.24339	.23740	.23163	.22608	.22073	.21558	.21062	.20584	.20123

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
60	.26136	.25502	.24892	.24304	.23738	.23192	.22666	.22158	.21669	.21196
61	.27339	.26695	.26075	.25477	.24900	.24343	.23806	.23288	.22787	.22304
62	.28578	.27925	.27295	.26687	.26100	.25533	.24985	.24456	.23945	.23451
63	.29854	.29192	.28553	.27935	.27339	.26762	.26205	.25666	.25145	.24641
64	.31164	.30494	.29846	.29221	.28615	.28030	.27463	.26915	.26384	.25870
65	.32508	.31831	.31177	.30543	.29930	.29336	.28761	.28203	.27663	.27140
66	.33891	.33208	.32547	.31906	.31285	.30684	.30101	.29536	.28987	.28456
67	.35318	.34630	.33963	.33316	.32689	.32081	.31491	.30918	.30363	.29823
68	.36785	.36093	.35422	.34770	.34138	.33524	.32928	.32349	.31787	.31240
69	.38290	.37595	.36920	.36265	.35628	.35009	.34408	.33824	.33256	.32703
70	.39823	.39127	.38450	.37791	.37151	.36529	.35924	.35335	.34762	.34204
71	.41378	.40681	.40003	.39343	.38701	.38076	.37467	.36875	.36298	.35736
72	.42950	.42253	.41575	.40914	.40271	.39644	.39034	.38438	.37858	.37293
73	.44535	.43840	.43162	.42502	.41858	.41231	.40619	.40022	.39440	.38872
74	.46139	.45446	.44771	.44112	.43469	.42842	.42230	.41632	.41049	.40479
75	.47769	.47080	.46408	.45752	.45111	.44485	.43874	.43277	.42693	.42123
76	.49430	.48747	.48079	.47427	.46790	.46167	.45558	.44963	.44380	.43811
77	.51123	.50447	.49786	.49139	.48506	.47888	.47282	.46690	.46111	.45543
78	.52845	.52177	.51523	.50884	.50257	.49645	.49044	.48457	.47881	.47317
79	.54584	.53926	.53282	.52650	.52032	.51426	.50833	.50251	.49681	.49122
80	.56325	.55678	.55044	.54423	.53813	.53216	.52630	.52056	.51492	.50939
81	.58054	.57419	.56797	.56186	.55587	.54999	.54422	.53856	.53300	.52754
82	.59762	.59140	.58530	.57931	.57343	.56766	.56198	.55641	.55094	.54557
83	.61448	.60840	.60243	.59657	.59081	.58515	.57958	.57411	.56874	.56346
84	.63124	.62531	.61949	.61376	.60813	.60259	.59715	.59179	.58652	.58134
85	.64800	.64224	.63657	.63099	.62550	.62010	.61478	.60955	.60441	.59934
86	.66461	.65902	.65351	.64810	.64276	.63751	.63233	.62724	.62222	.61728
87	.68083	.67541	.67008	.66483	.65965	.65455	.64953	.64458	.63970	.63489
88	.69663	.69140	.68624	.68116	.67615	.67121	.66634	.66154	.65680	.65213
89	.71201	.70696	.70199	.69708	.69224	.68747	.68276	.67811	.67353	.66900
90	.72694	.72209	.71730	.71257	.70791	.70330	.69876	.69427	.68984	.68547
91	.74117	.73650	.73190	.72735	.72286	.71842	.71404	.70972	.70545	.70123
92	.75439	.74991	.74548	.74110	.73678	.73251	.72829	.72412	.72000	.71593
93	.76664	.76233	.75806	.75385	.74969	.74557	.74150	.73748	.73350	.72957
94	.77809	.77394	.76983	.76578	.76177	.75780	.75388	.75000	.74616	.74237
95	.78899	.78500	.78106	.77715	.77329	.76947	.76569	.76195	.75826	.75460
96	.79928	.79544	.79165	.78790	.78418	.78050	.77686	.77326	.76970	.76617
97	.80883	.80514	.80149	.79787	.79430	.79075	.78725	.78377	.78033	.77693
98	.81781	.81427	.81075	.80727	.80382	.80041	.79703	.79368	.79036	.78708
99	.82661	.82320	.81982	.81648	.81316	.80988	.80662	.80340	.80020	.79704

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	8.2%	8.4%	8.6%	8.8%	9.0%	9.2%	9.4%	9.6%	9.8%	10.0%
100	.83519	.83192	.82868	.82547	.82228	.81913	.81600	.81290	.80982	.80678
101	.84368	.84055	.83744	.83437	.83131	.82829	.82529	.82231	.81936	.81643
102	.85203	.84904	.84607	.84313	.84021	.83731	.83444	.83159	.82876	.82596
103	.86034	.85748	.85465	.85184	.84906	.84629	.84355	.84082	.83812	.83544
104	.86923	.86653	.86385	.86119	.85855	.85593	.85333	.85074	.84818	.84563
105	.87792	.87537	.87283	.87032	.86782	.86534	.86287	.86042	.85799	.85557
106	.88918	.88683	.88450	.88218	.87987	.87758	.87530	.87304	.87079	.86855
107	.90291	.90082	.89873	.89666	.89460	.89255	.89051	.88849	.88647	.88447
108	.92455	.92288	.92123	.91958	.91794	.91630	.91468	.91306	.91145	.90984
109	.96211	.96125	.96041	.95956	.95872	.95788	.95704	.95620	.95537	.95455

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
0	.01488	.01463	.01439	.01417	.01396	.01377	.01359	.01343	.01327	.01312
1	.00662	.00636	.00612	.00589	.00568	.00548	.00530	.00513	.00497	.00482
2	.00654	.00626	.00600	.00576	.00554	.00533	.00514	.00496	.00479	.00463
3	.00670	.00641	.00613	.00588	.00564	.00542	.00522	.00502	.00484	.00468
4	.00699	.00668	.00639	.00612	.00587	.00563	.00542	.00521	.00502	.00484
5	.00739	.00706	.00675	.00646	.00620	.00595	.00571	.00550	.00529	.00510
6	.00786	.00751	.00718	.00687	.00659	.00633	.00608	.00585	.00563	.00543
7	.00841	.00803	.00769	.00736	.00706	.00678	.00652	.00627	.00604	.00582
8	.00902	.00863	.00826	.00791	.00759	.00730	.00702	.00675	.00651	.00628
9	.00973	.00931	.00892	.00856	.00822	.00790	.00760	.00733	.00706	.00682
10	.01055	.01010	.00969	.00930	.00894	.00861	.00829	.00799	.00772	.00746
11	.01146	.01099	.01055	.01014	.00976	.00940	.00907	.00875	.00846	.00818
12	.01246	.01196	.01150	.01106	.01066	.01028	.00993	.00960	.00928	.00899
13	.01351	.01298	.01249	.01204	.01161	.01121	.01084	.01049	.01016	.00985
14	.01455	.01400	.01348	.01300	.01255	.01213	.01173	.01136	.01102	.01069
15	.01555	.01497	.01443	.01392	.01345	.01300	.01259	.01220	.01183	.01148
16	.01648	.01587	.01530	.01477	.01427	.01380	.01336	.01295	.01257	.01220
17	.01737	.01673	.01612	.01556	.01504	.01455	.01408	.01365	.01324	.01286
18	.01822	.01754	.01691	.01632	.01576	.01525	.01476	.01430	.01387	.01347
19	.01908	.01837	.01770	.01708	.01650	.01595	.01544	.01495	.01450	.01407
20	.01999	.01924	.01854	.01788	.01726	.01669	.01615	.01564	.01516	.01471
21	.02096	.02017	.01943	.01874	.01809	.01748	.01691	.01637	.01586	.01539
22	.02197	.02114	.02036	.01963	.01895	.01830	.01770	.01713	.01660	.01610
23	.02306	.02218	.02136	.02059	.01987	.01919	.01855	.01795	.01739	.01686
24	.02424	.02331	.02245	.02163	.02087	.02016	.01948	.01885	.01825	.01769

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
25	.02552	.02455	.02364	.02278	.02197	.02122	.02051	.01984	.01920	.01861
26	.02692	.02589	.02493	.02403	.02318	.02238	.02162	.02091	.02025	.01961
27	.02846	.02738	.02636	.02541	.02451	.02367	.02287	.02212	.02141	.02074
28	.03012	.02898	.02791	.02690	.02595	.02506	.02422	.02342	.02267	.02196
29	.03190	.03070	.02957	.02851	.02751	.02656	.02567	.02483	.02404	.02329
30	.03381	.03254	.03135	.03023	.02917	.02817	.02723	.02634	.02551	.02471
31	.03583	.03450	.03324	.03206	.03094	.02989	.02890	.02796	.02707	.02623
32	.03799	.03659	.03527	.03402	.03284	.03173	.03068	.02968	.02874	.02785
33	.04031	.03883	.03744	.03612	.03488	.03371	.03260	.03155	.03055	.02961
34	.04279	.04123	.03976	.03838	.03707	.03583	.03465	.03354	.03249	.03149
35	.04545	.04382	.04227	.04081	.03943	.03812	.03688	.03571	.03459	.03354
36	.04830	.04658	.04495	.04341	.04196	.04058	.03927	.03803	.03685	.03573
37	.05134	.04953	.04782	.04620	.04467	.04321	.04183	.04052	.03928	.03809
38	.05462	.05272	.05092	.04921	.04760	.04606	.04461	.04322	.04191	.04066
39	.05812	.05613	.05424	.05245	.05075	.04913	.04760	.04614	.04475	.04343
40	.06190	.05981	.05782	.05594	.05415	.05245	.05083	.04929	.04783	.04643
41	.06597	.06378	.06170	.05972	.05784	.05605	.05435	.05272	.05118	.04970
42	.07035	.06806	.06587	.06380	.06182	.05994	.05815	.05644	.05481	.05326
43	.07505	.07265	.07036	.06818	.06611	.06414	.06225	.06045	.05874	.05710
44	.08008	.07757	.07518	.07290	.07072	.06865	.06667	.06478	.06298	.06125
45	.08542	.08279	.08029	.07791	.07563	.07346	.07138	.06940	.06750	.06569
46	.09108	.08834	.08573	.08324	.08085	.07858	.07640	.07432	.07233	.07043
47	.09705	.09419	.09147	.08886	.08637	.08399	.08172	.07954	.07745	.07545
48	.10335	.10038	.09754	.09482	.09222	.08973	.08735	.08507	.08288	.08078
49	.10999	.10690	.10394	.10111	.09840	.09581	.09332	.09093	.08864	.08644
50	.11701	.11380	.11073	.10778	.10496	.10225	.09965	.09716	.09477	.09247
51	.12441	.12108	.11789	.11482	.11189	.10907	.10636	.10376	.10126	.09886
52	.13217	.12871	.12540	.12222	.11916	.11623	.11341	.11071	.10810	.10560
53	.14028	.13670	.13327	.12997	.12680	.12375	.12082	.11801	.11529	.11268
54	.14875	.14505	.14150	.13808	.13480	.13163	.12859	.12566	.12284	.12012
55	.15760	.15378	.15011	.14657	.14317	.13989	.13674	.13370	.13077	.12794
56	.16684	.16290	.15911	.15546	.15194	.14855	.14528	.14213	.13909	.13615
57	.17648	.17242	.16851	.16474	.16111	.15760	.15422	.15096	.14781	.14477
58	.18647	.18229	.17827	.17438	.17064	.16702	.16353	.16015	.15689	.15374
59	.19678	.19249	.18835	.18435	.18049	.17676	.17316	.16968	.16631	.16305
60	.20740	.20300	.19875	.19464	.19066	.18682	.18311	.17952	.17604	.17268
61	.21837	.21385	.20949	.20527	.20119	.19724	.19341	.18971	.18613	.18266
62	.22973	.22511	.22064	.21631	.21212	.20807	.20414	.20033	.19664	.19306
63	.24152	.23680	.23222	.22779	.22350	.21934	.21530	.21139	.20760	.20392
64	.25372	.24890	.24422	.23969	.23529	.23103	.22690	.22289	.21899	.21521
65	.26633	.26141	.25664	.25201	.24752	.24316	.23893	.23482	.23083	.22695
66	.27940	.27439	.26953	.26481	.26023	.25577	.25145	.24724	.24316	.23918
67	.29299	.28790	.28296	.27815	.27348	.26894	.26453	.26024	.25606	.25200
68	.30709	.30193	.29691	.29202	.28728	.28265	.27816	.27378	.26952	.26537
69	.32166	.31643	.31134	.30639	.30157	.29687	.29230	.28785	.28351	.27928

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	10.2%	10.4%	10.6%	10.8%	11.0%	11.2%	11.4%	11.6%	11.8%	12.0%
70	.33661	.33133	.32618	.32116	.31628	.31152	.30688	.30235	.29794	.29364
71	.35188	.34654	.34134	.33627	.33133	.32651	.32181	.31722	.31275	.30838
72	.36742	.36204	.35679	.35168	.34668	.34181	.33706	.33241	.32788	.32345
73	.38317	.37776	.37248	.36733	.36229	.35738	.35257	.34788	.34330	.33882
74	.39923	.39380	.38849	.38330	.37823	.37328	.36844	.36370	.35908	.35455
75	.41566	.41021	.40489	.39968	.39459	.38961	.38474	.37997	.37531	.37074
76	.43254	.42709	.42176	.41655	.41144	.40645	.40156	.39677	.39208	.38749
77	.44988	.44444	.43912	.43391	.42880	.42380	.41891	.41411	.40940	.40479
78	.46765	.46224	.45694	.45174	.44665	.44166	.43677	.43197	.42726	.42265
79	.48574	.48037	.47510	.46993	.46487	.45990	.45502	.45024	.44554	.44094
80	.50397	.49865	.49343	.48830	.48327	.47834	.47349	.46873	.46406	.45947
81	.52219	.51693	.51176	.50669	.50171	.49682	.49201	.48729	.48265	.47809
82	.54029	.53510	.53000	.52499	.52007	.51523	.51047	.50580	.50120	.49667
83	.55826	.55315	.54813	.54319	.53834	.53356	.52886	.52424	.51969	.51522
84	.57624	.57123	.56629	.56144	.55666	.55195	.54732	.54277	.53828	.53386
85	.59435	.58944	.58460	.57984	.57516	.57054	.56599	.56151	.55710	.55275
86	.61241	.60762	.60289	.59824	.59365	.58913	.58468	.58029	.57596	.57170
87	.63015	.62548	.62087	.61633	.61185	.60744	.60309	.59880	.59456	.59039
88	.64753	.64299	.63851	.63409	.62973	.62543	.62118	.61700	.61287	.60879
89	.66454	.66013	.65579	.65150	.64726	.64308	.63895	.63488	.63086	.62689
90	.68115	.67689	.67268	.66853	.66442	.66037	.65637	.65241	.64851	.64465
91	.69706	.69294	.68887	.68486	.68089	.67696	.67309	.66925	.66547	.66173
92	.71190	.70792	.70399	.70011	.69627	.69247	.68872	.68501	.68134	.67771
93	.72569	.72184	.71804	.71429	.71057	.70689	.70326	.69967	.69611	.69259
94	.73861	.73490	.73123	.72759	.72400	.72044	.71692	.71344	.71000	.70659
95	.75097	.74739	.74384	.74033	.73686	.73342	.73002	.72665	.72331	.72001
96	.76267	.75922	.75579	.75240	.74905	.74572	.74243	.73917	.73595	.73275
97	.77356	.77022	.76691	.76363	.76039	.75718	.75399	.75084	.74772	.74463
98	.78382	.78059	.77740	.77423	.77110	.76799	.76491	.76186	.75884	.75584
99	.79390	.79079	.78771	.78465	.78162	.77862	.77565	.77270	.76978	.76688
100	.80376	.80076	.79779	.79485	.79193	.78904	.78617	.78333	.78051	.77771
101	.81353	.81066	.80780	.80497	.80217	.79938	.79662	.79388	.79117	.78847
102	.82318	.82042	.81768	.81496	.81227	.80960	.80694	.80431	.80170	.79911
103	.83278	.83014	.82752	.82491	.82233	.81977	.81723	.81470	.81220	.80971
104	.84310	.84059	.83810	.83563	.83317	.83073	.82831	.82591	.82352	.82115
105	.85318	.85079	.84843	.84607	.84374	.84142	.83911	.83682	.83455	.83229
106	.86633	.86413	.86193	.85975	.85758	.85543	.85329	.85116	.84904	.84694
107	.88247	.88049	.87852	.87656	.87460	.87266	.87073	.86881	.86690	.86500
108	.90825	.90666	.90507	.90350	.90193	.90037	.89881	.89727	.89572	.89419
109	.95372	.95290	.95208	.95126	.95045	.94964	.94883	.94803	.94723	.94643

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
0	.01298	.01285	.01273	.01261	.01250	.01240	.01230	.01221	.01212	.01203
1	.00468	.00455	.00443	.00431	.00420	.00410	.00400	.00391	.00382	.00374
2	.00448	.00435	.00421	.00409	.00398	.00387	.00376	.00366	.00357	.00348
3	.00452	.00437	.00423	.00410	.00398	.00386	.00375	.00365	.00355	.00345
4	.00468	.00452	.00437	.00423	.00410	.00397	.00386	.00375	.00364	.00354
5	.00493	.00476	.00460	.00445	.00431	.00418	.00405	.00393	.00382	.00371
6	.00524	.00506	.00489	.00473	.00458	.00444	.00430	.00418	.00406	.00394
7	.00562	.00543	.00525	.00508	.00492	.00477	.00462	.00449	.00436	.00423
8	.00606	.00586	.00566	.00548	.00531	.00515	.00499	.00485	.00471	.00458
9	.00659	.00637	.00616	.00597	.00579	.00561	.00545	.00529	.00514	.00500
10	.00721	.00698	.00676	.00655	.00636	.00617	.00600	.00583	.00567	.00552
11	.00792	.00767	.00744	.00722	.00701	.00682	.00663	.00645	.00628	.00612
12	.00871	.00845	.00821	.00797	.00775	.00754	.00735	.00716	.00698	.00681
13	.00955	.00928	.00902	.00877	.00854	.00831	.00810	.00790	.00771	.00753
14	.01038	.01009	.00981	.00955	.00930	.00907	.00885	.00864	.00843	.00824
15	.01116	.01085	.01056	.01028	.01002	.00977	.00954	.00932	.00910	.00890
16	.01186	.01153	.01123	.01094	.01066	.01040	.01015	.00992	.00969	.00948
17	.01250	.01215	.01183	.01152	.01124	.01096	.01070	.01045	.01022	.00999
18	.01308	.01272	.01238	.01206	.01175	.01147	.01119	.01093	.01068	.01044
19	.01367	.01329	.01293	.01259	.01227	.01196	.01167	.01140	.01113	.01088
20	.01428	.01388	.01350	.01314	.01280	.01248	.01217	.01188	.01161	.01134
21	.01494	.01451	.01411	.01373	.01337	.01303	.01271	.01240	.01211	.01183
22	.01562	.01517	.01475	.01435	.01397	.01361	.01326	.01294	.01263	.01233
23	.01635	.01588	.01543	.01501	.01460	.01422	.01386	.01351	.01319	.01287
24	.01716	.01665	.01618	.01573	.01530	.01489	.01451	.01415	.01380	.01347
25	.01804	.01751	.01701	.01653	.01608	.01565	.01524	.01485	.01448	.01413
26	.01902	.01845	.01792	.01741	.01693	.01648	.01604	.01563	.01524	.01487
27	.02011	.01951	.01895	.01841	.01790	.01742	.01696	.01652	.01610	.01571
28	.02129	.02066	.02006	.01949	.01895	.01844	.01795	.01748	.01704	.01662
29	.02258	.02191	.02127	.02067	.02009	.01955	.01903	.01853	.01806	.01762
30	.02396	.02325	.02257	.02193	.02132	.02074	.02019	.01966	.01916	.01869
31	.02543	.02467	.02396	.02328	.02263	.02201	.02143	.02087	.02034	.01983
32	.02701	.02621	.02545	.02472	.02404	.02338	.02276	.02217	.02160	.02106
33	.02871	.02786	.02706	.02629	.02556	.02487	.02420	.02357	.02297	.02240
34	.03054	.02964	.02879	.02797	.02720	.02646	.02576	.02509	.02445	.02383
35	.03253	.03158	.03067	.02981	.02898	.02820	.02745	.02674	.02606	.02541
36	.03467	.03366	.03269	.03178	.03090	.03007	.02928	.02852	.02779	.02710
37	.03697	.03590	.03488	.03391	.03298	.03209	.03125	.03044	.02967	.02893
38	.03947	.03833	.03725	.03622	.03524	.03430	.03340	.03254	.03172	.03094
39	.04217	.04096	.03982	.03873	.03768	.03669	.03573	.03482	.03395	.03312
40	.04510	.04383	.04262	.04146	.04035	.03930	.03828	.03732	.03639	.03550
41	.04830	.04695	.04567	.04445	.04327	.04215	.04108	.04005	.03907	.03812
42	.05177	.05035	.04900	.04770	.04646	.04527	.04413	.04304	.04200	.04100
43	.05553	.05404	.05261	.05123	.04992	.04866	.04746	.04630	.04520	.04413
44	.05960	.05802	.05651	.05506	.05368	.05235	.05107	.04985	.04867	.04754

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

INTEREST RATE

AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
45	.06395	.06229	.06069	.05917	.05770	.05630	.05495	.05365	.05241	.05121
46	.06860	.06685	.06517	.06356	.06202	.06053	.05911	.05774	.05643	.05516
47	.07353	.07169	.06992	.06823	.06660	.06504	.06353	.06209	.06070	.05936
48	.07877	.07684	.07498	.07320	.07149	.06984	.06826	.06673	.06527	.06385
49	.08433	.08231	.08036	.07849	.07669	.07495	.07329	.07168	.07013	.06864
50	.09026	.08814	.08609	.08413	.08224	.08042	.07867	.07698	.07535	.07378
51	.09655	.09433	.09219	.09013	.08815	.08624	.08440	.08262	.08091	.07926
52	.10318	.10086	.09863	.09647	.09439	.09239	.09046	.08860	.08680	.08506
53	.11017	.10774	.10541	.10315	.10098	.09888	.09686	.09491	.09302	.09120
54	.11750	.11498	.11254	.11019	.10792	.10572	.10361	.10156	.09958	.09767
55	.12522	.12258	.12005	.11759	.11522	.11294	.11072	.10859	.10652	.10451
56	.13332	.13059	.12794	.12539	.12292	.12054	.11823	.11599	.11383	.11174
57	.14183	.13899	.13624	.13359	.13102	.12853	.12613	.12380	.12154	.11936
58	.15070	.14775	.14490	.14215	.13948	.13689	.13439	.13197	.12962	.12734
59	.15990	.15685	.15389	.15103	.14826	.14558	.14298	.14046	.13801	.13564
60	.16942	.16626	.16321	.16024	.15737	.15459	.15189	.14927	.14673	.14426
61	.17929	.17603	.17287	.16981	.16684	.16395	.16115	.15844	.15580	.15324
62	.18960	.18623	.18297	.17980	.17673	.17375	.17085	.16803	.16530	.16264
63	.20035	.19688	.19352	.19025	.18708	.18400	.18100	.17809	.17525	.17250
64	.21154	.20797	.20451	.20114	.19787	.19469	.19159	.18859	.18566	.18281
65	.22318	.21951	.21595	.21249	.20912	.20584	.20265	.19955	.19652	.19358
66	.23532	.23156	.22790	.22434	.22088	.21751	.21422	.21102	.20791	.20487
67	.24804	.24419	.24044	.23679	.23324	.22977	.22640	.22311	.21990	.21678
68	.26133	.25740	.25356	.24983	.24618	.24263	.23917	.23579	.23250	.22929
69	.27516	.27114	.26723	.26341	.25969	.25605	.25251	.24905	.24567	.24237
70	.28945	.28536	.28137	.27747	.27367	.26996	.26633	.26279	.25934	.25596
71	.30412	.29996	.29590	.29193	.28806	.28427	.28057	.27696	.27343	.26998
72	.31913	.31491	.31078	.30675	.30281	.29895	.29519	.29150	.28790	.28438
73	.33444	.33016	.32597	.32188	.31788	.31396	.31013	.30638	.30271	.29913
74	.35012	.34579	.34155	.33741	.33335	.32938	.32549	.32168	.31795	.31430
75	.36628	.36190	.35762	.35343	.34932	.34530	.34136	.33750	.33372	.33001
76	.38299	.37858	.37427	.37004	.36589	.36183	.35784	.35394	.35011	.34636
77	.40028	.39585	.39151	.38725	.38307	.37898	.37496	.37103	.36716	.36337
78	.41812	.41368	.40933	.40506	.40086	.39675	.39271	.38874	.38485	.38103
79	.43641	.43198	.42762	.42334	.41914	.41502	.41096	.40698	.40308	.39924
80	.45496	.45054	.44619	.44192	.43772	.43360	.42954	.42556	.42164	.41779
81	.47360	.46920	.46487	.46061	.45643	.45231	.44827	.44429	.44038	.43653
82	.49223	.48785	.48355	.47932	.47516	.47106	.46703	.46307	.45916	.45532
83	.51081	.50648	.50221	.49802	.49388	.48982	.48581	.48187	.47799	.47416
84	.52951	.52523	.52101	.51686	.51277	.50874	.50477	.50086	.49701	.49321
85	.54847	.54425	.54009	.53600	.53196	.52798	.52406	.52019	.51638	.51262
86	.56749	.56335	.55926	.55523	.55126	.54734	.54348	.53966	.53591	.53220
87	.58627	.58221	.57820	.57425	.57035	.56650	.56270	.55895	.55526	.55161
88	.60477	.60079	.59688	.59301	.58919	.58542	.58170	.57802	.57439	.57081
89	.62297	.61909	.61527	.61149	.60776	.60408	.60044	.59685	.59330	.58979

TABLE S
BASED ON LIFE TABLE 90CM
SINGLE LIFE REMAINDER FACTORS
APPLICABLE AFTER APRIL 30, 1999

	INTEREST RATE									
AGE	12.2%	12.4%	12.6%	12.8%	13.0%	13.2%	13.4%	13.6%	13.8%	14.0%
90	.64084	.63707	.63335	.62968	.62604	.62246	.61891	.61540	.61194	.60851
91	.65803	.65437	.65076	.64719	.64366	.64017	.63672	.63330	.62993	.62659
92	.67412	.67058	.66707	.66360	.66017	.65678	.65342	.65010	.64682	.64357
93	.68911	.68567	.68227	.67890	.67557	.67227	.66901	.66578	.66258	.65942
94	.70321	.69988	.69657	.69330	.69006	.68686	.68369	.68055	.67744	.67437
95	.71674	.71351	.71031	.70713	.70399	.70088	.69781	.69476	.69174	.68875
96	.72959	.72646	.72335	.72028	.71724	.71422	.71123	.70828	.70534	.70244
97	.74156	.73853	.73552	.73254	.72959	.72666	.72376	.72089	.71804	.71522
98	.75287	.74993	.74702	.74413	.74126	.73842	.73561	.73282	.73006	.72732
99	.76401	.76117	.75834	.75555	.75277	.75002	.74730	.74459	.74191	.73926
100	.77494	.77219	.76946	.76676	.76408	.76142	.75878	.75616	.75357	.75099
101	.78580	.78315	.78052	.77791	.77532	.77275	.77021	.76768	.76517	.76268
102	.79654	.79399	.79146	.78894	.78645	.78397	.78152	.77908	.77666	.77426
103	.80724	.80479	.80236	.79994	.79755	.79517	.79280	.79046	.78813	.78582
104	.81879	.81646	.81413	.81183	.80954	.80726	.80501	.80276	.80054	.79832
105	.83005	.82782	.82560	.82340	.82121	.81904	.81688	.81474	.81260	.81049
106	.84485	.84277	.84071	.83866	.83662	.83459	.83257	.83057	.82857	.82659
107	.86311	.86124	.85937	.85751	.85566	.85382	.85199	.85017	.84835	.84655
108	.89266	.89114	.88963	.88812	.88662	.88513	.88364	.88216	.88068	.87922
109	.94563	.94484	.94405	.94326	.94248	.94170	.94092	.94014	.93937	.93860

LIFE TABLE
TABLE 90CM
APPLICABLE AFTER APRIL 30, 1999

Age x	l(x)	Age x	l(x)	Age x	l(x)
(1)	(2)	(1)	(2)	(1)	(2)
0	100000	37	95969	74	62852
1	99064	38	95780	75	60449
2	98992	39	95581	76	57955
3	98944	40	95373	77	55373
4	98907	41	95156	78	52704
5	98877	42	94928	79	49943
6	98850	43	94687	80	47084
7	98826	44	94431	81	44129
8	98803	45	94154	82	41091
9	98783	46	93855	83	37994
10	98766	47	93528	84	34876
11	98750	48	93173	85	31770
12	98734	49	92787	86	28687
13	98713	50	92370	87	25638
14	98681	51	91918	88	22658
15	98635	52	91424	89	19783
16	98573	53	90885	90	17046
17	98497	54	90297	91	14466
18	98409	55	89658	92	12066
19	98314	56	88965	93	9884
20	98215	57	88214	94	7951
21	98113	58	87397	95	6282
22	98006	59	86506	96	4868
23	97896	60	85537	97	3694
24	97784	61	84490	98	2745
25	97671	62	83368	99	1999
26	97556	63	82169	100	1424
27	97441	64	80887	101	991
28	97322	65	79519	102	672
29	97199	66	78066	103	443
30	97070	67	76531	104	284
31	96934	68	74907	105	175
32	96791	69	73186	106	105
33	96642	70	71357	107	60
34	96485	71	69411	108	33
35	96322	72	67344	109	17
36	96150	73	65154	110	0

(e) *Effective dates.* This section applies after April 30, 1999.

§20.2031–7T [Removed]

Par. 13a. Section 20.2031–7T is removed.

Par. 14. Section 20.7520–1 is amended by revising paragraphs (a)(2), (b)(2), (c)(1), (c)(2) and (d) to read as follows:

§20.7520–1 Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests.

(a) * * *

(2) In the case of a transfer to a pooled income fund with a valuation date after April 30, 1999, see §1.642(c)–6(e) (or, for certain prior periods, §1.642(c)–6A of this chapter) of this chapter with respect to the valuation of the remainder interest.

* * * * *

(b) * * *

(2) *Mortality component. The* mortality component reflects the mortality data most recently available from the United States Census. As new mortality data becomes available after each decennial census, the mortality component described in this section will be revised periodically and the mortality component tables will be published in the regulations at that time. For decedents' estates with valuation dates after April 30, 1999, the mortality component table (Table 90CM) is included in §20.2031–7(d)(7). See §20.2031–7A for mortality component tables applicable to decedent's estates with valuation dates before May 1, 1999.

(c) * * *

(1) *Regulation sections containing tables with interest rates between 4.2 and 14 percent for valuation dates after April 30, 1999.* Section 1.642(c)–6(e)(6) of this chapter contains Table S used for determining the present value of a single life remainder interest in a pooled income fund as defined in §1.642(c)–5 of this chapter. See §1.642(c)–6A of this chapter for single life remainder factors applicable to valuation dates before May 1, 1999. Section 1.664–4(e)(6) of this chapter contains Table F (payout factors) and Table D (actuarial factors used in determining the present value of a remainder interest postponed for a term of years). Section 1.664–4(e)(7) of this chapter contains Table U(1) (unitrust single life remainder factors). These tables are used in determining the present value of a remainder interest in a charitable remainder unitrust as defined in §1.664–3 of this chapter. See §1.664–4A of this chapter for unitrust single life remainder factors applicable to valuation dates before May 1, 1999. Section 20.2031–7(d)(6) contains Table B (actuarial factors used in determining the present value of an interest for a term of years), Table K (annuity end-of-interval adjustment factors), and Table J (term certain annuity beginning-of-interval adjustment factors). Section 20.2031–7(d)(7) contains Table S (single life remainder factors) and Table 90CM (mortality components). These tables are used in determining the present value of annuities, life estates, remainders, and reversions. See §20.2031–7A for single life remainder factors and mortality components applicable to valuation dates before May 1, 1999.

(2) *Internal Revenue Service publications containing tables with interest rates between 2.2 and 22 percent for valuation dates after April 30, 1999.* The following documents are available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402:

(i) Internal Revenue Service Publication 1457, "Actuarial Values, Book Aleph," (7-1999). This publication includes tables of valuation factors, as well as examples that show how to compute other valuation factors, for determining the present value of annuities, life estates, terms of years, remainders, and reversions, measured by one or two lives. These factors may also be used in the valuation of interests in a charitable remainder annuity trust as defined in §1.664–2 of this chapter and a pooled income fund as defined in §1.642(c)–5 of this chapter. See §20.2031–7A for publications containing tables for valuation dates before May 1, 1999.

(ii) Internal Revenue Service Publication 1458, "Actuarial Values, Book Beth," (7-1999). This publication includes term certain tables and tables of one and two life valuation factors for determining the present value of remainder interests in a charitable remainder unitrust as defined in §1.664–3 of this chapter. See §1.664–4A of this chapter for publications containing tables for valuation dates before May 1, 1999.

(iii) Internal Revenue Service Publication 1459, "Actuarial Values, Book Gimel," (7-1999). This publication includes tables for computing depreciation adjustment factors. See §1.170A–12 of this chapter.

(d) *Effective date.* This section applies after April 30, 1989.

§20.7520–1T [Removed]

Par. 15. Section 20.7520–1T is removed.

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

Par. 16. The authority citation for part 25 is amended by removing the entries for Sections 25–2512–5T and 25.7520–1T to read in part as follows:

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

§25.2512–0 [Amended]

Par. 17. Section 25.2512–0 is amended by removing the entry for §25.2512–5T from the contents listing.

Par. 18. Section 25.2512–5 is amended by revising paragraphs (c), (d) and (e) to read as follows:

§25.2512–5 Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests.

* * * * *

(c) *Actuarial valuations.* The present value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions transferred by gift after April 30, 1999, is determined under paragraph (d) of this section. The present value of annuities, unitrust interests, life estates, terms of years, remainders, and reversions transferred by gift before May 1, 1999, is determined under the following sections:

Transfers		Applicable
After	Before	Regulations
	01-01-52	25.2512–5A(a)
12-31-51	01-01-71	25.2512–5A(b)
12-31-70	12-01-83	25.2512–5A(c)
11-30-83	05-01-89	25.2512–5A(d)
04-30-89	05-01-99	25.2512–5A(e)

(d) *Actuarial valuations after April 30, 1999*—(1) *In general.* Except as otherwise provided in paragraph (b) of this section and §25.7520–3(b) (relating to exceptions to the use of prescribed tables under certain circumstances), if the valuation date for the gift is after April 30, 1999, the fair market value of annuities, life estates, terms of years, remainders, and reversions transferred after April 30, 1999, is the present value of such interests determined under paragraph (d)(2) of this section and by use of standard or special section 7520 actuarial factors. These factors are derived by using the appropriate section 7520 interest rate and, if applicable, the mortality component for the valuation date of the interest that is being valued. See §§25.7520–1 through 25.7520–4. The fair market value of a qualified annuity interest described in section 2702(b)(1) and a qualified unitrust interest described in section 2702(b)(2) is the present value of such interests determined under §25.7520–1(c).

(2) *Specific interests.* When the donor transfers property in trust or otherwise and retains an interest therein, generally, the value of the gift is the value of the property transferred less the value of the donor's retained interest. However, if the donor transfers property after October 8, 1990, to or for the benefit of a member of the donor's family, the value of the gift is the value of the property transferred less the value of the donor's retained interest as determined under section 2702. If the donor assigns or relinquishes an annuity, life estate, remainder, or reversion that the donor holds by virtue of a transfer previously made by the donor or another, the value of the gift is the value of the interest transferred. However, see section 2519 for a special rule in the case of the assignment of an income interest by a person who received the interest from a spouse.

(i) *Charitable remainder trusts.* The fair market value of a remainder interest in a pooled income fund, as defined in §1.642(c)–5 of this chapter, is its value determined under §1.642(c)–6(e) of this chapter (see §1.642(c)–6A for certain prior periods). The fair market value of a remainder interest in a charitable remainder annuity trust, as described in §1.664–2(a) of this chapter, is its present value determined under §1.664–2(c) of this chapter. The fair market value of a remainder interest in a charitable remainder unitrust, as defined in §1.664–3 of this chapter, is its present value determined under §1.664–4(e) of this chapter. The fair market value of a life interest or term for years in a charitable remainder unitrust is the fair market value of the property as of the date of transfer less the fair market value of the remainder interest, determined under §1.664–4(e)(4) and (5) of this chapter.

(ii) *Ordinary remainder and reversionary interests.* If the interest to be valued is to take effect after a definite number of years or after the death of one individual, the present value of the interest is computed by multiplying the value of the property by the appropriate remainder interest actuarial factor (that corresponds to the applicable section 7520 interest rate and remainder interest period) in Table B (for a term certain) or the appropriate Table S (for one measuring life), as the case may be. Table B is contained in §20.2031–7(d)(6) of this chapter and Table S (for one measuring life when the valuation date is after April 30, 1999) is included in §20.2031–7(d)(7) of this chapter and Internal Revenue Service Publication 1457. See §20.2031–7A(e)(4) of this chapter containing Table S and Life Table 80CNSMT for valuation of interests after April 30, 1989, and before May 1, 1999. For information about obtaining actuarial factors for other types of remainder interests, see paragraph (d)(4) of this section.

(iii) *Ordinary term-of-years and life interests.* If the interest to be valued is the right of a person to receive the income of certain property, or to use certain nonincome-producing property, for a term of years or for the life of one individual, the present value of the interest is computed by multiplying the value of the property by the appropriate term-of-years or life interest actuarial factor (that corresponds to the applicable section 7520 interest rate and term-of-years or life interest period). Internal Revenue Service Publication 1457 includes actuarial factors for an interest for a term of years in Table B and for the life of one individual in Table S (for one measuring life when the valuation date is after April 30, 1999). However, term-of-years and life interest actuarial factors are not included in Table B in §20.2031–7(d)(6) or Table S in §20.2031–7(d)(7) (or in §20.2031–7A(e)(4)) of this chapter. If Internal Revenue Service Publication 1457 (or any other reliable source of term-of-years and life interest actuarial factors) is not conveniently available, an actuarial factor for the interest may be derived mathematically. This actuarial factor may be derived by subtracting the correlative remainder factor (that corresponds to the applicable section 7520 interest rate) in Table B (for a term of years) in §20.2031–7(d)(6) of this chapter or in Table S (for the life of one individual) in §20.2031–7(d)(7) of this chapter, as the case may be, from 1.000000. For information about obtaining actuarial factors for other types of term-of-years and life interests, see paragraph (d)(4) of this section.

(iv) *Annuities.* (A) If the interest to be valued is the right of a person to receive an annuity that is payable at the end of each year for a term of years or for the life of one individual, the present value of the interest is computed by multiplying the aggregate amount payable annually by the appropriate annuity actuarial factor (that corresponds to the applicable section 7520 interest rate and annuity period). Internal Revenue Service Publication 1457 includes actuarial factors in Table B (for an annuity payable for a term of years)

and in Table S (for an annuity payable for the life of one individual when the valuation date is after April 30, 1999). However, annuity actuarial factors are not included in Table B in §20.2031–7(d)(6) of this chapter or Table S in §20.2031–7(d)(7) (or in §20.2031–7A(e)(4)) of this chapter. If Internal Revenue Service Publication 1457 (or any other reliable source of annuity actuarial factors) is not conveniently available, an annuity factor for a term of years or for one life may be derived mathematically. This annuity factor may be derived by subtracting the applicable remainder factor (that corresponds to the applicable section 7520 interest rate and annuity period) in Table B (in the case of a term-of-years annuity) in §20.2031–7(d)(6) of this chapter or in Table S (in the case of a one-life annuity) in §20.2031–7(d)(7) of this chapter, as the case may be, from 1.000000 and then dividing the result by the applicable section 7520 interest rate expressed as a decimal number. See §20.2031–7(d)(2)(iv) of this chapter for an example that illustrates the computation of the present value of an annuity.

(B) If the annuity is payable at the end of semiannual, quarterly, monthly, or weekly periods, the product obtained by multiplying the annuity factor by the aggregate amount payable annually is then multiplied by the applicable adjustment factor set forth in Table K in §20.2031–7(d)(6) of this chapter at the appropriate interest rate component for payments made at the end of the specified periods. The provisions of this paragraph (d)(2)(iv)(B) are illustrated by the following example:

Example. In July, the donor agreed to pay the annuitant the sum of $10,000 per year, payable in equal semiannual installments at the end of each period. The semiannual installments are to be made on each December 31st and June 30th. The annuity is payable until the annuitant's death. On the date of the agreement, the annuitant is 68 years and 5 months old. The donee annuitant's age is treated as 68 for purposes of computing the present value of the annuity. The section 7520 rate on the date of the agreement is 10.6 percent. Under Table S in §20.2031–7(d)(7) of this chapter, the factor at 10.6 percent for determining the present value of a remainder interest payable at the death of an individual aged 68 is .29691. Converting the remainder factor to an annuity factor, as described above, the annuity factor for determining the present value of an annuity transferred to an individual age 68 is 6.6329 (1.00000 minus .29691 divided by .106). The adjustment factor from Table K in §20.2031–7(d)(6) of this chapter in the column for payments made at the end of each semiannual period at the rate of 10.6 percent is 1.0258. The aggregate annual amount of the annuity, $10,000, is multiplied by the factor 6.6329 and the product multiplied by 1.0258. The present value of the donee's annuity is, therefore, $68,040.29 ($10,000 X 6.6329 X 1.0258).

(C) If an annuity is payable at the beginning of annual, semiannual, quarterly, monthly, or weekly periods for a term of years, the value of the annuity is computed by multiplying the aggregate amount payable annually by the annuity factor described in paragraph (d)(2)(iv)(A) of this section; and the product so obtained is then multiplied by the adjustment factor in Table J in §20.2031–7(d)(6) of this chapter at the appropriate interest rate component for payments made at the beginning of specified periods. If an annuity is payable at the beginning of annual, semiannual, quarterly, monthly, or weekly periods for one or more lives, the value of the annuity is the sum of the first payment plus the present value of a similar annuity, the first payment of which is not to be made until the end of the payment period, determined as provided in paragraph (d)(2)(iv)(B) of this section.

(v) *Annuity and unitrust interests for a term of years or until the prior death of an individual*—(A) *Annuity interests.* The present value of an annuity interest that is payable until the earlier to occur of the lapse of a specific number of years or the death of an individual may be computed with values from the tables in §20.2031–7(d)(6) and (d)(7) of this chapter as described in the following example:

Example. The donor transfers $100,000 into a trust and retains the right to receive an annuity from the trust in the amount of $6,000 per year, payable in equal semiannual installments at the end of each period. The semiannual installments are to be made on each June 30th and December 31st. The annuity is payable for 10 years or until the donor's prior death. At the time of the transfer, the donor is 59 years and 6 months old. The donor's age is taken as 60 for purposes of computing the present value of the retained annuity. The section 7520 rate for the month in which the transfer occurred is 9.8 percent. The present value of the donor's retained interest is $35,709.13, determined as follows:

TABLE S value at 9.8 percent, age 60	.21669
TABLE S value at 9.8 percent, age 70	.34762
TABLE 90CM value at age 70	71357
TABLE 90CM value at age 60	85537
TABLE B value at 9.8 percent, 10 years	.392624
TABLE K value at 9.8 percent	1.0239

Factor for donor's retained interest at 9.8 percent:

$$\frac{(1.00000 - .21669) - (.392624 \text{ X } (71357/85537) \text{ X } (1.00000 - .34762))}{.098} = 5.8126$$

Present value of donor's retained interest:

($6,000 X 5.8126 X 1.0239) $35,709.13

(B) *Unitrust interests.* The present value of a unitrust interest that is payable until the earlier to occur of the lapse of a specific number of years or the death of an individual may be computed with values from the tables in §§1.664–4(e)(6) and (e)(7) and §20.2031–7(d)(7) of this chapter as described in the following example:

Example. The donor who, as of the nearest birthday, is 60 years old, transfers $100,000 to a unitrust on January 1st. The trust instrument requires that each year the trust pay to the donor, in equal semiannual installments on June 30th and December 31st, 6 percent of the fair market value of the trust assets, valued as of January 1st each year, for 10 years or until the prior death of the donor. The section 7520 rate for the January in which the transfer occurred is 9.8 percent. Under Table F(9.8) in §1.664–4(e)(6) of this chapter, the appropriate adjustment factor is .932539 for semiannual payments payable at the end of the semiannual period. The adjusted payout rate is 5.595 percent (6% X .932539). The present value of the donor's retained interest is $40,848.00 determined as follows:

TABLE U(1) value at 5.6 percent, age 60 ..... .35375
TABLE U(1) value at 5.6 percent, age 70 49342
TABLE 90CM value at age 70 71357
TABLE 90CM value at age 60 85537
TABLE D value at 5.6 percent, 10 years ..... .561979

Factor for donor's retained interest at 5.6 percent:

(1.000000 - .35375) - (.561979 X (71357/85537) X (1.000000 - .49342)) = .40876

TABLE U(1) value at 5.4 percent, age 60 36542
TABLE U(1) value at 5.4 percent, age 70 50473
TABLE 90CM value at age 70 71357
TABLE 90CM value at age 60 85537
TABLE D value at 5.4 percent, 10 years 573999

Factor for donor's retained interest at 5.4 percent:

(1.000000 - .36542) - (.573999 X (71357/85537) X (1.000000 - .50473)) = .39742
Difference .01134

Interpolation adjustment:

$$\frac{5.595\% - 5.4\%}{0.2\%} = \frac{x}{.01134}$$

$$x = .01106$$

Factor at 5.4 percent, age 60 39742
Plus: Interpolation adjustment 01106
Interpolated Factor 40848
Present value of donor's retained interest:

($100,000 X .40848) $40,848.00

(3) *Transitional rule.* If the valuation date of a transfer of property by gift is after April 30, 1999, and before July 1, 1999, the fair market value of the interest transferred is determined by use of the section 7520 interest rate for the month in which the valuation date occurs (see §§25.7520–1(b) and 25.7520–2(a)(2)) and the appropriate actuarial tables under either paragraph (d)(2) of this section or §25.2512–5A(e), at the option of the donor. However, with respect to each individual transaction and with respect to all transfers occurring on the valuation date, the donor must use the same actuarial tables (for example, gift and income tax charitable deductions with respect to the same transfer must be determined based on the same tables, and all transfers made on the same date must be valued based on the same tables).

(4) *Publications and actuarial computations by the Internal Revenue Service.* Many standard actuarial factors not included in §§20.2031–7(d)(6) or (d)(7) of this chapter are included in Internal Revenue Service Publication 1457, "Actuarial Values, Book Aleph," (7-1999). Internal Revenue Service Publication 1457 also includes examples that illustrate how to compute many special factors for more unusual situations. A copy of this publication is available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402. See §25.2512–5A for publications containing actuarial factors for valuing interests for which the valuation date is before May 1, 1999. If a special factor is required in the case of a completed gift, the Service may furnish the factor to the donor upon a request for a ruling. The request for a ruling must be accompanied by a recitation of the facts including a statement of the date of birth for each measuring life, the date of the gift, any other applicable dates, and a copy of the will, trust, or other relevant documents. A request for a ruling must comply with the instructions for requesting a ruling published periodically in the Internal Revenue Bulletin (see §§601.201 and 601.601(d)(2)(ii)(*b*) of this chapter) and include payment of the required user fee.

(e) *Effective dates.* This section applies after April 30, 1999.

§25.2512–5T [Removed]

Par. 19. Section 25.2512–5T is removed.

Par. 20. Section 25.7520–1 is amended by revising paragraphs (b)(2), (c)(1), (c)(2) and (d) to read as follows:

§25.7520–1 Valuation of annuities, unitrust interests, interests for life or term of years, and remainder or reversionary interests.

* * * * *

(b) * * *

(2) *Mortality component.* The mortality component reflects the mortality data most recently available from the United States Census. As new mortality data becomes available after each decennial census, the mortality component described in this section will be revised periodically and the mortality component tables will be published in the regulations at that time. For gifts with valuation dates after April 30, 1999, the mortality component table (Table 90CM) is included in §20.2031–7(d)(7) of this chapter. See §20.2031–7A of this chapter for mortality component tables applicable to decedent's estates with valuation dates before May 1, 1999.

(c) * * *

(1) *Regulation sections containing tables with interest rates between 4.2 and 14 percent for valuation dates after April 30, 1999.* Section 1.642(c)–6(e)(6) of this chapter contains Table S used for deter-

mining the present value of a single life remainder interest in a pooled income fund as defined in §1.642(c)–5 of this chapter. See §1.642(c)–6A for single life remainder factors applicable to valuation dates before May 1, 1999. Section 1.664–4(e)(6) of this chapter contains Table F (payout factors) and Table D (actuarial factors used in determining the present value of a remainder interest postponed for a term of years). Section 1.664–4(e)(7) of this chapter contains Table U(1) (unitrust single life remainder factors). These tables are used in determining the present value of a remainder interest in a charitable remainder unitrust as defined in §1.664–3 of this chapter. See §1.664–4A for unitrust single life remainder factors applicable to valuation dates before May 1, 1999. Section 20.2031–7(d)(6) of this chapter contains Table B (actuarial factors used in determining the present value of an interest for a term of years), Table K (annuity end-of-interval adjustment factors), Table J (term certain annuity beginning-of-interval adjustment factors). Section 20.2031–7(d)(7) of this chapter contains Table S (single life remainder factors) and Table 90CM (mortality components). These tables are used in determining the present value of annuities, life estates, remainders, and reversions. See §20.2031–7A of this chapter for single life remainder factors and mortality components applicable to valuation dates before May 1, 1999.

(2) *Internal Revenue Service publications containing tables with interest rates between 2.2 and 22 percent for valuation dates after April 30, 1999.* The following documents are available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington, DC 20402:

(i) Internal Revenue Service Publication 1457, "Actuarial Values, Book Aleph," (7-1999). This publication includes tables of valuation factors, as well as examples that show how to compute other valuation factors, for determining the present value of annuities, life estates, terms of years, remainders, and reversions, measured by one or two lives. These factors may also be used in the valuation of interests in a charitable remainder annuity trust as defined in §1.664–2 of this chapter and a pooled income fund as defined in §1.642(c)–5 of this chapter. See §25–2512–5A for publications containing tables for valuation dates before May 1, 1999.

(ii) Internal Revenue Service Publication 1458, "Actuarial Values, Book Beth," (7-1999). This publication includes term certain tables and tables of one and two life valuation factors for determining the present value of remainder interests in a charitable remainder unitrust as defined in §1.664–3 of this chapter. See §1.664–4A of this chapter for publications containing tables for valuation dates before May 1, 1999.

(iii) Internal Revenue Service Publication 1459, "Actuarial Values, Book Gimel," (7-1999). This publication includes tables for computing depreciation adjustment factors. See §1.170A–12 of this chapter.

(d) *Effective date.* This section applies after April 30, 1989.

§25.7520–1T [Removed]

Par. 21. Section 25.7520–1T is removed.

PARTS 1, 20 AND 25 [AMENDED]

Par. 22. In the list below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Section	Remove	Add
1.170A–12(e)(2), following the formula	§20.2031–7T	§20.2031–7
1.642(c)–6A(e)(2)(ii), last sentence	§1.642(c)–6T(e)(3)(ii)	§1.642(c)–6(e)(3)(ii)
1.642(c)–6A(e)(3)	§1.642(c)–6T(e)(4)	§1.642(c)–6(e)(4)
1.642(c)–6A(e)(4), last sentence	§1.642(c)–6T(e)(5)	§1.642(c)–6(e)(5)
1.664–1(a)(6), introductory text	§§1.664–4T(e), 1.664–4T(e) and 1.664–4A(d) and (e)	§§1.664–4(e) and 1.664–4A(d) and (e)
1.664–4(e)(6), second sentence	§1.664–4T(e)(7)	paragraph (e)(5) of this section
1.664–4A(e)(4), fifth sentence	§1.664–4T(e)(4)	§1.664–4(e)(4)
1.664–4A(e)(4), last sentence	§1.664–4T(e)(4)	§1.664–4(e)(4)

Section	Remove	Add
1.664–4A(e)(5), fourth sentence	§1.664–4T(e)(5)	§1.664–4(e)(5)
1.664–4A(e)(5), last sentence	§1.664–4T(e)(5)	§1.664–4(e)(5)
1.7520–1(a)(2)	§1.642(c)–6T(e)	§1.642(c)–6(e)
20.2031–7A(e)(1), first sentence	§20.2031–7T(d)	§20.2031–7(d)
20.2055–2(f)(4)	§20.2031–7T(d)	§20.2031–7(d)
25.2512–5A(e)(1), first sentence	§25.2512–5T(d)	§25.2512–5(d)
25.7520–1(a)(2)	§1.642(c)–6T(e)	§1.642(c)–6(e)
25.7520–3(b)(2)(v), *Example 5* (iii)	§20.2031–7T(d)(7)	§20.2031–7(d)(7)

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved May 17, 2000.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Ragister on June 9, 2000, 8:45 a.m., and published in the issue of the Federal Register for June 12, 2000, 65 F.R. 36908)

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 2000. See Rev. Rul. 2000–32, page 1.

Part III. Administrative, Procedural, and Miscellaneous

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 2000–28

1.1.1 Purpose

The purpose of this revenue procedure is to set forth the requirements for the year 2000 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 recipients.

1.1.2 Which Forms Are Covered?

This revenue procedure contains specifications for these 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 listed above 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 (the Code) 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 **Part 4** for specifications that apply to recipient statements **(generally Copy B).**

In general, section 6011 of the Code contains requirements for filers of information returns. A filer must file information returns on magnetic media, through 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 by magnetic media or electronic filing.

Exception. Filers are not required to use magnetic media or electronic filing 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 or electronically. See the legal requirements for filing information returns (and providing a copy to a payee) in the **2000 General 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 at **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 this year's Revenue Procedure:

- A new Part 4, made up of sections from other Parts, has been added to better address recipient statements. (Old Part 4 is now Part 5.)
- We have rearranged certain sections in the document for easier understanding. For instance, **Section 1.4** of last year's Revenue Procedure is now **Section 2.2.**
- We are now providing general and specific form instructions as separate products for 2000. The **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G** contain general information for all forms. Separate specific instructions provide information for specific 2000 forms. These new products are referred to on the faces and in the notes on the backs of the forms.
- We slightly revised **Section 5.1** (OMB Requirements).
- The form dimensions shown on the exhibits have been slightly revised to reflect the actual dimensions of official IRS forms.

Section 1.2 - General 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 2000 forms only.**

1.2.2 Copy A Specifications

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 Code. 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 Specifications

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 Code. 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 **Section 4.2.**

Copy B of the following forms are:

Form	Recipient
1098	For Payer/Borrower
1098-E; 1099-A	For Borrower
1098-T	For Student
1099-C	For Debtor
1099-LTC	For Policyholder
1099-R; W-2G	(These forms may require Copy B to be attached to the Federal income tax return.)
1099-S	For Transferor
All other Forms 1099	For Recipient
5498; 5498-MSA	For Participant

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.** This statement must be furnished to a person (form recipient), as defined under the applicable provisions of the Code 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 4.2.** A composite statement **may not** be filed with the IRS.

Part 2
Specifications for Substitute Forms 1096 and Copies A of Forms 1098, 1099,and 5498 (All Filed With the IRS)

Section 2.1 - Specifications

2.1.1 General Requirements

Form identifying numbers (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 numbers must be 10-point boxes. The "VOID" checkbox is in print position 25. The "CORRECTED" checkbox is in position 33. Measurements are from the left edge of the paper, not including the perforated strip. See **Exhibits D and K.**

The substitute form must be an exact replica of the official IRS form with respect to layout and content. 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.

2.1.2 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 x 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

2.1.3 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. Front and back chemically treated paper cannot be processed properly by machine.
- Carbon-coated forms are not permitted.
- 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.

2.1.4 Printing

All print on **Copy A of Forms 1098, 1099, 5498,** and the print on **Form 1096** 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 front and 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.

2.1.5 OCR Specifications

The contractor must initiate or have a quality control program to assure OCR ink density. 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.

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

2.1.6 Typography

Type must be substantially identical in size and shape to the official form. All rules are either 1/2-point or 3/4-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.*

2.1.7 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 mar-

gin 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 32/3 inches, the same depth as the official form.

Exception. The depth of **Form 1099-R** is 51/2 inches.

2.1.8 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 3_" forms (5_" 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* ***Forms 1099-R*** *and* ***1099- MISC,*** *and Copy D for* ***Forms 1099-LTC*** *and* ***1099-R)*** *in the set.*

2.1.9 What To Include

You must include the OMB Number on **Copies A** and **Form 1096** in the same location as on the official form.

The words "For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General 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 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G" must** be printed on **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.

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.**

The Catalog Number (Cat. No.) shown on the 2000 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.

Section 2.2 - Instructions for Preparing Paper Forms That Will Be Filed With the IRS

2.2.1 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. 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.

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.

2.2.2 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.

2.2.3 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).**

2.2.4 Where To File

Mail completed paper forms to the IRS service center shown on the back of Form 1096 and in the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.** Specific information needed to complete the forms mentioned in this revenue procedure are given in the specific form instructions. A chart is included in the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G** giving a quick guide to which form must be filed to report a particular payment.

Part 3
Specifications for Substitute Form W-2G (Filed With the IRS)

Section 3.1 - General

3.1.1 Purpose

The following specifications give the format requirements for substitute **Form W-2G (Copy A only),** which is filed with the IRS.

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 x 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 1/2 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 x 3 2/3 inches deep, exclusive of a 2/3 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 1/4 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 specifiedfor 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
Substitute Statements to Form Recipients and Form Recipient Copies

Section 4.1 - Specifications

4.1.1 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.*

4.1.2 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 only.** 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). Except for state income tax withholding information, information not required by the official form should not be included on the substitute form.

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 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.
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 5.
6. The form recipient statement must contain the tax year (e.g., 2000), 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 **Section 4.4** 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 of **Forms 1099-DIV, 1099-INT, 1099-OID,** and **1099-PATR** *must* include the direct access telephone number of an individual who can answer questions about the statement. **Include that 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.**

4.1.3 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*** *and* ***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** in **Section 4.3.2** 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 4.1.3).**

Section 4.2 - Composite Statements

4.2.1 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 4.1.2.**

- 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.
- 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.
- 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.
- 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.

4.2.2 Composite Substitute Statements to Recipients for Forms Specified in Section 4.1.3

A composite form recipient statement for the forms specified in **Section 4.1.3** 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 4.1.3** and forms listed in **Section 4.1.2.**

Exceptions. Form 1099-B information may be reported on a composite form with the forms specified in **Section 4.1.2** as described in **Section 4.2.1.** 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 4.1.2.**

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 4.2.1** as well as the requirements in **Section 4.1.3.** A composite statement of **Forms 1098 and 1099-INT** (for interest reportable under section 6049) is **not** allowed.

Section 4.3 - Required Legends

4.3.1 Required Legends for Forms 1098

Form 1098 recipient statements **(Copy B)** 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."

4.3.2 Required Legends for Forms 1099

Forms 1099 and W-2G recipient statements must contain the following legends:

- **Forms 1099-A and 1099-C – 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 taxable income results from this transaction and the IRS determines that it has not been reported."
  and W-2G
- **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 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 – Copy B**
  "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 – 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."
- **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."

4.3.3 Required Legends for Forms 5498

Form 5498 recipient statements (**Copy B**) 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."

Section 4.4 - Miscellaneous Instructions for Copies B, C, D, 1, and 2

4.4.1 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 legally required to include all these copies with the privately printed substitute forms. Furnishing Copies B and, in some cases, C will satisfy the legal requirement to provide statements of information to form recipients.

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.*

4.4.2 Arrangement of Assembly

Copy A ("For Internal Revenue Service Center") of all forms must be on top. The rest of the assembly must be arranged, from top to bottom, as follows. For:

- **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."
- **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."

4.4.3 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.)

Part 5
Additional Instructions for Substitute Forms 1098, 1099, 5498, and W-2G

Section 5.1 - OMB Requirements

5.1.1 OMB Requirements

The Paperwork Reduction Act of 1995 (Public Law 104-13) requires that:

- The OMB approves all IRS tax forms that are subject to the Paperwork Reduction Act.
- Each form shows the OMB approval number in or near 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 6.)
- The form (or its instructions) states:
  1. Why the IRS needs the information,
  2. How it will be used, and
  3. Whether or not the information is required to be furnished to the IRS.

Any users of official or substitute IRS forms or instructions must be provided with this information.

5.1.2 Substitute Form Requirements

The OMB requirements for substitute IRS forms are:

- Any substitute form or substitute statement to a 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

5.1.3 Required Explanation to Users

All substitute forms (**Copy A only**) must state "For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**"

If no instructions are provided to users of your forms, you must furnish them the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 5.2 - Reproducible Copies

5.2.1 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.

5.2.2 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

5.2.3 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 using the IRS's Internet Web Site at www.irs.gov/cdorders.

5.2.4 GPO Supt. of Documents Bookstores

The Government Printing Office (GPO) Superintendent of Documents Bookstores also sell individual copies of tax forms, instructions, and publications.

Section 5.3 - Effect on Other Revenue Procedures

5.3.1 Other Revenue Procedures

Revenue Procedure 99–34, 1999–40 I.R.B. *450,* which provides rules and specifications for private printing of 1999 substitute forms and statements to recipients, is superseded.

Part 6
Exhibits

Section 6.1 - Exhibits of Forms in the Revenue Procedure

6.1.1 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.

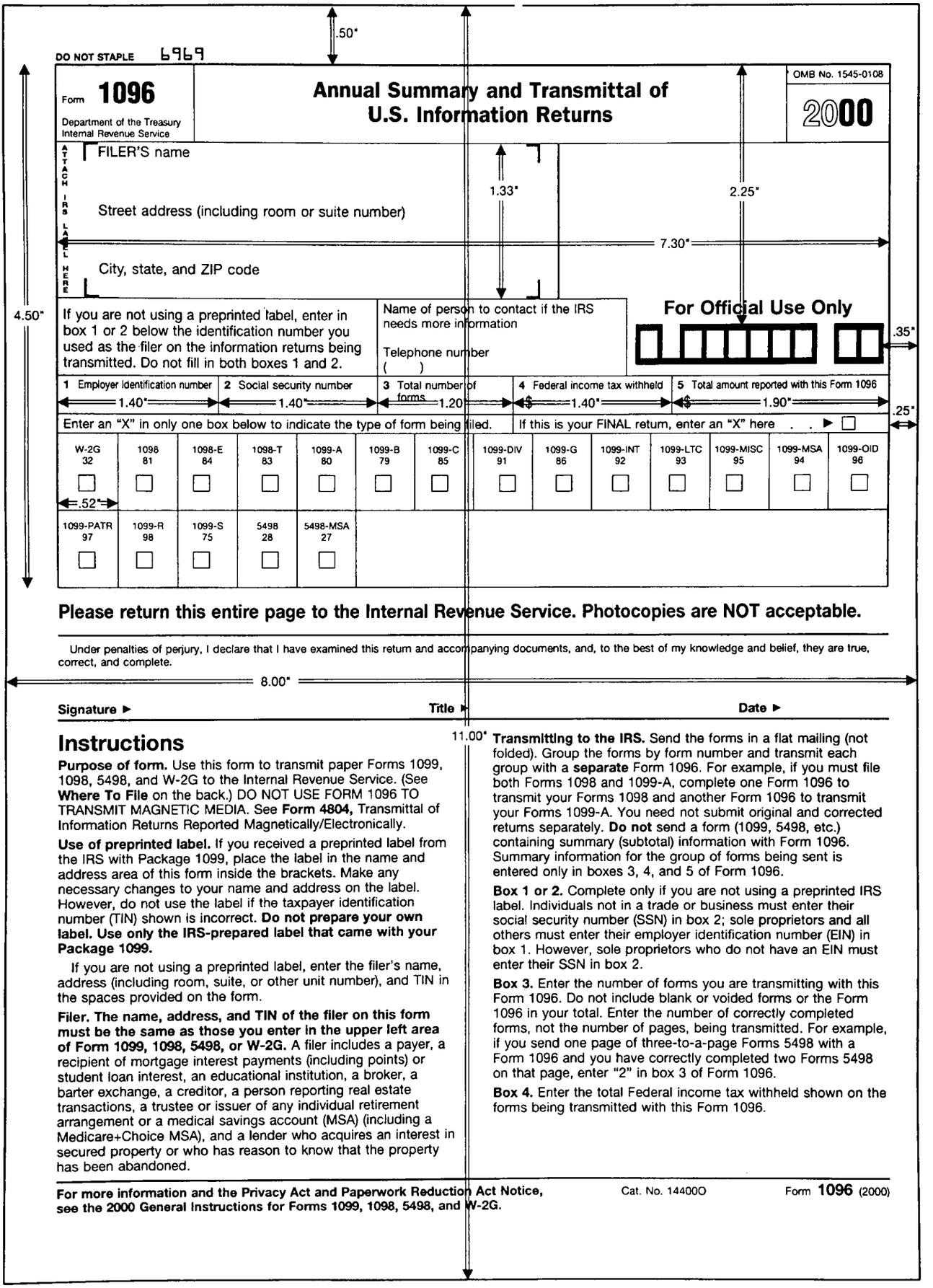
Generally, the illustrated dimensions apply to all like forms. For example, Exhibit B shows 11.00" from the top edge to the bottom edge of Form 1098 and .85" between the bottom rule of the top form and the top rule of the second form on the page. These dimensions apply to all forms that are printed three to a page.

6.1.2 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

2000

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 (SSN) in box 2; sole proprietors and all others must enter their employer identification number (EIN) in box 1. However, sole proprietors who do not have an EIN must enter their SSN 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 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.

Cat. No. 14400O

Form **1096** (2000)

Exhibit B

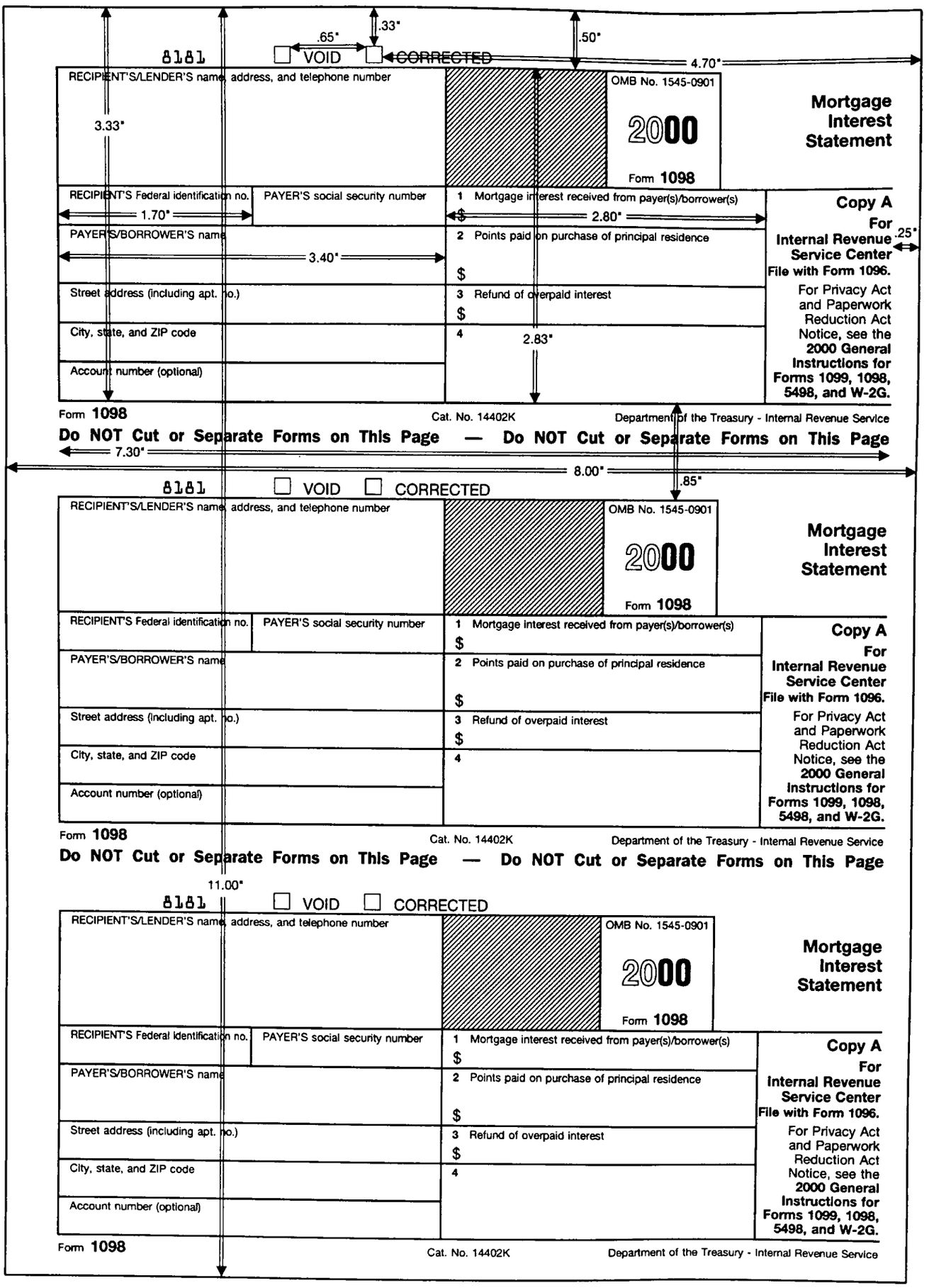

8181
VOID
CORRECTED
.65"
.33"
.50"
4.70"
3.33"
RECIPIENT'S/LENDER'S name, address, and telephone number
OMB No. 1545-0901
2000
Form 1098
Mortgage Interest Statement
RECIPIENT'S Federal identification no.
PAYER'S social security number
1 Mortgage interest received from payer(s)/borrower(s)
$
1.70"
2.80"
PAYER'S/BORROWER'S name
2 Points paid on purchase of principal residence
$
3.40"
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.
.25"
For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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
7.30"
8.00"
.85"
8181
VOID
CORRECTED
RECIPIENT'S/LENDER'S name, address, and telephone number
OMB No. 1545-0901
2000
Form 1098
Mortgage Interest Statement
RECIPIENT'S Federal identification no.
PAYER'S social security number
1 Mortgage interest received from payer(s)/borrower(s)
$
PAYER'S/BORROWER'S name
2 Points paid on purchase of principal residence
$
Street address (including apt. no.)
3 Refund of overpaid interest
$
City, state, and ZIP code
4
Account number (optional)
Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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
11.00"
8181
VOID
CORRECTED
RECIPIENT'S/LENDER'S name, address, and telephone number
OMB No. 1545-0901
2000
Form 1098
Mortgage Interest Statement
RECIPIENT'S Federal identification no.
PAYER'S social security number
1 Mortgage interest received from payer(s)/borrower(s)
$
PAYER'S/BORROWER'S name
2 Points paid on purchase of principal residence
$
Street address (including apt. no.)
3 Refund of overpaid interest
$
City, state, and ZIP code
4
Account number (optional)
Copy A
For Internal Revenue Service Center
File with Form 1096.
For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
Form 1098
Cat. No. 14402K
Department of the Treasury - Internal Revenue Service

Exhibit C

8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 2000 Form 1098-E	Student Loan Interest Statement
RECIPIENT'S Federal identification no.	BORROWER'S social security number	1 Student loan interest received by lender $ (2.80")	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
BORROWER'S name (3.40")			
Street address (including apt. no.)			
City, state, and ZIP code		(2.83")	
Account number (optional)			

Form **1098-E** Cat. No. 25088U 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

8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 2000 Form 1098-E	Student Loan Interest Statement
RECIPIENT'S Federal identification no.	BORROWER'S social security number	1 Student loan interest received by lender $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General 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

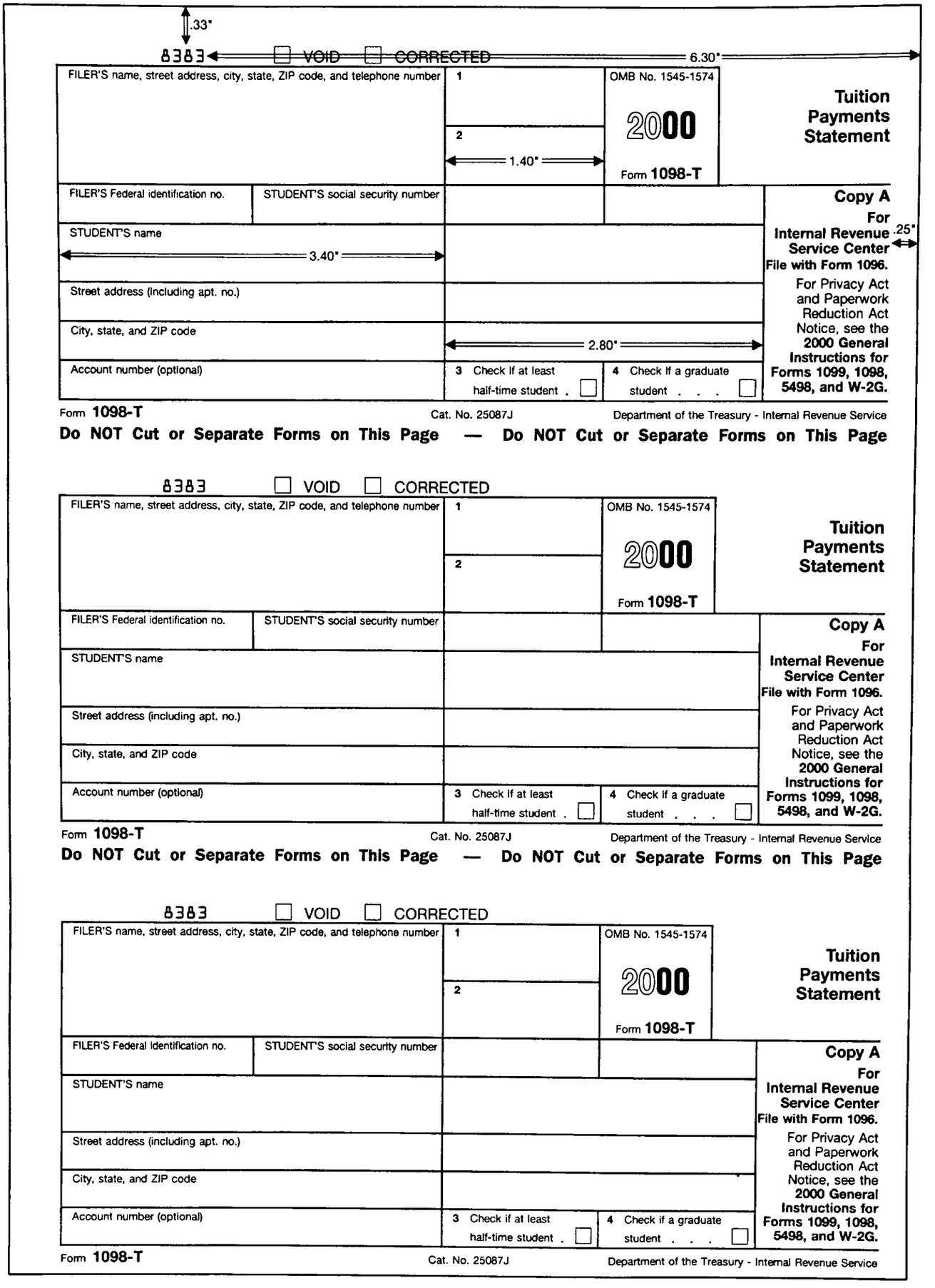
Do NOT Cut or Separate Forms on This Page — Do NOT Cut or Separate Forms on This Page

8484 ☐ VOID ☐ CORRECTED

RECIPIENT'S/LENDER'S name, address, and telephone number		OMB No. 1545-1576 2000 Form 1098-E	Student Loan Interest Statement
RECIPIENT'S Federal identification no.	BORROWER'S social security number	1 Student loan interest received by lender $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General 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



.33"

8383 ☐ VOID ☐ CORRECTED — 6.30"

FILER'S name, street address, city, state, ZIP code, and telephone number	1	OMB No. 1545-1574	Tuition Payments Statement
	2 (1.40")	2000 Form 1098-T	
FILER'S Federal identification no. / STUDENT'S social security number			Copy A For Internal Revenue Service Center File with Form 1096. .25"
STUDENT'S name (3.40")			For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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	2000 Form 1098-T	
FILER'S Federal identification no. / STUDENT'S social security number			Copy A For Internal Revenue Service Center File with Form 1096.
STUDENT'S name			For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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	2000 Form 1098-T	
FILER'S Federal identification no. / STUDENT'S social security number			Copy A For Internal Revenue Service Center File with Form 1096.
STUDENT'S name			For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 2000 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 $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.**
BORROWER'S name	3	4 Fair market value of property $	For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
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)			

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 2000 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 $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.**
BORROWER'S name	3	4 Fair market value of property $	For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
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)			

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 2000 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 $	**Copy A** **For Internal Revenue Service Center** **File with Form 1096.**
BORROWER'S name	3	4 Fair market value of property $	For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
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)			

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	**Proceeds From Broker and Barter Exchange Transactions**
	1b CUSIP No.	**2000** Form **1099-B**	
	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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
	Regulated Futures Contracts		
Street address (including apt. no.)	6 Profit or (loss) realized in 2000 $	7 Unrealized profit or (loss) on open contracts—12/31/99 $	
City, state, and ZIP code	8 Unrealized profit or (loss) on open contracts—12/31/2000 $	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	**Proceeds From Broker and Barter Exchange Transactions**
	1b CUSIP No.	**2000** Form **1099-B**	
	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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
	Regulated Futures Contracts		
Street address (including apt. no.)	6 Profit or (loss) realized in 2000 $	7 Unrealized profit or (loss) on open contracts—12/31/99 $	
City, state, and ZIP code	8 Unrealized profit or (loss) on open contracts—12/31/2000 $	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	**Proceeds From Broker and Barter Exchange Transactions**
	1b CUSIP No.	**2000** Form **1099-B**	
	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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
	Regulated Futures Contracts		
Street address (including apt. no.)	6 Profit or (loss) realized in 2000 $	7 Unrealized profit or (loss) on open contracts—12/31/99 $	
City, state, and ZIP code	8 Unrealized profit or (loss) on open contracts—12/31/2000 $	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 **2000** Form **1099-C**	**Cancellation of Debt**
CREDITOR'S Federal identification number / DEBTOR'S identification number	1 Date canceled (1.40")	2 Amount of debt canceled (1.40")	**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.** (1.35")
DEBTOR'S name (3.40")	3 Interest if included in box 2 $	4	
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 **2000** 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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
DEBTOR'S name	3 Interest if included in box 2 $	4	
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 **2000** 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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
DEBTOR'S name	3 Interest if included in box 2 $	4	
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 2000 Form 1099-DIV	Dividends and Distributions
	2a Total capital gain distr. $ (1.40")		
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 File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	2d Section 1202 gain $	3 Nontaxable distributions $	
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. ☐ (2.80") (.60")	8 Cash liquidation distr. $	9 Noncash liquidation distr. $ (4.50")	

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 2000 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 File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	2d Section 1202 gain $	3 Nontaxable distributions $	
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 2000 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 File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
RECIPIENT'S name	2d Section 1202 gain $	3 Nontaxable distributions $	
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 1.40" $	OMB No. 1545-0120 2000 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.
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 ▶ ☐	For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
City, state, and ZIP code			
Account number (optional)			

1.15"

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 2000 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.
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 ▶ ☐	For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 2000 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.
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 ▶ ☐	For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 **2000** 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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		2 Early withdrawal penalty 1.40" $	3 Interest on U.S. Savings Bonds and Treas. obligations $	
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) 2.80"	2nd TIN Not. ☐ .60"	$	4.15"	

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 **2000** 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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		2 Early withdrawal penalty $	3 Interest on U.S. Savings Bonds and Treas. obligations $	
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 **2000** 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.** For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
RECIPIENT'S name		2 Early withdrawal penalty $	3 Interest on U.S. Savings Bonds and Treas. obligations $	
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 — 4.50"

PAYER'S name, street address, city, state, ZIP code, and telephone no.	1 Gross long-term care benefits paid $	OMB No. 1545-1519 2000 Form 1099-LTC	Long-Term Care and Accelerated Death Benefits
	2 Accelerated death benefits paid $		
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 File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
POLICYHOLDER'S name (3.40")	INSURED'S name		
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 (1.00")	

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 2000 Form 1099-LTC	Long-Term Care and Accelerated Death Benefits
	2 Accelerated death benefits paid $		
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 File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
POLICYHOLDER'S name	INSURED'S name		
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 2000 Form 1099-LTC	Long-Term Care and Accelerated Death Benefits
	2 Accelerated death benefits paid $		
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 File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
POLICYHOLDER'S name	INSURED'S name		
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 $ (1.40")	OMB No. 1545-0115	Miscellaneous Income
	2 Royalties $	2000	
	3 Other income $	Form 1099-MISC	

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, see the 2000 General 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) (2.80")	2nd TIN Not. ☐ (.60")	12 State/Payer's state number	13 $ (4.15")	

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	Miscellaneous Income
	2 Royalties $	2000	
	3 Other income $	Form 1099-MISC	

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, see the 2000 General 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	Miscellaneous Income
	2 Royalties $	2000	
	3 Other income $	Form 1099-MISC	

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, see the 2000 General 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 2000 Form 1099-MSA	Distributions From an MSA or Medicare+Choice MSA
PAYER'S Federal identification number	RECIPIENT'S identification number	1 Gross distribution $ (1.40")	2 Earnings on excess contributions $ (1.40")
RECIPIENT'S name (3.40")		3 Distribution code	4 FMV on date of death $
Street address (including apt. no.)		5 Medicare+Choice MSA . . . . ☐	
City, state, and ZIP code		(3.90")	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 2000 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 $
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			Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 2000 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 $
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			Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 2000 (1.40") $	OMB No. 1545-0117 2000 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.
RECIPIENT'S name	5 Description		For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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) (2.80") / 2nd TIN Not. ☐	(4.15")		

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 2000 $	OMB No. 1545-0117 2000 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.
RECIPIENT'S name	5 Description		For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 2000 $	OMB No. 1545-0117 2000 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.
RECIPIENT'S name	5 Description		For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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 $ (1.40")	OMB No. 1545-0118	Taxable Distributions Received From Cooperatives
	2 Nonpatronage distributions $	2000	
	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.
RECIPIENT'S name	5 Redemption of nonqualified notices and retain allocations $		For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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) (2.80") / 2nd TIN Not. ☐	(4.15")		

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 $	2000	
	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.
RECIPIENT'S name	5 Redemption of nonqualified notices and retain allocations $		For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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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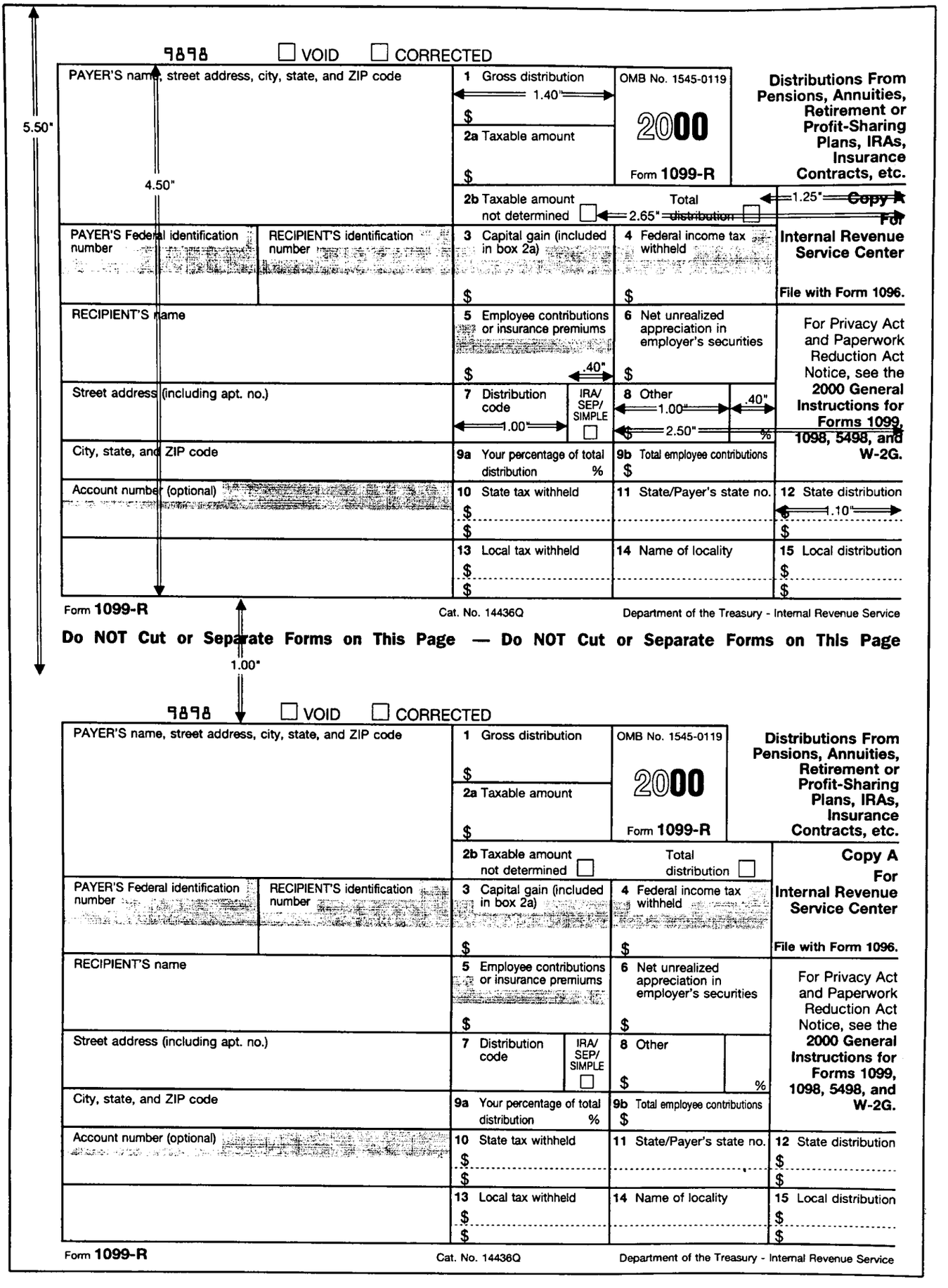
9797 ☐ VOID ☐ CORRECTED

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 $	2000	
	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.
RECIPIENT'S name	5 Redemption of nonqualified notices and retain allocations $		For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
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



9898 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code	1 Gross distribution $	OMB No. 1545-0119 2000 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
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	File with Form 1096.
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, see the 2000 General 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

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9898 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code	1 Gross distribution $	OMB No. 1545-0119 2000 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
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	File with Form 1096.
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, see the 2000 General 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 (1.40")	OMB No. 1545-0997 2000 Form 1099-S	Proceeds From Real Estate Transactions
	2 Gross proceeds $		

FILER'S Federal identification number (1.70")	TRANSFEROR'S identification number (1.70")	3 Address or legal description (including city, state, and ZIP code) (2.80")	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G. (1.15")
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 2000 Form 1099-S	Proceeds From Real Estate Transactions
	2 Gross proceeds $		

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, see the 2000 General 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 2000 Form 1099-S	Proceeds From Real Estate Transactions
	2 Gross proceeds $		

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, see the 2000 General 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 2000 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, see the 2000 General 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 2000 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, see the 2000 General 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 2000 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, see the 2000 General 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 2000 and 2001 for 2000 $	OMB No. 1545-1518 2000 Form 5498-MSA	MSA or Medicare+Choice MSA Information
	2 Total contributions made in 2000 ←1.40"→ $		
TRUSTEE'S Federal identification number / PARTICIPANT'S social security number	3 Total MSA contributions made in 2001 for 2000 $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General 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 2000 and 2001 for 2000 $	OMB No. 1545-1518 2000 Form 5498-MSA	MSA or Medicare+Choice MSA Information
	2 Total contributions made in 2000 $		
TRUSTEE'S Federal identification number / PARTICIPANT'S social security number	3 Total MSA contributions made in 2001 for 2000 $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General 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 2000 and 2001 for 2000 $	OMB No. 1545-1518 2000 Form 5498-MSA	MSA or Medicare+Choice MSA Information
	2 Total contributions made in 2000 $		
TRUSTEE'S Federal identification number / PARTICIPANT'S social security number	3 Total MSA contributions made in 2001 for 2000 $		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General 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 Street address (3.00") City, state, and ZIP code Federal identification number Telephone number	1 Gross winnings (1.45")	2 Federal income tax withheld (1.45")
	3 Type of wager	4 Date won
	5 Transaction	6 Race
	7 Winnings from identical wagers	8 Cashier
WINNER'S name (2.85") Street address (including apt. no.) City, state, and ZIP code	9 Winner's taxpayer identification no.	10 Window
	11 First I.D.	12 Second I.D.
	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 ►

OMB No. 1545-0238

2000

Form W-2G

Certain Gambling Winnings (1.40")

For Privacy Act and Paperwork Reduction Act Notice, see the **2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.**

File with Form 1096.

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 Street address City, state, and ZIP code Federal identification number Telephone number	1 Gross winnings	2 Federal income tax withheld
	3 Type of wager	4 Date won
	5 Transaction	6 Race
	7 Winnings from identical wagers	8 Cashier
WINNER'S name Street address (including apt. no.) City, state, and ZIP code	9 Winner's taxpayer identification no.	10 Window
	11 First I.D.	12 Second I.D.
	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 ►

OMB No. 1545-0238

2000

Form W-2G

Certain Gambling Winnings

For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.

File with Form 1096.

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 Street address City, state, and ZIP code Federal identification number Telephone number	1 Gross winnings	2 Federal income tax withheld
	3 Type of wager	4 Date won
	5 Transaction	6 Race
	7 Winnings from identical wagers	8 Cashier
WINNER'S name Street address (including apt. no.) City, state, and ZIP code	9 Winner's taxpayer identification no.	10 Window
	11 First I.D.	12 Second I.D.
	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 ►

OMB No. 1545-0238

2000

Form W-2G

Certain Gambling Winnings

For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.

File with Form 1096.

Copy A For Internal Revenue Service Center

Form W-2G Cat. No. 10138V Department of the Treasury - Internal Revenue Service

Taxable Fuel Measurement

Notice 2000–33

Section 48.4081–8(a) of the Manufacturers and Retailers Excise Tax Regulations provides that volumes of taxable fuel may be measured on the basis of either actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit. Section 48.4081–8(a) also provides, however, that beginning July 1, 2000, for each period from July 1 through the following June 30, a person liable for tax on a removal may use only one of the two bases of measurement with respect to taxable fuel removed from any particular terminal, refinery, or blending facility. This rule also applies to taxable entries and sales.

The Internal Revenue Service and the Treasury Department have determined that many taxpayers will have to change their accounting systems to comply with the rule applicable beginning July 1, 2000, and will be unable to complete the necessary changes by that date. Accordingly, taxpayers will not be required to comply with the rule before July 1, 2001. In the meantime, a taxpayer may use either basis of measurement for each taxable removal, entry, or sale of taxable fuel.

The principal author of this notice is Frank Boland of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Boland at (202) 622-3130 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Information Reporting for Payments of Qualified Tuition and Payments of Interest on Qualified Education Loans; Magnetic Media Filing Requirements for Information Returns

REG–105316–98

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and requests to videoconference the public hearing.

SUMMARY: This document contains proposed regulations relating to the information reporting requirements under section 6050S of the Internal Revenue Code for payments of qualified tuition and related expenses and interest on qualified education loans, including the filing of information returns on magnetic media. The regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. The regulations provide guidance to eligible educational institutions and insurers receiving payments of, or making reimbursements or refunds of, qualified tuition and related expenses. The regulations also provide guidance to payees receiving interest payments on qualified education loans. This document also announces that a public hearing will be held on the proposed regulations upon request and that persons outside the Washington, DC, area who wish to testify at the hearing may request that the IRS videoconference the hearing to their sites.

DATES: Written or electronically generated comments must be received by September 14, 2000. Requests to videoconference the hearing to other sites must be received by August 15, 2000. ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–105316–98), 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–105316–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Taxpayers may also 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 IRS will publish the time and date of the public hearing and the locations of any videoconferencing sites in the Federal Register.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Donna Welch, (202) 622-4910; 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; concerning the magnetic media filing specifications, waivers for filing on magnetic media, and extensions of time, contact the Internal Revenue Service, Martinsburg Computing Center, (304) 263-8700 (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 August 15, 2000. 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 §§1.6050S–1 and 1.6050S–2. In general, eligible educational institutions and insurers must file a Form 1098-T, "Tuition Payments Statement," with the IRS for each individual with respect to whom payments of qualified tuition and related expenses were received, or reimbursements or refunds of such expenses were made, and furnish an information statement to such individual. This collection of information is required in order to assist the IRS and taxpayers in calculating the amount of any education tax credit allowable under section 25A. In addition, payees who receive from any payor interest payments aggregating $600 or more on one or more qualified education loans must file a Form 1098-E, "Student Loan Interest Statement," with the IRS and furnish an information statement to the payor. This collection of information is required in order to assist the IRS and taxpayers in calculating the amount of any student loan interest deduction allowable under section 221. The likely respondents are businesses or other for-profit institutions and nonprofit institutions.

Estimated total annual reporting burden for 1998 for Form 1098-T: 2,419,438 hours.

Estimated average annual burden hours per response for

Form 1098-T: 7 minutes.

Estimated number of responses for 1998 for Form 1098-T: 20,738,039.

Estimated annual frequency of responses: Once.

Estimated total annual reporting burden for 1998 for Form 1098-E: 437,691 hours.

Estimated average annual burden hours per response for

Form 1098-E: 3 minutes.

Estimated number of responses for 1998 for Form 1098-E: 8,753,819.

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 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

1. *Information Reporting Requirements*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) relating to information reporting requirements under section 6050S. The Taxpayer Relief Act of 1997 (Public Law 105-34 (111 Stat. 788) (TRA '97)) added section 25A of the Internal Revenue Code to provide the Hope Scholarship Credit and the Lifetime Learning Credit (education tax credits). In general, the Hope Scholarship Credit and the Lifetime Learning Credit allow certain taxpayers who pay qualified tuition and related expenses to an eligible educational institution to claim a nonrefundable credit against their Federal income tax liability. On January 6, 1999, the IRS issued proposed regulations under section 25A. See 64 F.R. 794 (1999).

TRA '97 also added section 221 of the Internal Revenue Code to allow certain taxpayers who pay interest on qualified education loans to claim a Federal income tax deduction for their interest payments. In general, a deduction is allowed for interest payments made during the first 60 months in which interest payments are required on a qualified education loan. However, no interest deduction is allowed for any interest paid before January 1, 1998. On January 21, 1999, the IRS issued proposed regulations under section 221. See 64 F.R. 3257 (1999).

In addition, TRA '97 added section 6050S of the Internal Revenue Code, which requires eligible educational institutions to file information returns and to furnish written information statements to assist taxpayers and the IRS in determining any education tax credit allowable under section 25A. Similarly, section 6050S requires any person engaged in a trade or business of making payments to any individual under an insurance agreement as reimbursements or refunds of qualified tuition and related expenses to file information returns and to furnish written information statements. Lastly, section 6050S requires certain payees who receive payments of interest on one or more qualified education loans to file information returns and to furnish written information statements to assist taxpayers and the IRS in determining any interest deduction allowable under section 221.

The IRS has published several notices prescribing limited information reporting for eligible educational institutions for the years 1998, 1999, and 2000. On December 22, 1997, the IRS published Notice 97–73 (1997–2 C.B. 335), which describes the information that an eligible educational institution must report for 1998. On September 8, 1998, the IRS published Notice 98–46 (1998–36 I.R.B. 21), which extends the application of Notice 97–73 to information returns required under section 6050S for 1999. On December 7, 1998, the IRS published Notice 98–59 (1998–49 I.R.B. 16), which modifies the prior Notices by providing that an institution is not required to file information returns for students who are: (1) enrolled during the year only in courses for which the student receives no academic credit; or (2) nonresident alien students, unless the student requests the institution to report. On July 26, 1999, the IRS published Notice 99–37 (1999–30 I.R.B. 124), which extends the application of Notice 97–73 (as modified) to information returns required under section 6050S for 2000.

In addition, the IRS has published several notices describing the information reporting for certain payees who receive interest on qualified education loans during the years 1998, 1999, and 2000. On January 20, 1998, the IRS published Notice 98–7 (1998–1 C.B. 339), which describes the information reporting required under section 6050S for 1998. On November 16, 1998, the IRS published Notice 98–54 (1998–2 C.B. 641), which modifies Notice 98–7 to reflect a technical change to section 221 made by the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105-206 (112 Stat. 685)), and extends the application of Notice 98–7 (as modified) to information reporting required under section 6050S for 1999. On July 26, 1999, the IRS published Notice 99–37, which extends the application of Notice 98–7 (as modified) to information returns required under section 6050S for 2000.

2. *Magnetic Media Requirements*

This document also contains proposed amendments to the Regulations on Procedure and Administration (26 part 301) relating to the filing of information returns on magnetic media under section 6011(e). Section 6011(e) authorizes the Secretary to prescribe regulations providing the standards for determining which returns must be filed on magnetic media. Section 6011(e)(2)(A) provides that the Secretary shall not require any person to file returns on magnetic media unless the person is required to file at least 250 returns during the calendar year. Section 6011(e)(2)(B) provides that, in prescribing regulations, the Secretary shall consider the ability of the taxpayer to comply at reasonable cost with the requirements of the regulations.

Explanation of Provisions

1. *Information Reporting for Payments and Reimbursements or Refunds of Qualified Tuition and Related Expenses*

The proposed regulations require an eligible educational institution (as defined in section 25A(f)(2) and the regulations thereunder) (an institution) that receives payments of qualified tuition and related expenses (as defined in section 25A(f)(1) and the regulations thereunder) with respect to any individual, or makes reimbursements or refunds of such amounts, to file a Form 1098-T with the IRS. In addition, the proposed regulations require any person engaged in a trade or business of making payments under an insurance arrangement as reimbursements or refunds (or other similar amounts) of qualified tuition and related expenses (an insurer) to file a Form 1098-T with the IRS.

Under the proposed regulations, the following information must be reported on Form 1098-T: (a) the name, address, and taxpayer identification number (TIN)(as defined in section 7701(a)(41)) of the institution or the insurer; (b) the name, address, and TIN of the individual

with respect to whom payments of qualified tuition and related expenses were received, or reimbursements or refunds were made; (c) the aggregate amount of payments of qualified tuition and related expenses from any source that the institution received with respect to the individual during the calendar year; (d) the aggregate amount of reimbursements or refunds of qualified tuition and related expenses that the institution or insurer made with respect to the individual during the calendar year; (e) the aggregate amount of any scholarships or grants that the institution processed during the calendar year for the payment of the individual's costs of attendance; (f) an indication by the institution whether the individual was enrolled for at least half of the normal full-time work load for the course of study the individual is pursuing for at least one academic period that begins during the calendar year; (g) an indication by the institution whether the individual was enrolled in a program leading to a graduate-level degree, graduate-level certificate, or other recognized graduate-level educational credential; and (h) any other information required by Form 1098-T and its instructions.

The proposed regulations reserve the requirement in section 6050S(b)(2)(B) that an institution or insurer obtain and report the name, address, and TIN of any taxpayer who will claim the individual with respect to whom payments are received, or reimbursements or refunds are made, as a dependent for purposes of the deduction allowable under section 151 for the taxable year. Thus, under the proposed regulations, there is no requirement to obtain and report the name, address, and TIN of any taxpayer who will claim the individual as a dependent on the taxpayer's Federal income tax return.

Consistent with the exceptions to required reporting in Notice 98–59, the proposed regulations provide that an institution or insurer is not required to file a Form 1098-T for an individual who is a nonresident alien, unless the individual requests that the institution or insurer report. In addition, an institution is not required to file a Form 1098-T for an individual who is enrolled during the calendar year only in courses for which the individual receives no academic credit. Under the proposed regulations, the term *academic credit* means credit awarded by an institution for the completion of coursework leading toward a post-secondary degree, certificate, or other recognized post-secondary educational credential.

The proposed regulations provide that, in determining the payments for qualified tuition and related expenses that an institution must report, payments received with respect to an individual from any source (except for any scholarship or grant that, by its terms, must be applied to expenses other than qualified tuition and related expenses, such as room and board) are treated as payments of qualified tuition and related expenses up to the total amount billed for such expenses.

The proposed regulations provide that an institution or insurer must furnish an information statement to each individual for whom it is required to file a Form 1098-T. The proposed regulations provide that the statement must include the information included on the Form 1098-T filed with the IRS and a legend that identifies the statement as important tax information being furnished to the IRS. The statement must include instructions that state that the taxpayer may not be able to claim an education tax credit under section 25A and the regulations thereunder with respect to the total payments of qualified tuition and related expenses reported for the calendar year. The instructions must state that the amount of the scholarships, grants, reimbursements, or refunds reported for the calendar year and other similar amounts not reported (because they are not processed by the institution) may reduce the amount of any allowable education tax credit for the taxable year or a prior taxable year. The instructions must state that the taxpayer should refer to relevant IRS forms and publications (such as Form 8863, "Education Credits," and Publication 970, "Tax Benefits for Higher Education") for explanations relating to the eligibility requirements for, and the calculation of, any allowable education tax credit.

The proposed regulations reserve the requirement in section 6050S(d) that an institution or insurer furnish a statement to any taxpayer who will claim the individual with respect to whom payments are received, or reimbursements or refunds are made, as a dependent for purposes of the deduction allowable under section 151 for the taxable year. Thus, under the proposed regulations, there is no requirement to furnish a statement to any taxpayer who will claim the individual as a dependent on the taxpayer's Federal income tax return.

The proposed regulations describe the rules for the time and manner of filing information returns with the IRS and furnishing information statements. Forms 1098-T must generally be filed with the IRS on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the payments were received, or reimbursements or refunds were made. In general, an institution or insurer must furnish an information statement to each individual with respect to whom payments of qualified tuition and related expenses were received, or reimbursements or refunds were made, on or before January 31 of the year following the calendar year in which payments were received, or reimbursements or refunds were made. Although the regulations do not specifically address the issue of electronic transmission of information statements, the IRS is currently studying the issue. Accordingly, the IRS may address that issue in future guidance.

Under the proposed regulations, an institution or insurer may be subject to a penalty under section 6721 for failure to file correct Forms 1098-T and a penalty under section 6722 for failure to furnish correct information statements. The proposed regulations generally follow the rules under section 6724 for waivers of penalties for certain failures due to reasonable cause. The regulations also provide special rules for soliciting an individual's TIN. An institution or insurer that complies with those rules will not be penalized for any failure to obtain or include a correct TIN on a Form 1098-T or the related information statement.

2. *Information Reporting for Payments of Interest on Qualified Education Loans*

The proposed regulations require any person engaged in a trade or business that receives from any payor interest of $600 or more for any calendar year on one or more qualified education loans (as defined in section 221(e)(1) and the regulations thereunder) (a payee) to file a Form 1098-E with the IRS. Under the proposed

regulations, a payee must report the name, address, and taxpayer identification number (TIN) of the payee; the name, address, and TIN of the payor; and the aggregate amount of interest received during the calendar year from the payor. The payee may be the lender, the holder of the loan, or the loan servicer. The regulations define the *payor* as the individual carried on the books and records of the payee as the borrower on a qualified education loan. If there are multiple borrowers, the principal borrower indicated on the payee's books and records is treated as the payor for purposes of section 6050S.

Under the proposed regulations, a payee is required to report only interest payments received on a qualified education loan during the first 60 months in which interest payments are required on the loan. The proposed regulations, in general, incorporate the rules of section 221 and the regulations thereunder to determine the 60-month period for which interest payments must be reported. Under the proposed regulations, the 60-month period generally begins on the date the qualified education loan first enters repayment status. However, for qualified education loans made before January 1, 1998, if the payee does not know, and does not have reason to know, the date on which the loan entered repayment status, then, for information reporting purposes, the 60-month period begins on January 1, 1998. For defaulted loans made before January 1, 1998, if the payee does not know, and does not have reason to know, the date on which the loan entered repayment status, then, for information reporting purposes, the 60-month period begins on the earlier of the date the loan went into default or January 1, 1998. If the payee does not know, and does not have reason to know, either the date the loan entered repayment status or the default date, then, for information reporting purposes, the 60-month period begins on January 1, 1998.

The proposed regulations provide that, in determining the aggregate amount of interest payments to be reported by a payee, the term *interest* includes stated interest, loan origination fees (other than any fees for services), and capitalized interest as described in proposed regulations §1.221–1(h)(2). However, in order to provide payees sufficient time to develop systems to report amounts other than stated interest, the proposed regulations do not require payees to report loan origination fees and capitalized interest for loans made before January 1, 2002.

The proposed regulations provide rules to determine which loans are qualified education loans subject to information reporting under section 6050S. The regulations provide that, unless the loan is subsidized, guaranteed, financed, or otherwise treated as a student loan under a program of the Federal, state, or local government or an eligible educational institution, the payee must request and obtain a certification from the payor that the loan will be used solely to pay qualified higher education expenses. The regulations provide that the payee may use Form W-9S, "Request for Student's Social Security Number and Borrower Certification," to request and obtain the certification. If a payee fails to obtain a required certification, the loan is not treated as a qualified education loan for purposes of section 6050S.

The proposed regulations provide that a payee must furnish an information statement to each payor for whom it is required to file a Form 1098-E. The proposed regulations provide that the statement must include the information included on the Form 1098-E filed with the IRS and a legend that identifies the statement as important tax information being furnished to the IRS. The statement must include instructions that state that, under section 221 and the regulations thereunder, the payor may not be able to deduct the full amount of interest reported on the statement. The instructions must state that interest payments are deductible only during the first 60-months that interest payments are required. If the payee reports only stated interest, the instructions must state that the payor may be able to deduct additional amounts (e.g., certain loan origination fees and capitalized interest) not reported on the statement. The instructions must also state that the payor should refer to relevant IRS forms and publications (such as Publication 970) for explanations relating to the eligibility requirements for, and the calculation of, any allowable interest deduction on qualified education loans.

The proposed regulations describe the rules for the time and manner of filing information returns with the IRS and furnishing information statements to payors. Forms 1098-E must generally be filed with the IRS on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the interest payments were received. In general, a payee must furnish an information statement to the payor on or before January 31 of the year following the calendar year in which interest payments were received. Although the regulations do not specifically address the issue of electronic transmission of information statements, the IRS is currently studying the issue. Accordingly, the IRS may address that issue in future guidance.

Under the proposed regulations, a payee may be subject to a penalty under section 6721 for failure to file correct Forms 1098-E and a penalty under section 6722 for a failure to furnish correct information statements. The proposed regulations generally follow the rules under section 6724 for waivers of penalties for certain failures due to reasonable cause. The regulations also provide special rules for soliciting the payor's TIN. A payee that complies with those rules will not be penalized for any failure to obtain or include a correct TIN on a Form 1098-E or the related information statement.

3. *Requirement to File Information Returns on Magnetic Media*

The proposed regulations amend the regulations under section 6011(e) to require eligible educational institutions, insurers, and payees who are required to file 250 or more Forms 1098-T or 1098-E to file on magnetic media. Under §301.6011–2(a)(1), the term *magnetic media* means any media permitted under applicable regulations, revenue procedures, or publications, including magnetic tape, tape cartridge, and diskette, as well as other media (such as electronic filing).

Proposed Effective Date

These regulations are proposed to apply to information returns required to be filed, and information statements required to be furnished, after December 31, 2001. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in the pro-

posed regulations, the future guidance will be applied without retroactive effect.

Special Analyses

It has been determined that these proposed regulations are 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. An initial regulatory flexibility analysis has been prepared for this notice of proposed rulemaking under 5 U.S.C. 603 and is set forth under the heading "Initial Regulatory Flexibility Analysis" in this preamble. 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.

Initial Regulatory Flexibility Analysis

The collection of information contained in §§1.6050S–1(a) and (b) and 1.6050S–2(a) and (c) is needed to assist the IRS and taxpayers in determining the amount of any education credit allowable under section 25A and the amount of any interest deduction allowable under section 221. The objectives of the proposed regulations are to provide uniform, practicable, and administrable rules under section 6050S. The types of small entities to which the proposed regulations may apply are small eligible educational institutions (such as colleges and universities), certain insurers who reimburse educational expenses, and certain payees who receive payments of interest on qualified education loans. As of the end of December 1999, a total of 20,738,039 Forms 1098-T were filed with the IRS for 1998 and a total of 8,753,819 Forms 1098-E were filed with the IRS for 1998. The current estimated reporting burden is 7 minutes per Form 1098-T and 3 minutes per Form 1098-E. No special professional skills are necessary for preparation of the reports or records. There are no known Federal rules that duplicate, overlap, or conflict with these proposed regulations. The regulations proposed are considered to have the least economic impact on small entities of all alternatives considered.

Moreover, the proposed regulations requiring filing Forms 1098-T and 1098-E on magnetic media impose no additional reporting or recordkeeping and only prescribe the method of filing information returns that are already required to be filed. Further, these regulations are consistent with the statutory requirement that an eligible educational institution, insurer, or payee is not required to file Forms 1098-T or 1098-E on magnetic media unless required to file at least 250 or more returns during the year. Finally, the economic impact caused by requiring Forms 1098-T and 1098-E on magnetic media should be minimal because most institution's, insurer's, and payee's operations are computerized. Even if their operations are not computerized, the incremental cost of magnetic media reporting should be minimal in most cases because of the availability of computer service bureaus. In addition, the existing regulations under section 6011(e) provide that the IRS may waive the magnetic media filing requirements on a showing of hardship. The waiver authority will be exercised so as not to unduly burden institutions, insurers, and payees lacking both the necessary data processing facilities and access at a reasonable cost to computer service bureaus.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written and electronic comments that are submitted timely to the IRS. The IRS and Treasury 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 will be scheduled in the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. The IRS recognizes that persons outside the Washington, DC, area may also wish to testify at the public hearing through videoconferencing. Requests to include videoconferencing sites must be received by August 15, 2000. If the IRS receives sufficient indications of interest to warrant videoconferencing to a particular city, and if the IRS has videoconferencing 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 time and date of the public hearing and the locations of any videoconferencing sites in a document in the **Federal Register**.

Drafting Information

The principal author of the regulations is Donna Welch, 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.

* * * * *

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 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.6050S–1 also issued under section 26 U.S.C. 6050S(g).

Section 1.6050S–2 also issued under section 26 U.S.C. 6050S(g). * * *

Par. 2. Sections 1.6050S–0 through 1.6050S–2 are added to read as follows:

§1.6050S–0 Table of contents

This section lists captions contained in §§1.6050S–1 and 1.6050S–2.

§1.6050S–1 Information reporting for payments and reimbursements or refunds of qualified tuition and related expenses.

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(1) In general.

(2) Exceptions.

(i) No reporting for nonresident alien individuals.

(ii) No reporting for individuals enrolled in noncredit courses.

(A) In general.

(B) Academic credit defined.

(C) Example.

(b) Requirement to file return.

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(2) Information included on return.

(i) In general.

(ii) Requirement to include name, address, and TIN of any taxpayer who will claim the individual as a dependent on the taxpayer's Federal income tax return. [Reserved]

(3) Time and place for filing return.

(i) In general.
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(iii) Extensions of time.
(4) Use of magnetic media.
(c) Requirement to furnish statement.
(1) In general.
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(3) Time and manner for furnishing statement.
(i) In general.
(ii) Statement to nonresident alien individual.
(iii) Extensions of time.
(4) Time and manner for furnishing statement to any taxpayer who will claim the individual as a dependent on the taxpayer's Federal income tax return. [Reserved]
(5) Copy of Form 1098-T.
(d) Special rules.
(1) Payments received for qualified tuition and related expenses determined.
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(ii) Example.
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(i) In general.
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(3) Governmental units.
(e) Penalty provisions.
(1) Failure to file correct returns.
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(3) Waiver of penalties for failures to include a correct TIN.
(i) In general.
(ii) Acting in a responsible manner.
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§1.6050S–2 Information reporting for payments of interest on qualified education loans.
(a) Information reporting requirement.
(1) In general.
(2) Reporting period.
(i) In general.
(ii) Calculation of 60-month period.
(iii) Transitional rules for reporting on loans made before January 1, 1998.
(b) Definitions.
(c) Requirement to file return.
(1) Form of return.
(2) Information included on return.
(3) Time and place for filing return.
(i) In general.
(ii) Extensions of time.
(4) Use of magnetic media.
(d) Requirement to furnish statement.
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(2) Time and manner for furnishing statement.
(i) In general.
(ii) Extensions of time.
(3) Copy of Form 1098-E.
(e) Special rules.
(1) Transitional rule for reporting of loan origination fees and capitalized interest.
(2) Qualified education loan certification.
(3) Payments of interest received or collected by one or more persons.
(i) In general.
(ii) Exception.
(4) Reporting by foreign persons.
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(f) Penalty provisions.
(1) Failure to file correct returns.
(2) Failure to furnish correct information statements.
(3) Waiver of penalties for failures to include a correct TIN.
(i) In general.
(ii) Acting in a responsible manner.
(iii) Manner of soliciting TIN.
(4) Failure to furnish TIN.
(g) Effective date.
§1.6050S–1 Information reporting for payments and reimbursements or refunds of qualified tuition and related expenses.

(a) *Information reporting requirement*—(1) *In general.* Except as provided in paragraph (a)(2) of this section, any eligible educational institution (as defined in section 25A(f)(2) and §1.25A–2(b))(an institution) that receives payments of qualified tuition and related expenses (as defined in section 25A(f)(1) and §1.25A–2(d)) from any source for any calendar year, or that makes reimbursements or refunds (or similar payments) of such amounts, and any person engaged in a trade or business of making payments under an insurance arrangement as reimbursements or refunds (or other similar amounts) of qualified tuition and related expenses (an insurer) must—

(i) File an information return, as described in paragraph (b) of this section, with the Internal Revenue Service (IRS) with respect to each individual for whom such payments are received, or reimbursements or refunds are made; and

(ii) Furnish a statement, as described in paragraph (c) of this section, to each individual described in paragraph (c) of this section.

(2) *Exceptions*—(i) *No reporting for nonresident alien individuals.* The information reporting requirements of this section do not apply with respect to any individual who is a nonresident alien (as defined in section 7701(b) and §301.7701(b)–3 of this chapter) during the calendar year, unless the individual requests the institution or insurer to report. If a nonresident alien individual requests an institution or insurer to report, the institution or insurer must comply with the requirements of this section for the year with respect to which the request is made and all years after such request in which it receives payments of qualified tuition and related expenses or makes reimbursements or refunds of such amounts with respect to such individual.

(ii) *No reporting for individuals enrolled in noncredit courses*—(A) *In general.* The information reporting requirements of this section do not apply with respect to any individual who is enrolled during the calendar year only in courses for which the individual receives no academic credit.

(B) *Academic credit defined. Academic credit* means credit awarded by an institution for the completion of coursework leading toward a post-secondary degree, certificate, or other recognized post-secondary educational credential.

(C) *Example.* The following example illustrates the rules of this paragraph (a)(2)(ii):

Example. Student A, a medical doctor, takes a course at University X's medical school. Student A takes the course to fulfill State Y's licensing requirement that medical doctors attend continuing medical education courses each year. Student A is not enrolled in a degree program at University X and takes the medical course through University X's continuing professional education division. University X does not award Student A credit toward a post-secondary degree on an academic transcript for the completion of the course but gives Student A a certificate of attendance upon completion. Under this paragraph (a)(2)(ii), University X is not subject to the information reporting requirements of section 6050S and this section for the medical education course taken by Student A.

(b) *Requirement to file return*—(1) *Form of return.* Except as otherwise provided in this section, an institution or insurer must file an information return for each individual with respect to whom payments of qualified tuition and related expenses are received, or reimbursements or refunds of such amounts are made, during the calendar year on Form 1098-T, "Tuition Payments Statement." An institution or insurer may use a substitute for Form 1098-T if the substitute form complies with applicable revenue procedures relating to substitute forms.

(2) *Information included on return*—(i) *In general.* An institution or insurer must include on Form 1098-T—

(A) The name, address, and taxpayer identification number (TIN)(as defined in section 7701(a)(41)) of the institution or the insurer;

(B) The name, address, and TIN of the individual with respect to whom payments of qualified tuition and related expenses were received, or reimbursements or refunds of such amounts were made;

(C) The aggregate amount of payments of qualified tuition and related expenses from any source that the institution received with respect to the individual during the calendar year;

(D) The aggregate amount of reimbursements or refunds of qualified tuition and related expenses that the institution or insurer made with respect to the individual during the calendar year;

(E) The aggregate amount of any scholarships or grants that the institution processed during the calendar year for the payment of the individual's costs of attendance;

(F) An indication by the institution whether the individual was enrolled for at least half of the normal full-time work load for the course of study the individual is pursuing for at least one academic period that begins during the calendar year (see §1.25A–3(d)(1)(ii));

(G) An indication by the institution whether the individual was enrolled in a program leading to a graduate-level degree, graduate-level certificate, or other recognized graduate-level educational credential; and

(H) Any other information required by Form 1098-T and its instructions.

(ii) *Requirement to include name, address, and TIN of any taxpayer who will claim the individual as a dependent on the taxpayer's Federal income tax return.* [Reserved]

(3) *Time and place for filing return*—(i) *In general.* Except as provided in paragraphs (b)(3)(ii) and (iii) of this section, Form 1098-T must be filed on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which payments of qualified tuition or related expenses were received, or reimbursements or refunds of such amounts were made. An institution or insurer must file Form 1098-T with the IRS according to the instructions to Form 1098-T.

(ii) *Return for nonresident alien individual.* In general, an institution or insurer is not required to file a return on behalf of a nonresident alien individual. However, if a nonresident alien individual requests an institution or insurer to report, the institution or insurer must file a return described in paragraph (b)(2) of this section with the IRS on or before the date prescribed in paragraph (b)(3)(i) of this section, or on or before the thirtieth day after the request, whichever is later.

(iii) *Extensions of time.* The IRS may grant an institution or insurer an extension of time to file returns required in this section upon a showing of good cause. See the instructions to Form 1098-T and applicable revenue procedures for rules relating to extensions of time to file.

(4) *Use of magnetic media.* See section 6011(e) and §301.6011–2 of this chapter for rules relating to the requirement to file Forms 1098-T on magnetic media.

(c) *Requirement to furnish statement*—(1) *In general.* An institution or insurer must furnish a statement to each individual for whom it is required to file a Form 1098-T. The statement must include—

(i) The information required under paragraph (b)(2) of this section;

(ii) A legend that identifies the statement as important tax information that is being furnished to the IRS;

(iii) Instructions that—

(A) State that the taxpayer may not be able to claim an education tax credit under section 25A and the regulations thereunder with respect to the total payments of qualified tuition and related expenses reported for the calendar year;

(B) State that the amount of any scholarships, grants, refunds, or reimbursements reported for the calendar year and other similar amounts not reported (because they are not processed by the institution) may reduce the amount of any allowable education tax credit for the taxable year or a prior taxable year;

(C) State that the taxpayer should refer to relevant IRS forms and publications for explanations relating to the eligibility requirements for, and calculation of, any allowable education tax credit; and

(D) Include the name, address, and phone number of the individual who is the information contact for the institution or insurer that filed the Form 1098-T.

(2) *Statement furnished to any taxpayer who will claim the individual as a dependent on the taxpayer's Federal income tax return.* [Reserved]

(3) *Time and manner for furnishing statement*—(i) *In general.* Except as provided in paragraphs (c)(3)(ii) and (iii) of this section, an institution or insurer must furnish the statement described in paragraph (c)(1) of this section to each individual with respect to whom payments of qualified tuition and related expenses were received, or reimbursements or refunds were made, on or before January 31 of the year following the calendar year in which payments were received or reimbursements or refunds were made. If mailed, the statement must be sent to the individual's permanent address, or the individual's temporary address if the institution or insurer does not know the individual's permanent address.

(ii) *Statement to nonresident alien individual.* If an information return is filed for a nonresident alien individual, the institution or insurer must furnish a statement described in paragraph (c)(1) of this section to the individual in the manner and on or before the date prescribed in paragraph (c)(3)(i) of this section, or on or before the thirtieth day after the nonresident alien's request to report, whichever is later.

(iii) *Extensions of time.* The IRS may grant an institution or insurer an extension of time to furnish the statements required in this section upon a showing of good cause. See the instructions to Form 1098-T and applicable revenue procedures for rules relating to extensions of time to furnish statements.

(4) *Time and manner for furnishing statement to any taxpayer who will claim*

the individual as a dependent on the taxpayer's Federal income tax return. [Reserved]

(5) *Copy of Form 1098-T.* An institution or insurer may satisfy the requirement of this paragraph (c) by furnishing either a copy of Form 1098-T and its instructions or another document that contains all of the information filed with the IRS and the information required by paragraph (c)(1) of this section if the document complies with applicable revenue procedures relating to substitute statements.

(d) *Special rules*—(1) *Payments received for qualified tuition and related expenses determined*—(i) *In general.* In determining the aggregate amount of payments of qualified tuition and related expenses that an institution must report, payments received with respect to an individual during the calendar year from any source (except for any scholarship or grant that, by its terms, must be applied to expenses other than qualified tuition and related expenses, such as room and board) will be treated as payments of qualified tuition and related expenses up to the total amount billed by the institution for such expenses.

(ii) *Example.* The following example illustrates the rules of this paragraph (d)(1):

Example. (i) During the 2002 Spring semester, Student C attends College X and enrolls in a program leading toward an associate's degree. Student C lives on-campus. In December 2001, College X charges Student C $2,000 for room and board for the 2002 Spring semester. In addition, in December 2001, College X charges Student C $4,000 for qualified tuition and related expenses for the 2002 Spring semester. In December 2001, Student C pays College X $1,500. In early January 2002, College X receives and processes a $4,500 scholarship that may be applied to any of Student C's costs of attendance. Assume that there are no other payments during the calendar years 2001 and 2002.

(ii) Under this paragraph (d)(1), for the calendar year 2001, College X must report $1,500 for payments of qualified tuition and related expenses received during the calendar year 2001. In addition, for the calendar year 2002, College X must report:

(A) $2,500 for payments of qualified tuition and related expenses received during the calendar year 2002 ($4,000 total charges for qualified tuition and related expenses less the $1,500 payments received during 2001); and

(B) $4,500 of scholarships processed during the calendar year 2002.

(2) *Payments of qualified tuition and related expenses received or collected on behalf of an institution*—(i) *In general.* If an institution contracts with another person to receive or collect payments of qualified tuition and related expenses on its behalf, the other person must satisfy the information reporting requirements of this section.

(ii) *Exception.* If the institution does not provide the other person with the information necessary to comply with the reporting requirements of this section, the other person must request the information necessary to comply with the information reporting requirements from the institution. If the institution does not provide the other person with the necessary information upon request, the institution must satisfy the information reporting requirements of this section.

(3) *Governmental units.* An institution or insurer that is a governmental unit, or an agency or instrumentality of a governmental unit, is subject to the information reporting requirements of this section and an appropriately designated officer or employee of the governmental entity must satisfy the information reporting requirements of this section.

(e) *Penalty provisions*—(1) *Failure to file correct returns.* The section 6721 penalty may apply to an institution or insurer that fails to file information returns required by section 6050S and this section on or before the required filing date; that fails to include all of the required information on the return; or that includes incorrect information on the return. See section 6721, and the regulations thereunder, for rules relating to penalties for failure to file correct returns. See section 6724, and the regulations thereunder, for rules relating to waivers of penalties for certain failures due to reasonable cause.

(2) *Failure to furnish correct information statements.* The section 6722 penalty may apply to an institution or insurer that fails to furnish statements required by section 6050S and this section on or before the prescribed date; that fails to include all the required information on the statement; or that includes incorrect information on the statement. See section 6722, and the regulations thereunder, for rules relating to penalties for failure to furnish correct statements. See section 6724, and the regulations thereunder, for rules relating to waivers of penalties for certain failures due to reasonable cause.

(3) *Waiver of penalties for failures to include a correct TIN*—(i) *In general.* In the case of a failure to include a correct TIN on Form 1098-T or a related information statement, penalties may be waived if the failure is due to reasonable cause. Reasonable cause may be established if the failure arose from events beyond the institution's or insurer's control, such as a failure of the individual to furnish a correct TIN. However, the institution or insurer must establish that it acted in a responsible manner both before and after the failure.

(ii) *Acting in a responsible manner.* An institution or insurer must request the TIN of each individual with respect to whom payments of qualified tuition were received, or reimbursements or refunds were made, if it does not already have a record of the individual's correct TIN. If the institution or insurer does not have a record of the individual's correct TIN, then it must solicit the TIN in the manner described in paragraph (e)(3)(iii) of this section on or before December 31 of each year during which it receives payments of, or makes reimbursements of, qualified tuition and related expenses with respect to the individual. If an individual refuses to provide his or her TIN upon request, the institution or insurer must file the return and furnish the statement required by this section without the individual's TIN, but with all other required information. The specific solicitation requirements of paragraph (e)(3)(iii) of this section apply in lieu of the solicitation requirements of §301.6724–1(e) and (f) of this chapter for the purpose of determining whether an institution or insurer acted in a responsible manner in attempting to obtain a correct TIN. An institution or insurer that complies with the requirements of this paragraph (e)(3) will be considered to have acted in a responsible manner within the meaning of §301.6724–1(d) of this chapter with respect to any failure to include the correct TIN of an individual on a return or statement required by section 6050S and this section.

(iii) *Manner of soliciting TIN.* An institution or insurer must request the individual's TIN in writing and must clearly notify the individual that the law requires the individual to furnish a TIN so that it may be included on an information return filed by the institution or insurer. An institution or insurer must notify the individual that the individual's failure to fur-

nish his or her TIN to the institution or insurer may result in a $50 penalty being imposed against the individual as authorized by law. A request for a TIN made on Form W-9S, "Request for Student's or Borrower's Social Security Number and Certification," satisfies the requirements of this paragraph (e)(3)(iii). An institution or insurer may establish a system for individuals to submit Forms W-9S electronically as described in applicable forms and instructions. An institution or insurer may also develop a separate form to request the individual's TIN or incorporate the request into other forms customarily used by the institution or insurer, such as financial aid applications.

(4) *Requirement to request and obtain TIN of any taxpayer who will claim the individual as a dependent on the taxpayer's Federal income tax return.* [Reserved]

(5) *Failure to furnish TIN.* The section 6723 penalty may apply to any individual who is required (but fails) to furnish his or her TIN to an institution or insurer. See section 6723, and the regulations thereunder, for rules relating to the penalty for failure to furnish a TIN.

(f) *Effective date.* The rules in this section apply to information returns required to be filed, and information statements required to be furnished, after December 31, 2001.

§1.6050S–2 Information reporting for payments of interest on qualified education loans.

(a) *Information reporting requirement*—(1) *In general.* Except as otherwise provided in this section, any person engaged in a trade or business that, in the course of that trade or business, receives from any payor (as defined in paragraph (b)(2) of this section) interest payments that aggregate $600 or more for any calendar year on one or more qualified education loans (as defined in section 221(e)(1) and §1.221–1(f)(3))(a payee) must—

(i) File an information return, as described in paragraph (c) of this section, with the IRS with respect to the payor; and

(ii) Furnish a statement, as described in paragraph (d) of this section, to the payor.

(2) *Reporting period*—(i) *In general.* The information reporting requirements of this section apply only to interest payments received on a qualified education loan during the first 60 months in which interest payments are required on the loan.

(ii) *Calculation of 60-month period.* In general, the 60-month period described in paragraph (a)(2)(i) of this section begins on the date the qualified education loan first enters repayment status and ends 60 months later. However, if the payee knows, or has reason to know, of any periods of deferment or forbearance during which the 60-month period is suspended under the rules described in §1.221–1(e)(3), the 60-month period described in paragraph (a)(2)(i) of this section is extended by the period of such deferment or forbearance. The date on which the qualified education loan first enters repayment status is determined under the terms of the loan agreement or, in the case of a loan issued or guaranteed under a federal post-secondary education loan program, under applicable federal regulations. For purposes of reporting under section 6050S and this section for refinanced loans and consolidated and collapsed loans, the rules of §1.221–1(h)(1), relating to the date on which the 60-month period begins, apply.

(iii) *Transitional rules for reporting on loans made before January 1, 1998.* For qualified education loans made before January 1, 1998, the 60-month period described in paragraph (a)(2)(i) of this section is determined in accordance with the rules of paragraph (a)(2)(ii) of this section, except that if the payee does not know, and does not have reason to know, the date on which the loan entered repayment status, then, for reporting purposes only, the 60-month period begins on January 1, 1998. For defaulted loans made before January 1, 1998, if the payee does not know, and does not have reason to know, the date on which the loan entered repayment status, then, for reporting purposes only, the 60-month period begins on the earlier of the date the loan went into default or January 1, 1998. If the payee does not know, and does not have reason to know, either the date the loan entered repayment status or the default date, then, for reporting purposes only, the 60-month period begins on January 1, 1998. For purposes of this paragraph (a)(2)(iii), a defaulted loan is a loan with respect to which required payments of interest and principal have not been made when due over a period of time such that the holder has declared the loan in default based on its terms and conditions, and, if applicable, has sought recourse against the ultimate guarantor of the loan.

(b) *Definitions.* The following definitions apply for purposes of this section:

(1) *Interest* includes stated interest, loan origination fees (other than fees for services), and capitalized interest as described in §1.221–1(h)(2). See paragraph (e)(1) of this section for a special transitional rule relating to reporting of loan origination fees and capitalized interest.

(2) *Payor* means the individual who is carried on the books and records of the payee as the borrower on a qualified education loan. If there are multiple borrowers, the principal borrower on the payee's books and records is treated as the payor for purposes of section 6050S and this section.

(c) *Requirement to file return*—(1) *Form of return.* A payee must file an information return for the payor on Form 1098-E, "Student Loan Interest Statement." A payee may use a substitute for Form 1098-E if the substitute form complies with the applicable revenue procedures relating to substitute forms.

(2) *Information included on return.* A payee must include on Form 1098-E—

(i) The name, address, and taxpayer identification number (TIN)(as defined in section 7701(a)(41)) of the payee;

(ii) The name, address, and TIN of the payor;

(iii) The aggregate amount of interest payments received during the calendar year from the payor; and

(iv) Any other information required by Form 1098-E and its instructions.

(3) *Time and place for filing return*—(i) *In general.* Except as provided in paragraph (c)(3)(ii) of this section, the Form 1098-E must be filed on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which interest payments were received. A payee must file Form 1098-E with the IRS according to the instructions to Form 1098-E.

(ii) *Extensions of time.* The IRS may grant a payee an extension of time to file returns required in this section upon a showing of good cause. See the instructions to Form 1098-E and applicable revenue procedures for rules relating to extensions of time to file.

(4) *Use of magnetic media.* See section 6011(e) and §301.6011–2 of this chapter for rules relating to the requirement to file Forms 1098-E on magnetic media.

(d) *Requirement to furnish statement*—(1) *In general.* A payee must furnish a statement to each payor for whom it is required to file a Form 1098-E. The statement must include—

(i) The information required under paragraph (c)(2) of this section;

(ii) A legend that identifies the statement as important tax information that is being furnished to the IRS;

(iii) Instructions that—

(A) State that, under section 221 and the regulations thereunder, the payor may not be able to deduct the full amount of interest reported on the statement;

(B) State that interest payments are deductible only during the first 60 months that interest payments are required;

(C) In the case of qualified education loans made before January 1, 2002, for which the payee does not report payments of interest other than stated interest, state that the payor may be able to deduct additional amounts (such as certain loan origination fees and capitalized interest) not reported on the statement;

(D) State that the payor should refer to relevant IRS forms and publications for explanations relating to the eligibility requirements for, and calculation of, any allowable deduction for interest paid on a qualified education loan; and

(E) Include the name, address, and phone number of the individual who is the information contact for the payee that filed the Form 1098-E.

(2) *Time and manner for furnishing statement*—(i) *In general.* Except as provided in paragraph (d)(2)(ii) of this section, a payee must furnish the statement described in paragraph (d)(1) of this section to the payor on or before January 31 of the year following the calendar year in which payments of interest on a qualified education loan were received. If mailed, the statement must be sent to the payor's last known address.

(ii) *Extensions of time.* The IRS may grant a payee an extension of time to furnish statements required in this section upon a showing of good cause. See the instructions to Form 1098-E and applicable revenue procedures for rules relating to extensions of time to furnish statements.

(3) *Copy of Form 1098-E.* A payee may satisfy the requirement of this paragraph (d) by furnishing either a copy of Form 1098-E and its instructions or another document that contains all the information filed with the IRS and the information required by paragraph (d)(1) of this section if the document complies with applicable revenue procedures relating to substitute statements.

(e) *Special rules*—(1) *Transitional rule for reporting of loan origination fees and capitalized interest.* For qualified education loans made before January 1, 2002, a payee is not required to report payments of loan origination fees and capitalized interest as interest under section 6050S and this section.

(2) *Qualified education loan certification.* If a loan is not subsidized, guaranteed, financed, or is not otherwise treated as a student loan under a program of the Federal, state, or local government or an eligible educational institution, a payee must request a certification from the payor that the loan will be used solely to pay for qualified higher education expenses. A payee may use Form W-9S, "Request for Student's or Borrower's Social Security Number and Certification," to obtain the certification. A payee may establish an electronic system for payors to submit Forms W-9S electronically as described in applicable forms and instructions. A payee may also develop a separate form to obtain the payor certification or may incorporate certification into other forms customarily used by the payee, such as loan applications, provided the certification is clearly set forth. If the certification is not received, the loan is not a qualified education loan for purposes of section 6050S and this section.

(3) *Payments of interest received or collected by one or more persons*—(i) *In general.* If a payee contracts with another person to receive or collect payments on a qualified education loan on its behalf, the other person must satisfy the information reporting requirements of this section.

(ii) *Exception.* If the payee does not provide the other person with information necessary to comply with the information reporting requirements of this section, the other person must request the information necessary to comply with the information reporting requirements from the payee. If the payee does not provide the other person with the necessary information upon request, the payee must satisfy the information reporting requirements of this section.

(4) *Reporting by foreign persons.* A payee that is not a United States person (as defined in section 7701(a)(30)) must report payments of interest it receives on a qualified education loan only if it receives the payment—

(i) At a location in the United States; or

(ii) At a location outside the United States if the payee is–

(A) A controlled foreign corporation (within the meaning of section 957(a)); or

(B) A person 50 percent or more of the gross income of which, from all sources for the three-year period ending with the close of the taxable year preceding the taxable year in which interest payments were received (or for such part of the period as the person was in existence), was effectively connected with the conduct of a trade or business within the United States.

(5) *Governmental units.* A governmental unit, or an agency or instrumentality of a governmental unit, that receives from any payor interest payments that aggregate $600 or more for any calendar year on one or more qualified education loans is a payee, without regard to the requirement of paragraph (a)(1) of this section that the interest be received in the course of a trade or business.

(f) *Penalty provisions*—(1) *Failure to file correct returns.* The section 6721 penalty may apply to a payee that fails to file information returns required by section 6050S and this section on or before the required filing date; that fails to include all of the required information on the return; or that includes incorrect information on the return. See section 6721, and the regulations thereunder, for rules relating to penalties for failure to file correct returns. See section 6724, and the regulations thereunder, for rules relating to waivers of penalties for certain failures due to reasonable cause.

(2) *Failure to furnish correct information statements.* The section 6722 penalty may apply to a payee that fails to furnish statements required by section 6050S and this section on or before the prescribed date; that fails to include all the required information on the statement; or that includes incorrect information on the state-

ment. See section 6722, and the regulations thereunder, for rules relating to penalties for failure to furnish correct statements. See section 6724, and the regulations thereunder, for rules relating to waivers of penalties for certain failures due to reasonable cause.

(3) *Waiver of penalties for failures to include a correct TIN*—(i) *In general.* In the case of a failure to include a correct TIN on Form 1098-E or a related information statement, penalties may be waived if the failure is due to reasonable cause. Reasonable cause may be established if the failure arose from events beyond the payee's control, such as a failure of the payor to furnish a correct TIN. However, the payee must establish that it acted in a responsible manner both before and after the failure.

(ii) *Acting in a responsible manner.* A payee must request the TIN of each payor if it does not already have a record of the payor's correct TIN. If the payee does not have a record of the payor's correct TIN, then it must solicit the TIN in the manner described in paragraph (f)(3)(iii) of this section on or before December 31 of each year during which it receives payments of interest. If a payor refuses to provide his or her TIN upon request, the payee must file the return and furnish the statement required by this section without the payor's TIN, but with all other required information. The specific solicitation requirements of paragraph (f)(3)(iii) of this section apply in lieu of the solicitation requirements of §301.6724–1(e) and (f) of this chapter for the purpose of determining whether a payee acted in a responsible manner in attempting to obtain a correct TIN. A payee that complies with the requirements of this paragraph (f)(3) will be considered to have acted in a responsible manner within the meaning of §301.6724–1(d) of this chapter with respect to any failure to include the correct TIN of a payor on a return or statement required by section 6050S and this section.

(iii) *Manner of soliciting TIN.* A payee must request the payor's TIN in writing and must clearly notify the payor that the law requires the payor to furnish a TIN so that it may be included on an information return filed by the payee. A payee must notify the payor that the payor's failure to furnish his or her TIN to the payee may result in a $50 penalty being imposed against the individual as authorized by law. A request for a TIN made on Form W-9S, "Request for Student's or Borrower's Social Security Number and Certification," satisfies the requirements of this paragraph (f)(3)(iii). A payee may establish a system for payors to submit Forms W-9S electronically as described in applicable forms and instructions. A payee may also develop a separate form to request the payor's TIN or incorporate the request into other forms customarily used by the payee, such as loan applications.

(4) *Failure to furnish TIN.* The section 6723 penalty may apply to any payor who is required (but fails) to furnish his or her TIN to a payee. See section 6723, and the regulations thereunder, for rules relating to the penalty for failure to furnish a TIN.

(g) *Effective date.* The rules in this section apply to information returns required to be filed, and information statements required to be furnished, after December 31, 2001.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

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

Par. 4. Section 301.6011–2 is amended by:

1. Revising the first sentence of paragraph (b)(1).
2. Revising paragraph (g)(1).
3. Adding paragraph (g)(3).

The revisions and additions read as follows:

§301.6011–2 Required use of magnetic media.

* * * * *

(b) *Returns required on magnetic media.* (1) If the use of Form 1042-S, 1098 series, 1099 series, 5498, 8027, W-2G, or other form treated as a form specified in this paragraph (b)(1) is required by the applicable regulations or revenue procedures for the purpose of making an information return, the information required by the form must be submitted on magnetic media, except as otherwise provided in paragraph (c) of this section. * * *

* * * * *

(g) *Effective dates.* (1) Except as otherwise provided in paragraph (g)(2) or (g)(3) of this section, this section applies to returns required to be filed after December 31, 1986.

* * * * *

(3) This section applies to returns on Forms 1098-T and 1098-E required to be filed after December 31, 2001.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the office of the Federal Register on June 15, 2000, 8:45 a.m., and published in the issue of the Federal Register for June 16, 2000, 65 F.R. 37728)

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

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001–3: Modification of debt instruments.

Rev. Proc. 2000–29 modifies Rev. Proc. 99–18, 1999–11 I.R.B. 7, by removing the sunset date of June 30, 2000. Rev. Proc. 99–18 provides taxpayers with an election that allows them to treat a debt substitution, in certain circumstances, as a realization event even though it does not result in a significant modification under section 1.1001–3 of the Income Tax Regulations. See Rev. Proc. 2000–29, page 113.

Section 1273.—Determination of Amount of Original Issue Discount

26 CFR 1.1273–2: Determination of issue price and issue date.

Will the Service require a depositor who receives a "*de minimis* premium" to treat the value of the premium as includible in gross income or to reduce the basis in the account, and will it require a financial institution that provides a "*de minimis* premium" to treat it as interest for purposes of information reporting under section 6049. See Rev. Proc. 2000–30, page 113.

Section 1275.—Other Definitions and Special Rules

26 CFR 1.1275–2: Special rules relating to debt instruments.

Rev. Proc. 2000–29 modifies Rev. Proc. 99–18, 1999–11 I.R.B. 7, by removing the sunset date of June 30, 2000. Rev. Proc. 99–18 provides taxpayers with an election that allows them to treat a debt substitution, in certain circumstances, as a realization event even though it does not result in a significant modification under section 1.1001–3 of the Income Tax Regulations. See Rev. Proc. 2000–29, page 113.

Section 1398. — Rules Relating to Individuals' Title 11 Cases

Ct. D. 2068

SUPREME COURT OF THE UNITED STATES
RALEIGH, chapter 7 trustee for the ESTATE OF
STOECKER v. ILLINOIS DEPARTMENT OF REVENUE

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 99—387. Argued April 17, 2000–Decided May 30, 2000

While debtor Stoecker was its president, a now-defunct Illinois company purchased a plane out of State and moved it to Illinois. Respondent claims that this purchase was subject to the State's use tax. When such tax is unpaid, respondent issues a Notice of Tax Liability to the taxpayer and may issue a Notice of Penalty Liability against any corporate officer responsible for paying the tax who willfully fails to file the return or make the payment. By the time respondent discovered that the tax was unpaid in this case, the company was defunct and Stoecker was in bankruptcy, with petitioner as his trustee. Respondent filed, *inter alia*, a Notice of Penalty Liability against Stoecker. The fact that there was no affirmative proof that he was responsible for or willfully evaded the payment was not dispositive, for Illinois law shifts the burden of proof, both on production and persuasion, to the responsible officer once a Notice of Penalty Liability is issued. The Seventh Circuit ruled for respondent, holding that the burden of proof remained with petitioner, just as it would have been on Stoecker had the proceedings taken place outside of bankruptcy, and finding that petitioner had not satisfied the burden of persuasion.

Held: When the substantive law creating a tax obligation puts the burden of proof on a taxpayer, the burden of proof on the tax claim in bankruptcy court remains where the substantive law put it (in this case, on the trustee in bankruptcy). Pp. 4—10.

(a) Creditors' entitlements in bankruptcy arise from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary Bankruptcy Code provisions. See *Butner* v. *United States,* 440 U.S. 48, 55. The basic federal rule in bankruptcy is that state law governs the substance of claims. *Id.,* at 57. In this case, Illinois tax law establishes the estate's obligation to respondent, placing the burden of proof on the responsible officer. That burden of proof is a substantive aspect of such a claim, given its importance to the outcome of cases. See, *e.g., Director, Office of Workers' Compensation Programs* v. *Greenwich Collieries,* 512 U.S. 267, 271. Tax law is no candidate for exception from the general rule, for the very fact that the burden has often been shifted to the taxpayer indicates how critical it is. Several compelling rationales for this shift–the government's vital interest in acquiring its revenue, the taxpayer's readier access to the relevant information, and the importance of encouraging voluntary compliance–are powerful justifications not to be disregarded lightly. The Bankruptcy Code makes no provision for altering the burden of proof on a tax claim, and its silence indicates that no change was intended. Pp. 4—6.

(b) The trustee's appeals to Code silence are rejected. The state of pre-Code law does not indicate that the Code is silent because it was predicated on an alteration of the substantive law of obligations once a taxpayer enters bankruptcy. And although *Vanston Bondholders Protective Comm.* v. *Green,* 329 U.S. 156, suggested that "allowance" of claims is a federal matter, that case concerned distribution of assets, not the validity of claims in the first instance, which, *Vanston* specifically states, is to be determined by reference to state law, *id.,* at 161. Nor is the trustee helped by the reference, in *City of New York* v. *Saper,* 336 U.S. 328, 332, to "prov[ing]" government claims in the same manner as other debts, for that reference was to the procedure by which proof of claim was submitted, not to the validity of the claim. Finally, the trustee's argument that the Code-mandated priority enjoyed by taxing authorities over other creditors requires a compensating equality of treatment when it comes to demonstrating validity of claims distorts a bankruptcy court's legitimate powers and begs the question about the relevant principle of equality. Pp. 6—10.

179 F.3d 546, affirmed.

SOUTER, J., delivered the opinion for a unanimous Court.

SUPREME COURT OF THE UNITED STATES

No. 99—387

THOMAS E. RALEIGH, chapter 7 trustee for the ESTATE OF WILLIAM J. STOECKER, PETITIONER v. ILLINOIS DEPARTMENT OF REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

[May 30, 2000]

JUSTICE SOUTER delivered the opinion of the Court.

The question raised here is who bears the burden of proof on a tax claim in bankruptcy court when the substantive law creating the tax obligation puts the burden on the taxpayer (in this case, the trustee in bankruptcy). We hold that bankruptcy does not alter the burden imposed by the substantive law.

I

The issue of state tax liability in question had its genesis in the purchase of an airplane by Chandler Enterprises, Inc., a now-defunct Illinois company. William J. Stoecker, for whom petitioner Raleigh is the trustee in bankruptcy, was president of Chandler in 1988, when Chandler entered into a lease-purchase agreement for the plane, moved it to Illinois, and ultimately took title under the agreement. See *In re Stoecker*, 179 F.3d 546, 548 (CA7 1999).

According to respondent State Department of Revenue, the transaction was subject to the Illinois use tax, a sales-tax substitute imposed on Illinois residents such as Chandler who buy out of State. If the seller does not remit the tax, the buyer must, and, when buying a plane, must file a return and pay the tax within 30 days after the aircraft enters the State. Ill. Comp. Stat., ch. 35, §105/10 (1999). Chandler failed to do this.

When the State discovers a failure to file and pay taxes, its Department of Revenue (the respondent here) determines the amount of tax due and issues a Notice of Tax Liability to the taxpayer. §§105/12, 120/4. Unless the taxpayer protests within the time provided, the assessment becomes final, though still subject to judicial review in the Illinois circuit court. §§120/4, 12.

Illinois law also provides that any corporate officer "who has the control, supervision or responsibility of filing returns and making payment of the amount of any ... tax ... who willfully fails to file the return or make the payment ... shall be personally liable for a penalty equal to the total amount of tax unpaid by the [corporation]." §735/3—7. The department determines the amount, and its determination is "prima facie evidence of a penalty due," *ibid.*, though a Notice of Penalty Liability issued under this provision is open to challenge much like the antecedent Notice of Tax Liability.

By the time the department discovered the unpaid tax in this case, Chandler was defunct and Stoecker was in bankruptcy. The department issued both a Notice of Tax Liability against Chandler and a Notice of Penalty Liability against Stoecker. See 179 F.3d, at 549.

The record evidence about Chandler's operations is minimal. A person named Pluhar acted as its financial officer. There is no evidence directly addressing Stoecker's role in the filing of Chandler's tax returns or the payment of any taxes, and so no affirmative proof that he was either responsible for or willfully evaded the payment of the use tax, see *id.*, at 550. This evidentiary dearth is not necessarily dispositive, however, due to the provision of Illinois law shifting the burden of proof, both on production and persuasion, to the responsible officer once a Notice of Penalty Liability is issued, see *Branson* v. *Department of Revenue*, 168 Ill. 2d 247, 256—261, 659 N. E. 2d 961, 966—968 (1995). The Court of Appeals for the Seventh Circuit accordingly ruled for the Department of Revenue. 179 F.3d, at 550.

The Court of Appeals thought the trustee may have satisfied his burden of production by identifying Pluhar as the financial officer but, in any event, had not satisfied his burden of persuasion. Because Stoecker was the president and, as far as the record showed, he and Pluhar were the only officers, each would have been involved in Chandler's tax affairs. *Ibid.* While it is true that failure to pay must be willful (at least grossly negligent) to justify the penalty under Illinois law, see *Branson*, *supra*, at 254—255, 659 N. E. 2d, at 965, and true that Chandler had an opinion letter from a reputable lawyer that no tax was due because of certain details of the lease-purchase agreement, there was no evidence that Stoecker ever saw the letter or relied on it, and nothing else bearing on the issue of willfulness. See 179 F.3d, at 550—551.

Obviously, the burden of proof was critical to the resolution of the case, which the Department of Revenue won because the Court of Appeals held that the burden remained on the trustee, just as it would have been on the taxpayer had the proceedings taken place outside of bankruptcy. The Courts of Appeals are divided on this point: the Seventh Circuit joined the Third and Fourth Circuits in leaving the burden on the taxpayer. See *Resyn Corp.* v. *United States*, 851 F.2d 660, 663 (CA3 1988); *In re Landbank Equity Corp.*, 973 F.2d 265, 270—271 (CA4 1992). The Courts of Appeals for the Fifth, Eighth, Ninth, and Tenth Circuits have come out the other way. See *In re Placid Oil Co.*, 988 F.2d 554, 557 (CA5 1993); *In re Brown*, 82 F.3d 801, 804—805 (CA8 1996); *In re Macfarlane*, 83 F.3d 1041, 1044—1045 (CA9 1996), cert. denied, 520 U.S. 1115 (1997); *In re Fullmer*, 962 F.2d 1463, 1466 (CA10 1992). We granted certiorari to resolve the issue, 528 U.S. 1068 (2000), and now affirm.

II

Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code. See *Butner* v. *United States*, 440 U.S. 48, 55 (1979); *Vanston Bondholders Protective Comm.* v. *Green*, 329 U.S. 156, 161—162 (1946). The "basic federal rule" in bankruptcy is that state law governs the substance of claims, *Butner, supra*, at 57, Congress having "generally left the determination of property rights in the assets of a bankrupt's estate to state law," 440 U.S., at 54 (footnote omitted). "Unless some federal interest requires a different result, there is no reason why [the state] interests should be an-

alyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.*, at 55. In this case, the bankruptcy estate's obligation to the Illinois Department of Revenue is established by that State's tax code, which puts the burden of proof on the responsible officer of the taxpayer, see *Branson, supra,* at 260—262, 659 N. E. 2d, at 968.

The scope of the obligation is the issue here. Do the State's right and the taxpayer's obligation include the burden of proof? Our cases point to an affirmative answer. Given its importance to the outcome of cases, we have long held the burden of proof to be a "substantive" aspect of a claim. See, *e.g., Director, Office of Workers' Compensation Programs* v. *Greenwich Collieries,* 512 U.S. 267, 271 (1994); *Dick* v. *New York Life Ins. Co.,* 359 U.S. 437, 446 (1959); *Garrett* v. *Moore-McCormack Co.,* 317 U.S. 239, 249 (1942). That is, the burden of proof is an essential element of the claim itself; one who asserts a claim is entitled to the burden of proof that normally comes with it.

Tax law is no candidate for exception from this general rule, for the very fact that the burden of proof has often been placed on the taxpayer indicates how critical the burden rule is, and reflects several compelling rationales: the vital interest of the government in acquiring its lifeblood, revenue, see *Arkansas* v. *Farm Credit Servs. of Central Ark.,* 520 U.S. 821, 826 (1997); the taxpayer's readier access to the relevant information, see *United States* v. *Rexach,* 482 F.2d 10, 16 (CA1), cert. denied, 414 U.S. 1039 (1973); and the importance of encouraging voluntary compliance by giving taxpayers incentives to self-report and to keep adequate records in case of dispute, see *United States* v. *Bisceglia,* 420 U.S. 141, 145 (1975). These are powerful justifications not to be disregarded lightly.[1]

Congress of course may do what it likes with entitlements in bankruptcy, but there is no sign that Congress meant to alter the burdens of production and persuasion on tax claims. The Code in several places, to be sure, establishes particular burdens of proof. See, *e.g.,* 11 U.S.C. § 362(g) (relief from automatic stay), §363(*o*) (adequate protection for creditors), §364(d)(2) (same), §547(g) (avoidability of preferential transfer), §1129(d) (confirmation of plan for purpose of avoiding taxes). But the Code makes no provision for altering the burden on a tax claim, and its silence says that no change was intended.[2]

III

The trustee looks for an advantage in the very silence of the Code, however, first by arguing that actual, historical practice favored trustees under the Bankruptcy Act of 1898 and various pre-Code revisions up to the current Code's enactment in 1978. He says that courts operating in the days of the Bankruptcy Act, which was silent on the burden to prove the validity of claims, almost uniformly placed the burden on those seeking a share of the bankruptcy estate. Because the Code generally incorporates pre-Code practice in the absence of explicit revision, the argument goes, and because the Code is silent here, we should follow the pre-Code practice even when this would reverse the burden imposed outside bankruptcy. This tradition makes sense, petitioner urges, because in bankruptcy tax authorities are no longer opposed to the original taxpayer, and the choice is no longer merely whether the tax claim is paid but whether other innocent creditors must share the bankruptcy estate with the taxing government.

We, however, find history less availing to the trustee than he says. While some pre-Code cases put the burden of proof on taxing authorities,[3] others put it on the trustee,[4] and still others cannot be fathomed.[5] This state of things is the end of the argument, for without the weight of solid authority on the trustee's side, we cannot treat the Code as predicated on an alteration of the substantive law of obligations once a taxpayer enters bankruptcy. Cf. *United Sav. Assn. of Tex.* v. *Timbers of Inwood Forest Associates, Ltd.,* 484 U.S. 365, 381—382 (1988) ("The at best divided [pre-Code] authority ... removes all cause for wonder that the alleged departure from it should not have been commented on in the legislative history").

The trustee makes a different appeal to Code silence in pointing to language in *Vanston Bondholders Protective Comm.* v. *Green,* 329 U.S. 156 (1946), suggesting that "allowance" of claims is a federal matter. But "allowance" referred to the ordering of valid claims when that case was decided, see *id.,* at 162—163, and *Vanston,* in fact, concerned distribution of assets, not the validity of claims in the first instance, see *In re Highland Superstores, Inc.,* 154 F.3d 573, 578 (CA6 1998); *Fahs* v. *Martin,* 224 F.2d 387, 394—395 (CA5 1955). The burden of

[1] It is true that a trustee may have less access to the facts than a taxpayer with personal knowledge, but the trustee takes custody of the taxpayer's records, see 11 U.S.C. § 521(4), and may have greater access to the taxpayer than a creditor. Even if the trustee's advantage is somewhat less than the original taxpayer's, the difference hardly overcomes the compelling justifications for shifting the burden of proof. The government, of course, is in no better position than it ever was, and remains without access to sources of proof when the taxpayer has not kept sufficient documentation.

2. The legislative history indicates that the burden of proof on the issue of establishing claims was left to the Rules of Bankruptcy Procedure. See S. Rep. No. 95—989, p. 62 (1978); H. R. Rep. No. 95—595, p. 352 (1977). The Bankruptcy Rules are silent on the burden of proof for claims; while Federal Rule of Bankruptcy Procedure 3001(f) provides that a proof of claim (the name for the proper form for filing a claim against a debtor) is "prima facie evidence of the validity and amount of the claim," this rule does not address the burden of proof when a trustee disputes a claim. The Rules thus provide no additional guidance.

3. See, *e.g., United States* v. *Sampsell,* 224 F.2d 721, 722—723 (CA9 1955); *In re Avien, Inc.,* 390 F. Supp. 1335, 1341—1342 (EDNY 1975), aff'd, 532 F.2d 273 (CA2 1976); *In re Gorgeous Blouse Co.,* 106 F. Supp. 465 (SDNY 1952); see also *In re Highway Constr. Co.,* 105 F.2d 863, 866 (CA6 1939) (apparently accepting lower court's placement of burden of proof on tax authority).

4. See, *e.g., In re Uneco, Inc.,* 532 F.2d 1204, 1207 (CA8 1976); *Paschal* v. *Blieden,* 127 F.2d 398, 401—402 (CA8 1942); *In re Lang Body Co.,* 92 F.2d 338, 341 (CA6 1937), cert. denied *sub nom. Hipp* v. *Boyle,* 303 U.S. 637 (1938); *United States* v. *Knox-Powell-Stockton Co.,* 83 F.2d 423, 425 (CA9), cert. denied, 299 U.S. 573 (1936). Some of these cases, such as *Paschal* and *Lang Body Co.,* appear to confuse the burden of production (which ceases to be relevant upon presentation of a trustee's case) with the burden of persuasion, under tax statutes that shift the entire burden of proof to the taxpayer. Whatever we make of their reasoning, these cases do not follow the rule whose pedigree petitioner wishes to establish.

5. See, *e.g., Fiori* v. *Rothensies,* 99 F.2d 922 (CA3 1938) *(per curiam)* (discussing prima facie value of tax authority's claim, but failing to discuss burden of proof); *Dickinson* v. *Riley,* 86 F.2d 385 (CA8 1936) (resolving claim without reference to burden of proof); *In re Clayton Magazines, Inc.,* 77 F.2d 852 (CA2 1935) (same).

proof rule in question here bears only on validity, and as to that the *Vanston* opinion specifically states that "[w]hat claims of creditors are valid and subsisting obligations ... is to be determined by reference to state law." 329 U.S., at 161 (footnote omitted). Nor is the trustee helped by *City of New York* v. *Saper,* 336 U.S. 328, 332 (1949), which mentions "prov[ing]" government claims in the same manner as other debts; the reference was to the procedure by which proof of claim was submitted and not to the validity of the claim. While it is true that federal law has generally evolved to impose the same procedural requirements for claim submission on tax authorities as on other creditors, *ibid.*, nothing in that evolution has touched the underlying laws on the elements sufficient to prove a valid state claim.

Finally, the trustee argues that the Code-mandated priority enjoyed by taxing authorities over other creditors, see 11 U.S.C. §§ 507(a), 503(b)(1)(B), requires a compensating equality of treatment when it comes to demonstrating validity of claims. But we think his argument distorts the legitimate powers of a bankruptcy court and begs the question about the relevant principle of equality.

Bankruptcy courts do indeed have some equitable powers to adjust rights between creditors. See, *e.g.*, §510(c) (equitable subordination). That is, within the limits of the Code, courts may reorder distributions from the bankruptcy estate, in whole or in part, for the sake of treating legitimate claimants to the estate equitably. But the scope of a bankruptcy court's equitable power must be understood in the light of the principle of bankruptcy law discussed already, that the validity of a claim is generally a function of underlying substantive law. Bankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying law controlling the validity of creditors' entitlements, but are limited to what the Bankruptcy Code itself provides. See *United States* v. *Reorganized CF&I Fabricators of Utah, Inc.,* 518 U.S. 213, 228—229 (1996); *United States* v. *Noland,* 517 U.S. 535, 543 (1996).

Moreover, even on the assumption that a bankruptcy court were to have a free hand, the case for a rule placing the burden of proof uniformly on all bankruptcy creditors is not self-evidently justified by the trustee's invocation of equality. Certainly the trustee has not shown that equal treatment of all bankruptcy creditors in proving debts is more compelling than equal treatment of comparable creditors in and out of bankruptcy. The latter sort of equality can be provided by a bankruptcy court as a matter of course, whereas the trustee's notion of equality could not be uniformly observed consistently with other bankruptcy principles. Consider the case when tax litigation is pending at the time the taxpayer files for bankruptcy. The tax litigation will be subject to an automatic stay, but the stay can be lifted by the bankruptcy court for cause, see 11 U.S.C. § 362(d)(1), which could well include, among other things, a lack of good faith in attempting to avoid tax proceedings, or in attempting to favor private creditors who might escape the disadvantage of a priority tax claim under the trustee's proposed rule. See generally 3 Collier on Bankruptcy ¶362.07[6][a], pp. 362—101 to 362—102 (rev. 15th ed. 2000) (noting that bad faith commencement of case justifies lifting stay); *Internal Revenue Service* v. *Bacha,* 166 B. R. 611, 612 (Bkrtcy. Ct. Md. 1993) (lifting automatic stay when bankruptcy filing was attempt to avoid tax proceedings). If the bankruptcy court exercises its discretion to lift the stay, the burden of proof will be on the taxpayer in the pre-existing tax litigation, and a tax liability determination will be final. See 11 U.S.C. § 505(a)(2)(A). We see no reason that Congress would have intended the burden of proof (and consequent vindication of this trustee's vision of equality) to depend on whether tax authorities have initiated proceedings against a debtor before a bankruptcy filing. Thus, the uncertainty and increased complexity that would be generated by the trustee's position is another reason to stick with the simpler rule, that in the absence of modification expressed in the Bankruptcy Code the burden of proof on a tax claim in bankruptcy remains where the substantive tax law puts it.

The judgment of the Court of Appeals is affirmed.

It is so ordered.

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. 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 April 1, 2000, shall be at the rate of 26 1/2 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 April 1, 2000, 37.2 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 62.8 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 March 1, 2000.
By authority of the Board.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on March 16, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 17, 2000, 65 F.R. 14636)

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049–4: Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.

Will the Service require a depositor who receives a "*de minimis* premium" to treat the value of the premium as includible in gross income or to reduce the basis in the account, and will it require a financial institution that provides a "*de minimis* premium" to treat it as interest for purposes of information reporting under section 6049. See Rev. Proc. 2000–30, page 113.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.601: Rules and regulations.
(Also Part I, §§ 1001; 1.1001–3, 1.1275–2.)

Rev. Proc. 2000-29

SECTION 1. PURPOSE

In response to comments, this revenue procedure removes the sunset date in Rev. Proc. 99-18, 1999–11 I.R.B. 7.

SECTION 2. BACKGROUND

.01 Rev. Proc. 99-18 provides an election that facilitates the substitution of newly issued debt instruments for outstanding debt instruments. Under the election, taxpayers can treat a substitution of debt instruments, in certain circumstances, as a realization event for federal income tax purposes even though it does not result in a significant modification under § 1.1001–3 of the Income Tax Regulations (and, therefore, is not otherwise an exchange for purposes of § 1.1001–1(a)). Under section 4 of Rev. Proc. 99-18, taxpayers do not recognize any realized gain or loss on the date of the substitution. Instead, the gain or loss generally is taken into account as income or deductions over the term of the new debt instruments. Rev. Proc. 99-18 is effective for substitutions that occur between March 1, 1999, and June 30, 2000.

.02 The Internal Revenue Service requested comments on Rev. Proc. 99-18, including comments on whether the revenue procedure should be made permanent. In response to the request for comments, taxpayers asked that Rev. Proc. 99-18 be made permanent. In addition, taxpayers asked for several other changes, including the coordination of Rev. Proc. 99-18 with the regulations dealing with qualified reopenings of debt instruments. *See* § 1.1275-2T(d) of the temporary Income Tax Regulations and § 1.1275-2(k) of the proposed Income Tax Regulations published in the Federal Register on November 5, 1999 (64 Fed. Reg. 60395).

.03 This revenue procedure modifies only the effective period of Rev. Proc. 99-18. The Treasury Department and the Internal Revenue Service plan to reconsider the other provisions of Rev. Proc. 99-18 when the regulations dealing with qualified reopenings are finalized.

SECTION 3. APPLICATION

Section 5 of Rev. Proc. 99-18 is modified to read as follows: This revenue procedure applies to substitutions that occur on or after March 1, 1999.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–18, 1999–11 I.R.B. 7, is modified.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective June 22, 2000.

CONTACT PERSON

For further information regarding this revenue procedure, contact William E. Blanchard of the Office of Assistant Chief Counsel (Financial Institutions and Products) on (202) 622–3950 (not a toll-free call).

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26 CFR 1.61-7: Interest.
(Also Part I, §§ 1273, 6049; 1.1273-2, 1.6049-4.)

Rev. Proc. 2000-30

SECTION 1. PURPOSE

This revenue procedure provides guidance to depositors who receive "*de minimis* premiums" (as defined below) from financial institutions. It also provides guidance to financial institutions on their information reporting obligations for those premiums.

SECTION 2. BACKGROUND

.01 Banks and other financial institutions sometimes provide premiums as inducements to depositors to open new accounts or add to existing accounts. Questions have arisen as to a depositor's tax treatment of non-cash premiums and the financial institution's information reporting obligations for the premiums.

.02 Interest (including original issue discount) generally is includible in a recipient's gross income under § 61(a)(4) of the Internal Revenue Code and § 1.61-7 of the Income Tax Regulations. The term "interest" means amounts paid for the use or forbearance of money, which includes amounts, whether or not designated as interest, paid on savings accounts and other deposit arrangements. Under § 1.1273-2, a payment from a financial institution to a depositor upon the origination of an account reduces the issue price of the account and, in effect, the depositor's basis in the account. The reduction generally creates original issue discount on the account. In addition, payments made on an account over its term are first treated as a payment of accrued but unpaid interest and then as a payment of principal. See §§ 1.446-2(e) and 1.1275-2(a).

.03 Under § 6049 and § 1.6049-4, a person who pays interest aggregating $10 or more to another person during a calendar year generally must file a return setting forth certain required information.

SECTION 3. DEFINITION

For purposes of this revenue procedure, a "*de minimis* premium" is a non-cash inducement, provided by a financial institution (as defined in § 265(b)(5)) to a depositor to open or add to an account, that does not have a value in excess of $10 for a deposit of less than $5,000 or $20 for a deposit of $5,000 or more. The cost to the financial institution of the premium is used in determining whether the dollar limitations are met.

SECTION 4. APPLICATION

.01 *Depositor.* For administrative convenience, the Internal Revenue Service will not require a depositor who receives a "*de minimis* premium" to treat the value of the premium as includible in gross income. In addition, the Service will not require the depositor to reduce the basis in the account by the "*de minimis* premium."

.02 *Financial Institution.* For administrative convenience, the Service will not require a financial institution that provides a "*de minimis* premium" to treat it as interest for purposes of information reporting under § 6049.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for "*de minimis* premiums" provided after December 31,1999.

DRAFTING INFORMATION

The principal author of this revenue procedure is G. Channing Horton of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure contact Mr. Horton on (202) 622-4920 (not a toll free call).

Part IV. Items of General Interest

Guidance Under Section 1032 Relating to the Treatment of a Disposition by an Acquiring Entity of the Stock of a Corporation in a Taxable Transaction; Correction

Announcement 2000–57

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains a correction to Treasury Decision 8883 (2000–23 I.R.B. 1151), which was published in the **Federal Register** on Tuesday, May 16, 2000 (65 FR 31073), which provides guidance under section 1032 of the Internal Revenue Code, relating to the treatment of a disposition by an acquiring entity of the stock of a corporation in a taxable transaction.

EFFECTIVE DATE: This correction is effective on May 16, 2000.

FOR FURTHER INFORMATION CONTACT: Filiz Serbes at (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to correction are under section 1032 of the Internal Revenue Code.

Need for Correction

As published, Treasury Decision 8883 contains an error which may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (TD 8883), which was the subject of FR Doc. 00-11900, is corrected as follows:

§1.1032-3 [Corrected]

On page 31076, column 3, §1.1032-3(c)(1), is corrected to read as follows:

§1.1032-3 Disposition of stock or stock options in certain transactions not qualifying under any other nonrecognition provision.

* * * * *

(c) * * *

(1) The acquiring entity acquires stock of the issuing corporation directly or indirectly from the issuing corporation in a transaction in which, but for this section, the basis of the stock of the issuing corporation in the hands of the acquiring entity would be determined, in whole or in part, with respect to the issuing corporation's basis in the issuing corporation's stock under section 362(a) or 723 (provided that, in the case of an indirect acquisition by the acquiring entity, the transfers of issuing corporation stock through intermediate entities occur immediately after one another);

* * * * *

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

(Filed by the Office of the Federal Register on June 14, 2000, 8:45 a.m., and published in the issue of the Federal Register for June 15, 2000, 65 F.R. 37481)

Part III. Administrative, Procedural, and Miscellaneous

Letter Ruling and Technical Advice Procedures—Effect of Reorganization

Notice 2000–35

This Notice advises the public that the procedures in Rev. Proc. 2000–1, Rev. Proc. 2000–2, Rev. Proc. 2000–3, and Rev. Proc. 2000–7 for issuing letter rulings, determination letters, and information letters, and for furnishing technical advice, continue to apply to issues under the jurisdiction of the Office of Chief Counsel even though the offices and titles in these revenue procedures may have changed as a result of the reorganization of the Office of Chief Counsel of the Internal Revenue Service.

Taxpayers should continue to send requests for letter rulings or pre-submission conferences on issues under the jurisdiction of the Office of Chief Counsel to the appropriate address stated in section 8.03(1) of Rev. Proc. 2000–1. Taxpayers may continue to address these requests to the associate chief counsel offices listed in section 8.03(1) even though some of these offices have changed names or some of the duties of the offices have been re-assigned. We will forward the requests to the appropriate office. Taxpayers that are requesting a pre-submission conference by telephone should continue to call the telephone numbers listed in section 11.07(1) of Rev. Proc. 2000–1. If the jurisdiction of the issue has been assigned to another office, we will forward your call to the appropriate office.

Also, district or appeals offices will continue to send requests for technical advice on issues under the jurisdiction of the Office of Chief Counsel to the appropriate address listed in section 9.03 of Rev. Proc. 2000–2.

The principal author of this notice is Kathleen Reed of the Office of Assistant Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Ms. Reed at (202) 622-3110 (not a toll-free call).

Revision of Charitable Remainder Trust Sample Forms

Notice 2000–37

PURPOSE

This notice invites suggestions from the public for updating the charitable remainder annuity trust and unitrust sample forms and provisions previously published by the Internal Revenue Service.

BACKGROUND

If interests in the same property are transferred for both charitable and noncharitable purposes, the charitable interest will qualify for the charitable deduction for federal income, gift, and estate tax purposes only if the interest is in a certain prescribed form. If the charitable interest is a remainder interest, §§ 170, 2522, and 2055 of the Internal Revenue Code generally require that the charitable interest be in the form of a charitable remainder annuity trust (CRAT) described in § 664(d)(1), a charitable remainder unitrust (CRUT) described in § 664(d)(2) and (3), or a pooled income fund described in § 642(c)(5).

A CRAT is a trust that pays a sum certain to one or more beneficiaries (at least one of whom is noncharitable), for a specified term of years, or for the life or lives of named individuals. On termination of these payments, the remainder interest in the trust passes to or for the benefit of charity. A CRUT is a trust that pays a unitrust amount to one or more beneficiaries (at least one of whom is noncharitable), with the remainder interest passing to or for the benefit of charity. The unitrust amount can be calculated under one of three methods. Under the first method, the unitrust amount is a fixed percentage of the net fair market value of the trust assets valued annually (fixed percentage method). Under the second method, the unitrust amount is the lesser of a fixed percentage of the net fair market value of the trust assets valued annually or the annual net income of the trust (net income method). Under the third method, the unitrust amount is the amount determined under the net income method, but in any year where the trust income exceeds the fixed percentage amount, the excess trust income is paid to make up for any shortfall in payments in prior years when the trust income was less than the fixed percentage amount (net income with make-up method).

The Service has issued a series of revenue procedures providing sample forms for one and two life inter vivos and testamentary CRATs and CRUTs. Rev. Proc. 89–20, 1989–1 C.B. 841; Rev. Proc. 89–21, 1989–1 C.B. 842; Rev. Proc. 90–30, 1990–1 C.B. 534; Rev. Proc. 90–31, 1990–1 C.B. 539; Rev. Proc. 90–32, 1990–1 C.B. 546. In addition, Rev. Rul. 72–395, 1972–2 C.B. 340, and later clarifications by Rev. Rul. 80–123, 1980–1 C.B. 205, Rev. Rul. 82–165, 1982–2 C.B. 117, and Rev. Rul. 88–81, 1988–2 C.B. 127, provide substantive rules and sample provisions for CRATs and CRUTs.

Since the publication of this guidance, there have been several changes to the statutory and regulatory provisions governing CRATs and CRUTs. For example, § 1089 of the Taxpayer Relief Act of 1997 (the 1997 Act), 1997–4 (Vol. 1) C.B. 1, amended § 664(d)(1)(A) and (d)(2)(A) to limit the annuity or unitrust amount to 50% of the fair market value of the trust assets. In addition, § 1089 of the 1997 Act added § 664(d)(1)(D) and (d)(2)(D) to require that the actuarial value of the charitable remainder interest be at least 10% of the initial net fair market value of the property transferred to the trust.

Under recently promulgated regulations, the governing instrument of a net income or net income with make-up CRUT may provide that the CRUT can convert to the fixed percentage method for calculating the unitrust amount under certain circumstances. *See* § 1.664–3(a)(1)(i)(c) of the Income Tax Regulations. The recently promulgated regulations also impose new rules for payment of the annuity or unitrust amount after the close of the taxable year in which the payment is due. *See* § 1.664–2(a)(1)(i)(a) and (b) and § 1.664–3(a)(1)(i)(g) and (h).

The regulations, as amended, provide that the proceeds from the sale of the assets of a net income or net income with make-up CRUT, at least to the extent of the fair market value of the assets when contributed to the trust, must be allocated

to trust principal. However, the governing instrument, if permitted under applicable local law, may allow the allocation of post-contribution capital gain to trust income. *See* § 1.664–3(a)(1)(i)(b)(4).

REQUEST FOR PUBLIC COMMENT

The Internal Revenue Service and the Treasury Department intend to revise the aforementioned published guidance to reflect the changes in the statutory and regulatory provisions governing CRATs and CRUTs. The current sample forms contain self-contained trust documents that address different factual situations. The Service and Treasury are considering whether the revised forms should be more generic with optional provisions to address the different situations. Comments are invited on possible revisions to the sample forms and trust provisions, including comments on the type of format that would be most useful.

Taxpayers may submit comments in writing to:

Internal Revenue Service
Attn: CC:DOM:CORP:R (Notice 2000–37, Room 5226)
PO Box 7604
Ben Franklin Station
Washington, DC 20044

or hand delivered between the hours of 8:00 a.m. and 5:00 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:DOM:CORP:R (Notice 2000–37, Room 5226)
1111 Constitution Ave., NW
Washington, DC 20224

Alternatively, taxpayers may submit comments electronically at:

sharon.y.horn@M1.IRSCounsel.treas.gov

Comments and suggestions should be received by December 1, 2000. All comments and suggestions submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Caroline Watson of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Caroline Watson or George Masnik at (202) 622-3090 (not a toll-free call).

Part IV. Items of General Interest

Changes to Publications 515 and 901

Announcement 2000–59

Changes apply to Tables 1 and 2 in Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations (For Withholding in 2000)*, and in Publication 901, *U.S. Tax Treaties*. These changes are needed to reflect the new income tax treaty with Denmark. The provisions for taxes withheld at source are effective for amounts paid or credited on or after May 1, 2000. For other taxes, the provisions are effective for tax years beginning on or after January 1, 2001.

A person entitled to benefits under the previous treaty with Denmark, can elect to have that treaty apply in its entirety for one year following the date the new treaty would otherwise apply.

Note. The footnotes in the column headings in the Publication 515 tables generally apply to this new treaty.

Table 1. **Withholding Tax Rates on Income Other Than Personal Service Income Under Chapter 3, Internal Revenue Code, and Income Tax Treaties—For Withholding in 2000.**

Income code number		1	2	3	6	7	9	10	11	12	13	14
Country of residence of payee					Dividends paid by				Copyright royalties			
Name	Code	Interest paid by U.S. obligors General	Interest on real property mortgages	Interest paid to controlling foreign corporations	U.S. Corporations General	U.S. subsidiaries to foreign parent corporations	Capital Gains	Industrial Royalties	Motion Pictures and Television	Other	Real Property Income and Natural Resources Royalties	Pensions and Annuities
Denmark	DA	[a,b]0	[a,b,c]0	[a,b]0	[a]15	[a,d,e]5	[f]0	[a]0	[a]0	[a]0	30	[g,h,i]30

[a] The exemption or reduction in rate does not apply if the recipient has a permanent establishment in the United States and the property giving rise to the income is effectively connected with this permanent establishment. The exemption or reduction in rate also does not apply if the property giving rise to the income is effectively connected with a fixed base in the United States from which the recipient performs independent personal services. Even with the treaty, if the income is not effectively connected with a trade or business in the United States by the recipient, the recipient will be considered as not having a permanent establishment in the United States under IRC section 894(b).

[b] The rate is 15% for interest determined with reference to (a) receipts, sales, income, profits or other cash flow of the debtor or a related person, (b) any change in the value of any property of the debtor or a related person, or (c) any dividend, partnership distribution or similar payment made by the debtor to a related party.

[c] Exemption or reduced rate does not apply to an excess inclusion for a residual interest in a real estate mortgage investment conduit (REMIC).

[d] The reduced rate applies to dividends paid by a subsidiary to a foreign parent corporation that has the required percentage of stock ownership.

[e] The rate in column 6 applies to dividends paid by a regulated investment company (RIC) or real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (a) an individual holding not more than a 10% interest in the REIT, (b) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (c) a person holding not more than a 10% interest in the REIT and the REIT is diversified.

[f] Gain on real property or on personal property attributable to a permanent establishment or a fixed base is subject to U.S. tax. See Publication 515 for when withholding is required.

[g] Annuities are exempt.

[h] A U.S. government (federal, state, or local) pension paid to an individual who is a resident and a national of Denmark is exempt from U.S. tax.

[i] Generally, if the person was receiving pension distributions before March 31, 2000, the distributions continue to be exempt from U.S. tax.

Table 2. **Compensation for Personal Services Performed in United States Exempt from Withholding and U.S. Income Tax Under Income Tax Treaties.**

Country (1)	Code (2)	Category of Personal Services — Purpose (3)	Maximum Presence in U.S. (4)	Required Employer or Payer (5)	Maximum Amount of Compensation (6)	Treaty Article Citation (7)
Denmark	16	Independent personal services[2]	No limit	Any contractor	No limit	14
		Public entertainment[3]	No limit	Any contractor	$20,000 p.a.[8]	17
	17	Dependent personal services[4,5]	183 days	Any foreign resident	No limit	15
		Public entertainment[3]	183 days	Any foreign resident	$20,000 p.a.[8]	17
	19	Studying and training:[6,7]				
		Remittances or allowances	3 years[9]	Any foreign resident	No limit	20

[1] Refers to income code numbers described in Publication 515 and to be reported on Forms 1042-S. Personal services must be performed by a nonresident alien individual who is a resident of the specified treaty country.

[2] Exemption does not apply to the extent income is attributable to the recipient's fixed U.S. base.

[3] Withholding at 30% may be required because the factors on which the treaty exemption is based may not be determinable until after the close of the tax year. However, see *Withholding agreements*, and *Final payment exemption*, under *Pay for independent personal services*, and *Central withholding agreements*, under *Artists and Athletes*, discussed in Publication 515.

[4] Does not apply to fees of a foreign director of a U.S. corporation.

[5] The exemption does not apply if the employee's compensation is borne by a permanent establishment or a fixed base that the employer has in the United States.

[6] Does not apply to compensation for research work primarily for private benefit.

[7] Applies only to full-time student or trainee.

[8] Exemption does not apply if gross receipts (including reimbursements) exceed this amount during the year.

[9] The time limit pertains only to an apprentice or business trainee.

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

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others As Substantial Owners

26 CFR 1.671–2: Applicable principles.

T.D. 8890

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Definition of Grantor

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations defining the term *grantor* for purposes of part I of subchapter J, chapter 1 of the Internal Revenue Code. These regulations provide necessary guidance in determining who is the grantor of a trust in applying those Code sections. These regulations affect trusts and any person creating or funding a trust.

DATES: *Effective Date*: These regulations are effective July 5, 2000.

Applicability Dates: For dates of applicability of §1.671–2(e), see §1.671–2(e)(7).

FOR FURTHER INFORMATION CONTACT: James A. Quinn at (202) 622-3060 (not a toll-free number).

SUPPLEMENTARY INFORMATION

Background

On June 5, 1997, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–252487–96, 1997–1 C.B. 806) under section 671 of the Internal Revenue Code (Code) in the **Federal Register** (62 F.R. 30785). 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 section 671 were re-issued as proposed (64 F.R. 43323) and temporary regulations (64 F.R. 43267) on August 10, 1999.

The proposed and temporary regulations provide a definition of grantor for purposes of part I of subchapter J, chapter 1 of the Code. No comments were received in response to the Notice of Proposed Rulemaking published on August 10, 1999, in the **Federal Register**, and no one requested to speak at the public hearing scheduled for November 2, 1999. Accordingly, the public hearing was canceled on October 28, 1999 (64 F.R. 58006). This document finalizes the proposed regulations and removes the temporary 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 regulations' impact on small business.

Drafting Information

The principal author of these regulations is 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 removing the entry for section 1.671–2T and adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * * Section 1.671–2 also issued under 26 U.S.C. 643(a)(7) and 672(f)(6). * * *

§1.643(h)–1 [Amended]

Par. 2. Section 1.643(h)–1 is amended as follows:

1. In paragraph (a)(2)(i) the language "§1.671–2T(e)(2)" is removed, and "§1.671–2(e)(2)" is added in its place.

2. In paragraph (b)(1) the language "§1.671–2T(e)(2)" is removed, and "§1.671–2(e)(2)" is added in its place.

3. In paragraph (b)(2) the language "§1.671–2T(e)" is removed, and "§1.671–2(e)" is added in its place.

4. In paragraph (g) *Example 1* the language "§1.671–2T(e)(2)" is removed, and "§1.671–2(e)(2)" is added in its place.

Par. 3. Section 1.671–2(e) is revised to read as follows:

§1.671–2 Applicable principles.

* * * * *

(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 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 FT under sections 671 through 677 regardless of whether A retained any power over or interest in FT described in sections 673 through 677. Furthermore, A is not treated as an owner of any portion of FT under section 679. Both A and B are responsible parties for purposes of the requirements in section 6048.

Example 4. A creates and funds a trust, T. A does not retain any power or interest in T that would cause A to be treated as an owner of any portion of the trust under sections 671 through 677. 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 transfers $50,000 to T. The trustee invests the $50,000 in stock of Company X. C, B's uncle, purportedly 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.

§1.671–2T [Removed]

Par. 4. Section 1.671–2T is removed.

§1.672(f)–2 [Amended]

Par. 5. Section 1.672(f)–2 is amended as follows:

1. In paragraph (b)(1) the language "§1.671–2T(e)(2)" is removed, and "§1.671–2(e)(2)" is added in its place.

2. In paragraph (d) *Example 1* the language "§1.671–2T(e)" is removed, and "§1.671–2(e)" is added in its place.

§1.672(f)–3 [Amended]

Par. 6. Section 1.672(f)–3 is amended as follows:

1. In paragraph (a)(1) the language "§1.671–2T(e)" is removed, and "§1.671–2(e)" is added in its place.

2. In paragraph (a)(4) *Example 2* the language "§1.671–2T(e)" is removed, and "§1.671–2(e)" is added in its place.

3. In paragraph (b)(1) the language "§1.671–2T(e)(2)" is removed, and "§1.671–2(e)(2)" is added in its place.

4. In paragraph (b)(1) the language "§1.671–2T(e)" is removed, and "§1.671–2(e)" is added in its place.

5. In paragraph (b)(4) *Example 1* the language "§1.671–2T(e)" is removed, and "§1.671–2(e)" is added in its place.

6. In paragraph (b)(4) *Example 2* the language "§1.671–2T(e)" is removed and "§1.671–2(e)" is added in its place.

§1.672(f)–4 [Amended]

Par. 7. Section 1.672(f)–4 is amended as follows:

1. In paragraph (c)(1) the language "§1.671–2T(e)(2)" is removed, and "§1.671–2(e)(2)" is added in its place.

2. In paragraph (c)(1) the language "§1.671–2T(e)(4)" is removed, and "§1.671–2(e)(4)" is added in its place.

3. In paragraph (d)(1) the language "§1.671–2T(e)(2)(ii)" is removed, and "§1.671–2(e)(2)(ii)" is added in its place.

4. In paragraph (g) *Example 4* the language "§1.671–2T(e)" is removed, and "§1.671–2(e)" is added in its place.

§1.672(f)–5 [Amended]

Par. 8. In §1.672(f)–5, paragraph (a)(1) is amended by removing the language "§1.671–2T(e)(2)" and adding "§1.671–2(e)(2)" in its place.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 28, 2000.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 3, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 5, 2000, 65 F.R. 41332)

Section 894.—Income Affected by Treaty

26 CFR 1.894–1: Income affected by treaty.

T.D. 8889

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Guidance Regarding Claims for Certain Income Tax Convention Benefits

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to treaty withholding rates for items of income received by entities that are fiscally transparent in the United States and/or a foreign jurisdiction. The regulations affect the determination of tax treaty benefits available to foreign persons with respect to such items of income.

DATES: *Effective Dates*: These regulations are effective June 30, 2000.

Applicability Dates: These regulations apply to items of income paid on or after June 30, 2000.

FOR FURTHER INFORMATION CONTACT: Shawn R. Pringle, (202) 622-3850 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations relating to the Income Tax Regulations (CFR part 1) under section 894 of the Internal Revenue Code (Code). On June 30, 1997, the IRS and Treasury issued temporary regulations (T.D. 8722, 1997–2 C.B. 81) in the **Federal Register** (62 F.R. 35673, as corrected at 62 F.R. 46876, 46877) under section 894 of the Code relating to eligibility for benefits under income tax treaties for payments to entities. A notice of proposed rulemaking (REG–104893–97, 1997–2 C.B. 646) cross-referencing the temporary regulations was also published in the same issue of the **Federal Register** (62 F.R. 35755).

Need for Changes

Since the publication of T.D. 8722 and proposed regulation §1.894(d)(REG–104893–97, 62 F.R. 35755), the IRS and Treasury have received numerous comments. This Treasury decision contains changes made in response to some of those comments.

Explanation of Provisions

I. *General*

These final section 894 regulations clarify the availability of treaty benefits with respect to an item of U.S. source income paid to an entity that is treated as fiscally transparent under the laws of one or more jurisdictions (including the United States) with respect to that item of income. An entity that is treated as fiscally transparent in one jurisdiction but not another is referred to as a hybrid entity. If an item of U.S. source income is paid to a hybrid entity, the United States may regard the entity as fiscally transparent with respect to the item of income and the foreign treaty jurisdiction may regard the entity as deriving the item of income. Alternatively, the United States may regard the entity as deriving the item of income under U.S. tax principles, but a foreign treaty jurisdiction may regard the entity as fiscally transparent and may therefore regard the interest holders as deriving the item of income. This dual classification may give rise to inappropriate and unintended results under tax treaties, such as double non–taxation or double taxation of the item of income, unless the tax treaties are interpreted to resolve the conflict of laws.

These final regulations clarify how to apply U.S. treaties when the entity classification law of the United States and a foreign treaty jurisdiction conflict by providing that a reduced treaty rate for an item of U.S. source income is available only if the income is derived by a foreign recipient resident in the applicable treaty

jurisdiction. This general rule, which has been simplified but not substantially changed from the rule contained in the temporary and proposed section 894 regulations, is discussed in greater detail below.

These final regulations are fully consistent with existing U.S. treaties. They rely on the basic principle that tax treaties are intended to relieve double taxation or excessive taxation. Accordingly, the United States and its treaty partners agree to cede part or all of their taxation rights on income arising from sources within their respective borders on the mutual understanding that the other party is asserting tax jurisdiction over the items of income. This objective is generally achieved through treaty provisions that limit or eliminate the tax that the source state may impose on income arising within its borders to the extent that the income is considered to be derived by a resident of the other jurisdiction. In general, an item of income will be considered derived by a resident for treaty purposes only when the residence country is asserting taxing jurisdiction over the item of income. However, the source state does not necessarily require, as a condition for ceding its taxing jurisdiction, that the income actually be taxed in the residence state or taxed at a rate commensurate with the rate imposed in the source state. The source state and the residence state may come to different conclusions regarding the appropriate taxation principles that apply to a particular type of taxpayer or a particular type of income. Such differences reflect how each state has decided to assert its taxing jurisdiction over that taxpayer or item of income and may or may not affect the source state's willingness to forego its taxing rights in whole or in part during the treaty negotiation process.

The approach adopted in these final regulations is consistent with the evolving multilateral consensus among the member countries of the Organization for Economic Cooperation and Development (OECD) on the appropriate method for source countries to follow to determine if they should provide treaty benefits on items of income paid to fiscally transparent entities, particularly when an entity classification conflict exists between the source and residence states. This evolving multilateral consensus is described in greater detail in the OECD report, "The Application of the OECD Model Tax Convention to Partnerships" (OECD Partnership Report). The report generally provides that a source state is required to grant treaty benefits on income paid to an entity only if the income is considered to be derived by a resident of a treaty partner for purposes of the treaty partner's tax laws. IRS and Treasury will continue to coordinate these issues with U.S. tax treaty partners both bilaterally and multilaterally to resolve substantive issues arising from application of the principles set forth in the section 894 regulations and the OECD Partnership Report.

These regulations apply with respect to all U.S. income tax treaties regardless of whether such treaties contain partnership provisions, unless the competent authorities agree otherwise. As with the proposed and temporary regulations, the final regulations address only the treatment of U.S. source income that is not effectively connected with the conduct of a U.S. trade or business. The IRS and Treasury may issue additional regulations addressing the availability of other tax treaty benefits, such as the application of business profits provisions, with respect to the income of fiscally transparent entities, particularly where a conflict in entity classification exists.

II. *Objective Versus Subjective Regulatory Approach*

The temporary and proposed section 894 regulations adopted an objective approach to determining whether the United States should grant treaty benefits on U.S. source items of income paid to entities. Application of the regulations did not turn on whether there existed a tax avoidance motive for choosing a particular transaction or structure.

Commentators recommended a narrower approach that would deny treaty benefits on items of income paid to an entity only if the entity served a tax avoidance purpose. As part of this approach, commentators requested implementation of a ruling procedure that could be used to claim treaty benefits by rebutting any deemed tax avoidance motive for the items of income paid to an entity. This suggestion was not adopted. These final regulations are intended to provide objective rules regarding eligibility for treaty benefits on certain items of U.S. source income paid to entities. Although a ruling procedure was not adopted, taxpayers may still invoke the Mutual Agreement Procedures under an applicable treaty in appropriate circumstances.

III. *Simplified Standard For Determining When U.S. Source Income is Derived by a Treaty Resident*

The proposed and temporary regulations provided that the tax imposed by sections 871(a), 881(a), 1461, and 4948(a) on an item of income received by an entity is eligible for reduction under the terms of an income tax treaty to which the United States is a party if such item of income is treated as derived by a resident of an applicable treaty jurisdiction, such resident is a beneficial owner of the item of income, and all other applicable requirements for benefits under the treaty are satisfied. The proposed and temporary regulations further provided that an item of income received by an entity is treated as derived by a resident only to the extent the item of income is subject to tax in the hands of a resident of such jurisdiction. Numerous comments were received stating that this general rule needed clarification. As a result, the IRS and Treasury are eliminating the use of the terms beneficial ownership and subject to tax from the general rule, as described in greater detail below.

A. *Beneficial ownership*

Commentators requested clarification regarding the relationship between beneficial owner and the §1.881–3 anti-conduit regulations issued under the authority of section 7701(l). The anti-conduit rules under section 7701(l) are incorporated into the U.S. determination of beneficial owner. They are not separate additional requirements.

The concept of beneficial owner was included in the proposed regulations to explain the circumstances under which a hybrid entity may beneficially own an item of income for purposes of an income tax treaty, in light of the then proposed withholding regulations under §1.1441–1(c)(6)(ii)(B). However, the definition of beneficial owner in §1.1441–1(c)(6) of the amended final regulations (T.D. 8881, 2000–23 I.R.B 1158)

does not apply to claims for reduced withholding under an income tax treaty. Accordingly, because there is no longer a need to clarify the meaning of the term under the section 1441 regulations in the treaty context, these final regulations no longer provide specific rules for this determination. The concept of beneficial owner nevertheless remains an important condition for claiming tax treaty benefits that is determined under U.S. tax principles, including the anti-conduit rules.

B. *Subject to tax*

Commentators suggested that the term subject to tax in the proposed and temporary regulations was ambiguous and could be misinterpreted. Commentators suggested that the term subject to tax could be interpreted as requiring that an actual tax be paid rather than requiring an exercise of taxing jurisdiction by the applicable treaty jurisdiction, whether or not there is an actual tax paid. Commentators suggested that such an interpretation would lead to anomalous results, for example, in cases when the applicable treaty jurisdiction provides an exemption from income for U.S. source dividends under its tax laws.

The IRS and Treasury agree that the term subject to tax could cause unintentional confusion and that a more direct and simpler way of ensuring that an item of income is subject to the taxing jurisdiction of the residence country is to determine if the item of income is derived by a resident of a treaty jurisdiction. The concept of derived by a resident is a more useful surrogate for the concept of subject to the taxing jurisdiction of the residence state, the necessary prerequisite for the grant of treaty benefits on an item of income.

C. *New general rule based on "derived by" standard*

The regulations now provide three specific situations in which income is derived by a resident of a treaty jurisdiction, and thus considered subject to the taxing jurisdiction of the residence jurisdiction and eligible for treaty benefits.

In the first situation, an item of income paid to an entity is considered to be derived by the entity if the entity is not fiscally transparent with respect to the item of income under the laws of the entity's jurisdiction. The entity's jurisdiction is generally the place of the entity's organization, although it may be the place of management and control of the entity if it is a resident in a jurisdiction by reason of such factors.

In the second situation, regardless of whether the entity is found to be fiscally transparent with respect to the item of income under the laws of the entity's jurisdiction, an interest holder in the entity may derive the item of income if that interest holder can establish that, under the laws of the jurisdiction in which the interest holder is a resident, the entity is fiscally transparent with respect to the item of income. Under this test, the interest holder itself must not be considered fiscally transparent with respect to the item of income under the laws of its jurisdiction in order to claim the treaty benefit of that jurisdiction.

In the third situation, an item of income paid to a type of entity specifically listed in a treaty as a resident of that treaty jurisdiction is treated as derived by a resident of that jurisdiction. The reason for this rule is that the two treaty partners reached an explicit agreement on the appropriate treatment of that entity and treaty benefits accordingly should be provided on items of income paid to it.

In some circumstances, both the entity and the interest holders in the entity will be treated as deriving the item of income under the foregoing tests. In that event, both the interest holder and the entity may be entitled to treaty benefits if all other conditions are satisfied. See §1.1441–6(b)(2) for procedures for dual rate claims under separate income tax treaties.

IV. *Determining Fiscal Transparency*

A. *Generally*

The concept of fiscally transparent therefore is critical to the determination of whether an item of income is derived by an entity or an interest holder in an entity. Paragraph (d)(4)(ii) of the proposed and temporary regulations provided that an entity is treated as fiscally transparent by a jurisdiction to the extent the jurisdiction requires interest holders in the entity to take into account separately on a current basis their respective shares of the items of income paid to the entity and to determine the character of such item as if such items were realized directly from the source from which realized by the entity for purposes of the tax laws of the jurisdiction. The proposed and temporary regulations further provided that entities that are fiscally transparent for U.S. federal income tax purposes include partnerships, common trust funds described under section 584, simple trusts, grantor trusts, as well as certain other entities (including entities that have a single interest holder) that are treated as partnerships or as disregarded entities for U.S. federal income tax purposes.

The IRS and Treasury received numerous comments regarding the definition of fiscally transparent under the proposed regulations. The comments stated that it is unclear, in situations when multiple foreign jurisdictions are involved, which jurisdiction's laws apply in determining whether an entity is fiscally transparent. The comments further stated that the requirement that all items of income be separately stated is not consistent with the U.S. tax rules regarding partnerships, which permit partners not to state separately certain items if the outcome is the same whether or not the item is separately stated. Commentators also suggested that the regulations were unclear as to whether fiscal transparency is an item by item determination or a determination made with respect to the entity as a whole.

In response to the comments, several simplifying and clarifying changes were made to the regulations. When an entity is invoking the treaty, paragraph (d)(3)(ii) of the final regulations provides a definition for purposes of determining whether the entity will be treated as fiscally transparent under the laws of the entity's jurisdiction with respect to an item of income received by the entity. When an interest holder in an entity is invoking the treaty, paragraph (d)(3)(iii) of the final regulations provides a definition for purposes of determining whether the entity will be fiscally transparent under the laws of the interest holder's jurisdiction. This clarifies which jurisdiction's laws apply in determining fiscal transparency in cases in which multiple foreign jurisdictions are involved.

Paragraphs (d)(3)(ii) and (iii) of the final regulations generally retain the defi-

nition of fiscally transparent as provided by the proposed and temporary regulations, with certain clarifications and modifications. They provide that an entity will be fiscally transparent only if inclusion by the interest holders in the entity is required whether or not an item of income is distributed to such interest holders and, generally, the character and source of the item in the hands of the interest holder are determined as if such item were realized directly from the source from which realized by the entity. They also provide that fiscal transparency is determined on an item of income by item of income basis. Accordingly, for example, an entity can be fiscally transparent with respect to interest income, but not with respect to dividend income. The regulations further provide, however, that if an item of income is not separately taken into account by its interest holders, the entity may still be fiscally transparent with respect to that item of income if failure to take the item of income into account separately does not result in a treatment under the tax laws of the applicable treaty jurisdiction different from that which would be required if the interest holder did separately take the share of such item into account. This is consistent with the U.S. tax provisions with respect to partnerships.

Because the final regulations adopt an item by item determination of fiscal transparency, the provision in the proposed regulations stating that partnerships, common trust funds described in section 584, simple trusts, grantor trusts and certain other entities are fiscally transparent for U.S. federal income tax purposes has been deleted from the final regulations. The foregoing language implied that fiscal transparency is determined with respect to the entity as a whole. Although the final regulations remove this language, it is anticipated that such entities ordinarily will be fiscally transparent for federal income tax purposes with regard to all items of income received by them.

B. *Investment vehicles*

Commentators also requested clarification regarding the treatment of investment vehicles that may be allowed an exclusion or deduction from income for amounts distributed to interest holders. The final regulations clarify that if an entity such as an investment company is not otherwise fiscally transparent as defined in paragraphs (d)(3)(ii) and (iii) of the final regulations, it will not be deemed to be fiscally transparent merely because it is allowed to exclude or deduct from income amounts distributed to interest holders. Examples provide further guidance with respect to foreign investment vehicles, most of which will not be fiscally transparent under the final regulations.

C. *Treatment of tax exempt organizations*

In addition to the foregoing, several commentators suggested that the regulations undermine reciprocal treaty exemptions for pension funds and other tax exempt organizations by, for example, denying treaty benefits under circumstances when the fund or organization invests in U.S. LLCs that are treated as partnerships for purposes of U.S. tax law and as corporations under the laws of the applicable treaty jurisdiction. Treasury does not believe that the regulations conflict with U.S. treaty obligations to provide reduced treaty rates to pension funds and other tax exempt organizations investing in the United States. In most cases, the denial of benefits described by commentators can be avoided by ensuring that the pension fund or tax exempt organization invests directly or through an entity treated as fiscally transparent under the laws of the jurisdiction of the fund or organization, with the result that the fund or organization will still be able to claim exemptions under the applicable treaty. In addition, treaties may be negotiated that permit pensions and other tax exempt organizations to invest in the United States through nonfiscally transparent entities and still obtain reduced treaty rates. (See for example paragraph 2(b) of Article XXI of the U.S.-Canada treaty, with respect to pension funds). Further, paragraph (d)(4) gives the competent authorities the flexibility, in appropriate circumstances, to enter into a mutual reciprocal understanding that would depart from the rules of paragraph (d) with respect to certain classes of entities.

D. *Treatment of complex trusts*

The proposed and temporary regulations did not specifically address the treatment of section 661 trusts that are permitted to accumulate income from year to year. Commentators suggested that they should be treated as fiscally transparent for U.S. tax purposes because, under section 662, the distributable net income of such trusts retains its character in the hands of the beneficiaries if it is distributed in the current year and not accumulated. The definitions of fiscally transparent as set forth in the final regulations provide that, in order for the entity to be fiscally transparent with respect to an item of income, the interest holder must be required to take that item of income into account in a taxable year whether or not the item is distributed, and generally the character and source of the item in the hands of the interest holder are determined as if such item were realized directly from the source from which realized by the entity.

Thus, to the extent the beneficiaries of a trust are required under section 662 to take an item of the trust's income into account in a taxable year, whether or not the item is distributed, and the character and source of the item in the hands of the beneficiaries are determined as if such item were realized directly from the source from which realized by the entity, the trust will be treated as fiscally transparent for U.S. tax purposes with respect to that item of income. If inclusion by the interest holders is not required whether or not such item of income is distributed, or the character and source of the item in the hands of the interest holder are not determined as if such item were realized directly from the source from which realized by the entity, the trust will not be treated as fiscally transparent for U.S. tax purposes. In determining whether a trust, or any other entity, is fiscally transparent with respect to an item of income under the laws of any other jurisdiction, the treatment of that item of income under the laws of that jurisdiction controls, not the treatment under U.S. laws.

E. *Effect of Anti-Deferral Regimes*

Commentators also argued that controlled foreign corporations should be treated as fiscally transparent to the extent interest holders are required to account for the controlled foreign corporation's net passive income on a current basis. This suggestion was rejected because the nature of an inclusion under an anti-deferral regime is that of a deemed distribution of after-tax profits of the controlled for-

eign corporation, while an inclusion because an entity is fiscally transparent is in the nature of a share of the item of income itself, as if the interest holder realized the income directly. This follows from the definition of fiscal transparency contained in paragraph (d)(3)(iii), relating to whether an entity is fiscally transparent under the laws of the interest holder's jurisdiction.

V. *Treatment of Payments To and From Domestic Reverse Hybrid Entities*

Section 1.894–1T(d)(3) provided guidance on the appropriate treatment of items of income paid to an entity that is treated as a domestic corporation for U.S. tax purposes but is treated as fiscally transparent under the laws of an interest holder's jurisdiction (a "domestic reverse hybrid" entity). That section provided that §1.894–1T(d)(1) may not be applied to reduce the amount of federal income tax on U.S. source income received by a domestic reverse hybrid entity through application of an income tax treaty. Commentators expressed concern that this rule did not provide sufficient guidance and could lead to inappropriate results, noting that an item of income paid *by* a domestic reverse hybrid entity could be viewed as neither "received by" the interest holder nor "subject to tax" because the interest holder's jurisdiction would treat the domestic reverse hybrid entity as fiscally transparent. Thus, the interest holder's jurisdiction would view the interest holder as "receiving" the items of income paid *to* the domestic reverse hybrid entity and as being "subject to tax" on those items of income on an immediate basis, but may not recognize the items of income paid *by* the domestic reverse hybrid entity to the interest holder.

The IRS and Treasury are also aware of certain abusive structures involving domestic reverse hybrid entities, which are designed to manipulate differences in U.S. and foreign entity classification rules to produce inappropriate reductions in U.S. tax. These transactions give rise to some of the same concerns that led to the promulgation of the temporary and proposed regulations and caused Congress to enact section 894(c). Treasury and the IRS expect to issue guidance shortly regarding payments by domestic reverse hybrid entities to their interest holders in a separate regulation package. Thus, these final regulations reserve on the question of eligibility for treaty benefits with respect to payments by domestic reverse hybrid entities.

Effective Date

The final regulations apply to items of income paid on or after June 30, 2000. Withholding agents should consider the effect of these regulations on their withholding obligations, including the need to obtain a new withholding certificate to confirm claims of treaty benefits for items of income paid on or after the effective date.

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 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 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.

Drafting Information

The principal author of these regulations is Shawn R. Pringle of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, CFR 26 part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority for part 1 is amended by revising the entry for section 1.894–1 to read in part as follows:

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

Section 1.894–1 also issued under 26 U.S.C. 894 and 7701(l). * * *

Par. 2. In §1.894–1, paragraph (d) is revised to read as follows:

§1.894–1 Income affected by treaty.

* * * * *

(d) *Special rule for items of income received by entities*—(1) *In general.* The tax imposed by sections 871(a), 881(a), 1443, 1461, and 4948(a) on an item of income received by an entity, wherever organized, that is fiscally transparent under the laws of the United States and/or any other jurisdiction with respect to an item of income shall be eligible for reduction under the terms of an income tax treaty to which the United States is a party only if the item of income is derived by a resident of the applicable treaty jurisdiction. For this purpose, an item of income may be derived by either the entity receiving the item of income or by the interest holders in the entity or, in certain circumstances, both. An item of income paid to an entity shall be considered to be derived by the entity only if the entity is not fiscally transparent under the laws of the entity's jurisdiction, as defined in paragraph (d)(3)(ii) of this section, with respect to the item of income. An item of income paid to an entity shall be considered to be derived by the interest holder in the entity only if the interest holder is not fiscally transparent in its jurisdiction with respect to the item of income and if the entity is considered to be fiscally transparent under the laws of the interest holder's jurisdiction with respect to the item of income, as defined in paragraph (d)(3)(iii) of this section. Notwithstanding the preceding two sentences, an item of income paid directly to a type of entity specifically identified in a treaty as a resident of a treaty jurisdiction shall be treated as derived by a resident of that treaty jurisdiction.

(2) *Application to domestic reverse hybrid entities*—(i) *In general.* An income tax treaty may not apply to reduce the amount of federal income tax on U.S. source payments received by a domestic reverse hybrid entity. Further, notwithstanding paragraph (d)(1) of this section, the foreign interest holders of a domestic reverse hybrid entity are not entitled to the benefits of a reduction of U.S. income tax under an income tax treaty on items of income received from U.S. sources by such entity. A domestic reverse hybrid entity is a domestic entity that is treated as not fiscally transparent for U.S. tax purposes and as fiscally transparent under the laws of the interest holder's jurisdiction,

with respect to the item of income received by the domestic entity.

(ii) *Payments by domestic reverse hybrid entities.* [Reserved].

(3) *Definitions*—(i) *Entity.* For purposes of this paragraph (d), the term *entity* shall mean any person that is treated by the United States or the applicable treaty jurisdiction as other than an individual. The term *entity* includes disregarded entities, including single member disregarded entities with individual owners.

(ii) *Fiscally transparent under the law of the entity's jurisdiction*—(A) *General rule.* For purposes of this paragraph (d), an entity is fiscally transparent under the laws of the entity's jurisdiction with respect to an item of income to the extent that the laws of that jurisdiction require the interest holder in the entity, wherever resident, to separately take into account on a current basis the interest holder's respective share of the item of income paid to the entity, whether or not distributed to the interest holder, and the character and source of the item in the hands of the interest holder are determined as if such item were realized directly from the source from which realized by the entity. However, the entity will be fiscally transparent with respect to the item of income even if the item of income is not separately taken into account by the interest holder, provided the item of income, if separately taken into account by the interest holder, would not result in an income tax liability for that interest holder different from that which would result if the interest holder did not take the item into account separately, and provided the interest holder is required to take into account on a current basis the interest holder's share of all such nonseparately stated items of income paid to the entity, whether or not distributed to the interest holder. In determining whether an entity is fiscally transparent with respect to an item of income in the entity's jurisdiction, it is irrelevant that, under the laws of the entity's jurisdiction, the entity is permitted to exclude such item from gross income or that the entity is required to include such item in gross income but is entitled to a deduction for distributions to its interest holders.

(B) *Special definitions.* For purposes of this paragraph (d)(3)(ii), an entity's jurisdiction is the jurisdiction where the entity is organized or incorporated or may otherwise be considered a resident under the laws of that jurisdiction. An interest holder will be treated as taking into account that person's share of income paid to an entity on a current basis even if such amount is taken into account by the interest holder in a taxable year other than the taxable year of the entity if the difference is due solely to differing taxable years.

(iii) *Fiscally transparent under the law of an interest holder's jurisdiction*—(A) *General rule.* For purposes of this paragraph (d), an entity is treated as fiscally transparent under the law of an interest holder's jurisdiction with respect to an item of income to the extent that the laws of the interest holder's jurisdiction require the interest holder resident in that jurisdiction to separately take into account on a current basis the interest holder's respective share of the item of income paid to the entity, whether or not distributed to the interest holder, and the character and source of the item in the hands of the interest holder are determined as if such item were realized directly from the source from which realized by the entity. However, an entity will be fiscally transparent with respect to the item of income even if the item of income is not separately taken into account by the interest holder, provided the item of income, if separately taken into account by the interest holder, would not result in an income tax liability for that interest holder different from that which would result if the interest holder did not take the item into account separately, and provided the interest holder is required to take into account on a current basis the interest holder's share of all such nonseparately stated items of income paid to the entity, whether or not distributed to the interest holder. An entity will not be treated as fiscally transparent with respect to an item of income under the laws of the interest holder's jurisdiction, however, if, under the laws of the interest holder's jurisdiction, the interest holder in the entity is required to include in gross income a share of all or a part of the entity's income on a current basis year under any type of anti-deferral or comparable mechanism. In determining whether an entity is fiscally transparent with respect to an item of income under the laws of an interest holder's jurisdiction, it is irrelevant how the entity is treated under the laws of the entity's jurisdiction.

(B) *Special definitions.* For purposes of this paragraph (d)(3)(iii), an interest holder's jurisdiction is the jurisdiction where the interest holder is organized or incorporated or may otherwise be considered a resident under the laws of that jurisdiction. An interest holder will be treated as taking into account that person's share of income paid to an entity on a current basis even if such amount is taken into account by such person in a taxable year other than the taxable year of the entity if the difference is due solely to differing taxable years.

(iv) *Applicable treaty jurisdiction.* The term *applicable treaty jurisdiction* means the jurisdiction whose income tax treaty with the United States is invoked for purposes of reducing the rate of tax imposed under sections 871(a), 881(a), 1461, and 4948(a).

(v) *Resident.* The term *resident* shall have the meaning assigned to such term in the applicable income tax treaty.

(4) *Application to all income tax treaties.* Unless otherwise explicitly agreed upon in the text of an income tax treaty, the rules contained in this paragraph (d) shall apply in respect of all income tax treaties to which the United States is a party. Notwithstanding the foregoing sentence, the competent authorities may agree on a mutual basis to depart from the rules contained in this paragraph (d) in appropriate circumstances. However, a reduced rate under a tax treaty for an item of U.S. source income paid will not be available irrespective of the provisions in this paragraph (d) to the extent that the applicable treaty jurisdiction would not grant a reduced rate under the tax treaty to a U.S. resident in similar circumstances, as evidenced by a mutual agreement between the relevant competent authorities or by a public notice of the treaty jurisdiction. The Internal Revenue Service shall announce the terms of any such mutual agreement or public notice of the treaty jurisdiction. Any denial of tax treaty benefits as a consequence of such a mutual agreement or notice shall affect only payment of U.S. source items of income made after announcement of the terms of the agreement or of the notice.

(5) *Examples.* This paragraph (d) is illustrated by the following examples:

Example 1. Treatment of entity treated as part-

nership by U.S. and country of organization. (i) *Facts.* Entity A is a business organization formed under the laws of Country X that has an income tax treaty in effect with the United States. A is treated as a partnership for U.S. federal income tax purposes. A is also treated as a partnership under the laws of Country X, and therefore Country X requires the interest holders in A to separately take into account on a current basis their respective shares of the items of income paid to A, whether or not distributed to the interest holders, and the character and source of the items in the hands of the interest holders are determined as if such items were realized directly from the source from which realized by A. A receives royalty income from U.S. sources that is not effectively connected with the conduct of a trade or business in the United States.

(ii) *Analysis.* A is fiscally transparent in its jurisdiction within the meaning of paragraph (d)(3)(ii) of this section with respect to the U.S. source royalty income in Country X and, thus, A does not derive such income for purposes of the U.S.-X income tax treaty.

Example 2. Treatment of interest holders in entity treated as partnership by U.S. and country of organization. (i) *Facts.* The facts are the same as under *Example 1*. A's partners are M, a corporation organized under the laws of Country Y that has an income tax treaty in effect with the United States, and T, a corporation organized under the laws of Country Z that has an income tax treaty in effect with the United States. M and T are not fiscally transparent under the laws of their respective countries of incorporation. Country Y requires M to separately take into account on a current basis M's respective share of the items of income paid to A, whether or not distributed to M, and the character and source of the items of income in M's hands are determined as if such items were realized directly from the source from which realized by A. Country Z treats A as a corporation and does not require T to take its share of A's income into account on a current basis whether or not distributed.

(ii) *Analysis.* M is treated as deriving its share of the U.S. source royalty income for purposes of the U.S.-Y income tax treaty because A is fiscally transparent under paragraph (d)(3)(iii) with respect to that income under the laws of Country Y. Under Country Z law, however, because T is not required to take into account its share of the U.S. source royalty income received by A on a current basis whether or not distributed, A is not treated as fiscally transparent. Accordingly, T is not treated as deriving its share of the U.S. source royalty income for purposes of the U.S.-Z income tax treaty.

Example 3. Dual benefits to entity and interest holder. (i) *Facts.* The facts are the same as under *Example 2*, except that A is taxable as a corporation under the laws of Country X. Article 12 of the U.S.-X income tax treaty provides for a source country reduced rate of taxation on royalties of 5-percent. Article 12 of the U.S.-Y income tax treaty provides that royalty income may only be taxed by the beneficial owner's country of residence.

(ii) *Analysis.* A is treated as deriving the U.S. source royalty income for purposes of the U.S.-X income tax treaty because it is not fiscally transparent with respect to the item of income within the meaning of paragraph (d)(3)(ii) of this section in Country X, its country of organization. M is also treated as deriving its share of the U.S. source royalty income for purposes of the U.S.-Y income tax treaty because A is fiscally transparent under paragraph (d)(3)(iii) of this section with respect to that income under the laws of Country Y. T is not treated as deriving the U.S. source royalty income for purposes of the U.S.-Z income tax treaty because under Country Z law A is not fiscally transparent. Assuming all other requirements for eligibility for treaty benefits have been satisfied, A is entitled to the 5-percent treaty reduced rate on royalties under the U.S.-X income tax treaty with respect to the entire royalty payment. Assuming all other requirements for treaty benefits have been satisfied, M is also entitled to a zero rate under the U.S.-Y income tax treaty with respect to its share of the royalty income.

Example 4. Treatment of grantor trust. (i) *Facts.* Entity A is a trust organized under the laws of Country X, which does not have an income tax treaty in effect with the United States. M, the grantor and owner of A for U.S. income tax purposes, is a resident of Country Y, which has an income tax treaty in effect with the United States. M is also treated as the grantor and owner of the trust under the laws of Country Y. Thus, Country Y requires M to take into account all items of A's income in the taxable year, whether or not distributed to M, and determines the character of each item in M's hands as if such item was realized directly from the source from which realized by A. Country X does not treat M as the owner of A and does not require M to account for A's income on a current basis whether or not distributed to M. A receives interest income from U.S. sources that is neither portfolio interest nor effectively connected with the conduct of a trade or business in the United States.

(ii) *Analysis.* A is not fiscally transparent under the laws of Country X within the meaning of paragraph (d)(3)(ii) of this section with respect to the U.S. source interest income, but A may not claim treaty benefits because there is no U.S.-X income tax treaty. M, however, does derive the income for purposes of the U.S.-Y income tax treaty because under the laws of Country Y, A is fiscally transparent.

Example 5. Treatment of complex trust. (i) *Facts.* The facts are the same as in *Example 4* except that M is treated as the owner of the trust only under U.S. tax law, after application of section 672(f), but not under the law of Country Y. Although the trust document governing A does not require that A distribute any of its income on a current basis, some distributions are made currently to M. There is no requirement under Country Y law that M take into account A's income on a current basis whether or not distributed to him in that year. Under the laws of Country Y, with respect to current distributions, the character of the item of income in the hands of the interest holder is determined as if such item were realized directly from the source from which realized by A. Accordingly, upon a current distribution of interest income to M, the interest income retains its source as U.S. source income.

(ii) *Analysis.* M does not derive the U.S. source interest income because A is not fiscally transparent under paragraph (d)(3)(ii) of this section with respect to the U.S. source interest income under the laws of Country Y. Although the character of the interest in the hands of M is determined as if realized directly from the source from which realized by A, under the laws of Country Y, M is not required to take into account his share of A's interest income on a current basis whether or not distributed. Accordingly, neither A nor M is entitled to claim treaty benefits, since A is a resident of a non-treaty jurisdiction and M does not derive the U.S. source interest income for purposes of the U.S.-Y income tax treaty.

Example 6. Treatment of interest holders required to include passive income under anti-deferral regime. (i) *Facts.* The facts are the same as under *Example 2*. However, Country Z does require T, who is treated as owning 60-percent of the stock of A, to take into account its respective share of the royalty income of A under an anti-deferral regime applicable to certain passive income of controlled foreign corporations.

(ii) *Analysis.* T is still not eligible to claim treaty benefits with respect to the royalty income. T is not treated as deriving the U.S. source royalty income for purposes of the U.S.-Z income tax treaty under paragraph (d)(3)(iii) of this section because T is only required to take into account its pro rata share of the U.S. source royalty income by reason of Country Z's anti-deferral regime.

Example 7. Treatment of contractual arrangements operating as collective investment vehicles. (i) *Facts.* A is a contractual arrangement without legal personality for all purposes under the laws of Country X providing for joint ownership of securities. Country X has an income tax treaty in effect with the United States. A is a collective investment fund which is of a type known as a Common Fund under Country X law. Because of the absence of legal personality of the arrangement, A is not liable to tax at the entity level in Country X and is not a resident within the meaning of the Residence Article of the U.S.-X income tax treaty. A is treated as a partnership for U.S. income tax purposes and receives U.S. source dividend income. Under the laws of Country X, however, investors in A only take into account their respective share of A's income upon distribution from the Common Fund. Some of A's interest holders are residents of Country X and some of Country Y. Country Y has no income tax treaty in effect with the United States.

(ii) *Analysis.* A is not fiscally transparent under paragraph (d)(3)(ii) of this section with respect to the U.S. source dividend income because the interest holders in A are not required to take into account their respective shares of such income in the taxable year whether or not distributed. Because A is an arrangement without a legal personality that is not considered a resident of Country X under the Residence Article of the U.S.-X income tax treaty, however, A does not derive the income for purposes of the U.S.-X income tax treaty. Further, because A is not fiscally transparent under paragraph (d)(3)(iii) of this section with respect to the U.S. source dividend income, A's interest holders that are residents of Country X do not derive the income as residents of Country X for purposes of the U.S.-X income tax treaty.

Example 8. Treatment of person specifically listed as resident in applicable treaty. (i) *Facts.* The facts are the same as in *Example 7* except that A (the Common Fund) is organized in Country Z and the Residence Article of the U.S.-Z income tax treaty provides that "the term 'resident of a Contracting State' includes, in the case of Country Z, Common Funds...."

(ii) *Analysis.* A is treated, for purposes of the

U.S.-Z income tax treaty as deriving the dividend income as a resident of Country Z under paragraph (d)(1) of this section because the item of income is paid directly to A, A is a Common Fund under the laws of Country Z, and Common Funds are specifically identified as residents of Country Z in the U.S.-Z treaty. There is no need to determine whether A meets the definition of fiscally transparent under paragraph (d)(3)(ii) of this section.

Example 9. Treatment of investment company when entity receives distribution deductions, and all distributions sourced by residence of entity. (i) *Facts.* Entity A is a business organization formed under the laws of Country X, which has an income tax treaty in effect with the United States. A is treated as a partnership for U.S. income tax purposes. Under the laws of Country X, A is an investment company taxable at the entity level and a resident of Country X. It is also entitled to a distribution deduction for amounts distributed to its interest holders on a current basis. A distributes all its net income on a current basis to its interest holders and, thus, in fact, has no income tax liability to Country X. A receives U.S. source dividend income. Under Country X law, all amounts distributed to interest holders of this type of business entity are treated as dividends from sources within Country X and Country X imposes a withholding tax on all payments by A to foreign persons. Under Country X laws, the interest holders in A do not have to separately take into account their respective shares of A's income on a current basis if such income is not, in fact, distributed.

(ii) *Analysis.* A is not fiscally transparent under paragraph (d)(3)(ii) of this section with respect to the U.S. source dividends because the interest holders in A do not have to take into account their respective share of the U.S. source dividends on a current basis whether or not distributed. A is also not fiscally transparent under paragraph (d)(3)(ii) of this section because there is a change in source of the income received by A when A distributes the income to its interest holders and, thus, the character and source of the income in the hands of A's interest holder are not determined as if such income were realized directly from the source from which realized by A. Accordingly, A is treated as deriving the U.S. source dividends for purposes of the U.S.-Country X treaty.

Example 10. Item by item determination of fiscal transparency. (i) *Facts.* Entity A is a business organization formed under the laws of Country X, which has an income tax treaty in effect with the United States. A is treated as a partnership for U.S. income tax purposes. Under the laws of Country X, A is an investment company taxable at the entity level and a resident of Country X. It is also entitled to a distribution deduction for amounts distributed to its interest holders on a current basis. A receives both U.S. source dividend income and interest income from U.S. sources that is neither portfolio interest nor effectively connected with the conduct of a trade or business in the United States. Country X law sources all distributions attributable to dividend income based on the residence of the investment company. In contrast, Country X law sources all distributions attributable to interest income based on the residence of the payor of the interest. No withholding applies with respect to distributions attributable to U.S. source interest and the character of the distributions attributable to the interest income remains the same in the hands of A's interest holders as if such items were realized directly from the source from which realized by A. However, under Country X law the interest holders in A do not have to take into account their respective share of the interest income received by A on a current basis whether or not distributed.

(ii) *Analysis.* An item by item analysis is required under paragraph (d) of this section. The analysis is the same as *Example 9* with respect to the dividend income. A is also not fiscally transparent under paragraph (d)(3)(ii) of this section with respect to the interest income because, although the character of the distributions attributable to the interest income in the hands of A's interest holders is determined as if realized directly from the source from which realized by A, under Country X law the interest holders in A do not have to take into account their respective share of the interest income received by A on a current basis whether or not distributed. Accordingly, A derives the U.S. source interest income for purpose of the U.S.-X treaty.

Example 11. Treatment of charitable organizations. (i) *Facts.* Entity A is a corporation organized under the laws of Country X that has an income tax treaty in effect with the United States. Entity A is established and operated exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes. Entity A receives U.S. source dividend income from U.S. sources. A provision of Country X law generally exempts Entity A's income from Country X tax due to the fact that Entity A is established and operated exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes. But for such provision, Entity A's income would be subject to tax by Country X.

(ii) *Analysis.* Entity A is not fiscally transparent under paragraph (d)(3)(ii) of this section with respect to the U.S. source dividend income because, under Country X law, the dividend income is treated as an item of income of A and no other persons are required to take into account their respective share of the item of income on a current basis, whether or not distributed. Accordingly, Entity A is treated as deriving the U.S. source dividend income.

Example 12. Treatment of pension trusts. (i) *Facts.* Entity A is a trust established and operated in Country X exclusively to provide pension or other similar benefits to employees pursuant to a plan. Entity A receives U.S. source dividend income. A provision of Country X law generally exempts Entity A's income from Country X tax due to the fact that Entity A is established and operated exclusively to provide pension or other similar benefits to employees pursuant to a plan. Under the laws of Country X, the beneficiaries of the trust are not required to take into account their respective share of A's income on a current basis, whether or not distributed and the character and source of the income in the hands of A's interest holders are not determined as if realized directly from the source from which realized by A.

(ii) *Analysis.* A is not fiscally transparent under paragraph (d)(3)(ii) of this section with respect to the U.S. source dividend income because under the laws of Country X, the beneficiaries of A are not required to take into account their respective share of A's income on a current basis, whether or not distributed. A is also not fiscally transparent under paragraph (d)(3)(ii) of this section with respect to the U.S. source dividend income because under the laws of Country X, the character and source of the income in the hands of A's interest holders are not determined as if realized directly from the source from which realized by A. Accordingly, A derives the U.S. source dividend income for purposes of the U.S.-X income tax treaty.

(6) *Effective date.* This paragraph (d) applies to items of income paid on or after June 30, 2000.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 28, 2000.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on June 30, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 3, 2000, 65 F.R. 40993)

Part III. Administrative, Procedural, and Miscellaneous

Earnings Calculation for Returned or Recharacterized IRA Contributions

Notice 2000–39

I. PURPOSE

This notice permits a new method to be used for calculating the net income attributable to IRA contributions made after 1999 that are distributed as a returned contribution pursuant to § 408(d)(4) of the Internal Revenue Code ("Code") or recharacterized pursuant to § 408A(d)(6). However, until further guidance is issued, net income may continue to be calculated under the existing method set forth in the Income Tax Regulations.

II. BACKGROUND

A. Returned Contributions under § 408(d)(4)

Section 408(d)(4) provides that an IRA contribution will not be included in the IRA owner's gross income when distributed as a returned contribution if (1) it is received by the IRA owner on or before the day prescribed by law, including extensions, for filing the owner's Federal income tax return for the year of the contribution, (2) no deduction is allowed with respect to the contribution, and (3) the distribution is accompanied by the amount of net income attributable to the contribution.

Section 1.408–4(c)(2)(ii) of the Income Tax Regulations prescribes the method for calculating the amount of net income attributable to a contribution distributed pursuant to § 408(d)(4). That method, referred to in this notice as the "old method," bases the calculation of the amount of net income attributable to a contribution on the income earned by the IRA during the period beginning on the first day of the taxable year in which the contribution is made and ending on the date of the distribution from the account. Under the old method, net income cannot be a negative amount.

B. Recharacterizations under § 408A(d)(6)

Section 408A(d)(6) provides that a contribution made to one type of IRA may be recharacterized as having been made to another type of IRA if (1) the recharacterization transfer occurs on or before the date prescribed by law for filing the IRA owner's Federal income tax return for the year for which the contribution was made, (2) no deduction is allowed with respect to the contribution to the transferor IRA, and (3) the transfer is accompanied by any net income allocable to the contribution.

Section 1.408A–5, Q&A–2(c), provides that if a contribution being recharacterized is in an IRA that at any time contained other contributions, the net income attributable to the contribution being recharacterized is calculated in the manner prescribed by § 1.408–4(c)(2)(ii) (the old method), except that net income can be a negative amount. Section 1.408A, Q&A-2(b), provides that if an IRA is established with a contribution and no other contributions or distributions are made, then the subsequent recharacterization transfer of the entire account balance of the IRA will satisfy the requirement that the transfer be accompanied by any net income allocable to the contribution.

C. Requests for Alternative Method

The Internal Revenue Service has received comments that the old method for calculating net income attributable to an IRA contribution often does not reflect the actual earnings and losses of the IRA during the time it held the contribution. This is because, under the old method, account activity in the part of the year that precedes the date the contribution is made is taken into account in the calculation of the net income attributable to the contribution. In addition, IRA owners and other interested parties have indicated that net income should be permitted to be a negative amount.

In response to these comments, the Service and Treasury are providing a new method for calculating net income that generally bases the calculation of the amount of net income attributable to a contribution on the actual earnings and losses of the IRA during the time it held the contribution. Until further guidance is issued, net income may be calculated under either the new method or the old method. However, it is intended that future guidance will provide that the new method is the only method for calculating net income, and comments are requested regarding the new method and the effective date of mandatory use of the new method.

III. NEW METHOD FOR NET INCOME CALCULATION UNDER § 408(d)(4)

Under the new method, for purposes of returned contributions under § 408(d)(4), the net income attributable to a contribution made to an IRA after December 31, 1999, is determined by allocating to the contribution a pro-rata portion of the earnings accrued by the IRA during the period the IRA held the contribution. The new method is represented by the following formula:

$$\text{Net Income} = \text{Contribution} \times \frac{\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance}}{\text{Adjusted Opening Balance}}$$

The "adjusted opening balance" is the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions made to the IRA during the computation period (including the contribution that is distributed as a returned contribution pursuant to § 408(d)(4)).

The "adjusted closing balance" is the fair market value of the IRA at the end of the computation period plus the amount of any distributions made from the IRA during the computation period.

The "computation period" is the period beginning immediately prior to the time the particular contribution is made to the IRA and ending immediately prior to the removal of the contribution being returned.

For purposes of the above calculation, when an IRA asset is not normally valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most re-

cent, regularly determined, fair market value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of determining net income, recharacterized contributions are taken into account for the period they are actually held in a particular IRA.

Under the new method set forth above, net income may be a negative number.

In the case of multiple regular contributions to an IRA, the last regular contribution made to the IRA for a particular taxable year is deemed to be the contribution that is distributed as a returned contribution under § 408(d)(4), up to the amount of the contribution identified by the IRA owner as the amount distributed as a returned contribution. For purposes of this notice, a "regular contribution" is an IRA contribution made by the IRA owner that is neither a trustee-to-trustee transfer from another IRA nor a rollover from another IRA or retirement plan.

In the case of an individual who owns multiple IRAs, the net income calculation is performed only on the IRA designated by the owner as containing the contribution that is to be distributed as a returned contribution, and that IRA is the IRA that must distribute the contribution.

Under the new method described above, if an IRA is established with a contribution and no other contributions or distributions are made to or from that IRA, then the subsequent distribution of the entire account balance of the IRA pursuant to § 408(d)(4) will satisfy the requirement of that Code section that the return of a contribution be accompanied by the amount of net income attributable to the contribution.

The following examples illustrate the new method net income calculation under § 408(d)(4):

Example 1. (i) On May 1, 2000, when her IRA is worth $4,800, Taxpayer A makes a $1,600 regular contribution to her IRA. Taxpayer A requests that $400 of the May 1, 2000, contribution be returned to her pursuant to § 408(d)(4). Pursuant to this request, on February 1, 2001, when the IRA is worth $7,600, the IRA trustee distributes to Taxpayer A the $400 plus attributable net income. During this time, no other contributions have been made to the IRA and no distributions have been made.

(ii) The adjusted opening balance is $6,400 [$4,800 + $1,600] and the adjusted closing balance is $7,600. Thus, the net income attributable to the $400 May 1, 2000, contribution is $75 [$400 x ($7,600 - $6,400) ÷ $6,400]. Therefore, the total to be distributed on February 1, 2001, pursuant to § 408(d)(4) is $475.

Example 2. (i) Beginning in 2000, Taxpayer B contributes $200 on the 15th of each month by payroll deduction to an IRA for 2000, resulting in an excess regular contribution of $400 for the year. Taxpayer B requests that the $400 excess regular contribution be returned to her pursuant to § 408(d)(4). Pursuant to this request, on March 1, 2001, when the IRA is worth $16,000, the IRA trustee distributes to Taxpayer B the $400 plus attributable net income. The excess regular contributions to be returned are deemed to be the last two made in 2000: the $200 December 15 contribution, when the IRA was worth $12,000 immediately prior to the contribution; and the $200 November 15 contribution, when the IRA was worth $11,000 immediately prior to the contribution. No distributions have been made from the IRA and no contributions, other than the payroll deduction contributions (including $200 in January and February 2001), have been made.

(ii) For the December 15 contribution, the adjusted opening balance is $12,600 [$12,000 + $200 + $200 + $200] and the adjusted closing balance is $16,000. Thus, the net income attributable to the December 15 contribution is $54 [$200 x ($16,000 - $12,600) ÷ $12,600]. For the November 15 contribution, the adjusted opening balance is $11,800 [$11,000 + $200 + $200 + $200 + $200] and the adjusted closing balance is $16,000. Thus, the net income attributable to the November 15 contribution is $71 [$200 x ($16,000 - $11,800) ÷ $11,800]. Therefore, the total to be distributed as returned contributions on March 1, 2001, to correct the excess regular contribution is $525 [$200 + $200 + $54 + $71].

IV. NEW METHOD FOR NET INCOME CALCULATION UNDER § 408A(d)(6)

Under the new method, for purposes of recharacterizations under § 408A(d)(6), the net income allocable to a contribution made to an IRA after December 31, 1999, is determined by allocating to the contribution a pro-rata portion of the earnings accrued by the IRA during the period the IRA held the contribution. The new method is represented by the following formula:

$$\text{Net Income} = \text{Contribution} \times \frac{\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance}}{\text{Adjusted Opening Balance}}$$

The "adjusted opening balance" is the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions made to the IRA during the computation period (including the contribution that is recharacterized pursuant to § 408A(d)(6)).

The "adjusted closing balance" is the fair market value of the IRA at the end of the computation period plus the amount of any distributions made from the IRA during the computation period.

The "computation period" is the period beginning immediately prior to the time the particular contribution being recharacterized is made to the IRA and ending immediately prior to the recharacterizing transfer of the contribution.

For purposes of the above calculation, when an IRA asset is not normally valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent, regularly determined, fair market value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of determining net income, recharacterized contributions are taken into account for the period they are actually held in a particular IRA.

In the case of an individual with multiple IRAs, the net income calculation is performed only on the IRA designated by the owner as containing the particular contribution to be recharacterized, and that IRA is the IRA from which the recharacterizing transfer must be made.

As under the old method, net income may be a negative amount. Also, as under the old method, in the case of multiple contributions made to an IRA for a particular year that are eligible for recharacterization, the IRA owner can choose (by dollar amount, not by specific assets acquired with those dollars) which contribution, or portion thereof, is to be recharacterized.

Also as under the old method, if an IRA is established with a contribution and no other contributions or distributions are made to or from that IRA, then the subsequent recharacterization transfer of the entire account balance of the IRA pursuant to § 408A(d)(6) will satisfy the re-

quirement of that Code section that the transfer be accompanied by any net income allocable to the contribution.

The following examples illustrate the new method net income calculation under § 408A(d)(6):

Example 3. (i) On March 1, 2000, when her Roth IRA is worth $80,000, Taxpayer C makes a $160,000 conversion contribution to the Roth IRA. Subsequently, Taxpayer C discovers that she was ineligible to make a Roth conversion contribution in 2000 and so she requests that the $160,000 be recharacterized to a traditional IRA pursuant to § 408A(d)(6). Pursuant to this request, on March 1, 2001, when the IRA is worth $225,000, the Roth IRA trustee transfers to a traditional IRA the $160,000 plus allocable net income. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) The adjusted opening balance is $240,000 [$80,000 + $160,000] and the adjusted closing balance is $225,000. Thus the net income allocable to the $160,000 is -$10,000 [$160,000 x ($225,000 - $240,000) ÷ $240,000]. Therefore, in order to recharacterize the March 1, 2000, $160,000 conversion contribution on March 1, 2001, the Roth IRA trustee must transfer from Taxpayer C's Roth IRA to her traditional IRA $150,000 [$160,000 - $10,000].

Example 4. (i) On April 1, 2000, when her traditional IRA is worth $100,000, Taxpayer D converts the entire amount, consisting of 100 shares of stock in ABC Corp. and 100 shares of stock in XYZ Corp., by transferring the shares to a Roth IRA. At the time of the conversion, the 100 shares of stock in ABC Corp. are worth $50,000 and the 100 shares of stock in XYZ Corp. are also worth $50,000. Taxpayer D decides that she would like to recharacterize the ABC Corp. shares back to a traditional IRA. However, D may choose only by dollar amount the contribution or portion thereof that is to be recharacterized. On the date of transfer, November 1, 2000, the 100 shares of stock in ABC Corp. are worth $40,000 and the 100 shares of stock in XYZ Corp. are worth $70,000. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) If D requests that $50,000 (which was the value of the ABC Corp. shares at the time of conversion) be recharacterized, the net income allocable to the $50,000 is $5,000 [$50,000 x ($110,000 - $100,000) ÷ $100,000]. Therefore, in order to recharacterize $50,000 of the April 1, 2000, conversion contribution on November 1, 2000, the Roth IRA trustee must transfer from Taxpayer D's Roth IRA to a traditional IRA assets with a value of $55,000 [$50,000 + $5,000].

(iii) If, on the other hand, D requests that $40,000 (which was the value of the ABC Corp. shares on November 1) be recharacterized, the net income allocable to the $40,000 is $4,000 [$40,000 x ($110,000 - $100,000) ÷ $100,000]. Therefore, in order to recharacterize $40,000 of the April 1, 2000, conversion contribution on November 1, 2000, the Roth IRA trustee must transfer from Taxpayer D's Roth IRA to a traditional IRA assets with a value of $44,000 [$40,000 + $4,000].

(iv) Regardless of the amount of the contribution recharacterized, the determination of that amount (or of the net income allocable thereto) is not affected by whether the recharacterization is accomplished by the transfer of shares of ABC Corp. or of shares of XYZ Corp.

V. REQUEST FOR COMMENTS

The Service and Treasury invite comments and suggestions concerning the new method described in this notice for calculating net income under §§ 408(d)(4) and 408A(d)(6) and also concerning the effective date for a rule that would establish the new method as the only method for calculating net income under §§ 408(d)(4) and 408A(d)(6). Any correspondence received will be evaluated, together with appropriate considerations relating to tax administration, to determine the scope of future guidance.

Comments can be submitted to CC:DOM:CORP:R (Notice 2000–39), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 2000–39), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of Employee Plans (Tax Exempt and Government Entities Division). For further information regarding this notice, please contact the Employee Plans' 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.

Weighted Average Interest Rate Update

Notice 2000–40

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 2000 is 5.93 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	2000	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, 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

Targeted Jobs Tax Credit Settlement

Announcement 2000–58

The Internal Revenue Service announces today a settlement initiative under which taxpayers may resolve an issue under the Targeted Jobs Tax Credit (the "TJTC"), formerly section 51 of the Internal Revenue Code of 1986, as in effect prior to January 1, 1995 ("section 51"). The issue relates to whether a taxpayer may claim the TJTC with respect to an employee for whom it has not received a certification or denial from a designated local agency that the employee is a member of a targeted group.

The purpose of the settlement initiative is to relieve both taxpayers and the Service from the burdens associated with further development or litigation, and to permit a quick resolution of this issue. See *Perdue Farms, Inc. v. United States of America*, No. Y–97–3571 (D.C. MD June 14, 1999), and *H.E. Butt Grocery Co. v. United States*, No. SA–98–CA–336– EP (W.D. Tex. July 30, 1999; February 9, 2000).

The settlement initiative is available only to taxpayers who have timely claimed (or may timely claim) the TJTC and can satisfy all of the section 51 requirements, other than the certification requirement (Noncertified Employee Claims). If a timely claim is not currently pending (and the statute of limitations within which to make the claim is open), the taxpayer should submit its claim with the Indication of Interest described below. Under the settlement initiative, taxpayers may take a credit for 50% of the Verified Noncertified Employee Claims, as described below.

Steps to Follow to Participate in the Settlement Program for Taxpayers whose Claims are Pending with the Internal Revenue Service (including Appeals and Tax Court)

Step 1: An eligible taxpayer, whether or not currently under examination, before Appeals, or in Tax Court litigation, must first indicate in writing its interest in accepting the offer under this settlement initiative by mailing the following Indication of Interest to the address listed below:

Indication of Interest in TJTC Settlement Program

Taxpayer's Name:_____

Taxpayer's Address:_____

_____

Taxable Years Involved:_____

Employer Identification Number: _____

Amount of Claim: $_____x 50% =
Settlement: $_____

If Applicable:

Name, address and telephone number of I.R.S. employee responsible for claim year(s):

_____

_____

_____

On behalf of the above-named taxpayer, I am interested in accepting the settlement offer described in Announcement 2000–58, 2000–30 I.R.B. (July 24, 2000), relating to the TJTC and Noncertified Employee Claims.

By _____Date_____

Title_____

Mailing Address of Signatory

_____

The taxpayer should mail the completed Indication of Interest to the following address no later than 120 days after this Announcement appears in the Internal Revenue Bulletin to:

Internal Revenue Service
Kansas City, Missouri 64999
Attention: QMSS, Stop 4100, Annex 2.

If the taxpayer is under examination or before Appeals or in litigation before the Tax Court for the taxable year(s) listed in the Indication of Interest, the taxpayer should also provide a copy of their Indication of Interest to the IRS employee who is responsible for the examination or other consideration of the year(s). (The taxpayer should also state the name, address and telephone number of the I.R.S. employee responsible for the year(s) of the claim on the Indication of Interest.)

Step 2: Upon receiving the Indication of Interest, the IRS will send to the taxpayer instructions on how to accept the settlement offer.

These instructions will direct taxpayers to assemble the information that will be used to determine the Verified Noncertified Employee Claims. In order to accept the settlement offer, the taxpayer will be required to provide, and certify under penalties of perjury, the following information regarding the Noncertified Employee Claims for each taxable year: (1) the name and social security number of each employee included in the claim; (2) the targeted group in which it claims the employee belongs (e.g. economically disadvantaged youth, etc.); (3) the employee's start date; (4) the employee's end date, if any; (5) the amount of eligible wages; (6) the amount of the credit claimed for that employee; and (7) that the employer timely submitted a request for certification. Timely filing means: (a) a written request submitted to the designated local agency on or before the day the individual began work, or (b) if the individual presented the employer with a written preliminary determination from the designated local agency that the individual was a member of a targeted group, a written request submitted to the designated local agency no later than five days after the individual began work. The Service may also require the taxpayer to provide additional information to confirm the accuracy of any information submitted. Once the Service has confirmed to its satisfaction the accuracy of the information, that the statutory requirements for minimum hours are met, and that there are not duplicate claims, it will determine the amount of Verified Noncertified Employee Claims subject to the 50% settlement offer.

Step 3: The taxpayer will execute a closing agreement (Form 906) to document the resolution of this issue and appropriate adjustment of related matters (e.g., section 280C).

Steps to Follow to Participate in the Settlement Program For Taxpayers whose Claims are under the Jurisdiction of the Department of Justice

The settlement initiative does not apply to cases in litigation before the United States district courts or the United States

court of appeals. Settlements of those cases should be discussed with the U.S. Department of Justice attorneys handling them.

No taxpayer, including one currently under examination, in Appeals, or in Tax Court litigation, is required to accept the terms of the settlement initiative. If a taxpayer does not believe that the offer is appropriate for its case, the taxpayer may decline to participate in the settlement initiative, and the case will be handled under normal procedures. If participation is declined, the final result in a case could be either more or less favorable than the settlement offer, depending on the merits of the taxpayer's position.

For cases that are not resolved through the settlement initiative, the Service will continue to advance the legal argument that a taxpayer may not claim the TJTC with respect to an employee for whom it has not received a certification from a designated local agency that the employee is a member of a targeted group. The Service will also consider whether, as a factual matter, an employee is a member of a targeted group and the other statutory requirements are met. In addition, the Service believes that the Work Opportunity Tax Credit (WOTC), section 51 of the Code as in effect after September 30, 1996, also requires that an employer receive a certification before it is entitled to this credit. Accordingly, the Service will rely on the certification process required by the WOTC before allowing this credit.

Please contact the Retail ISP Specialist at (763) 549–1020 x 328 (not a toll-free number) if there are any questions regarding the initiative. The settlement initiative is also described at the "Tax Professional's Corner" of the IRS Web site at http://www.irs.ustreas.gov.

The principal author of this announcement is Robert G. Wheeler. Mr. Wheeler can be reached at (202) 622-6060 (not a toll free number).

Foundations Status of Certain Organizations

Announcement 2000–61

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:

AEONMS Health and Medical Research Foundation, Inc., Memphis, TN
Allen Outreach & Development Center, Inc., Orlando, FL
American Friends of Birkas Rifka, Inc., Lakewood, NJ
American Non-Profit Housing Corporation, Lake Oswego, OR
Assured Nonprofit Services, Inc., Sumner, WA
Athena Telematics Foundation, Inc., Hartsdale, NY
Austen Foundation, Inc., Ambridge, PA
Bread of Life Mission, Martinsville, VA
Brunettes Adult Residential Care Facility, Detroit, MI
Camp All American, Inc., Duluth, GA
Camptonville Education Fund, Camptonville, CA
Canon McMillan Baseball Association, Cannonsburg, PA
Caribbean Foundation, Hayes, VA
Center for the Development of Senior Horizons, Detroit, MI
Center for the Unfoldment of Heart, Mind, & Spirit, Freedom, CA
Charleston Council 22 056 Navy League of the United States, Charleston, SC
Child Development Center Parent Advisory Council, Ferguson, MO
Children's Homes Foundation, Oakley, CA
Children's Medical Research Foundation, Carlsbad, CA
Choreotectonics, Inc., New York, NY
Church Street Graveyard Preservation Foundation, Inc., Mobile, AL
City of Church Hill Community Chest, Church Hill, TN
Concerned Clergy Foundation, Inc., Indianapolis, IN
David Groves Ministries, Inc., Tulsa, OK
Deborah Salem Foundation, Brooklyn, NY
Edgartown Patrolmens Association, Inc., Edgartown, MA
Ezra Health Foundation, Beverly Hills, CA
Faith Human Services Ministry Incorporated, New Orleans, LA
Family Journey Center Foundation, Bluffdale, UT
Fort Bend Songwriters Association, Richmond, TX
Fortune Arms Corporation, Inc., Richmond, TX
Friends of the Holy Cross, Staunton, VA
Gang Outreach Covina, Covina, CA
GOYE Ministry, Chicago, IL
Helpline Soul Rescue Ministry, Inc., Baldwin, NY
Hope for Clevelands Children, Akron, OH
Joan Schuman Fund, Inc., New York, NY
John J. McMahon, Jr. Memorial Roller Hockey Club, Inc., Deer Park, NY
Los Islenos Heritage and Culture Society, Violet, LA
Love and Hope, Inc., Lynnwood, CA
Marietta Reading Center, Jackson, MS
Middlesex County Bar Foundation, Inc., Cambridge, MA
Minnesota Safety & Health Foundation, St. Paul, MN
National Learning Foundation, Las Vegas, NV
Nehemiah Ministries, Inc., Cleveland, OH
New Horizons Un-Limited, Inc., Wauwatosa, WI
Newport Volunteer Firefighters & Rescue Association, Newport, NC
New York Alliance of Black School Educators, Inc., Brooklyn, NY
Northern Lights Junior Drum & Bugle Corps Association, Longview, WA
Nurses Registry Care Center Foundations, Harahan, LA
Ocean Race Chesapeake, Inc., Baltimore, MD
Paradise Foundation, Ashford, CT
Peninsula Housing Development, Inc. IX, Miami, FL
Perfect Image Youth Center, Riverside, CA
Persian Community Center, Inc., Doraville, GA
Pious Propagating Islam over U.S., Fort Worth, TX
Pownal Education Foundation, Pownal, ME
Public Television Service, Inc., Columbia, MD

Rev. Willie Jordan Community Service Center, Harvey, IL
Russell House Association, Inc., Baltimore, MD
Sahmadan Foundation, Tempe, AZ
Shekinah Refuge, Inc., Sapulpa, OK
Skidrow Passion Outreach, Los Angeles, CA
Sonlight Ministries, Inc., Fort Collins, CO
Sub-Saharan Relief Fund, Inc., Washington, DC
Sullivan County Scenic Coalition, Inc., Livingston Manor, NY
Tennis in Motion, Chicago, IL
Tom Wick Agricultural Scholarship Fund, Brewster, WA
Trinity Adoption Services International, Inc., Houston, TX
Triple Cross Ranch, Inc., Okeechobee, FL
Truman High School Wrestling Team Parents Association, Bronx, NY
Two, Inc., Kingsport, TN
Urban Outpatient, Inc., Dorchester, MA
Urban Wall Street Community Development Corp., Kansas City, KS
Vintage War Birds, Louisville, KY
Woodburn, Inc., Cincinnati, OH
YBL Ohana Alliance, Pittsburgh, PA
YETA, Philadelphia, PA
Youth First Communications d/b/a Youth First Concerns, Englewood, CO
Youth Reach Out Program, Inc., Atlanta, GA
Youthventures, Inc., Miami, FL
Youth Your Opportunity Upward Through Hard Work, Lithonia, GA

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 2000–62

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 July 24, 2000, 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, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Animal Right
Seattle, WA

Conservation Education
Seattle, WA

Enviro Hope
Seattle, WA

Great Will
Seattle, WA

Green Nature Service
Seattle, WA

Nature Care
Seattle, WA

Nature &Animal Circle
Seattle, WA

Nature Educator
Seattle, WA

Nature Preservation
Seattle, WA

Project Life Ministries
San Diego, CA

Wildlife Conservation
Seattle, WA

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

Section 401.—Qualified Pension, Profit-Sharing And Stock Bonus Plans

26 CFR 1.401(a)(31)–1: Requirement to offer direct rollover of eligible rollover distributions; questions and answers.

Whether a qualified defined contribution plan can be amended to permit a default direct rollover of an involuntary cash-out to an individual retirement arrangement. See Rev. Rul. 2000–36, page 140.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(b)–1: Taxability of beneficiary under annuity contract purchased by a section 501(c)(3) organization or public school.

Section 403(b) plans; elective deferrals. This revenue ruling specifies the criteria to be met in order to automatically reduce an employee's compensation by a certain amount and have that amount contributed as an elective deferral to an employer's section 403(b) plan.

Rev. Rul. 2000–35

ISSUE

Will employer contributions to an annuity contract described in § 403(b) of the Internal Revenue Code (the "Code") fail to be considered to be made under a salary reduction agreement merely because they are made pursuant to an arrangement under which a fixed percentage of an employee's compensation is contributed to the annuity contract unless the employee affirmatively elects to receive the amount in cash?

FACTS

Employer X, an organization described in § 501(c)(3) which is exempt from tax under § 501(a), maintains Plan A, a plan described in § 403(b) of the Code and § 3(2) of the Employee Retirement Income Security Act of 1974 ("ERISA"). Under Plan A, any employee of Employer X, including a newly hired employee, may elect to have Employer X make contributions on the employee's behalf towards the purchase of an annuity contract in lieu of receiving that amount as cash compensation that would otherwise be payable to the employee. The employee may designate the amount of these compensation reduction contributions as a percentage of the employee's compensation, subject to certain limitations set forth in the plan. These compensation reduction contributions satisfy the § 403(b) requirements applicable to contributions made pursuant to a salary reduction agreement, and are treated for all purposes as made pursuant to a salary reduction agreement under the plan.

Plan A also provides that Employer X will make matching contributions on account of an employee's compensation reduction contributions up to a specified percentage of the employee's compensation. Plan A does not permit any other contributions.

Plan A is amended, effective the next January 1, to add an automatic compensation reduction election feature. Under this feature, each employee's compensation will automatically be reduced by 4 percent and this amount will be contributed towards the purchase of an annuity contract under Plan A unless the employee affirmatively elects to receive cash or have a different percentage contributed. Both before and after the amendment, the employee is not able to receive, prior to a distributable event described in § 403(b)(11), amounts contributed towards the purchase of an annuity contract. Both before and after the amendment, Plan A and the annuity contracts purchased thereunder satisfy the requirements of § 403(b). An election not to make compensation reduction contributions or to contribute a different percentage of compensation can be made at any time.

Under Plan A as amended, in the case of a newly hired employee, an election not to make compensation reduction contributions or to contribute a different percentage is effective for the first pay period and for subsequent pay periods (until superseded by a subsequent election) if filed when the employee is hired or if filed within a reasonable period thereafter ending before the compensation for the first pay period is currently available. Thus, if a newly hired employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed when the employee is hired or within a reasonable period thereafter ending before the compensation is currently available, then no compensation reduction contributions for the first pay period or subsequent pay period are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. Elections filed at a later date are effective for payroll periods beginning in the month next following the date the election is filed.

At the time an employee is hired, the employee will receive a notice that explains the automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election.

In the case of an employee hired before the January 1 effective date who has not elected compensation reduction contributions of at least 4 percent, Plan A as amended provides that the automatic election will become effective on the first pay period beginning on or after January 1 unless the employee elects during a specified reasonable period ending on January 1 to receive cash or have a different amount contributed to Plan A. Thus, if a current employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed during the reasonable period ending on the January 1 effective date, then no compensation reduction contributions for the first pay period beginning on or after the January 1 effective date or for subsequent pay periods are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. In the case of a current employee who has a compensation reduction contribution election in effect for less than 4 percent, who does not make a new compensation reduction contribution election during the reasonable period ending on the January 1 effective date, and whose compensation is therefore automatically reduced by 4 percent, if that employee thereafter makes an affirmative election to reduce his or her compensation by another

amount (or no amount), then that affirmative election will continue in effect until the employee makes a subsequent affirmative election for a different amount.

At the beginning of the reasonable period ending on the January 1 effective date, each current employee receives a notice that explains the new automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election.

Each employee is notified annually of his or her compensation reduction percentage, and of his or her right to change the percentage, including the procedure for exercising that right and the timing for implementation of any such election.

Plan A provides that both matching contributions and compensation reduction contributions will be invested in accordance with the participant's election among a broad range of annuity contracts. If no investment election is made by a participant, contributions are invested in an annuity contract providing an investment return based on the return on a balanced fund that includes both diversified equity and fixed-income investments[1].

LAW AND ANALYSIS

Section 403(b)(1) of the Code provides that amounts contributed by certain employers, including an employer described in § 501(c)(3) which is exempt from tax under § 501(a), for the purchase of an annuity contract for an employee of such an employer are excluded from the gross income of the employee if certain requirements are satisfied.

Contributions to purchase annuity contracts under § 403(b) may be made either pursuant to a salary reduction agreement or not pursuant to a salary reduction agreement. Contributions made pursuant to a salary reduction agreement are subject to different requirements than are contributions not made pursuant to a salary reduction agreement. (See, for example, §§ 403(b)(1)(E), 403(b)(7)(A)(ii), 403(b)–(11) and 403(b)(12).) In general, a contribution is not treated as made pursuant to a salary reduction agreement if under the agreement it is made pursuant to a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the agreement. See §§ 402(g)(3)(C) and 403(b)(12).

Section 1.403(b)–1(b)(3)(i) of the regulations prescribes rules applicable to contributions made pursuant to a salary reduction agreement, including rules relating to the frequency and revocability of such agreements and to the salary to which such agreements apply.

Section 1450(a) of the Small Business Job Protection Act of 1996 ("SBJPA") provides that, for purposes of § 403(b) of the Code, the frequency that an employee is permitted to make a salary reduction agreement, the salary to which such an agreement may apply and the ability to revoke such an agreement shall be determined under the rules applicable to cash or deferred elections under § 401(k). Section 1450(a) of SBJPA is effective for taxable years beginning after December 31, 1995. Thus, § 1.403(b)–1(b)(3)(i) of the regulations does not reflect current law, and the rules relating to these aspects of salary reduction agreements are the same as those for cash or deferred elections under § 401(k).

Section 401(k) provides that a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan can meet the requirements of § 401(a) even if it includes a qualified cash or deferred arrangement. Section 401(k) also sets forth the requirements that a cash or deferred arrangement must satisfy in order to be a qualified cash or deferred arrangement.

Section 1.401(k)–1(a)(2)(i) defines a cash or deferred arrangement as an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of § 401(a).

Section 1.401(k)–1(a)(3)(i) defines a cash or deferred election as any election (or modification of an earlier election) by an employee to have the employer either provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available or contribute an amount to a trust (or provide an accrual or other benefit) under a plan deferring the receipt of compensation. Section 1.401(k)–1(a)(3)(iv) provides that a cash or deferred election does not include a one-time irrevocable election, made at the time an employee commences employment with the employer or upon the employee's first becoming eligible under any plan of the employer, to have contributions made by the employer on the employee's behalf to the plan (or to any other plan of the employer) equal to a specified amount or percentage of the employee's compensation. Section 1.401(k)–1(g)(3) defines elective contributions as employer contributions made to a plan that were subject to a cash or deferred election under a cash or deferred arrangement.

Revenue Ruling 2000–8, 2000–7 I.R.B. 617 (February 14, 2000), holds that where a newly hired or a current employee has an effective opportunity to elect to receive an amount in cash or have that amount contributed by the employer to a profit-sharing plan, those employer contributions made on the employees' behalf to the plan in lieu of receipt of cash compensation will not fail to be considered elective contributions within the meaning of § 1.401(k)–1(g)(3) made under a qualified cash or deferred arrangement within the meaning of § 401(k) merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the plan.

The definition of a cash or deferred election in § 1.401(k)–1(a)(3)(i) requires that the employee have an election between the employer paying cash (or some other taxable benefit) to the employee or making a contribution to a trust on behalf of the employee. The regulation does not require that the employee receive an amount in

[1]The Department of Labor has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), fiduciaries of a plan must ensure that the plan is administered prudently and solely in the interest of plan participants and beneficiaries. While ERISA § 404(c) may serve to relieve certain fiduciaries from liability when participants or beneficiaries exercise control over the assets in their individual accounts, the Department of Labor has taken the position that a participant or beneficiary will not be considered to have exercised control when the participant or beneficiary is merely apprised of investments that will be made on his or her behalf in the absence of instructions to the contrary. See 29 CFR § 2550.404c–1 and 57 F.R. 46924.

cash in any case in which the employee does not make an affirmative election to have that amount contributed to the trust. Similarly, under § 403(b), there is no requirement that an employee receive an amount in cash in any case in which the employee does not make an affirmative election to have that amount contributed to an annuity contract. Thus, a contribution to purchase an annuity contract under § 403(b) will not fail to be made under a salary reduction agreement merely because, when an employee fails to make an affirmative election with respect to an amount of compensation, that amount is contributed on the employee's behalf to an annuity contract, provided that the employee had an effective opportunity to elect to receive that amount in cash. The employee has an effective opportunity to elect to receive an amount in cash as required under § 1.401(k)–1(a)(3)(i) if the employee receives notice of the availability of the election and the employee has a reasonable period before the cash is currently available to make the election.

In this case, compensation reduction contributions made by Employer X to Plan A, including those made on behalf of a newly hired employee who has not filed an election to the contrary and those made on behalf of a current employee who has elected less than 4-percent compensation reduction contributions, are amounts contributed pursuant to a procedure under which the employee receives a notice explaining his or her rights to have no compensation reduction contributions made and, after receiving the notice, the employee has a reasonable period before the cash is currently available to elect to receive the cash in lieu of having it contributed towards the purchase of an annuity contract. Thus, an employee has an effective opportunity to elect to receive cash or have a contribution made towards the purchase of an annuity contract. In addition, the employee is not able to receive, prior to a distributable event described in § 403(b)(11), amounts contributed towards the purchase of an annuity contract. Finally, compensation reduction contributions made under the plan are not contributions made pursuant to a one-time irrevocable election because the employee can change the election in the future. Consequently, the compensation reduction contributions under Plan A as amended are contributions made pursuant to a salary reduction agreement described in § 403(b).

HOLDING

Where, as in this case, a newly hired or current employee has an effective opportunity to elect to receive an amount in cash or have that amount contributed by the employer to an annuity contract described in § 403(b), those contributions made on the employee's behalf to the annuity contract in lieu of receipt of cash compensation will not fail to be considered to be made under a salary reduction agreement merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the annuity contract. This holding would be the same if (1) Plan A were described in § 403(b)(1)(A)(ii) (relating to arrangements maintained by State and local school systems), or (2) the funding vehicles under Plan A were custodial accounts described in § 403(b)(7) or retirement income accounts described in § 403(b)(9), provided the requirements of such respective Code sections are otherwise satisfied.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1694.

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 ruling are in the third, fifth, seventh and eighth paragraphs in the section headed "FACTS" and in the tenth paragraph in the section headed "LAW AND ANALYSIS." The collections of information are required to enable personnel in the Tax Exempt and Government Entities Division of the Internal Revenue Service to determine if an employer's retirement plan satisfies the requirements to obtain favorable tax treatment and to enable certain employee elections to meet the requirements of § 403(b). The collections of information are required to obtain a benefit. The likely respondents are State and local government entities and not-for-profit institutions.

The estimated total annual reporting burden is 175 hours. The estimated annual burden per respondent is 1 hour and 45 minutes. The estimated number of respondents is 100. 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 ruling is Roger Kuehnle of the Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, call the Employee Plans' 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.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)–4: Section 411(d)(6) protected benefits.
(Also, § 401; § 1.401(a)(31)–1.)

Qualified plan; default rollover; involuntary cash-out. This ruling provides that if plan participants are given adequate notice including their right to elect a cash distribution, a qualified plan can be amended to permit a default direct rollover under section 401(a)(31) of an involuntary cash-out without there being a violation of section 411(d)(6) of the Code.

Rev. Rul. 2000–36

ISSUE

Will an amendment to change the default method of payment to a direct rollover for involuntary distributions when a distributee fails affirmatively to elect to make a direct

rollover or to elect a cash payment under the facts described below cause the plan to fail to satisfy § 401(a)(31) or § 411(d)(6) of the Internal Revenue Code?

FACTS

Employer X maintains Plan A, a qualified defined contribution plan that does not include any after-tax contributions or other amounts that would not be included in gross income upon distribution. Plan A provides for an involuntary distribution to an employee upon separation from service if his or her vested account balance is $5,000 or less. Plan A includes a direct rollover option for all distributions. Plan A provides that if a separating employee's vested account balance is $5,000 or less, and the separating employee does not elect a direct rollover either to another qualified plan or to an individual retirement arrangement ("IRA"), the vested account balance is to be paid in a single sum cash payment to the employee.

Employer X amends Plan A to provide that the default form of payment of any involuntary cash-out from Plan A greater than $1,000 but less than or equal to $5,000 will be a direct rollover (an eligible rollover distribution that is paid directly to an eligible retirement plan for the benefit of the distributee) to an IRA, but that separating employees will instead receive a cash payment if they so elect. Under the amendment, this default direct rollover applies only if the separating employee fails to request affirmatively (1) a cash payment to that employee or (2) a direct rollover to another qualified plan or an IRA designated by the separating employee. The amendment also provides that in the case of a default direct rollover, the plan administrator will select [1] an IRA trustee, custodian, or issuer (the "trustee") that is unrelated to Employer X, establish the IRA with that trustee on behalf of any separating employee who fails affirmatively to elect a direct rollover or a cash payment, and make the initial investment choices for the account.

The administrative procedures of Plan A are changed with respect to any § 402(f) notice provided on or after the effective date of the amendment to a separating employee with a vested account balance greater than $1,000 but not greater than $5,000. After the change, the plan administrator will include with the § 402(f) notice an explanation, as required by § 1.401(a)(31)–1 of the Income Tax Regulations, of the default direct rollover (and other appropriate information such as the name, address, and telephone number of the IRA trustee and information regarding IRA maintenance and withdrawal fees and how the IRA funds will be invested). The default direct rollover will occur not less than 30 days and not more than 90 days after the § 402(f) notice with the explanation of the default direct rollover is provided to the separating employee.

LAW AND ANALYSIS

Section 401(a)(31) provides, in part, that a trust shall not constitute a qualified trust unless the plan of which the trust is a part provides that if the distributee of any eligible rollover distribution (i) elects to have the distribution paid to an eligible retirement plan, and (ii) specifies the eligible retirement plan to which the distribution is to be paid, the distribution will be paid in a direct rollover to the eligible retirement plan specified.

Section 402(f) requires a plan administrator, within a reasonable period of time before making an eligible rollover distribution from an eligible retirement plan, to provide to the recipient a written explanation of the rollover provisions of § 401(a)(31) and § 402(c) (direct rollover and 60-day rollover), the 20-percent mandatory withholding requirement under § 3405, and other tax provisions in § 402 that apply to the eligible rollover distribution.

Section 411(d)(6)(A) provides, in part, that a plan participant's accrued benefit may not be decreased by a plan amendment other than by an amendment described in § 412(c)(8) of the Code or § 4281 of the Employee Retirement Income Security Act of 1974. Section 411(d)(6)(B) provides that an amendment eliminating or reducing an optional form of benefit is treated as an amendment reducing an employee's accrued benefit unless otherwise provided in Income Tax Regulations.

Section 1.401(a)(31)–1, Q&A-7 provides, in part, that a plan administrator may establish a default procedure so that if a distributee fails to make an affirmative election, he or she is treated as having made a direct rollover election. However, that regulation requires the plan administrator to first furnish the distributee with an explanation of the default procedure and an explanation of the direct rollover option within the time period provided in § 1.402(f)–1, Q&A-2 for the written explanation described in § 402(f).

Section 1.402(f)–1, Q&A-1 prescribes the general rule with respect to the contents of the written explanation (§ 402(f) notice) that must be provided to a distributee by a plan administrator before an eligible rollover distribution is made. Section 1.402(f)–1, Q&A-2 provides generally that the plan administrator must provide a distributee of an eligible rollover distribution with a § 402(f) notice no less than 30 days and no more than 90 days before the date of the distribution. Although a participant may, under the circumstances described in § 1.402(f)–1, Q&A-2, affirmatively elect to receive a distribution before the expiration of the 30 days after the receipt of a § 402(f) notice, that rule would not apply to a default direct rollover.

Section 1.411(d)–4, Q&A-1(a) defines a "section 411(d)(6) protected benefit" as a benefit described in § 411(d)(6)(A), early retirement benefits and retirement-type subsidies described in § 411(d)(6)(B)(i), and optional forms of benefit described in § 411(d)(6)(B)(ii) and provides that those benefits, to the extent that they are accrued, are subject to the protections of § 411(d)(6).

The default status of an optional form of benefit is not a section 411(d)(6) protected benefit. Thus, an amendment to change Plan A's default method of pay-

[1]The Department of Labor (the "DOL") has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act ("ERISA"), in the context of a default direct rollover described in this ruling, where the distribution constitutes the entire benefit rights of the participant, the participant will cease to be a participant covered under the plan within the meaning of 29 CFR § 2510.3–3(d)(2)(ii)(B), and the distributed assets will cease to be plan assets within the meaning of 29 CFR § 2510.3–101. The DOL also noted that the selection of an IRA trustee, custodian or issuer and IRA investment for purposes of a default direct rollover would constitute a fiduciary act subject to the general fiduciary standards and prohibited transaction provisions of ERISA. In addition, plan provisions governing the default direct rollover of distributions, including the participant's ability to affirmatively opt out of the arrangement, must be described in the plan's summary plan description furnished to participants and beneficiaries.

ment for an involuntary distribution from a direct cash payment to a direct rollover does not violate § 411(d)(6). As required in § 1.401(a)(31)–1, Q&A-7, Plan A's procedures provide that each distributee subject to the default will receive an explanation of the default procedure and the direct rollover option within a time period before the default direct rollover that satisfies the timing requirements of § 1.402(f)–1, Q&A-2. Thus, the provision of a direct rollover as the default method of payment under the facts described above does not cause Plan A to fail to satisfy § 401(a)(31).

HOLDING

An amendment to change the default method of payment to a direct rollover as the default when a distributee fails affirmatively to elect to make a direct rollover or to elect a cash payment under the facts described above does not cause Plan A to fail to satisfy § 401(a)(31) or § 411(d)(6).

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Rubin of the Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, call the Employee Plans' 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. Mr. Rubin's telephone number is (202) 622-6214 (also not a toll-free call).

Section 457.—Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations

26 CFR 1.457–1: Compensation deferred under eligible deferred compensation plans.

Cash or deferred arrangements; nonqualified deferred compensation. This ruling specifies the criteria to be met in order to automatically defer a certain percentage of an employee's compensation into that employee's account in an eligible deferred compensation plan sponsored by the eligible employer.

ISSUE

Will a deferred compensation plan fail to be an "eligible deferred compensation plan" described in § 457(b) of the Internal Revenue Code merely because deferrals are made under an arrangement whereby a fixed percentage of an employee's compensation is deferred on the employee's behalf under the plan unless the employee affirmatively elects to receive the amount in cash?

FACTS

County M, a political subdivision of State X, maintains Plan A, an eligible deferred compensation plan described in § 457(b). Under Plan A, any employee of County M, including a newly hired employee, may choose to enter into an agreement pursuant to which the employee's taxable compensation is reduced and deferrals to the employee's account in Plan A are credited by County M on the employee's behalf. The employee may designate a percentage of the employee's compensation as elective deferrals, subject to the limitations of § 457(b). Plan A does not permit any other type of deferrals, and no other plan of County M permits employees to make elective deferrals. Deferrals under Plan A are immediately nonforfeitable and are subject to the limitations and requirements of § 457(b).

County M proposes to implement, effective the next January 1, an automatic election feature in Plan A under which, if a newly hired or current employee has not affirmatively elected to receive cash compensation or to have at least 2 percent of compensation deferred under Plan A, his or her compensation will automatically be reduced by 2 percent, and this amount will be credited to the employee's account in Plan A. An election not to make deferrals or to defer a different percentage of compensation can be made at any time. Elections filed at a later date are effective for the month next following the date the election is filed.

In the case of a new employee, the election not to make deferrals will be effective for the first month after the individual first became an employee and for subsequent months (until superseded by a subsequent election) if filed within a reasonable period of time ending before the beginning of the month. Thus, if a new employee files an election to receive cash in lieu of making deferrals and the election is filed a reasonable period ending before the beginning of the first month after the individual first becomes an employee, then no deferrals for that (or any subsequent) month are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. At the time the employee is hired, the employee will receive a notice that explains the automatic election and the employee's right to elect to have no such deferrals made under the plan or to alter the amount of those deferrals, including the procedure for exercising that right and the timing for implementation of any such election.

The proposed amendment to Plan A also provides that, with respect to current employees, if the employee files an election to receive cash in lieu of making deferrals and the election is filed during the reasonable period ending on the January 1 effective date, then no deferrals for the period beginning on or after the January 1 effective date are made on the employee's behalf under Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. At the beginning of the reasonable period ending on the January 1 effective date, each current employee receives a notice that explains the new automatic election and the employee's right to elect to have no such deferrals made under the plan or to alter the amount of those deferrals, including the procedure for exercising that right and the timing for implementation of any such election.

Thereafter, each employee is notified annually of his or her deferral percentage, and of his or her right to change the percentage or to elect not to make deferrals, including the procedure for exercising that right and the timing for implementation of any such election.

Plan A provides that deferrals will be invested in accordance with the participant's election among a broad range of investment funds held by the trustee of Plan A or, if no investment election is made by a participant, in the trust's balanced fund which includes both diversified equity and fixed income investments.

LAW AND ANALYSIS

Section 457(a) provides that in the case of a participant in an eligible deferred compensation plan, any amount

of compensation deferred under the plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary.

Section 457(b) defines the term "eligible deferred compensation plan." Section 457(b)(4) and §1.457–2(g) of the Income Tax Regulations provide that an "eligible deferred compensation plan" must provide that compensation will be deferred for any calendar month only if an agreement providing for the deferral has been entered into before the beginning of such month.

No provision of § 457(b) limits deferrals under an eligible plan to elective or voluntary deferrals, nor do the provisions of § 457(b) (including the limitations of § 457(b)(2) and (3)) distinguish between elective or voluntary deferrals and other types of deferrals. *See* Notice 87–13, Q &A 26, 1987–1 C.B. 432, 444. In the case of these other types of deferrals, the requirements of § 457(b)(4) are satisfied without the employee entering into an agreement to defer compensation. Rather, the obligation of the employer (or the obligation of the employee as a condition of employment) satisfies § 457(b)(4).

Similarly, the automatic election procedure described above will not cause a plan to fail the requirements of § 457(b)(4). In the absence of an affirmative election to the contrary entered into before the beginning of the month, deferrals with respect to compensation for the month will be made pursuant to the automatic election procedure. Alternatively, if an employee makes an affirmative election to change the automatic election and receive a corresponding amount in cash, the employee's affirmative election will govern any deferrals for the month. In either case, the deferrals for a month with respect to an employee are clearly established before the beginning of the month, and the requirements of § 457(b)(4) are satisfied.

HOLDING

Where, as under the proposed amendment to Plan A, the obligation to make deferrals with respect to an employee's compensation for a month is established before the beginning of a month by either an automatic election or by an agreement to alter the terms of the automatic election and receive cash in lieu of making deferrals, an eligible deferred compensation plan will satisfy the requirements of § 457(b)(4).

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1695.

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 ruling is in the third, fourth, and fifth paragraphs in the section headed "FACTS". The collection of information is necessary to ensure that the increased retirement savings due to automatic enrollment is truly voluntary. The collection of information is needed to obtain a benefit. The likely respondents are state and local governmental entities, and to a lesser extent, not-for-profit organizations.

The estimated total annual reporting burden is 500 hours. The estimated average annual burden per respondent is 1 hour. The estimated number of respondents is 500. 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 ruling is John Tolleris of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact him at (202) 622-6060 (not a toll free number).

Section 6012.—Persons Required to Make Returns of Income

26 CFR 1.6012–5: Composite return in lieu of specified form.

What are the obligations of those who participate in the Form 1040 IRS *e-file* program to the Service, taxpayers, and other participants. See Rev. Proc. 2000–31, page 146.

Section 6061.—Signing of Returns and Other Documents

26 CFR 1.6061–1: Signing of returns and other documents by individuals.

What are the obligations of those who participate in the Form 1040 IRS *e-file* program to the Service, taxpayers, and other participants. See Rev. Proc. 2000–31, page 146.

Section 6695.—Other Assessable Penalties With Respect to the Preparation of Income Tax Returns for Other Persons

26 CFR 1.6695(b): Failure to sign return.

T.D. 8893

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Retention of Income Tax Return Preparers' Signatures

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide income tax return preparers with two alternative means of meeting the requirement that a preparer retain the copy of the return or claim manually signed by the preparer. The regulations are necessary to inform preparers about the two alternatives and to provide them with the guidance needed to comply with the alternatives.

DATES: *Effective Date:* These regulations are effective July 18, 2000.

Applicability Date: For dates of applicability, see §1.6695–1(g) of these regulations.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) relating to the penalty for failure to sign an income tax return under section 6695(b) of the Internal Revenue Code.

On December 31, 1998, final and temporary regulations (T.D. 8803, 1999–12 I.R.B. 15) under section 6695 were published in the **Federal Register** (63 F.R. 72182). A notice of proposed rulemaking (REG–106386–98, 1999–12 I.R.B. 31) cross-referencing the temporary regulations was published in the **Federal Register** (63 F.R. 72218) on the same date. 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 6695 are adopted by this Treasury decision and the corresponding temporary regulations are removed.

Section 6695(b) provides that any person who is an income tax return preparer with respect to a return or claim for refund, who is required by regulations prescribed by the Secretary to sign the return or claim, and who fails to comply with those regulations, must pay a penalty of $50 for such failure, unless it is shown that the failure is due to reasonable cause and not willful neglect. The maximum penalty imposed with respect to documents filed during a calendar year will not exceed $25,000.

Section 7701(a)(36)(A) provides that, in general, the term *income tax return preparer* means any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax or claim for refund imposed by subtitle A. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim is treated as if it were the preparation of such return or claim.

Section 1.6695–1(b)(1) generally provides that an income tax return preparer, with respect to a return or claim for refund, must manually sign the return or claim (which may be a photocopy) in the appropriate space provided on the return or claim after it is completed and before it is presented to the taxpayer (or nontaxable entity) for signature.

Explanation of Provisions

The final regulations provide that the employer of the preparer or the partnership in which the preparer is a partner, or the preparer (if not employed or engaged by a preparer and not a partner of a partnership which is a preparer), must retain the manually signed copy of the return or claim. In the alternative, the person required to retain the manually signed copy of the return or claim may either retain a photocopy of that manually signed copy or use an electronic storage system meeting the requirements of section 4 of Rev. Proc. 97–22 (1997–1 C.B. 652), or procedures subsequently prescribed by the Commissioner, to store and produce a copy of the return or claim manually signed by the preparer.

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 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 & 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 is amended by removing the entry for section 1.6695–1T and by revising the entry for section 1.6695–1 to read in part as follows:

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

Section 1.6695–1 also issued under 26 U.S.C. 6060(b) and 6695(b). * * *

Par. 2. Section 1.6695–1 is amended by:

1. Revising paragraph (b)(4)(i).
2. Adding paragraph (g).
3. Removing the authority citation immediately following the end of the section.

The revision and addition read as follows:

§1.6695–1 Other assessable penalties with respect to the preparation of income tax returns for other persons.

* * * * *

(b) * * *

(4)(i) The manual signature requirement of paragraphs (b)(1) and (2) of this section may be satisfied by a photocopy of a copy of the return or claim for refund which copy is manually signed by the preparer after completion of its preparation. After a copy of the return or claim for refund is signed by the preparer and before it is photocopied, no person other than the preparer may alter any entries on the copy other than to correct arithmetical errors discernible on the return or claim for refund. The employer of the preparer or the partnership in which the preparer is a partner, or the preparer (if not employed or engaged by a preparer and not a partner of a partnership which is a preparer), must retain the manually signed copy of the return or claim for refund. In the alternative, for a return or claim for refund presented to a taxpayer for signature after December 31, 1998, and for returns or claims for refund retained on or before that date, the person required to retain the manually signed copy of the return or claim for refund may choose to retain a photocopy of the manually signed copy of the return or claim for refund, or use an electronic storage system to store and pro-

duce a copy of the manually signed return or claim for refund. For purposes of this paragraph (b)(4)(i), an electronic storage system must meet the electronic storage system requirements prescribed in section 4 of Rev. Proc. 97–22 (1997–1 C.B. 652)(see §601.601(d)(2) of this chapter) or other procedures prescribed by the Commissioner. A record of any arithmetical errors corrected must be retained and made available upon request by the person required to retain the manually signed copy of the return or claim for refund.

* * * * *

(g) *Effective date.* This section applies to income tax returns and claims for refund presented to a taxpayer for signature after December 31, 1998, and for returns or claims for refund retained on or before that date.

Section 1.6695–1T [Removed]

Par. 3. Section 1.6695–1T is removed.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 30, 2000.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 17, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 18, 2000, 65 F.R. 44436)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Tax forms and instructions. (Also Part I, sections 6012, 6061; 1.6012–5, 1.6061–1.)

Rev. Proc. 2000–31

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SECTION 1. PURPOSE

This revenue procedure informs those who participate in the IRS *e-file* Program of their obligations to the Internal Revenue Service, taxpayers, and other participants. The IRS *e-file* Program allows taxpayers to file their income tax returns through an Electronic Return Originator, or by using a personal computer, modem, and commercial tax preparation software (the Form 1040 IRS On-Line Filing Program). The following returns can be filed under the IRS *e-file* Program: (1) Form 1040 and Form 1040A, U. S. Individual Income Tax Return; and (2) Form 1040EZ, Income Tax Return for Single and Joint Filers with no Dependents. This revenue procedure modifies and supersedes Rev. Proc. 98–50, 1998–2 C.B. 368 (IRS *e-file* Program), and Rev. Proc. 98–51, 1998–2 C.B. 380 (Form 1040 IRS On-Line Filing Program).

SECTION 2. BACKGROUND AND CHANGES

.01 Section 1.6011–1(a) of the Income Tax Regulations provides that every person subject to income tax must make a return or statement as required by the regulations. The return or statement must include the information required by the applicable regulations or forms.

.02 Section 301.6061–1(b) of the Regulations on Procedure and Administration authorizes the Secretary to prescribe in forms, instructions, or other appropriate guidance the method of signing any return, statement, or other document required to be made under any provision of the internal revenue laws or regulations.

.03 Section 1.6012–5 of the regulations provides that the Commissioner may authorize the use, at the option of a person required to make a return, of a composite return in lieu of any form specified in 26 CFR Part 1 (Income Tax), subject to the conditions, limitations, and special rules governing the preparation, execution, filing, and correction thereof as the Commissioner may deem appropriate.

.04 This revenue procedure combines the rules governing the IRS *e-file* Program with the rules governing the Form 1040 IRS On-Line Filing Program (previously set forth in Rev. Proc. 98–50 and Rev. Proc. 98–51, respectively).

.05 This revenue procedure incorporates substantive changes made to the IRS *e-file* Program, including changes to the definitions of program participants (see section 3 of this revenue procedure) and changes to the sanctions that may be imposed upon Authorized IRS *e-file* Providers (see section 7 of this revenue procedure).

.06 Many of the rules governing participation in the IRS *e-file* Program are now set forth in IRS Publications. See section 5.01 of this revenue procedure.

SECTION 3. DEFINITIONS

.01 A participant in the IRS *e-file* Program is referred to as an "Authorized IRS *e-file* Provider." The Authorized IRS *e-file* Provider categories are:

(1) ELECTRONIC RETURN ORIGINATOR. An "Electronic Return Originator" (ERO) originates the electronic submission of income tax returns.

(2) INTERMEDIATE SERVICE PROVIDER. An "Intermediate Service Provider" receives tax return information from an ERO (or from a taxpayer who files electronically using a personal computer, modem, and commercial tax preparation software), processes the tax return information, and either forwards the information to a Transmitter, or sends the information back to the ERO (or taxpayer).

(3) SOFTWARE DEVELOPER. A "Software Developer" develops software for the purposes of (a) formatting electronic tax return information according to Publication 1346, Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns; and/or (b) transmitting electronic tax return information directly to the Service.

(4) TRANSMITTER. A "Transmitter" transmits electronic tax return information directly to the Service.

.02 The Authorized IRS *e-file* Provider categories are not mutually exclusive. For example, an ERO can, at the same time, be a Transmitter, Software Developer, or Intermediate Service Provider depending on the function(s) performed.

.03 A "Responsible Official" is an individual with authority over the IRS *e-file* operation of the office(s) of the Authorized IRS *e-file* Provider, is the first point of contact with the Service, and has authority to sign revised IRS *e-file* applications. A Responsible Official is responsible for ensuring that the Authorized IRS *e-file* Provider adheres to the provisions of this revenue procedure and the publications and notices governing the IRS *e-file* Program.

SECTION 4. ACCEPTANCE IN THE IRS *e-file* PROGRAM

.01 Individuals, businesses, and organizations that wish to participate in the IRS *e-file* Program must apply for participation and must be accepted by the Service.

.02 The procedures governing application to the IRS *e-file* Program are included in Publication 3112, The IRS *e-file* Application Package.

.03 The circumstances under which the Service may deny participation in the IRS *e-file* Program are included in Publi-

cation 1345, Handbook for Authorized *e-file* Providers of Individual Income Tax Returns. An applicant who is denied participation may seek administrative review of the denial. See section 8 of this revenue procedure.

.04 To continue participation in the IRS *e-file* Program, Authorized IRS *e-file* Providers must adhere to all requirements of this revenue procedure and the publications and notices governing the IRS *e-file* Program.

SECTION 5. RESPONSIBILITIES OF AN AUTHORIZED IRS *e-file* PROVIDER

.01 To ensure that returns are accurately and efficiently filed, an Authorized IRS *e-file* Provider must comply with the provisions of this revenue procedure and all publications and notices governing the IRS *e-file* Program. The Service will from time to time update such publications and notices to reflect changes to the program. It is the responsibility of the Authorized IRS *e-file* Provider to ensure that it complies with the latest version of all publications and notices. The publications and notices governing the IRS *e-file* Program include:

(1) Publication 1345, Handbook for Authorized IRS *e-file* Providers of Individual Income Tax Returns;

(2) Publication 1345A, Filing Season Supplement for Authorized IRS *e-file* Providers of Individual Income Tax Returns;

(3) Publication 1346, Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns;

(4) Publication 1436, Test Package for Electronic Filing of Individual Income Tax Returns;

(5) Publication 3112, The IRS *e-file* Application Package; and

(6) Postings to the Electronic Filing System Bulletin Board (EFS Bulletin Board) and the IRS "Digital Daily" web site at: http://www.irs.gov on the Internet.

.02 The publications and notices listed in section 5.01 supplement this revenue procedure but do not supersede it. A violation of a provision of these publications and notices is considered a violation of this revenue procedure and may subject the participant to the sanctions provided in section 7 of this revenue procedure.

SECTION 6. PENALTIES

.01 *Penalties for Disclosure or Use of Information.*

(1) An Authorized IRS *e-file* Provider, except a Software Developer that does not have access to taxpayer information, is a tax return preparer under the definition of § 301.7216–1(b). A tax return preparer is subject to a criminal penalty for unauthorized disclosure or use of tax return information. See § 7216 of the Internal Revenue Code and § 301.7216–1(a). In addition, § 6713 establishes civil penalties for unauthorized disclosure or use of tax return information.

(2) Under § 301.7216–2(h), disclosure of tax return information among Authorized IRS *e-file* Providers for the purpose of electronically filing a return is permissible. For example, an ERO may pass on tax return information to an Intermediate Service Provider and/or a Transmitter for the purpose of having an electronic return formatted and transmitted to the Service.

.02 *Other Preparer Penalties.*

(1) Preparer penalties may be asserted against an individual or firm meeting the definition of an income tax return preparer under § 7701(a)(36) and § 301.7701–15. Preparer penalties that may be asserted under appropriate circumstances include, but are not limited to, those set forth in §§ 6694, 6695, and 6713.

(2) Under § 301.7701–15(d), Authorized IRS *e-file* Providers are not income tax return preparers for the purpose of assessing most preparer penalties as long as their services are limited to "typing, reproduction, or other mechanical assistance in the preparation of a return or claim for refund."

(3) If an ERO, Intermediate Service Provider, Transmitter, or the product of a Software Developer alters the return information in a nonsubstantive way, this alteration will be considered to come under the "mechanical assistance" exception described in § 301.7701–15(d). A nonsubstantive change is a correction or change limited to a transposition error, misplaced entry, spelling error, or arithmetic correction.

(4) If an ERO, Intermediate Service Provider, Transmitter, or the product of a Software Developer alters the return information in a way that does not come under the "mechanical assistance" exception, the Authorized IRS *e-file* Provider may be held liable for income tax return preparer penalties. See § 301.7701–15; Rev. Rul. 85–189, 1985–2 C.B. 341 (which describes a situation where a Software Developer was determined to be an income tax return preparer and subject to certain preparer penalties).

.03 *Other Penalties.* In addition to the above specified provisions, the Service reserves the right to assert all appropriate preparer, nonpreparer, and disclosure penalties against an Authorized IRS *e-file* Provider as warranted under the circumstances.

SECTION 7. MONITORING AND SANCTIONING OF AN AUTHORIZED IRS *e-file* PROVIDER

.01 The Service will monitor Authorized IRS *e-file* Providers for compliance with the rules governing the IRS *e-file* Program. The Service may sanction an Authorized IRS *e-file* Provider for violating any provision of this revenue procedure or the publications and notices governing the IRS *e-file* Program.

.02 Sanctions that the Service may impose upon an Authorized IRS *e-file* Provider for violations described in section 7.01 of this revenue procedure include a written reprimand, suspension or expulsion from the program, and other sanctions, depending on the seriousness of the infraction. Publication 1345 describes the infraction categories and the rules governing the imposition of sanctions.

SECTION 8. ADMINISTRATIVE REVIEW PROCESS

.01 An applicant that has been denied participation in the IRS *e-file* Program (see section 4.03 of this revenue procedure) has the right to an administrative review. During the administrative review process, the denial of participation remains in effect.

.02 An Authorized IRS *e-file* Provider may seek administrative review for any sanction the Service may impose under section 7 of this revenue procedure.

.03 Publication 1345 describes the procedures regarding administrative review of a denial of participation in the IRS *e-file* Program and any sanction imposed by the Service.

SECTION 9. PILOT PROGRAMS

.01 The Service regularly conducts pilot programs to introduce new technology into the IRS *e-file* Program. These pilot programs are usually conducted within a limited geographic area or within a limited taxpayer or practitioner community. The Service establishes rules for participating in these pilot programs and embodies these rules in an implementing document typically referred to as a "Memorandum of Understanding" (MOU) or "Memorandum of Agreement" (MOA). Pilot participants must agree to the provisions of the implementing document in order to participate in the pilot program.

.02 An implementing document supplements this revenue procedure, but does not supersede it. Participants in a pilot program remain subject to the provisions of this revenue procedure unless the implementing document specifically provides otherwise.

.03 A violation of a provision of an implementing document is considered a violation of this revenue procedure and may subject the participant to sanctions (see section 7 of this revenue procedure).

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 98–50, 1998–2 C.B. 368, and Rev. Proc. 98–51, 1998–2 C.B. 380, are modified and, as modified, are superseded.

SECTION 11. EFFECTIVE DATE

This revenue procedure is effective July 13, 2000, except for the provisions of section 7 of this revenue procedure, which are effective for sanctions imposed on or after January 1, 2001.

SECTION 12. INTERNAL REVENUE SERVICE OFFICE CONTACT

All questions regarding this revenue procedure should be directed to the Internal Revenue Service. The telephone number for this purpose is (202) 283-0531 (not a toll-free number).

Part IV. Items of General Interest

Automatic Enrollment Features in Prototype Section 401(k) Plans

Announcement 2000–60

The Service would like to bring to the attention of prototype plan sponsors and employers that currently maintain, or are considering adopting, § 401(k) plans the availability of automatic enrollment features in pre-approved § 401(k) plans. In general, § 401(k) plans that have automatic enrollment features reportedly have had significantly higher employee participation rates than § 401(k) plans without such features.

Under an automatic enrollment feature in an employer's § 401(k) plan, a participant's compensation is automatically reduced by a specified percentage, and that amount is contributed as an elective contribution on the participant's behalf to the plan, unless the participant affirmatively elects not to have his or her compensation reduced or to have it reduced by a different amount. See Rev. Rul. 2000–8, 2000–7 I.R.B. 617 (February 14, 2000).

The Service "pre-approves" certain tax-qualified retirement plans, including § 401(k) plans, under the Service's prototype plan program, which is set forth in Rev. Proc. 2000–20, 2000–6 I.R.B. 553. Prototype plans are submitted by sponsors to the Service for review for compliance with applicable laws and procedures. Sponsors, who may be financial institutions or others, offer their Service-approved prototype plans to employers to adopt for the benefit of employees.

Bad Debt Reserves of Thrift Institutions

Announcement 2000–63

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of proposed regulations.

SUMMARY: This document withdraws proposed regulations amending the income tax regulations. This action is taken to remove from the IRS' inventory of regulations projects certain proposed regulations that will not be published in final form because under a subsequent amendment the underlying statute does not apply to taxable years beginning after December 31, 1995.

DATES: These proposed regulations are withdrawn July 12, 2000.

FOR FURTHER INFORMATION CONTACT: Craig Wojay, of the Office of Assistant Chief Counsel, Financial Institutions and Products, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC 20224. Telephone (202) 622-3920, (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document withdraws certain proposed regulations previously published in the **Federal Register** (FI–42–90, 1992–1 C.B. 1072 [57 F.R. 1232]) by the IRS. These proposed regulations, §§1.593–12, 1.593–13, and 1.593–14, are being withdrawn because under a subsequent amendment the underlying statute, section 593, does not apply subsections (a), (b), (c), and (d) to taxable years beginning after December 31, 1995.

Drafting Information

The principal author of this withdrawal notice is Craig Wojay, Office of the Assistant Chief Counsel (Financial Institutions and Products) within the Office of the Chief Counsel, IRS. However, other personnel from the IRS and the Treasury Department participated in developing the withdrawal notice.

* * * * *

Withdrawal of Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the proposed rulemaking that was published in the **Federal Register** on Monday, January 13, 1992 (57 F.R. 1232) is withdrawn.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 11, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 12, 2000, 65 F.R. 42900)

Supplemental Information on Treasury Bills for Publication 1212

Announcement 2000–64

Banks, brokers, and other middlemen who report discount on Treasury bill redemptions on Form 1099–INT must use the owner's purchase price, where available, to determine the amount of discount to report. This information can usually be obtained from the owner's or middleman's records. However, if the owner's purchase price is not available from existing records, the middleman must report the discount as if the holder had purchased the Treasury bill at its original issue price. In this case, the middleman must use as the original issue price the noncompetitive issue price for the longest-maturity Treasury bill maturing on that date.

For Treasury bill redemptions when the owner's purchase price *cannot* be determined, the following list gives the noncompetitive issue prices and corresponding amounts of discount to be reported on Form 1099–INT for Treasury bills maturing May through July 2000. This list, which should also help middlemen determine any amounts subject to backup withholding, supplements the list that appears in 1999 edition of Publication 1212, *List of Original Issue Discount Instruments.*

Short-Term United States Treasury Bills
Issued at a Discount and Maturing August 2000-December 2000

	CUSIP Number	Maturity Date	Issue Date	Noncompetitive Issue Price (% of Principal Amount)	Dollar Amount of OID to be reported (per $1,000 of Maturity Value)
	912795EV9	08/03/2000	02/02/2000	97.116	28.84
	912795EW7	08/10/2000	02/10/2000	97.083	29.17
*	912795EE7	08/17/2000	08/19/1999	95.000	50.00
	912795EX5	08/24/2000	02/24/2000	97.085	29.15
	912795EY3	08/31/2000	03/02/2000	97.085	29.15
	912795EZ0	09/07/2000	03/09/2000	97.055	29.45
*	912795EF4	09/14/2000	09/16/1999	94.944	50.56
	912795FA4	09/21/2000	03/23/2000	97.202	27.98
	912795FB2	09/28/2000	03/30/2000	97.015	29.85
	912795FC0	10/05/2000	04/06/2000	97.017	29.83
*	912795EG2	10/12/2000	10/14/1999	94.828	51.72
	912795FD8	10/19/2000	04/20/2000	97.085	29.15
	912795FE6	10/26/2000	04/27/2000	97.096	29.04
	912795FF3	11/02/2000	05/04/2000	97.000	30.00
*	912795EH0	11/09/2000	11/12/1999	94.787	52.13
	912795FG1	11/16/2000	05/18/2000	96.840	31.60
	912795FH9	11/24/2000	05/25/2000	96.886	31.14
	912795FJ5	11/30/2000	06/01/2000	96.891	31.09
*	912795EJ6	12/07/2000	12/09/1999	94.591	54.09
	912795FK2	12/14/2000	06/15/2000	96.964	30.36
	912795FL0	12/21/2000	06/22/2000	97.007	29.93
	912795FM8	12/28/2000	06/29/2000	96.989	30.11

* 52-week bill

Tax Treatment of Cafeteria Plans; Public Hearing

Announcement 2000–65

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of public hearing on proposed rulemaking.

SUMMARY: This document contains a notice of public hearing on proposed regulations relating to the tax treatment of cafeteria plans.

DATES: The public hearing is being held on August 17, 2000, at 10 a.m. The IRS must receive outlines of the topics to be discussed at the hearing by August 3, 2000.

ADDRESSES: The public hearing is being held in Room 4718, 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: Regulations Unit CC (REG–117162–99), 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: Regulations Unit CC (REG–117162–99), 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 CONTACT: Concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, contact Treena Garrett, (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is the notice of proposed regulations (REG–117162–99, 2000–15 I.R.B. 871) that was published in the **Federal Register** on March 23, 2000 (65 F.R. 15587).

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 August 3, 2000.

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 CONTACT" section of this document.

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel,
(Modernization and Strategic Planning).

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 2000. See Rev. Rul. 2000–38, page 157.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2000. See Rev. Rul. 2000–38, page 157.

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 August 2000. See Rev. Rul. 2000–38, page 157.

Section 411.—Minimum Vesting Standards

26 CFR: 1.411(a)–7: Definitions and special rules.

T.D. 8891

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 31

Increase In Cash-Out Limit Under Sections 411(a)(7), 411(a)(11), and 417(e)(1) for Qualified Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the increase from $3,500 to $5,000 of the limit on distributions from qualified retirement plans that can be made without participant or spousal consent. This increase is contained in the Taxpayer Relief Act of 1997. In addition, these regulations eliminate the "lookback rule" pursuant to which certain qualified plan benefits are deemed to exceed this limit on involuntary distributions. The final regulations affect sponsors and administrators of qualified retirement plans, and participants in those plans.

DATES: *Effective Date*: These regulations are effective October 17, 2000.

Applicability Date: These regulations generally apply to distributions made on or after October 17, 2000.

FOR FURTHER INFORMATION CONTACT: Robert Walsh, (202) 622-6090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 21, 1998, a notice of proposed rulemaking (REG–113694–98, 1999–7 I.R.B. 56) was published in the **Federal Register** (63 F.R. 70356) regarding the "cash-out limit" under sections 411(a)(7), 411(a)(11), and 417(e)(1) of the Internal Revenue Code. That same day, temporary and final regulations (T.D. 8794, 1999–7 I.R.B. 4) were published in the **Federal Register** (63 F.R. 70335) which amended the Income Tax Regulations and the Employment Tax Regulations (26 CFR parts 1 and 31) relating to the increase in the cash-out limit enacted by section 1071 of the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788 (1997) (TRA '97). The text of the temporary regulations served as a portion of the text of the proposed regulations. Very few comments were submitted on the proposed regulations; no hearing was requested or held. After consideration of the comments, these final regulations adopt the provisions of the proposed regulations.

Explanation of Provisions

The temporary regulations made several changes to the cash-out rules under sections 411(a)(7), 411(a)(11), and 417(e)(1). In accordance with section 1071 of TRA '97, the temporary regulations increased the cash-out limit from $3,500 to $5,000. Thus, a qualified plan can generally distribute vested accrued benefits valued at $5,000 or less without participant or spousal consent. The temporary regulations also provided that, for purposes of section 411(a)(7)(B)(i), an involuntary distribution of an employee's vested accrued benefit valued at $5,000 or less could be treated as made due to termination of the employee's participation if the distribution could have been made at termination of participation but for the fact that the benefit was then valued at more than $3,500. Finally, the temporary regulations amended §1.411(a)–11(c)(3) to eliminate the "lookback rule" for distributions other than those made pursuant to an optional form of benefit under which at least one scheduled periodic distribution remained payable. Prior to this amendment, the lookback rule in §1.411(a)–11(c)(3) provided that the present value of a vested accrued benefit was deemed to exceed the cash-out limit if it had exceeded the cash-out limit at the time of any previous distribution. The temporary regulations did not change the parallel lookback rule under §1.417(e)–1(b)(2)(i).

The proposed regulations generally included the provisions of the temporary regulations, but they also proposed the complete removal (on a prospective basis) of the lookback rule under both §§1.411(a)–11(c)(3) and 1.417(e)–1(b)(2)(i). Thus, under the proposed regulations, the lookback rule would be eliminated both for plans subject to the spousal-consent provisions of sections 401(a)(11) and 417 and for plans not subject to those provisions. Under this removal of the lookback rule, a participant's vested accrued benefit valued at $5,000 or less could be distributed without consent even if the benefit had been valued at more than $5,000 at the time of a previous distribution. However, in accordance with section 417(e)(1), the proposed regulations also provided that, in the case of plans subject to sections 401(a)(11) and 417, consent would be required after the annuity starting date for the immediate distribution of the present value of an accrued benefit being distributed in any form, including a qualified joint and survivor annuity or a qualified preretirement survivor annuity, regardless of the amount of that present value.

Very few comments were received on the proposed regulations. One commentator inquired whether a cash-out could be made of a benefit presently valued at $4,500 that had been valued at $4,000

upon termination of the employee's employment more than two years earlier. As indicated in the preamble to the final and temporary regulations published with the proposed regulations, that benefit could be cashed out.

Another commentator indicated support for the content of the proposed regulations but expressed concern about the rule, derived from section 417(e)(1), prohibiting a cashout after the annuity starting date of a benefit being distributed in any form by a plan subject to sections 401(a)(11) and 417. The commentator observed that, under section 417(f)(2)(A), the annuity starting date for a benefit payable upon termination of employment in non-annuity form could be the date of termination. The commentator argued that the rule in the proposed regulations prohibiting a cashout after the annuity starting date could be read to preclude a cashout of a non-annuity benefit payable at termination, regardless of the present value of that benefit. To address this, the commentator urged the IRS and Treasury to redefine "annuity starting date" such that a cashout would be permitted as long as a benefit remains immediately distributable (that is, until the later of normal retirement age or age 62).

The provision in the proposed regulations prohibits a cashout after the annuity starting date of a benefit "being distributed in any form." The rule does not apply to any benefit that is not yet "being distributed" — that is, to any benefit with respect to which no payment has been made. If the present value of a benefit payable on or after termination of employment does not exceed the cashout limit, the rule of section 417(e)(1), as set forth in the proposed regulations, would not prohibit a cashout prior to the date on which a payment is first made (disregarding, obviously, the cashout payment itself). Thus, no change has been made to the regulations on this point.

Another commentator objected to the complete elimination of the lookback rule under the proposed regulations. The commentator cited three reasons for its opposition: first, that an amount distributed in a hardship or other type of distribution remains part of a participant's benefit; second, that a participant could manipulate a distribution in order to evade the spousal-consent requirements; and, third, that permitting cash-outs after a hardship or other distribution is contrary to the policy of discouraging non-retirement distributions.

In contrast, a comment received prior to the issuance of the proposed regulations noted problems faced by plan administrators due to the lookback rule. The commentator noted, for example, that if a plan provides for hardship distributions, the plan administrator must review its records to determine the value of the participant's benefits at the time of any prior distribution. The commentator added that this can be particularly difficult and costly where plans sponsored by other employers have merged into the plan. The commentator further stated that the cash-out provisions are designed to allow plans to reduce their administrative costs by making lump sum payments to participants with small benefits and that the lookback rule is contrary to that design because the rule (1) makes it more costly for administrators to determine whether the provisions apply and (2) can prevent a plan from relying on the provisions in many cases where the value of the participant's current benefit is well below $5,000.

After consideration of the comments, the IRS and Treasury have decided to adopt the regulation eliminating the lookback rule as proposed. The IRS and Treasury believe that the statutory cash-out provisions represent a balancing of the interests of participants in maintaining their benefits in qualified plans with the reasonable administrative needs of plan sponsors and administrators. The lookback rule prevents plans from cashing out a benefit currently valued below the cash-out limit simply because it had been valued above the cash-out limit at the time of an earlier distribution. This creates disparity in the treatment of benefits of equivalent value and requires plans to incur additional recordkeeping and other administrative costs.

The IRS and Treasury note that removal of the lookback rule is unlikely to present significant opportunities for participants to evade the spousal-consent rules. In the case of any plan subject to the spousal-consent provisions of sections 401(a)(11) and 417, a distribution that draws a participant's accrued benefit from a value above the cash-out limit to a value at or below the cash-out limit will itself require spousal consent. Furthermore, these final regulations strengthen the spousal-consent rules by clarifying that a plan subject to sections 401(a)(11) and 417 may not distribute a benefit after the annuity starting date without consent. This prohibition on cash-outs after the annuity starting date, which is statutory in source, applies without regard to the value of the benefit at the annuity starting date and without regard to the distribution form.

Finally, the IRS and Treasury note that concerns about non-retirement distributions of benefits are mitigated by the availability of rollovers. In almost all cases, an amount distributed from a qualified plan in a cash-out distribution will be an eligible rollover distribution that can be paid directly (or indirectly, through a 60-day rollover) to another qualified retirement plan or individual retirement arrangement.

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 business.

Drafting Information

The principal author of these regulations is Robert M. Walsh, 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 parts 1 and 31 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.411(a)–7T and by adding a new entry in numerical order to read in part as follows:

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

§1.411(a)–7 also issued under 26 U.S.C. 411(a)(7)(B)(i). * * *

Par. 2. Section 1.411(a)–7 is amended as follows:

1. Paragraph (d)(4)(i) is revised;

2. Paragraphs (d)(4)(vi) and (d)(4)(vii) are added.

The revision and additions read as follows:

§1.411(a)–7 Definitions and special rules.

* * * * *

(d) * * *

(4) *Certain cash-outs of accrued benefits*—(i) *Involuntary cash-outs.* For purposes of determining an employee's right to an accrued benefit derived from employer contributions under a plan, the plan may disregard service performed by the employee with respect to which—

(A) The employee receives a distribution of the present value of his entire nonforfeitable benefit at the time of the distribution;

(B) The requirements of section 411(a)(11) are satisfied at the time of the distribution;

(C) The distribution is made due to the termination of the employee's participation in the plan; and

(D) The plan has a repayment provision which satisfies the requirements of paragraph (d)(4)(iv) of this section in effect at the time of the distribution.

* * * * *

(vi) For purposes of paragraph (d)(4)(i) of this section, a distribution shall be deemed to be made due to the termination of an employee's participation in the plan if it is made no later than the close of the second plan year following the plan year in which such termination occurs, or if such distribution would have been made under the plan by the close of such second plan year but for the fact that the present value of the nonforfeitable accrued benefit then exceeded the cash-out limit in effect under §1.411(a)–11(c)(3)(ii). For purposes of determining the entire nonforfeitable benefit, the plan may disregard service after the distribution, as illustrated in paragraph (d)(2)(i) of this section.

(vii) *Effective date.* Paragraphs (d)(4)(i) and (vi) of this section apply to distributions made on or after March 22, 1999. However, an employer is permitted to apply paragraphs (d)(4)(i) and (vi) of this section to plan years beginning on or after August 6, 1997. Otherwise, for distributions prior to March 22, 1999, §§1.411(a)–7 and 1.411(a)–7T, in effect prior to October 17, 2000 (as contained in 26 CFR part 1, revised as of April 1, 2000) apply.

* * * * *

§1.411(a)–7T [Removed]

Par. 3. Section 1.411(a)–7T is removed.

Par. 4. Section 1.411(a)–11 is amended by revising paragraph (c)(3) to read as follows:

§1.411(a)–11 Restriction and valuation of distributions.

* * * * *

(c) * * *

(3) *Cash-out limit.* (i) Written consent of the participant is required before the commencement of the distribution of any portion of an accrued benefit if the present value of the nonforfeitable total accrued benefit is greater than the cash-out limit in effect under paragraph (c)(3)(ii) of this section on the date the distribution commences. The consent requirements are deemed satisfied if such value does not exceed the cash-out limit, and the plan may distribute such portion to the participant as a single sum. Present value for this purpose must be determined in the same manner as under section 417(e); see §1.417(e)–1(d).

(ii) The cash-out limit in effect for a date is the amount described in section 411(a)(11)(A) for the plan year that includes that date. The cash-out limit in effect for dates in plan years beginning on or after August 6, 1997, is $5,000. The cash-out limit in effect for dates in plan years beginning before August 6, 1997, is $3,500.

(iii) *Effective date.* Paragraphs (c)(3)(i) and (ii) of this section apply to distributions made on or after October 17, 2000. However, an employer is permitted to apply the $5,000 cash-out limit described in paragraph (c)(3)(ii) of this section to plan years beginning on or after August 6, 1997. Otherwise, for distributions prior to October 17, 2000, §1.411(a)–11 and 1.411(a)–11T in effect prior to October 17, 2000 (as contained in 26 CFR Part 1 revised as of April 1, 2000) apply.

* * * * *

§1.411(a)–11T [Removed]

Par. 5. Section 1.411(a)–11T is removed.

Par. 6. Section 1.417(e)–1 is amended by revising the last sentence of paragraph (b)(2)(i) and by adding new paragraph (b)(2)(iii) to read as follows:

§1.417(e)–1 Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

* * * * *

(b) * * *

(2) * * * (i) * * * After the annuity starting date, consent is required for the immediate distribution of the present value of the accrued benefit being distributed in any form, including a qualified joint and survivor annuity or a qualified preretirement survivor annuity, regardless of the amount of such present value.

* * * * *

(iii) Paragraph (b)(2)(i) of this section applies to distributions made on or after October 17, 2000. For distributions prior to October 17, 2000, §1.417(e)–1(b)(2)(i) in effect prior to October 17, 2000 (as contained in 26 CFR part 1 revised as of April 1, 2000) applies.

* * * * *

PARTS 1 AND 31—[AMENDED]

Par. 7. In the table below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Section	Remove	Add
1.401(a)–20, Q&A-8, paragraph (d), first sentence	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
1.401(a)–20, Q&A-24, paragraph (a)(1), fourth sentence	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
1.401(a)(4)–4, paragraph (b)(2)(ii)(C)	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
1.401(a)(26)–4, paragraph (d)(2), last sentence	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
1.401(a)(26)–6, paragraph (c)(4), first sentence	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
1.411(a)–11, paragraph (b), first sentence	§1.411(a)–11T(c)(3)(ii)	paragraph (c)(3)(ii) of this section
1.411(a)–11, paragraph (c)(7), third sentence	§1.411(a)–11T(c)(3)(ii)	paragraph (c)(3)(ii) of this section
1.411(d)–4, Q&A-2, paragraph (b)(2)(v), second, third, and fourth sentences	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
1.411(d)–4, Q&A-4, paragraph (a), eighth sentence	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
1.417(e)–1, paragraph (b)(2)(i) first, fourth, and fifth sentences	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)
31.3121(b)(7)–2, paragraph (d)(2)(i), last sentence	§1.411(a)–11T(c)(3)(ii)	§1.411(a)–11(c)(3)(ii)

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 10, 2000.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 18, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 19, 2000, 65 F.R. 44679)

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 2000. See Rev. Rul. 2000–38, page 157.

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 2000. See Rev. Rul. 2000–38, page 157.

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 2000. See Rev. Rul. 2000–38, page 157.

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 2000. See Rev. Rul. 2000–38, page 157.

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 2000. See Rev. Rul. 2000–38, page 157.

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 2000. See Rev. Rul. 2000–38, page 157.

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 2000. See Rev. Rul. 2000–38, page 157.

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 1999 and the recomputed differential earnings rate for 1998 are set forth for use by mutual life insurance companies to compute their income tax liabilities for 1999.

Rev. Rul. 2000–37

This revenue ruling contains the differential earnings rate for 1999 and the recomputed differential earnings rate for 1998. 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 1999. This revenue ruling also contains the figures on which the determinations of these rates are based. Notice 2000–16, 2000–12 I.R.B. 826, 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 earnings 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 1999 and the rate used to calculate the recomputed differential earnings amount for 1998 (the recomputed differential earnings rate for 1998), and the figures on which these two rates are based are set forth in Table 1.

Rev. Rul. 2000–37 Table 1

Determination of Rates To Be Used For Taxable Years Beginning in 1999

Differential earnings rate for 1999	0.249
Recomputed differential earnings rate for 1998	0.182
Imputed earnings rate for 1998	16.193
Imputed earnings rate for 1999	15.815
Base period stock earnings rate	18.221
Current stock earnings rate for 1999	17.465
Stock earnings rate for 1996	17.238
Stock earnings rate for 1997	19.321
Stock earnings rate for 1998	15.836
Average mutual earnings rate for 1997	15.566
Average mutual earnings rate for 1998	16.011

DRAFTING INFORMATION

The principal author of this revenue ruling is Katherine A. Hossofsky of the Office of the Associate 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).

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 2000. See Rev. Rul. 2000–38, 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 2000.

Rev. Rul. 2000–38

This revenue ruling provides various prescribed rates for federal income tax purposes for August 2000 (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. 2000–38 TABLE 1

Applicable Federal Rates (AFR) for August 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	6.37%	6.27%	6.22%	6.19%
110% AFR	7.02%	6.90%	6.84%	6.80%
120% AFR	7.66%	7.52%	7.45%	7.40%
130% AFR	8.32%	8.15%	8.07%	8.01%
Mid-Term				
AFR	6.33%	6.23%	6.18%	6.15%
110% AFR	6.97%	6.85%	6.79%	6.75%
120% AFR	7.62%	7.48%	7.41%	7.37%
130% AFR	8.26%	8.10%	8.02%	7.97%
150% AFR	9.57%	9.35%	9.24%	9.17%
175% AFR	11.20%	10.90%	10.76%	10.66%
Long-Term				
AFR	6.22%	6.13%	6.08%	6.05%
110% AFR	6.85%	6.74%	6.68%	6.65%
120% AFR	7.50%	7.36%	7.29%	7.25%
130% AFR	8.13%	7.97%	7.89%	7.84%

REV. RUL. 2000–38 TABLE 2

Adjusted AFR for August 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.63%	4.58%	4.55%	4.54%
Mid-term adjusted AFR	4.84%	4.78%	4.75%	4.73%
Long-term adjusted AFR	5.53%	5.46%	5.42%	5.40%

REV. RUL. 2000–38 TABLE 3

Rates Under Section 382 for August 2000

Adjusted federal long-term rate for the current month	5.53%
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.)	5.79%

REV. RUL. 2000–38 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for August 2000

Appropriate percentage for the 70% present value low-income housing credit	8.47%
Appropriate percentage for the 30% present value low-income housing credit	3.63%

REV. RUL. 2000–38 TABLE 5

Rate Under Section 7520 for August 2000

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	7.6%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2000. See Rev. Rul. 2000–38, page 157.

Section 6061.—Signing of Returns and Other Documents

26 CFR1.6061–2T: Signing of returns by voice signature (temporary).

T.D. 8892

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

TeleFile Voice Signature Test

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Removal of temporary regulations.

SUMMARY: This document removes temporary regulations that provide that an individual Federal income tax return completed as part of the Telefile Voice Signature test will be treated as a return that is signed, authenticated, verified and filed by the taxpayer as required by the Internal Revenue Code. The temporary regulations were published in the Federal Register on December 27, 1993. Because the temporary regulations applied only to 1992 and 1993 calendar year returns, the IRS is removing them.

EFFECTIVE DATE: These regulations are effective July 18, 2000.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 27, 1993, the IRS issued temporary regulations (T.D. 8510, 1994–1 C.B. 280) in the Federal Register (58 F.R. 68295) under sections 6012, 6061, and 6065 relating to the TeleFile Voice Signature test. Because the temporary regulations applied only to 1992 and 1993 calendar year returns, the IRS has decided to remove them. Therefore, temporary regulations §§1.6012–7T, 1.6061–2T, and 1.6065–2T are being removed.

On December 27, 1993, the IRS also issued a notice of proposed rulemaking (IA–38–93, 1994–1 C.B. 795 [58 F.R. 68335]) under sections 6012, 6061, and 6065. Although written comments and requests for a public hearing were solicited, no written or oral comments were received and no public hearing was requested or held. This notice of proposed rulemaking is being withdrawn in a separate document, Announcement 2000–68 on page 161.

Explanation of provisions

Under sections 6012, 6061, and 6065 of the Internal Revenue Code, each individual with gross income in excess of a specified amount must file an annual income tax return that (i) is signed in accordance with prescribed forms and instructions and, (ii) except as otherwise provided by the Service, contains (or is verified by) a written declaration that the return is made under penalties of perjury.

The temporary regulations provide rules to facilitate the implementation of the Telefile Voice Signature test. Generally, pursuant to the temporary regulations a taxpayer's individual income tax return will be treated as having been properly filed if the taxpayer is eligible to participate in the Telefile Voice Signature test and, pursuant to the instructions from the Telefile system interactive voice computer, provides the requested information and the voice signature during the telephonic filing season.

The Telefile Voice Signature test occurred during the 1993 and 1994 filing seasons. Since that time, the Service has published final regulations generally authorizing alternative signature methods. See §301.6061–1. Accordingly, the regulations relating to the Telefile Voice Signature test are being removed.

Drafting Information

The principal author of these regulations is Beverly A. Baughman of the Office of Assistant Chief Counsel (Income Tax and Accounting), IRS. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in their development.

* * * * *

Removal of Temporary Regulations

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 * * *

§1.6012–7T [Removed]

Par. 2. Section 1.6012–7T is removed.

§1.6061–2T [Removed]

Par. 3. Section 1.6061–2T is removed.

§1.6065–2T [Removed]

Par. 4. Section 1.6065–2T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for part 602 continues to read as follows:

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

Par. 6. Section 602.101(c) is amended by removing the following entries in the table:

§602.101 OMB Control numbers.

* * * * *

(c)* * *

CFR part or section where identified and described	Current OMB control number
* * * * *	
1.6012–7T	1545-1348
1.6061–2T	1545-1348
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved June 30, 2000.

Jonathan Talisman,
Assistant Secretary of the Treasury.

(Filed by the Office of Federal Register on July 17, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 18, 2000, 65 F.R. 44437)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2000. See Rev. Rul. 2000–38, page 157.

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 2000. See Rev. Rul. 2000–38, page 157.

Part IV. Items of General Interest

Dollar-Value LIFO Regulations; Inventory Price Index Computation Method; Correction

Announcement 2000–66

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains corrections to a notice of proposed rulemaking (REG–107644–98, 2000–23 I.R.B. 1229) which was published in the Federal Register on May 19, 2000 (65 F.R. 31841) relating to the dollar-value LIFO regulations.

FOR FURTHER INFORMATION CONTACT: Jeffery G. Mitchell at (202) 622-4970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The proposed regulations that are the subject of these corrections are under section 472 of the Internal Revenue Code.

Need for Correction

As published, this notice of proposed rulemaking contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–107644–98), which was subject to FR. Doc. 00–12174, is corrected as follows:

1. On page 31844, column 1, in the preamble under the paragraph heading *"New Base Year for IPIC Method Changes"*, line 1, the language "Section 1.472–8(e)(vi) requires a" is corrected to read "Section 1.472–8(e)(3)(vi) requires a".

2. On page 31849, column 1, §1.472–8 (e)(3)(iii)(F), paragraph (xii) of *Example 1.*, line 2, in the paragraph heading, the language *"the 1997 taxable year.* R computes the" is corrected to read *"the 1998 taxable year.* R computes the".

3. On page 31849, column 2, §1.472–8 (e)(3)(iii)(F), paragraph (xiii) of *Example 1.*, fourth line from the bottom of paragraph, the language "inventory at the end of the 1997 taxable year" is corrected to read "inventory at the end of the 1998 taxable year".

4. On page 31850, column 1, §1.472–8 (e)(3)(iii)(F), paragraph (vi) of *Example 2.*, line 2, in the paragraph heading, the language *"the 1997 taxable year.* R computes the" is corrected to read *"the 1998 taxable year.* R computes the".

5. On page 31850, column 2, §1.472–8 (e)(3)(iv)(A), second line from the bottom of column, the language "election of an appropriate representative" is corrected to read "election of a representative appropriate".

6. On page 31852, column 1, §1.472–8 (e)(3)(iv)(C)(*2*)(*ii*), paragraph (ii) of *Example.*, sixth line from the bottom of the paragraph, the language "($241,980.60 * 1.438793), Finally, the" is corrected to read "($124,180.60 * 1.438793). Finally, the".

7. On page 31852, column 1, §1.472–8 (e)(3)(iv)(C)(*2*)(*ii*), paragraph (ii) of *Example.*, fourth line from the bottom of the paragraph, the language "sold and increases Y's gross income for the" is corrected to read "sold and increase Y's gross income for the".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization and Strategic Planning).

(Filed by the Office of Federal Register on July 18, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 19, 2000, 65 F.R. 44709)

Foundations Status of Certain Organizations

Announcement 2000–67

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:

Alms for the Poor Corporation, Naples, FL
American Freedom Housing, Clearwater, FL
Americas Toys of the World Museum, Pawtucket, RI
Associated Builders & Contractors Western Oklahoma Inc., Training Fund, Oklahoma City, OK
M.L. Carr Foundation, Inc., Peabody, MA
Center for the Study of the Person & the Advancement of Human Rights, San Diego, CA
Chicago Philharmonic Orchestra, Chicago, IL
Children's Community Corner, Cleveland, OH
Choices Community Childcare Resource, Orlando, FL
Choices Unlimited, Inglewood, CA
Citizens Landmark Preservation, Chicago, IL
Cleburne County Schools Foundation, Heflin, AL
Cloverwood Development Corporation, Rochester, NY
Community Education Services, Inc., Greentown, IN
Contra Costa Boys Development Center, Pittsburg, CA
Creative Assistance Development, Inc., Elgin, IL
DCL Foundation, Inc., Del City, OK
De Best Shared Housing, Inc., Baltimore, MD
James C. Dezendorf Charitable Trust, Portland, OR
Elk Valley Band, Estill Springs, TN
Families in Crisis, Auburn, WA
Foundation for the Residents of Sturgis, Inc., Sturgis, SD
Friends of the Holy Cross, Staunton, VA
Frio Healthcare Foundation, Pearsall, TX
Greater Nebraska City Medical Care Foundation, Nebraska City, NE
Harlem Volunteer Ambulance Corps, Inc., New York, NY

Hmong-American Museum for the Future, Inc., Wausau, WI
Olive D. Hoffman Memorial, Inc., Great Falls, VA
Institute for Hindu Studies, Edmond, OK
International Cinema Museum, Glenview, IL
International Soccer Club, Incorporated, Hampton, VA
J&W Adult Care, Inc., Los Angeles, CA
Job Outreach for Youth, Chicago, IL
Just-Cause Volunteer Services, Inc., New York, NY
Lend-A-Hand Society, Inc., Fort Lee, NJ
Les Grands Ballets De Loony, Inc., New York, NY
Les Paul Foundation, New York, NY
Lifestream Foundation, St. Paul, MN
Los Ayudantes de Naranja, Newport Beach, CA
Medical Media, Orem, UT
Middlesex County Bar Foundation, Inc., Cambridge, MA
MTOTO, Inc., Brookpart, IL
Nicos Playhouse II, Chicago, IL
Northern Manhattan Legal Services Corporation, New York, NY
Oak Center Neighborhood Association, Oakland, CA
Owens-Jones Academy for Enrichments, Inc., Atlanta, GA
Pejepscot Terrace Corporation, Brunswick, ME
Physicians for Prevention, Inc., Jackonsville, FL
Plaza Community Playground, Inc., Baldwin, NY
Prairie Center for Environmental Learning and Living CELL, Inc., Hastings, NE
REACH Responsible Enough to Achieve Career Heights, Inc., Fayetteville, GA
Reginald L. Blair Memorial Fund, Sharon, VT
Regional AIDS Interfaith Network of Western New York, Buffalo, NY
Regional Economic and Civic Team, Farmington, MO
Sailboat Bend Historical Trust, Inc., Fort Lauderdale, FL
Samuel and Lydia Clark Foundation, Inc., Syracuse, NY
Science of Laws Institute, Poway, CA
Soul Unlimited Outreach Ministries, Silvus, IL
Sound In Spirit Broadcasting, Inc., Oskaloosa, IA
Southeastern Queens Youth Alternative, Inc., St. Albans, NY
Strategies to Independence, Inc., N. Attleboro, MA
Tampa Bay Inner City Youth Tennis Academy, Inc., St. Petersburg, FL
Texas Saltwater Association, Houston, TX
Three in One Group Home, Inc., Oakland, CA
Tribute 21 Foundation, Inc., New York, NY
True Deliverance Worldwide Ministries, Inc., Little Rock, AR
Tulsa Firefighters Educational Clowns, Inc., Tulsa, OK
Two Cities, St. Paul, MN
USA Television Corporation, LaPlace, LA
Vietnam Veterans of America, Ohio State Council, Inc., Columbus, OH
Village Voice Obies Foundation, Inc., New York, NY
West Virginia Local Health, Incorporated, Wellsburg, WV
Tim Wynacht Ministries, Lakeport, CA
World Pal, White Plains, 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.

TeleFile Voice Signature Test

Announcement 2000–68

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of cross-referencing notice of proposed rulemaking.

SUMMARY: This document withdraws the notice of proposed rulemaking relating to the Telefile Voice Signature test that was published in the **Federal Register** on December 27, 1993. The notice of proposed rulemaking cross-referenced temporary regulations published on the same day that provided that an individual federal income tax return completed as part of the Telefile Voice Signature test would be treated as a return that is signed, authenticated, verified and filed by the taxpayer as required by the Internal Revenue Code.

EFFECTIVE DATE: These regulations are effective July 18, 2000.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 27, 1993, the IRS issued proposed regulations (REG–209640–93) in the **Federal Register** (IA–38–93, 1994–1 C.B. 795 [58 F.R. 68335]) under sections 6012, 6061, and 6065 relating to the Tele-File Voice Signature test. The notice of proposed rulemaking cross-referenced temporary regulations (T.D. 8510, 1994–1 C.B. 280) published in the **Federal Register** for the same day (58 F.R. 68295). Although written comments and requests for a public hearing were solicited, no written or oral comments were received and no public hearing was requested or held. Because the applicable temporary regulations apply only to 1992 and 1993 calendar year returns, the IRS has decided not to finalize those regulations and, thus, is withdrawing the proposed regulations.

* * * * *

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking that was published in the **Federal Register** on December 27, 1993, (58 F.R. 68335) is withdrawn.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 17, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 18, 2000, 65 F.R. 44491)

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

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72(p)–1: Loans treated as distributions.

T.D. 8894

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Loans From a Qualified Employer Plan to Plan Participants or Beneficiaries

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to loans made from a qualified employer plan to plan participants or beneficiaries. These final regulations provide guidance on the application of section 72(p) of the Internal Revenue Code. These regulations affect administrators of, participants in, and beneficiaries of qualified employer plans that permit participants or beneficiaries to receive loans from the plan, including loans from section 403(b) contracts and other contracts issued under qualified employer plans.

DATES: *Effective Date*: These regulations are effective July 31, 2000.

Applicability Date: For dates of applicability, see §1.72(p)–1, Q&A-22 (a) through (c)(2).

FOR FURTHER INFORMATION CONTACT: Vernon S. Carter, (202) 622-6070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations (26 CFR Part 1) under section 72 of the Internal Revenue Code of 1986 (Code). These regulations provide guidance concerning the tax treatment of loans that are deemed to be distributed under section 72(p). Section 72(p) was added by section 236 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324), and amended by the Technical Corrections Act of 1982 (96 Stat. 2365), the Deficit Reduction Act of 1984 (98 Stat. 494), the Tax Reform Act of 1986 (100 Stat. 2085), and the Technical and Miscellaneous Revenue Act of 1988 (102 Stat. 3342).

On December 21, 1995, a notice of proposed rulemaking (EE–106–82, 1996–1 C.B. 732) was published in the **Federal Register** (60 F.R. 66233) with respect to many of the issues arising under section 72(p)(2). The preamble to the 1995 proposed regulations requested comments on certain issues that were not addressed. Following publication of the 1995 proposed regulations, comments were received and a public hearing was held on June 28, 1996. One of the issues on which comments were requested and received was the effect of a deemed distribution on the tax treatment of subsequent distributions from a plan (such as whether a participant has tax basis as a result of a deemed distribution). After reviewing the written comments and comments made at the public hearing, additional proposed regulations addressing this issue were published January 2, 1998 (REG–209476–82, 1998–1 C.B. 594), in the **Federal Register** (63 F.R. 42). Written comments were received on the 1998 proposed regulations, but no public hearing was requested. After consideration of all comments received on both the 1995 and the 1998 proposed regulations, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 72(p)(1)(A) provides that a loan from a qualified employer plan (including a contract purchased under a qualified employer plan) to a participant or beneficiary is treated as received as a distribution from the plan for purposes of section 72 (a deemed distribution). Section 72(p)(1)(B) provides that an assignment or pledge of (or an agreement to assign or pledge) any portion of a participant's or beneficiary's interest in a qualified employer plan is treated as a loan from the plan.

Section 72(p)(2) provides that section 72(p)(1) does not apply to the extent certain conditions are satisfied. Specifically, under section 72(p)(2), a loan from a qualified employer plan to a participant or beneficiary is not treated as a distribution from the plan if the loan satisfies requirements relating to the term of the loan and the repayment schedule, and to the extent the loan satisfies certain limitations on the amount loaned. For example, except in the case of certain home loans, the exception in section 72(p)(2) only applies to a loan that by its terms is to be repaid over not more than five years in substantially level installments.

For purposes of section 72, a qualified employer plan includes a plan that qualifies under section 401 (relating to qualified trusts), 403(a) (relating to qualified annuities) or 403(b) (relating to tax sheltered annuities[1]), as well as a plan (whether or not qualified) maintained by the United States, a State or a political subdivision thereof, or an agency or instrumentality thereof. A qualified employer plan also includes a plan which was (or was determined to be) a qualified plan or a government plan.

Summary of Comments Received and Changes Made and Summary of the Final Regulations

In general, comments received on the proposed regulations were favorable and, accordingly, the final regulations retain the general structure and substance of the proposed regulations, including a wide variety of examples illustrating the rules in the final regulations. However, commentators made a number of specific recommendations for modifications and clarifications of the regulations. The comments are summarized below, along with the IRS' and Treasury's consideration of those comments.

[1]With respect to coverage under Title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829) (ERISA), the Department of Labor (DOL) has advised the IRS that an employer's tax-sheltered annuity program would not necessarily fail to satisfy the Department's regulation at 29 CFR 2510.3–2(f) merely because the employer permits employees to make repayments of loans made in connection with the tax-sheltered annuity program through payroll deductions as part of the employer's payroll deduction system, if the program operates within the limitations set by that regulation.

A. Cure Period for Missed Payments

The 1995 proposed regulations stated that the section 72(p)(2)(C) requirement that repayments be made in level installments at least quarterly would not be violated if payments are not made until the end of a grace period that the plan administrator may allow, but only to the extent the grace period does not continue beyond the last day of the calendar quarter following the calendar quarter in which the required installment payment was due. Commentators suggested that the proposed regulations should specify how the grace period is to be established, such as whether the grace period must be contained in the plan document, a separate loan program that is deemed to be a part of the plan document pursuant to DOL 29 CFR 2550.408b–1(d)(2), or the summary plan description, and whether it is permissible for a plan to have grace periods on a participant by participant basis (so long as this did not discriminate in favor of the highly compensated employees).

Some commentators requested that a plan participant have a reasonable period of time (such as up to 30 days) to cure a default after the plan administrator has sent a notice of default, and that the section 72(p) regulations mandate that the plan administrator send a notice of default within a reasonable period of time (such as 30 days) after it has discovered the default. These commentators suggested that grace and cure periods might be conditioned upon the plan administrator having an appropriate procedure in place for timely identification of defaults and curing defects. Some commentators requested that final regulations permit a plan administrator to use his or her discretion, under special circumstances, to provide a grace period of up to one year from the date of a missed payment.

Many of these suggested changes relate to legal requirements other than section 72(p), such as the application of the fiduciary requirements of ERISA[2] and Federal and state laws that apply to debtors and creditors. The 1995 proposed regulations allowed a grace period up to the end of the next following quarter. Thus, a plan could select a grace period of, for example, 30 days or 90 days and could provide a special notice to the participant concerning the grace period. Thus, many of the suggested changes would involve the imposition of new and complicated rules for which there is no apparent basis in section 72(p) and which would in any case be difficult to enforce and to administer. Accordingly, the final regulations retain the same rules as the proposed regulations. However, the final regulations use the term *cure period* instead of *grace period.*

The final regulations also include a new cross-reference to section 414(u)(4), (relating to military service) which was added to the Code by the Small Business Job Protection Act of 1996 (110 Stat. 1755).

B. Treatment of Loans after Deemed Distribution.

The 1998 proposed regulations provide that once a loan is deemed distributed under section 72(p) of the Code, interest that accrues thereafter on that loan is not included in income and, for purposes of calculating the maximum permitted amount of any subsequent loan, a loan that has been deemed distributed is considered outstanding until the loan obligation has been satisfied. The majority of the comments on this issue urged that the positions taken in the 1998 proposed regulations addressing post-default interest be adopted in the final regulations. Some commentators asked that the regulations provide further guidance on or revise the treatment of interest that accrues on a loan that is a deemed distribution under section 72(p), as described in Q&A-19 of the 1998 proposed regulations. Commentators noted that, in the case of a plan that has chosen to permit additional loans after a default that has not been cured, the rule in the proposed regulations requiring interest to be taken into account in determining the maximum amount of any subsequent loan would involve costs to make system and procedural changes to calculate the accrued interest on the defaulted loan for this limited application. Other commentators urged that participants be taxed on the additional interest after a default, either annually or as an accumulated amount at the time of a loan offset, as an incentive for the participant to repay the loan.

One commentator raised the issue of how a deemed distribution would be taken into account in a plan with a graded vesting schedule.

The final regulations generally adopt the rules in the proposed regulations, but the regulations have been revised to indicate that a deemed distribution is not taken into account as a distribution for purposes of the requirements of §1.411(a)–7(d)(5) (relating to the determination of a participant's account balance if a distribution is made at a time when the participant's vesting percentage may increase).

C. Enforceable Agreement and New Technologies

The 1995 proposed regulations required that a loan be evidenced by a legally enforceable agreement and that the legally enforceable agreement be set forth in writing or in another form approved by the Commissioner. Commentators asked whether a participant needs to sign a loan agreement document and whether loans made electronically, such as over phone or voice response units, would be permitted.

Some comments requested elimination of the requirement that a loan be evi-

[2]The Department of Labor has advised the IRS that, with respect to plans covered by Title I of ERISA, the administration of a participant loan program involves the management of plan assets. Therefore, fiduciary conduct undertaken in the administration of such a loan program must conform to the rules that govern transactions involving plan assets. See, generally, ERISA sections 403, 404, and 406. Fiduciary conduct in the administration of a loan program would include decisions concerning the rules governing the program, including establishing standards to govern the appropriateness of making any particular loan and the appropriate treatment of any defaulted loan. Further, absent an exemption, any loan between a plan covered by Title I of ERISA and a party in interest to the plan (including plan participants and beneficiaries) would constitute a prohibited transaction under section 406(a)(1)(B) of ERISA. DOL has promulgated a regulation at 29 CFR 2550.408b–1 providing guidance regarding the statutory exemption contained in section 408(b)(1) of ERISA for plan loans to parties in interest who are participants or beneficiaries. Further, some loans by plans (whether or not covered under Title I of ERISA) may constitute prohibited transactions under section 4975(c)(1)(B) of the Internal Revenue Code. Under section 102 of Reorganization Plan No. 4 of 1978, (43 FR 47,713) (1978), the Secretary of Labor has jurisdiction to promulgate regulations under section 4975(d)(1) of the Internal Revenue Code, which provides a limited exemption to the prohibition of section 4975(c)(1)(B) of the Internal Revenue Code.

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

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72(p)–1: Loans treated as distributions.

T.D. 8894

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Loans From a Qualified Employer Plan to Plan Participants or Beneficiaries

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to loans made from a qualified employer plan to plan participants or beneficiaries. These final regulations provide guidance on the application of section 72(p) of the Internal Revenue Code. These regulations affect administrators of, participants in, and beneficiaries of qualified employer plans that permit participants or beneficiaries to receive loans from the plan, including loans from section 403(b) contracts and other contracts issued under qualified employer plans.

DATES: *Effective Date*: These regulations are effective July 31, 2000.

Applicability Date: For dates of applicability, see §1.72(p)–1, Q&A-22 (a) through (c)(2).

FOR FURTHER INFORMATION CONTACT: Vernon S. Carter, (202) 622-6070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations (26 CFR Part 1) under section 72 of the Internal Revenue Code of 1986 (Code). These regulations provide guidance concerning the tax treatment of loans that are deemed to be distributed under section 72(p). Section 72(p) was added by section 236 of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324), and amended by the Technical Corrections Act of 1982 (96 Stat. 2365), the Deficit Reduction Act of 1984 (98 Stat. 494), the Tax Reform Act of 1986 (100 Stat. 2085), and the Technical and Miscellaneous Revenue Act of 1988 (102 Stat. 3342).

On December 21, 1995, a notice of proposed rulemaking (EE–106–82, 1996–1 C.B. 732) was published in the **Federal Register** (60 F.R. 66233) with respect to many of the issues arising under section 72(p)(2). The preamble to the 1995 proposed regulations requested comments on certain issues that were not addressed. Following publication of the 1995 proposed regulations, comments were received and a public hearing was held on June 28, 1996. One of the issues on which comments were requested and received was the effect of a deemed distribution on the tax treatment of subsequent distributions from a plan (such as whether a participant has tax basis as a result of a deemed distribution). After reviewing the written comments and comments made at the public hearing, additional proposed regulations addressing this issue were published January 2, 1998 (REG–209476–82, 1998–1 C.B. 594), in the **Federal Register** (63 F.R. 42). Written comments were received on the 1998 proposed regulations, but no public hearing was requested. After consideration of all comments received on both the 1995 and the 1998 proposed regulations, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 72(p)(1)(A) provides that a loan from a qualified employer plan (including a contract purchased under a qualified employer plan) to a participant or beneficiary is treated as received as a distribution from the plan for purposes of section 72 (a deemed distribution). Section 72(p)(1)(B) provides that an assignment or pledge of (or an agreement to assign or pledge) any portion of a participant's or beneficiary's interest in a qualified employer plan is treated as a loan from the plan.

Section 72(p)(2) provides that section 72(p)(1) does not apply to the extent certain conditions are satisfied. Specifically, under section 72(p)(2), a loan from a qualified employer plan to a participant or beneficiary is not treated as a distribution from the plan if the loan satisfies requirements relating to the term of the loan and the repayment schedule, and to the extent the loan satisfies certain limitations on the amount loaned. For example, except in the case of certain home loans, the exception in section 72(p)(2) only applies to a loan that by its terms is to be repaid over not more than five years in substantially level installments.

For purposes of section 72, a qualified employer plan includes a plan that qualifies under section 401 (relating to qualified trusts), 403(a) (relating to qualified annuities) or 403(b) (relating to tax sheltered annuities[1]), as well as a plan (whether or not qualified) maintained by the United States, a State or a political subdivision thereof, or an agency or instrumentality thereof. A qualified employer plan also includes a plan which was (or was determined to be) a qualified plan or a government plan.

Summary of Comments Received and Changes Made and Summary of the Final Regulations

In general, comments received on the proposed regulations were favorable and, accordingly, the final regulations retain the general structure and substance of the proposed regulations, including a wide variety of examples illustrating the rules in the final regulations. However, commentators made a number of specific recommendations for modifications and clarifications of the regulations. The comments are summarized below, along with the IRS' and Treasury's consideration of those comments.

[1]With respect to coverage under Title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829) (ERISA), the Department of Labor (DOL) has advised the IRS that an employer's tax-sheltered annuity program would not necessarily fail to satisfy the Department's regulation at 29 CFR 2510.3–2(f) merely because the employer permits employees to make repayments of loans made in connection with the tax-sheltered annuity program through payroll deductions as part of the employer's payroll deduction system, if the program operates within the limitations set by that regulation.

A. Cure Period for Missed Payments

The 1995 proposed regulations stated that the section 72(p)(2)(C) requirement that repayments be made in level installments at least quarterly would not be violated if payments are not made until the end of a grace period that the plan administrator may allow, but only to the extent the grace period does not continue beyond the last day of the calendar quarter following the calendar quarter in which the required installment payment was due. Commentators suggested that the proposed regulations should specify how the grace period is to be established, such as whether the grace period must be contained in the plan document, a separate loan program that is deemed to be a part of the plan document pursuant to DOL 29 CFR 2550.408b–1(d)(2), or the summary plan description, and whether it is permissible for a plan to have grace periods on a participant by participant basis (so long as this did not discriminate in favor of the highly compensated employees).

Some commentators requested that a plan participant have a reasonable period of time (such as up to 30 days) to cure a default after the plan administrator has sent a notice of default, and that the section 72(p) regulations mandate that the plan administrator send a notice of default within a reasonable period of time (such as 30 days) after it has discovered the default. These commentators suggested that grace and cure periods might be conditioned upon the plan administrator having an appropriate procedure in place for timely identification of defaults and curing defects. Some commentators requested that final regulations permit a plan administrator to use his or her discretion, under special circumstances, to provide a grace period of up to one year from the date of a missed payment.

Many of these suggested changes relate to legal requirements other than section 72(p), such as the application of the fiduciary requirements of ERISA[2] and Federal and state laws that apply to debtors and creditors. The 1995 proposed regulations allowed a grace period up to the end of the next following quarter. Thus, a plan could select a grace period of, for example, 30 days or 90 days and could provide a special notice to the participant concerning the grace period. Thus, many of the suggested changes would involve the imposition of new and complicated rules for which there is no apparent basis in section 72(p) and which would in any case be difficult to enforce and to administer. Accordingly, the final regulations retain the same rules as the proposed regulations. However, the final regulations use the term *cure period* instead of *grace period.*

The final regulations also include a new cross-reference to section 414(u)(4), (relating to military service) which was added to the Code by the Small Business Job Protection Act of 1996 (110 Stat. 1755).

B. Treatment of Loans after Deemed Distribution.

The 1998 proposed regulations provide that once a loan is deemed distributed under section 72(p) of the Code, interest that accrues thereafter on that loan is not included in income and, for purposes of calculating the maximum permitted amount of any subsequent loan, a loan that has been deemed distributed is considered outstanding until the loan obligation has been satisfied. The majority of the comments on this issue urged that the positions taken in the 1998 proposed regulations addressing post-default interest be adopted in the final regulations. Some commentators asked that the regulations provide further guidance on or revise the treatment of interest that accrues on a loan that is a deemed distribution under section 72(p), as described in Q&A-19 of the 1998 proposed regulations. Commentators noted that, in the case of a plan that has chosen to permit additional loans after a default that has not been cured, the rule in the proposed regulations requiring interest to be taken into account in determining the maximum amount of any subsequent loan would involve costs to make system and procedural changes to calculate the accrued interest on the defaulted loan for this limited application. Other commentators urged that participants be taxed on the additional interest after a default, either annually or as an accumulated amount at the time of a loan offset, as an incentive for the participant to repay the loan.

One commentator raised the issue of how a deemed distribution would be taken into account in a plan with a graded vesting schedule.

The final regulations generally adopt the rules in the proposed regulations, but the regulations have been revised to indicate that a deemed distribution is not taken into account as a distribution for purposes of the requirements of §1.411(a)–7(d)(5) (relating to the determination of a participant's account balance if a distribution is made at a time when the participant's vesting percentage may increase).

C. Enforceable Agreement and New Technologies

The 1995 proposed regulations required that a loan be evidenced by a legally enforceable agreement and that the legally enforceable agreement be set forth in writing or in another form approved by the Commissioner. Commentators asked whether a participant needs to sign a loan agreement document and whether loans made electronically, such as over phone or voice response units, would be permitted.

Some comments requested elimination of the requirement that a loan be evi-

[2]The Department of Labor has advised the IRS that, with respect to plans covered by Title I of ERISA, the administration of a participant loan program involves the management of plan assets. Therefore, fiduciary conduct undertaken in the administration of such a loan program must conform to the rules that govern transactions involving plan assets. See, generally, ERISA sections 403, 404, and 406. Fiduciary conduct in the administration of a loan program would include decisions concerning the rules governing the program, including establishing standards to govern the appropriateness of making any particular loan and the appropriate treatment of any defaulted loan. Further, absent an exemption, any loan between a plan covered by Title I of ERISA and a party in interest to the plan (including plan participants and beneficiaries) would constitute a prohibited transaction under section 406(a)(1)(B) of ERISA. DOL has promulgated a regulation at 29 CFR 2550.408b–1 providing guidance regarding the statutory exemption contained in section 408(b)(1) of ERISA for plan loans to parties in interest who are participants or beneficiaries. Further, some loans by plans (whether or not covered under Title I of ERISA) may constitute prohibited transactions under section 4975(c)(1)(B) of the Internal Revenue Code. Under section 102 of Reorganization Plan No. 4 of 1978, (43 FR 47,713) (1978), the Secretary of Labor has jurisdiction to promulgate regulations under section 4975(d)(1) of the Internal Revenue Code, which provides a limited exemption to the prohibition of section 4975(c)(1)(B) of the Internal Revenue Code.

denced by a legally enforceable agreement. However, the final regulations retain this requirement. There is, arguably, no difference between a loan that is not legally enforceable and a cash distribution that the employee is permitted to return to the plan. The final regulations clarify that, as long as a signature is not required in order for the loan to be enforceable under applicable law, the agreement need not be signed.

The final regulations also require the agreement to be set forth in a written paper document or in another form approved by the Commissioner. However, the final regulations also treat this requirement as satisfied if the loan agreement is set forth in any electronic medium that satisfies certain standards. The standards in these final regulations for use of an electronic medium for a loan are the same as the standards for use of an electronic medium for a consent to a distribution under §1.411(a)–11(f)(2). 65 F.R. 6001 (February 8, 2000). Specifically, a loan agreement will not fail to satisfy section 72(p)(2) of the Code merely because the loan agreement is in an electronic medium reasonably accessible to the participant or the beneficiary under a system that is reasonably designed to preclude anyone other than the participant or the beneficiary from requesting a loan, that provides the participant or the beneficiary with a reasonable opportunity to review the terms of the loan and to confirm, modify, or rescind the terms of the loan before the loan is made, and that provides the participant or the beneficiary, within a reasonable period after the loan is made, with a confirmation of the loan terms through a written paper document or an electronic medium.[3] If an electronic medium is used to provide confirmation of the loan terms, the electronic medium must be reasonably accessible to the participant or the beneficiary and the electronic confirmation must be provided under a system reasonably designed to give the confirmation in a manner no less understandable to the participant or the beneficiary than a written paper document. Also, the participant or the beneficiary must be advised of the right to request and to receive a copy of the confirmation on a written paper document without charge.

The Electronic Signatures in Global and National Commerce Act (114 Stat. 464) (the Electronic Signatures Act) was signed on June 30, 2000. Title I of the Electronic Signatures Act, which is generally effective October 1, 2000, applies to certain electronic records and signatures in commerce. In the Notice of Proposed Rulemaking, REG–116495–99 on page 179, comments are requested on the impact of the Electronic Signatures Act on these regulations and on any future guidance that may be needed on the application of the Electronic Signatures Act to plan loan transactions.

D. Mortgage Investment Program

Some commentators requested that the special rule in the 1995 proposed regulations under which section 72(p) would not apply to loans made under a residential mortgage investment program be revised to eliminate the requirement that the loans also be available to nonparticipants. This special rule is not based on an explicit statutory provision, but is based on legislative history[4] indicating the understanding that section 72(p) was not intended to apply to loans made in the ordinary course of a bona fide residential mortgage investment program. The IRS and Treasury have concluded that there is a risk that the intent of the section 72(p)(2) limitations might be thwarted if a category of loans extended solely to participants were not subject to section 72(p). However, the extension of this requirement to otherwise bona fide mortgage investment programs that were in effect at the time the 1995 proposed regulations were issued would be inappropriate and, accordingly, the final regulations permit plans with these preexisting programs to continue to make such loans. The special rule in the final regulations is not intended to provide guidance on whether, or to what extent, a plan that is covered by Title I of ERISA may make such residential mortgage loans available to participants or beneficiaries of the plan without violating the provisions of Title I of ERISA.[5]

E. Other Changes

The requirement that a loan be repaid within five years does not apply to a loan used to acquire a dwelling unit which will within a reasonable time be used as the principal residence of the participant. For this purpose, the 1995 proposed regulations provided that a principal residence has the same meaning as a principal residence under section 1034. To reflect the repeal of section 1034[6] and the use of the same term in section 121, the final regulations provide that a principal residence has the same meaning as a principal residence under section 121.[7]

F. Effective Date of Final Regulations

Both the 1995 and the 1998 proposed regulations were proposed to apply for assignments, pledges, and loans made on or after the first January 1 that is at least six months after the issuance of final regulations. Under certain limited conditions, the 1998 proposed regulations permitted loans made before this proposed general effective date to apply Q&A-19, relating to interest accruing after a deemed distribution, and Q&A-20, relating to basis resulting from repayments after a deemed distribution. Comments on these transition conditions were generally favorable, but one commentator requested that plan sponsors be permitted to rely on these rules for loans made before the general effective date if any reasonable and consistent method had been used to report deemed distributions before the general effective date. The rules in the 1998 proposed regulations for pre-effective date loans included carefully considered, specific conditions in order for such loans to be able to rely on Q&A-19 and Q&A-20 (including several detailed examples illustrating the application of these transition conditions) and these rules have been retained in the final regulations.

[3]Neither the regulations regarding use of electronic medium under section 411 nor these regulations apply for purposes of satisfying the requirements of section 417, including the requirement of section 417(a)(2)(A) that spousal consent be witnessed by a notary public or plan representative.

[4]H.R. Conf. Rep. No. 97–760, 97th Cong., 2d Sess. 620 (1982), 1982–2 C.B. 672 and S. Rep. No. 97–494, 97th Cong., 2d Sess. 319, 321 (1982).

[5]See, for example, PTCE 88–59.

[6]Section 1034 was repealed by section 312(b) of the Taxpayer Relief Act of 1997 (Public Law 105–34) (111 Stat. 788).

[7]Like the 1995 proposed regulations, the final regulations (at Q&A-7) apply the tracing rules of section 163(h)(3) of the Code to trace whether a loan is a principal residence plan loan. Notice 88–74 (1988–2 C.B. 385), sets forth certain standards applicable under section 163(h)(3).

Commentators also requested that the general effective date be the first January 1 that is at least 6 or 12 months after the date of the final regulations to allow for proper redesign and testing of plan loan administration systems. Consistent with the proposed effective date and these comments, the final regulations are applicable to assignments, pledges, and loans made on or after January 1, 2002.

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 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 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 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 Vernon S. Carter, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). 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 1.72–17A is amended as follows:

1. Paragraphs (d)(1), (d)(2) and (d)(3) are redesignated as paragraphs (d)(2), (d)(3) and (d)(4), respectively.

2. New paragraph (d)(1) is added.

The addition reads as follows:

§1.72–17A Special rules applicable to employee annuities and distributions under deferred compensation plans to self-employed individuals and owner-employees.

* * * * *

(d) * * * (1) The references in this paragraph (d) to section 72(m)(4) are to that section as in effect on August 13, 1982. Section 236(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 324) repealed section 72(m)(4), generally effective for assignments, pledges and loans made after August 13, 1982, and added section 72(p). See section 72(p) and §1.72(p)–1 for rules governing the income tax treatment of certain assignments, pledges and loans from qualified employer plans made after August 13, 1982.

* * * * *

Par. 3. Section 1.72(p)–1 is added to read as follows:

§1.72(p)–1 Loans treated as distributions.

The questions and answers in this section provide guidance under section 72(p) pertaining to loans from qualified employer plans (including government plans and tax-sheltered annuities and employer plans that were formerly qualified). The examples included in the questions and answers in this section are based on the assumption that a bona fide loan is made to a participant from a qualified defined contribution plan pursuant to an enforceable agreement (in accordance with paragraph (b) of Q&A-3 of this section), with adequate security and with an interest rate and repayment terms that are commercially reasonable. (The particular interest rate used, which is solely for illustration, is 8.75 percent compounded annually.) In addition, unless the contrary is specified, it is assumed in the examples that the amount of the loan does not exceed 50 percent of the participant's nonforfeitable account balance, the participant has no other outstanding loan (and had no prior loan) from the plan or any other plan maintained by the participant's employer or any other person required to be aggregated with the employer under section 414(b), (c) or (m), and the loan is not excluded from section 72(p) as a loan made in the ordinary course of an investment program as described in Q&A-18 of this section. The regulations and examples in this section do not provide guidance on whether a loan from a plan would result in a prohibited transaction under section 4975 of the Internal Revenue Code or on whether a loan from a plan covered by Title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829) (ERISA) would be consistent with the fiduciary standards of ERISA or would result in a prohibited transaction under section 406 of ERISA. The questions and answers are as follows:

Q-1: In general, what does section 72(p) provide with respect to loans from a qualified employer plan?

A-1: (a) *Loans.* Under section 72(p), an amount received by a participant or beneficiary as a loan from a qualified employer plan is treated as having been received as a distribution from the plan (a deemed distribution), unless the loan satisfies the requirements of Q&A-3 of this section. For purposes of section 72(p) and this section, a loan made from a contract that has been purchased under a qualified employer plan (including a contract that has been distributed to the participant or beneficiary) is considered a loan made under a qualified employer plan.

(b) *Pledges and assignments.* Under section 72(p), if a participant or beneficiary assigns or pledges (or agrees to assign or pledge) any portion of his or her interest in a qualified employer plan as security for a loan, the portion of the individual's interest assigned or pledged (or subject to an agreement to assign or pledge) is treated as a loan from the plan to the individual, with the result that such portion is subject to the deemed distribution rule described in paragraph (a) of this Q&A-1. For purposes of section 72(p) and this section, any assignment or pledge of (or agreement to assign or to pledge) any portion of a participant's or beneficiary's interest in a contract that has been purchased under a qualified employer plan (including a contract that has been distributed to the participant or beneficiary) is considered an assignment or pledge of (or agreement to assign or pledge) an interest in a qualified employer plan. However, if all or a portion of a participant's or beneficiary's interest in a qualified employer plan is pledged or as-

signed as security for a loan from the plan to the participant or the beneficiary, only the amount of the loan received by the participant or the beneficiary, not the amount pledged or assigned, is treated as a loan.

Q-2: What is a qualified employer plan for purposes of section 72(p)?

A-2: For purposes of section 72(p) and this section, a qualified employer plan means—

(a) A plan described in section 401(a) which includes a trust exempt from tax under section 501(a);

(b) An annuity plan described in section 403(a);

(c) A plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b);

(d) Any plan, whether or not qualified, established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of the United States, a State or a political subdivision of a State; or

(e) Any plan which was (or was determined to be) described in paragraph (a), (b), (c), or (d) of this Q&A-2.

Q-3: What requirements must be satisfied in order for a loan to a participant or beneficiary from a qualified employer plan not to be a deemed distribution?

A-3: (a) *In general.* A loan to a participant or beneficiary from a qualified employer plan will not be a deemed distribution to the participant or beneficiary if the loan satisfies the repayment term requirement of section 72(p)(2)(B), the level amortization requirement of section 72(p)(2)(C), and the enforceable agreement requirement of paragraph (b) of this Q&A-3, but only to the extent the loan satisfies the amount limitations of section 72(p)(2)(A).

(b) *Enforceable agreement requirement.* A loan does not satisfy the requirements of this paragraph unless the loan is evidenced by a legally enforceable agreement (which may include more than one document) and the terms of the agreement demonstrate compliance with the requirements of section 72(p)(2) and this section. Thus, the agreement must specify the amount and date of the loan and the repayment schedule. The agreement does not have to be signed if the agreement is enforceable under applicable law without being signed. The agreement must be set forth either—

(1) In a written paper document;

(2) In an electronic medium that is reasonably accessible to the participant or the beneficiary and that is provided under a system that satisfies the following requirements:

(i) The system must be reasonably designed to preclude any individual other than the participant or the beneficiary from requesting a loan.

(ii) The system must provide the participant or the beneficiary with a reasonable opportunity to review and to confirm, modify, or rescind the terms of the loan before the loan is made.

(iii) The system must provide the participant or the beneficiary, within a reasonable time after the loan is made, a confirmation of the loan terms either through a written paper document or through an electronic medium that is reasonably accessible to the participant or the beneficiary and that is provided under a system that is reasonably designed to provide the confirmation in a manner no less understandable to the participant or beneficiary than a written document and, under which, at the time the confirmation is provided, the participant or the beneficiary is advised that he or she may request and receive a written paper document at no charge, and, upon request, that document is provided to the participant or beneficiary at no charge.

or

(3) In such other form as may be approved by the Commissioner.

Q-4: If a loan from a qualified employer plan to a participant or beneficiary fails to satisfy the requirements of Q&A-3 of this section, when does a deemed distribution occur?

A-4: (a) *Deemed distribution.* For purposes of section 72, a deemed distribution occurs at the first time that the requirements of Q&A-3 of this section are not satisfied, in form or in operation. This may occur at the time the loan is made or at a later date. If the terms of the loan do not require repayments that satisfy the repayment term requirement of section 72(p)(2)(B) or the level amortization requirement of section 72(p)(2)(C), or the loan is not evidenced by an enforceable agreement satisfying the requirements of paragraph (b) of Q&A-3 of this section, the entire amount of the loan is a deemed distribution under section 72(p) at the time the loan is made. If the loan satisfies the requirements of Q&A-3 of this section except that the amount loaned exceeds the limitations of section 72(p)(2)(A), the amount of the loan in excess of the applicable limitation is a deemed distribution under section 72(p) at the time the loan is made. If the loan initially satisfies the requirements of section 72(p)(2)(A), (B) and (C) and the enforceable agreement requirement of paragraph (b) of Q&A-3 of this section, but payments are not made in accordance with the terms applicable to the loan, a deemed distribution occurs as a result of the failure to make such payments. See Q&A-10 of this section regarding when such a deemed distribution occurs and the amount thereof and Q&A-11 of this section regarding the tax treatment of a deemed distribution.

(b) *Examples.* The following examples illustrate the rules in paragraph (a) of this Q&A-4 and are based upon the assumptions described in the introductory text of this section:

Example 1. (i) A participant has a nonforfeitable account balance of $200,000 and receives $70,000 as a loan repayable in level quarterly installments over five years.

(ii) Under section 72(p), the participant has a deemed distribution of $20,000 (the excess of $70,000 over $50,000) at the time of the loan, because the loan exceeds the $50,000 limit in section 72(p)(2)(A)(i). The remaining $50,000 is not a deemed distribution.

Example 2. (i) A participant with a nonforfeitable account balance of $30,000 borrows $20,000 as a loan repayable in level monthly installments over five years.

(ii) Because the amount of the loan is $5,000 more than 50% of the participant's nonforfeitable account balance, the participant has a deemed distribution of $5,000 at the time of the loan. The remaining $15,000 is not a deemed distribution. (Note also that, if the loan is secured solely by the participant's account balance, the loan may be a prohibited transaction under section 4975 because the loan may not satisfy 29 CFR 2550.408b–1(f)(2).)

Example 3. (i) The nonforfeitable account balance of a participant is $100,000 and a $50,000 loan is made to the participant repayable in level quarterly installments over seven years. The loan is not eligible for the section 72(p)(2)(B)(ii) exception for loans used to acquire certain dwelling units.

(ii) Because the repayment period exceeds the maximum five-year period in section 72(p)(2)(B)(i), the participant has a deemed distribution of $50,000 at the time the loan is made.

Example 4. (i) On August 1, 2002, a participant has a nonforfeitable account balance of $45,000 and borrows $20,000 from a plan to be repaid over five

years in level monthly installments due at the end of each month. After making monthly payments through July 2003, the participant fails to make any of the payments due thereafter.

(ii) As a result of the failure to satisfy the requirement that the loan be repaid in level monthly installments, the participant has a deemed distribution. See paragraph (c) of Q&A-10 of this section regarding when such a deemed distribution occurs and the amount thereof.

Q-5: What is a principal residence for purposes of the exception in section 72(p)(2)(B)(ii) from the requirement that a loan be repaid in five years?

A-5: Section 72(p)(2)(B)(ii) provides that the requirement in section 72(p)(2)(B)(i) that a plan loan be repaid within five years does not apply to a loan used to acquire a dwelling unit which will within a reasonable time be used as the principal residence of the participant (a principal residence plan loan). For this purpose, a principal residence has the same meaning as a principal residence under section 121.

Q-6: In order to satisfy the requirements for a principal residence plan loan, is a loan required to be secured by the dwelling unit that will within a reasonable time be used as the principal residence of the participant?

A-6: A loan is not required to be secured by the dwelling unit that will within a reasonable time be used as the participant's principal residence in order to satisfy the requirements for a principal residence plan loan.

Q-7: What tracing rules apply in determining whether a loan qualifies as a principal residence plan loan?

A-7: The tracing rules established under section 163(h)(3)(B) apply in determining whether a loan is treated as for the acquisition of a principal residence in order to qualify as a principal residence plan loan.

Q-8: Can a refinancing qualify as a principal residence plan loan?

A-8: (a) *Refinancings.* In general, no, a refinancing cannot qualify as a principal residence plan loan. However, a loan from a qualified employer plan used to repay a loan from a third party will qualify as a principal residence plan loan if the plan loan qualifies as a principal residence plan loan without regard to the loan from the third party.

(b) *Example.* The following example illustrates the rules in paragraph (a) of this Q&A-8 and is based upon the assumptions described in the introductory text of this section:

Example. (i) On July 1, 2003, a participant requests a $50,000 plan loan to be repaid in level monthly installments over 15 years. On August 1, 2003, the participant acquires a principal residence and pays a portion of the purchase price with a $50,000 bank loan. On September 1, 2003, the plan loans $50,000 to the participant, which the participant uses to pay the bank loan.

(ii) Because the plan loan satisfies the requirements to qualify as a principal residence plan loan (taking into account the tracing rules of section 163(h)(3)(B)), the plan loan qualifies for the exception in section 72(p)(2)(B)(ii).

Q-9: Does the level amortization requirement of section 72(p)(2)(C) apply when a participant is on a leave of absence without pay?

A-9: (a) *Leave of absence.* The level amortization requirement of section 72(p)(2)(C) does not apply for a period, not longer than one year (or such longer period as may apply under section 414(u)), that a participant is on a bona fide leave of absence, either without pay from the employer or at a rate of pay (after income and employment tax withholding) that is less than the amount of the installment payments required under the terms of the loan. However, the loan (including interest that accrues during the leave of absence) must be repaid by the latest date permitted under section 72(p)(2)(B) (e.g., the suspension of payments cannot extend the term of the loan beyond 5 years, in the case of a loan that is not a principal residence plan loan) and the amount of the installments due after the leave ends (or, if earlier, after the first year of the leave or such longer period as may apply under section 414(u)) must not be less than the amount required under the terms of the original loan.

(b) *Military service.* See section 414(u)(4) for special rules relating to military service.

(c) *Example.* The following example illustrates the rules of paragraph (a) of this Q&A-9 and is based upon the assumptions described in the introductory text of this section:

Example. (i) On July 1, 2002, a participant with a nonforfeitable account balance of $80,000 borrows $40,000 to be repaid in level monthly installments of $825 each over 5 years. The loan is not a principal residence plan loan. The participant makes 9 monthly payments and commences an unpaid leave of absence that lasts for 12 months. Thereafter, the participant resumes active employment and resumes making repayments on the loan until the loan is repaid in full (including interest that accrued during the leave of absence). The amount of each monthly installment is increased to $1,130 in order to repay the loan by June 30, 2007.

(ii) Because the loan satisfies the requirements of section 72(p)(2), the participant does not have a deemed distribution. Alternatively, section 72(p)(2) would be satisfied if the participant continued the monthly installments of $825 after resuming active employment and on June 30, 2007 repaid the full balance remaining due.

Q-10: If a participant fails to make the installment payments required under the terms of a loan that satisfied the requirements of Q&A-3 of this section when made, when does a deemed distribution occur and what is the amount of the deemed distribution?

A-10: (a) *Timing of deemed distribution.* Failure to make any installment payment when due in accordance with the terms of the loan violates section 72(p)(2)(C) and, accordingly, results in a deemed distribution at the time of such failure. However, the plan administrator may allow a cure period and section 72(p)(2)(C) will not be considered to have been violated if the installment payment is made not later than the end of the cure period, which period cannot continue beyond the last day of the calendar quarter following the calendar quarter in which the required installment payment was due.

(b) *Amount of deemed distribution.* If a loan satisfies Q&A-3 of this section when made, but there is a failure to pay the installment payments required under the terms of the loan (taking into account any cure period allowed under paragraph (a) of this Q&A-10), then the amount of the deemed distribution equals the entire outstanding balance of the loan (including accrued interest) at the time of such failure.

(c) *Example.* The following example illustrates the rules in paragraphs (a) and (b) of this Q&A-10 and is based upon the assumptions described in the introductory text of this section:

Example. (i) On August 1, 2002, a participant has a nonforfeitable account balance of $45,000 and borrows $20,000 from a plan to be repaid over 5 years in level monthly installments due at the end of each month. After making all monthly payments due through July 31, 2003, the participant fails to make the payment due on August 31, 2003 or any other monthly payments due thereafter. The plan administrator allows a three-month cure period.

(ii) As a result of the failure to satisfy the requirement that the loan be repaid in level installments pursuant to section 72(p)(2)(C), the partici-

pant has a deemed distribution on November 30, 2003, which is the last day of the three-month cure period for the August 31, 2003 installment. The amount of the deemed distribution is $17,157, which is the outstanding balance on the loan at November 30, 2003. Alternatively, if the plan administrator had allowed a cure period through the end of the next calendar quarter, there would be a deemed distribution on December 31, 2003 equal to $17,282, which is the outstanding balance of the loan at December 31, 2003.

Q-11: Does section 72 apply to a deemed distribution as if it were an actual distribution?

A-11: (a) *Tax basis.* If the employee's account includes after-tax contributions or other investment in the contract under section 72(e), section 72 applies to a deemed distribution as if it were an actual distribution, with the result that all or a portion of the deemed distribution may not be taxable.

(b) *Section 72(t) and (m).* Section 72(t) (which imposes a 10 percent tax on certain early distributions) and section 72(m)(5) (which imposes a separate 10 percent tax on certain amounts received by a 5-percent owner) apply to a deemed distribution under section 72(p) in the same manner as if the deemed distribution were an actual distribution.

Q-12: Is a deemed distribution under section 72(p) treated as an actual distribution for purposes of the qualification requirements of section 401, the distribution provisions of section 402, the distribution restrictions of section 401(k)(2)(B) or 403(b)(11), or the vesting requirements of §1.411(a)–7(d)(5) (which affects the application of a graded vesting schedule in cases involving a prior distribution)?

A-12: No; thus, for example, if a participant in a money purchase plan who is an active employee has a deemed distribution under section 72(p), the plan will not be considered to have made an in-service distribution to the participant in violation of the qualification requirements applicable to money purchase plans. Similarly, the deemed distribution is not eligible to be rolled over to an eligible retirement plan and is not considered an impermissible distribution of an amount attributable to elective contributions in a section 401(k) plan. See also §1.402(c)–2, Q&A-4(d) and §1.401(k)– 1(d)(6)(ii).

Q-13: How does a reduction (offset) of an account balance in order to repay a plan loan differ from a deemed distribution?

A-13: (a) *Difference between deemed distribution and plan loan offset amount.* (1) Loans to a participant from a qualified employer plan can give rise to two types of taxable distributions—

(i) A deemed distribution pursuant to section 72(p); and

(ii) A distribution of an offset amount.

(2) As described in Q&A-4 of this section, a deemed distribution occurs when the requirements of Q&A-3 of this section are not satisfied, either when the loan is made or at a later time. A deemed distribution is treated as a distribution to the participant or beneficiary only for certain tax purposes and is not a distribution of the accrued benefit. A distribution of a plan loan offset amount (as defined in §1.402(c)–2, Q&A-9(b)) occurs when, under the terms governing a plan loan, the accrued benefit of the participant or beneficiary is reduced (offset) in order to repay the loan (including the enforcement of the plan's security interest in the accrued benefit). A distribution of a plan loan offset amount could occur in a variety of circumstances, such as where the terms governing the plan loan require that, in the event of the participant's request for a distribution, a loan be repaid immediately or treated as in default.

(b) *Plan loan offset.* In the event of a plan loan offset, the amount of the account balance that is offset against the loan is an actual distribution for purposes of the Internal Revenue Code, not a deemed distribution under section 72(p). Accordingly, a plan may be prohibited from making such an offset under the provisions of section 401(a), 401(k)(2)(B) or 403(b)(11) prohibiting or limiting distributions to an active employee. See §1.402(c)–2, Q&A-9(c), *Example 6.* See also Q&A-19 of this section for rules regarding the treatment of a loan after a deemed distribution.

Q-14: How is the amount includible in income as a result of a deemed distribution under section 72(p) required to be reported?

A-14: The amount includible in income as a result of a deemed distribution under section 72(p) is required to be reported on Form 1099–R (or any other form prescribed by the Commissioner).

Q-15: What withholding rules apply to plan loans?

A-15: To the extent that a loan, when made, is a deemed distribution or an account balance is reduced (offset) to repay a loan, the amount includible in income is subject to withholding. If a deemed distribution of a loan or a loan repayment by benefit offset results in income at a date after the date the loan is made, withholding is required only if a transfer of cash or property (excluding employer securities) is made to the participant or beneficiary from the plan at the same time. See §§35.3405–1, f-4, and 31.3405(c)–1, Q&A-9 and Q&A-11, of this chapter for further guidance on withholding rules.

Q-16: If a loan fails to satisfy the requirements of Q&A-3 of this section and is a prohibited transaction under section 4975, is the deemed distribution of the loan under section 72(p) a correction of the prohibited transaction?

A-16: No, a deemed distribution is not a correction of a prohibited transaction under section 4975. See §§141.4975–13 and 53.4941(e)–1(c)(1) of this chapter for guidance concerning correction of a prohibited transaction.

Q-17: What are the income tax consequences if an amount is transferred from a qualified employer plan to a participant or beneficiary as a loan, but there is an express or tacit understanding that the loan will not be repaid?

A-17: If there is an express or tacit understanding that the loan will not be repaid or, for any reason, the transaction does not create a debtor-creditor relationship or is otherwise not a bona fide loan, then the amount transferred is treated as an actual distribution from the plan for purposes of the Internal Revenue Code, and is not treated as a loan or as a deemed distribution under section 72(p).

Q-18: If a qualified employer plan maintains a program to invest in residential mortgages, are loans made pursuant to the investment program subject to section 72(p)?

A-18: (a) Residential mortgage loans made by a plan in the ordinary course of an investment program are not subject to section 72(p) if the property acquired with the loans is the primary security for such loans and the amount loaned does not exceed the fair market value of the property. An investment program exists only if the plan has established, in advance of a specific investment under the program, that a

certain percentage or amount of plan assets will be invested in residential mortgages available to persons purchasing the property who satisfy commercially customary financial criteria. A loan will not be considered as made under an investment program if—

(1) Any of the loans made under the program matures upon a participant's termination from employment;

(2) Any of the loans made under the program is an earmarked asset of a participant's or beneficiary's individual account in the plan; or

(3) The loans made under the program are made available only to participants or beneficiaries in the plan.

(b) Paragraph (a)(3) of this Q&A-18 shall not apply to a plan which, on December 20, 1995, and at all times thereafter, has had in effect a loan program under which, but for paragraph (a)(3) of this Q&A-18, the loans comply with the conditions of paragraph (a) of this Q&A-18 to constitute residential mortgage loans in the ordinary course of an investment program.

(c) No loan that benefits an officer, director, or owner of the employer maintaining the plan, or their beneficiaries, will be treated as made under an investment program.

(d) This section does not provide guidance on whether a residential mortgage loan made under a plan's investment program would result in a prohibited transaction under section 4975, or on whether such a loan made by a plan covered by Title I of ERISA would be consistent with the fiduciary standards of ERISA or would result in a prohibited transaction under section 406 of ERISA. See 29 CFR 2550.408b–1.

Q-19: If there is a deemed distribution under section 72(p), is the interest that accrues thereafter on the amount of the deemed distribution an indirect loan for income tax purposes?

A-19: (a) *General rule.* Except as provided in paragraph (b) of this Q&A-19, a deemed distribution of a loan is treated as a distribution for purposes of section 72. Therefore, a loan that is deemed to be distributed under section 72(p) ceases to be an outstanding loan for purposes of section 72, and the interest that accrues thereafter under the plan on the amount deemed distributed is disregarded in applying section 72 to the participant or beneficiary. Even though interest continues to accrue on the outstanding loan (and is taken into account for purposes of determining the tax treatment of any subsequent loan in accordance with paragraph (b) of this Q&A-19), this additional interest is not treated as an additional loan (and, thus, does not result in an additional deemed distribution) for purposes of section 72(p). However, a loan that is deemed distributed under section 72(p) is not considered distributed for all purposes of the Internal Revenue Code. See Q&A-11 through Q&A-16 of this section.

(b) *Exception for purposes of applying section 72(p)(2)(A) to a subsequent loan.* In the case of a loan that is deemed distributed under section 72(p) and that has not been repaid (such as by a plan loan offset), the unpaid amount of such loan, including accrued interest, is considered outstanding for purposes of applying section 72(p)(2)(A) to determine the maximum amount of any subsequent loan to the participant or beneficiary.

Q-20: May a participant refinance an outstanding loan or have more than one loan outstanding from a plan?

A-20: [Reserved]

Q-21: Is a participant's tax basis under the plan increased if the participant repays the loan after a deemed distribution?

A-21: (a) *Repayments after deemed distribution.* Yes, if the participant or beneficiary repays the loan after a deemed distribution of the loan under section 72(p), then, for purposes of section 72(e), the participant's or beneficiary's investment in the contract (tax basis) under the plan increases by the amount of the cash repayments that the participant or beneficiary makes on the loan after the deemed distribution. However, loan repayments are not treated as after-tax contributions for other purposes, including sections 401(m) and 415(c)(2)(B).

(b) *Example.* The following example illustrates the rules in paragraph (a) of this Q&A-21 and is based on the assumptions described in the introductory text of this section:

Example. (i) A participant receives a $20,000 loan on January 1, 2003, to be repaid in 20 quarterly installments of $1,245 each. On December 31, 2003, the outstanding loan balance ($19,179) is deemed distributed as a result of a failure to make quarterly installment payments that were due on September 30, 2003 and December 31, 2003. On June 30, 2004, the participant repays $5,147 (which is the sum of the three installment payments that were due on September 30, 2003, December 31, 2003, and March 31, 2004, with interest thereon to June 30, 2004, plus the installment payment due on June 30, 2004). Thereafter, the participant resumes making the installment payments of $1,245 from September 30, 2004 through December 31, 2007. The loan repayments made after December 31, 2003 through December 31, 2007 total $22,577.

(ii) Because the participant repaid $22,577 after the deemed distribution that occurred on December 31, 2003, the participant has investment in the contract (tax basis) equal to $22,577 (14 payments of $1,245 each plus a single payment of $5,147) as of December 31, 2007.

Q-22: When is the effective date of section 72(p) and the regulations in this section?

A-22: (a) *Statutory effective date.* Section 72(p) generally applies to assignments, pledges, and loans made after August 13, 1982.

(b) *Regulatory effective date.* This section applies to assignments, pledges, and loans made on or after January 1, 2002.

(c) *Loans made before the regulatory effective date*—(1) *General rule.* A plan is permitted to apply Q&A-19 and Q&A-21 of this section to a loan made before the regulatory effective date in paragraph (b) of this Q&A-22 (and after the statutory effective date in paragraph (a) of this Q&A-22) if there has not been any deemed distribution of the loan before the transition date or if the conditions of paragraph (c)(2) of this Q&A-22 are satisfied with respect to the loan.

(2) *Consistency transition rule for certain loans deemed distributed before the regulatory effective date.* (i) The rules in this paragraph (c)(2) of this Q&A-22 apply to a loan made before the regulatory effective date in paragraph (b) of this Q&A-22 (and after the statutory effective date in paragraph (a) of this Q&A-22) if there has been any deemed distribution of the loan before the transition date.

(ii) The plan is permitted to apply Q&A-19 and Q&A-21 of this section to the loan beginning on any January 1, but only if the plan reported, in Box 1 of Form 1099–R, for a taxable year no later than the latest taxable year that would be permitted under this section (if this section had been in effect for all loans made after the statutory effective date in paragraph (a) of this Q&A-22), a gross distribution of an amount at least equal to the

initial default amount. For purposes of this section, the initial default amount is the amount that would be reported as a gross distribution under Q&A-4 and Q&A-10 of this section and the transition date is the January 1 on which a plan begins applying Q&A-19 and Q&A-21 of this section to a loan.

(iii) If a plan applies Q&A-19 and Q&A-21 of this section to such a loan, then the plan, in its reporting and withholding on or after the transition date, must not attribute investment in the contract (tax basis) to the participant or beneficiary based upon the initial default amount.

(iv) This paragraph (c)(2)(iv) of this Q&A-22 applies if—

(A) The plan attributed investment in the contract (tax basis) to the participant or beneficiary based on the deemed distribution of the loan;

(B) The plan subsequently made an actual distribution to the participant or beneficiary before the transition date; and

(C) Immediately before the transition date, the initial default amount (or, if less, the amount of the investment in the contract so attributed) exceeds the participant's or beneficiary's investment in the contract (tax basis). If this paragraph (c)(2)(iv) of this Q&A-22 applies, the plan must treat the excess (the loan transition amount) as a loan amount that remains outstanding and must include the excess in the participant's or beneficiary's income at the time of the first actual distribution made on or after the transition date.

(3) *Examples.* The rules in paragraph (c)(2) of this Q&A-22 are illustrated by the following examples, which are based on the assumptions described in the introductory text of this section (and, except as specifically provided in the examples, also assume that no distributions are made to the participant and that the participant has no investment in the contract with respect to the plan). *Example 1*, *Example 2*, and *Example 4* of this paragraph (c)(3) of this Q&A-22 illustrate the application of the rules in paragraph (c)(2) of this Q&A-22 to a plan that, before the transition date, did not treat interest accruing after the initial deemed distribution as resulting in additional deemed distributions under section 72(p). *Example 3* of this paragraph (c)(3) of this Q&A-22 illustrates the application of the rules in paragraph (c)(2) of this Q&A-22 to a plan that, before the transition date, treated interest accruing after the initial deemed distribution as resulting in additional deemed distributions under section 72(p). The examples are as follows:

Example 1. (i) In 1998, when a participant's account balance under a plan is $50,000, the participant receives a loan from the plan. The participant makes the required repayments until 1999 when there is a deemed distribution of $20,000 as a result of a failure to repay the loan. For 1999, as a result of the deemed distribution, the plan reports, in Box 1 of Form 1099–R, a gross distribution of $20,000 (which is the initial default amount in accordance with paragraph (c)(2)(ii) of this Q&A-22) and, in Box 2 of Form 1099–R, a taxable amount of $20,000. The plan then records an increase in the participant's tax basis for the same amount ($20,000). Thereafter, the plan disregards, for purposes of section 72, the interest that accrues on the loan after the 1999 deemed distribution. Thus, as of December 31, 2001, the total taxable amount reported by the plan as a result of the deemed distribution is $20,000 and the plan's records show that the participant's tax basis is the same amount ($20,000). As of January 1, 2002, the plan decides to apply Q&A-19 of this section to the loan. Accordingly, it reduces the participant's tax basis by the initial default amount of $20,000, so that the participant's remaining tax basis in the plan is zero. Thereafter, the amount of the outstanding loan is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2003 and receives a distribution of the full account balance under the plan consisting of $60,000 in cash and the loan receivable. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $60,000 in cash.

(ii) For the year 2003, the plan must report a gross distribution of $60,000 in Box 1 of Form 1099–R and a taxable amount of $60,000 in Box 2 of Form 1099–R.

Example 2. (i) The facts are the same as in *Example 1*, except that in 1999, immediately prior to the deemed distribution, the participant's account balance under the plan totals $50,000 and the participant's tax basis is $10,000. For 1999, the plan reports, in Box 1 of Form 1099–R, a gross distribution of $20,000 (which is the initial default amount in accordance with paragraph (c)(2)(ii) of this Q&A-22) and reports, in Box 2 of Form 1099–R, a taxable amount of $16,000 (the $20,000 deemed distribution minus $4,000 of tax basis ($10,000 times ($20,000/$50,000)) allocated to the deemed distribution). The plan then records an increase in tax basis equal to the $20,000 deemed distribution, so that the participant's remaining tax basis as of December 31, 1999, totals $26,000 ($10,000 minus $4,000 plus $20,000). Thereafter, the plan disregards, for purposes of section 72, the interest that accrues on the loan after the 1999 deemed distribution. Thus, as of December 31, 2001, the total taxable amount reported by the plan as a result of the deemed distribution is $16,000 and the plan's records show that the participant's tax basis is $26,000. As of January 1, 2002, the plan decides to apply Q&A-19 of this section to the loan. Accordingly, it reduces the participant's tax basis by the initial default amount of $20,000, so that the participant's remaining tax basis in the plan is $6,000. Thereafter, the amount of the outstanding loan is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2003 and receives a distribution of the full account balance under the plan consisting of $60,000 in cash and the loan receivable. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $60,000 in cash.

(ii) For the year 2003, the plan must report a gross distribution of $60,000 in Box 1 of Form 1099–R and a taxable amount of $54,000 in Box 2 of Form 1099–R.

Example 3. (i) In 1993, when a participant's account balance in a plan is $100,000, the participant receives a loan of $50,000 from the plan. The participant makes the required loan repayments until 1995 when there is a deemed distribution of $28,919 as a result of a failure to repay the loan. For 1995, as a result of the deemed distribution, the plan reports, in Box 1 of Form 1099–R, a gross distribution of $28,919 (which is the initial default amount in accordance with paragraph (c)(2)(ii) of this Q&A-22) and, in Box 2 of Form 1099–R, a taxable amount of $28,919. For 1995, the plan also records an increase in the participant's tax basis for the same amount ($28,919). Each year thereafter through 2001, the plan reports a gross distribution equal to the interest accruing that year on the loan balance, reports a taxable amount equal to the interest accruing that year on the loan balance reduced by the participant's tax basis allocated to the gross distribution, and records a net increase in the participant's tax basis equal to that taxable amount. As of December 31, 2001, the taxable amount reported by the plan as a result of the loan totals $44,329 and the plan's records for purposes of section 72 show that the participant's tax basis totals the same amount ($44,329). As of January 1, 2002, the plan decides to apply Q&A-19 of this section. Accordingly, it reduces the participant's tax basis by the initial default amount of $28,919, so that the participant's remaining tax basis in the plan is $15,410 ($44,329 minus $28,919). Thereafter, the amount of the outstanding loan is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2003 and receives a distribution of the full account balance under the plan consisting of $180,000 in cash and the loan receivable equal to the $28,919 outstanding loan amount in 1995 plus interest accrued thereafter to the payment date in 2003. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $180,000 in cash.

(ii) For the year 2003, the plan must report a gross distribution of $180,000 in Box 1 of Form 1099–R and a taxable amount of $164,590 in Box 2 of Form 1099–R ($180,000 minus the remaining tax basis of $15,410).

Example 4. (i) The facts are the same as in *Example 1*, except that in 2000, after the deemed distribution, the participant receives a $10,000 hardship distribution. At the time of the hardship distribution, the participant's account balance under the plan totals $50,000. For 2000, the plan reports, in Box 1 of Form 1099–R, a gross distribution of $10,000 and, in Box 2 of Form 1099–R, a taxable amount of $6,000 (the $10,000 actual distribution minus

$4,000 of tax basis ($10,000 times ($20,000/$50,000)) allocated to this actual distribution). The plan then records a decrease in tax basis equal to $4,000, so that the participant's remaining tax basis as of December 31, 2000, totals $16,000 ($20,000 minus $4,000). After 1999, the plan disregards, for purposes of section 72, the interest that accrues on the loan after the 1999 deemed distribution. Thus, as of December 31, 2001, the total taxable amount reported by the plan as a result of the deemed distribution plus the 2000 actual distribution is $26,000 and the plan's records show that the participant's tax basis is $16,000. As of January 1, 2002, the plan decides to apply Q&A-19 of this section to the loan. Accordingly, it reduces the participant's tax basis by the initial default amount of $20,000, so that the participant's remaining tax basis in the plan is reduced from $16,000 to zero. However, because the $20,000 initial default amount exceeds $16,000, the plan records a loan transition amount of $4,000 ($20,000 minus $16,000). Thereafter, the amount of the outstanding loan, other than the $4,000 loan transition amount, is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2003 and receives a distribution of the full account balance under the plan consisting of $60,000 in cash and the loan receivable. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $60,000 in cash.

(ii) In accordance with paragraph (c)(2)(iv) of this Q&A-22, the plan must report in Box 1 of Form 1099-R a gross distribution of $64,000 and in Box 2 of Form 1099-R a taxable amount for the participant for the year 2003 equal to $64,000 (the sum of the $60,000 paid in the year 2003 plus $4,000 as the loan transition amount).

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved July 13, 2000.

Jonathan Talisman,
Deputy Assistant Secretary of the Treasury.

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Section 457.—Deferred Compensation Plans of State and Local Governments and Tax-Exempt Organizations

26 CFR 1.457–1: Compensation deferred under eligible deferred compensation plans.

This notice describes the withholding and reporting requirements applicable to eligible deferred compensation plans described in section 457(b) of the Internal Revenue Code of 1986. See Notice 2000–38, page 174.

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.

Rev. Proc. 2000–32

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, 1998. 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, 1998. 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, 1997, see Rev. Proc. 99–30, 1999–31 I.R.B. 221.

SECTION 2. CHANGES

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 1999. 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, 1998, the relevant domestic asset/liability percentages are:

113.8 percent for foreign life insurance companies, and

169.4 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 1999. 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, 1998, the relevant domestic investment yields are:

7.6 percent for foreign life insurance companies, and

6.1 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 1999. The section 842(b) percentages to be used for the 1999 tax year are based on tax return data following the same methodology used for the 1998 year.

SECTION 3. APPLICATION — ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 1998, 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 publication 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. 99–30 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, 1998.

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.

Losses Claimed on Certain Intangible Assets

Notice 2000–34

This notice informs Blue Cross Blue Shield insurance organizations ("BCBS organizations") that the Internal Revenue Service will challenge deductions for losses for the termination of individual customer, provider, or employee contracts or relationships associated with customer lists, provider networks, and workforce in place with respect to which the taxpayer claims an adjusted basis derived from § 1012(c)(3)(A)(ii) of the Tax Reform Act of 1986 (the Act).

Section 1012 of the Act revoked the tax-exempt status of BCBS organizations and added § 833 of the Internal Revenue Code (the "Code"), which treats those organizations as taxable stock insurance companies. Under § 1012(c)(3)(A)(ii) of the Act, each organization's adjusted bases in its assets, for purposes of determining gain or loss, is deemed equal to the assets' fair market values as of the first day of its first taxable year beginning after December 31, 1986.

The Conference Committee Report accompanying the Act states that this fair market value basis adjustment was provided "solely for purposes of determining gain or loss upon the sale or exchange of the assets, not for purposes of determining amounts of depreciation or for other purposes." H.R. Conf. Rept. 841, 99th Cong., 2d Sess. II- 350 (1986). The Conference Report further clarifies that the basis adjustment was provided because

the conferees believed that the formerly tax-exempt organizations should not be taxed on unrealized appreciation or depreciation that accrued during the period the organization was not generally subject to income taxation. *Id.*

The Service has learned that some BCBS organizations are claiming annual or periodic loss deductions under § 165 of the Code with respect to certain intangible assets, including customer lists, provider networks, and workforce in place using the fair market value basis provided under § 1012(c)(3)(A)(ii) of the Act for purposes of determining gain or loss. For example, some BCBS organizations are claiming loss deductions in the year in which a customer terminates its relationship with the BCBS plan, on the theory that each customer relationship is a separate asset for federal income tax purposes.

The Service believes that BCBS organizations are not entitled to these loss deductions. In addition to carefully scrutinizing the valuations obtained for the assets at issue, the Service will challenge the loss deductions under various theories, as appropriate, including the following:

- These individual customer, provider, or employee contracts or relationships are not separate assets. The Supreme Court's decision in *Newark Morning Ledger Co. v. United States*, 507 U.S. 546 (1993), did not disturb earlier authority denying current loss deductions upon the termination of an individual customer, provider, or employee contract or relationship or similar component of a single asset. *See, e.g., Golden State Towel and Linen Service v. United States*, 373 F.2d 938 (Ct. Cl. 1967). In *Newark Morning Ledger*, the Supreme Court cited *Golden State Towel* with approval.
- Under the facts set forth above, annual or periodic loss deductions are the functional equivalent of amortizing the single assets composed of individual customer, provider, or employee contracts or relationships, and as such are contrary to Congress's express prohibition against using the § 1012(c)(3)(A)(ii) basis for amortization purposes. That is, some BCBS organizations are using these annual loss deductions as a mechanism for regularly converting a portion of a single intangible asset's § 1012(c)(3)(A)(ii) basis into an offset against current income, producing the same tax effect as amortizing that asset's § 1012(c)(3)(A)(ii) basis.
- By enacting § 1012 of the Act, Congress intended to take away the advantage the BCBS organizations enjoyed as tax-exempt entities in competing with commercial insurance companies by subjecting the BCBS organizations to the payment of federal income taxes to the same extent as commercial insurance providers. H.R. Rep. No. 426, 99th Cong., 1st Sess. 664 (1985). The legislative history to the Act indicates that Congress expected to remedy this inequity immediately, with the BCBS organizations beginning to pay tax in their initial years as taxable entities. The annual use of a portion of the § 1012(c)(3)(A)(ii) basis to offset a substantial amount of taxable income immediately upon becoming taxable would permit BCBS organizations to maintain the competitive advantage they enjoyed prior to the Act by effectively delaying for many years their obligation to pay federal income taxes to the same extent as other commercial insurance providers.
- By not having claimed loss deductions upon the termination of individual customer, provider, or employee contracts or relationships in prior years, BCBS organizations effectively adopted a method of accounting that treats customer lists, provider networks, and workforce in place as single assets composed of individual customer, provider, or employee contracts or relationships. A method of accounting cannot be changed without permission from the Secretary. Section 446(e); Rev. Rul. 90–38, 1990–1 C.B. 57. BCBS insurance organizations that file claims for refund to begin recovering the basis in individual customer, provider, or employee contracts or relationships that terminated in prior years are attempting to make an unauthorized change in method of accounting. *See* Treas. Reg. § 1.446–1(e)(2)(ii)(a).

DRAFTING INFORMATION

The principal author of this notice is Grace Matuszeski of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice contact Kay Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions & Products) at (202) 622-3970 (not a toll-free call).

IRS Releases New Form 8871, *Political Organization Notice of Section 527 Status*

Notice 2000–36

The Internal Revenue Service on July 12, 2000, announced the release of the new form that section 527 political organizations must file and detailed plans for implementing other aspects of the new law governing these groups.

Starting immediately, section 527 political organizations must file Form 8871 with the IRS. This notice of organization must be filed by July 31, 2000.

The IRS action follows a new law approved last month by Congress and signed July 1, 2000, by President Clinton. The legislation creates a new set of rules for political organizations established under section 527 of the Internal Revenue Code. Under the new law, these 527 groups will be required to publicly disclose details about their organization, contributors, expenditures, annual returns and other information.

"The IRS is moving quickly to put these new rules in place. We want to make information from these organizations available to the public as soon as possible," IRS Commissioner Charles O. Rossotti said.

The IRS has also released new forms and other details involving reporting and disclosure requirements for 527 organizations.

The first step is the release of Form 8871, *Political Organization Notice of Section 527 Status*. The form is now available at the IRS web site, www.irs.gov, in the "Forms and Pubs" section.

Organizations must file Form 8871 both electronically and in writing. The form can be filed electronically at www.irs.gov/bus_info/eo/pol-file.html.

Every political organization under section 527 must file Form 8871 unless it reasonably expects annual gross receipts to always be less than $25,000 in each taxable year. Political committees also do not have to submit this form if they are required to file reports with the Federal Election Commission. Section 501(c) organizations such as social welfare groups, labor unions and trade associations that file Form 1120-POL and pay taxes under section 527(f)(1) also will not have to submit Form 8871.

The law requires newly established organizations to file Form 8871 within 24 hours of their creation. However, the IRS realizes some of these section 527 organizations may not yet be aware of this requirement. Consequently, the IRS has extended the due date for filing Form 8871 until July 31, 2000, for any organizations established after June 30, 2000. Organizations already in existence on June 30, 2000, already have until July 31, 2000, to file Form 8871.

Form 8871 contains a variety of information about 527 organizations, including the organization's purpose, a list of related entities, contact persons, record custodians, e-mail addresses and lists of officers, directors and highly compensated employees.

By August 15, 2000, the IRS will make available on its Internet site a list of organizations filing Form 8871. Copies of the Form 8871 will be available through the 527 organizations. The IRS is working on procedures to make copies of the forms available for public inspection as soon as possible.

The IRS has also released another form that 527 organizations will use to periodically disclose contributions and expenditures made after July 1, 2000. Form 8872, *Political Organization Report of Contributions and Expenditures*, will include names, addresses, employers and occupations for contributors of $200 or more annually. Organizations or individuals receiving $500 or more annually from 527 organizations also will be listed on these forms.

For more information about Form 8872, see Notice 2000–41, page 177.

Information from filed Forms 8872 will be available for public inspection.

The IRS also is in the process of determining which forms will be used as annual returns by 527 organizations with gross receipts of $25,000 or more. These returns also will be available for public review.

"Putting these new rules in place poses a major challenge for the IRS given the short time frame available," Rossotti said. "However, we are committed to serving taxpayers by implementing this important new law in a timely and convenient manner."

DRAFTING INFORMATION

The principal author of this notice is Judith E. Kindell of the Exempt Organizations Division. For further information regarding this announcement contact Judith E. Kindell on (202) 622-6494 (not a toll-free call).

Eligible Deferred Compensation Plans under Section 457

Notice 2000–38

I. PURPOSE AND SCOPE

This notice describes the withholding and reporting requirements "applicable to eligible deferred compensation plans described in § 457(b) of the Internal Revenue Code of 1986 ("§ 457(b) plans").

Specifically, this notice addresses —

- income tax withholding and reporting with respect to annual deferrals made to a § 457(b) plan;
- income tax withholding and reporting with respect to distributions from a § 457(b) plan;
- Federal Insurance Contributions Act (FICA) payment and reporting with respect to annual deferrals under a § 457(b) plan;
- employer identification numbers (EINs) used in connection with trusts established under § 457(g); and
- the application of annual reporting requirements to § 457(b) plan administrators and trustees holding assets of a § 457(b) plan in accordance with § 457(g).

This notice addresses only reporting and withholding rules that apply to § 457(b) plan participants who are or were employees of state and local governments or tax-exempt organizations and does not cover special reporting rules that may apply to § 457(b) plan participants who are or were independent contractors.

II. BACKGROUND

Section 457 provides rules for nonqualified deferred compensation plans established by eligible employers. State and local governments and tax-exempt organizations are eligible employers. They can establish either eligible plans that meet the requirements of § 457(b) or plans that do not meet the requirements of § 457(b) and that are therefore subject to tax treatment under § 457(f).

Section 1448 of the Small Business Job Protection Act of 1996, ("SBJPA"), 1996–3 C.B. 155, 212, amended § 457 by adding § 457(g), which requires that § 457(b) plans maintained by state or local government employers hold all plan assets and income in trust, or in custodial accounts or annuity contracts described in § 401(f), for the exclusive benefit of participants and their beneficiaries. Section 457(g) applies generally to assets and income held by a governmental § 457(b) plan on and after August 20, 1996. However, with respect to a governmental § 457(b) plan in existence on August 20, 1996, a trust (or a custodial account or annuity contract) was not required to have been established before January 1, 1999. Section 457(g) does not apply to a § 457(b) plan established by a tax-exempt organization that is not a state or local governmental entity.

Notice 98–8, 1998–1 C.B. 355, provides guidance regarding the amendments made to § 457(b) by the SBJPA. Following publication of the 1998 notice, the Service received additional inquiries regarding the statutory changes made in § 457(b) by the SBJPA and the Taxpayer Relief Act of 1997, Pub. L. No. 105–34. Specifically, taxpayers, employers, and plan administrators asked what employment and income tax reporting requirements apply with respect to § 457(b) plans and whether a trustee or administrator of a trust established under § 457(g) must file annual information returns relating to the trust, such as Form 990, Return of Organization Exempt From Income Tax, or an appropriate version of Form 5500, Annual Return/Report of Employee Benefit Plan.

III. INCOME TAX WITHHOLDING AND REPORTING ON ANNUAL DEFERRALS

Section 457(a) provides that annual deferrals under a § 457(b) plan and any income attributable to the amounts so deferred will not be includible in a participant's gross income until that amount is paid or made available to the participant or beneficiary. Therefore, annual deferrals under a § 457(b) plan are not subject to income tax withholding at the time of the deferral. However, a participant's annual deferrals during the taxable year under a § 457(b) plan are reported on Form W-2, Wage and Tax Statement, in the manner described in the instructions to that form. "Annual deferrals", as used in this notice, means the amount of compensation deferred under the plan in accordance with section 457(b) whether by salary reduction or nonelective employer contribution, during a taxable year.

IV. INCOME TAX WITHHOLDING AND REPORTING ON § 457(b) PLAN DISTRIBUTIONS

A. Income Tax Withholding on § 457(b) Plan Distributions

"Distributions" from a § 457(b) plan to a participant or former participant include all amounts that are paid or made available under a § 457(b) plan. Distributions to a participant or former participant from a § 457(b) plan are wages under § 3401(a) that are subject to income tax withholding in accordance with the income tax withholding requirements of § 3402(a). The pension withholding rules of § 3405 do not apply. See § 35.3405–1, a–23, Q&A of the Temporary Employment Tax and Collection of Income Tax at Source Regulations.

Income tax withholding on distributions to a participant or former participant under a § 457(b) plan is calculated in the same manner as withholding on other types of wage payments. For guidance on the use of the flat rate withholding method as a supplement to regular wage withholding in cases where the payor is paying wages to the participant in addition to the distribution from the § 457(b) plan, see § 31.3402(g)–1(a) of the Employment Tax Regulations and Rev. Rul. 82–46, 1982–1 CB 158. If an eligible payor uses the flat rate of withholding as an alternative to regular wage withholding on a lump sum payment, section 13273 of the Omnibus Budget Reconciliation Act of 1993, 1993–3 C.B. 130 provides that a 28 percent flat rate must be used.

B. Person Responsible for Income Tax Withholding on Distributions

Section 3402(a) requires every employer making payment of wages to withhold income tax on these wages. However, § 3401(d)(1) provides that if the person for whom an individual performed services as an employee does not have control of the payment of the wages for those services, the person having control of the payment of the wages is responsible for income tax withholding on those wages. See § 31.3401(d)–1(f). Thus, if distributions are made by a § 457(g) trustee of a plan established by a state or local government, the trustee is responsible for income tax withholding and reporting on the distributions. Similarly, if distributions are made by a § 457(g) custodian or insurance carrier treated as a trustee under § 457(g), the custodian or insurance carrier is responsible for income tax withholding on the distributions. Subsections C, D, and E of this Section IV provide additional information regarding how the trustee (or custodian or insurance carrier) should withhold, deposit, and report distributions.

When distributions are made under a § 457(b) plan established by a tax-exempt organization, the tax-exempt organization or any other person having control of the payment of the distributions is responsible for income tax withholding on the distributions.

C. Reporting on Form W-2 for Distributions from a § 457(b) Plan

Distributions to a participant or former participant during a taxable year under a § 457(b) plan are reported on Form W-2, Wage and Tax Statement, in the manner described in the instructions to that form. See also Rev. Rul. 82–46, supra. Income tax withheld from § 457(b) plan distributions is reported quarterly on Form 941, Employer's Quarterly Federal Tax Return.

D. Reporting Death Benefit Payments

Distributions to a beneficiary of a deceased participant under a § 457(b) plan are reported on Form 1099–R, Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. See Rev. Rul. 86–109, 1986–2 C.B. 196. No income tax withholding is required for distributions from § 457(b) plans to beneficiaries. See Rev. Rul. 59–64, 1959–1 C.B. 31. The instructions for Form 1099–R describe how this form is completed for distributions made to a beneficiary from a nonqualified deferred compensation plan, such as a § 457(b) plan.

E. EINs and Income Tax Deposits with respect to § 457(g) Trust Accounts

Generally, the income tax withheld on distributions should be reported on the Form 941 of the person responsible for withholding, as described in section IV-B of this notice, and aggregated with other amounts reported by that person on Form 941 to determine the frequency of federal tax deposits under § 31.6302–1. This is the same as the first alternative described in Announcement 84–40, 1984–17 IRB 31. Alternatively, the IRS will permit trustees of § 457(g) trusts, or custodians or insurance carriers treated as trustees under § 457(g)(3) to use the other two alternatives contained in Announcement 84–40 for the tax administration of such withholdings:

1. The trustee, custodian, or insurance carrier may request an EIN solely for the purpose of reporting the aggregated withholding from the distributions of every § 457(g) trust, custodial account, or annuity contract under its control, making deposits and filing Form 941 accordingly.

2. The trustee, custodian, or insurance carrier may request and use a separate EIN for each § 457(g) trust (or custodial account or insurance contract), making deposits and filing Form 941 accordingly.

The trustee, custodian, or insurance carrier exercising any of the above alternatives for depositing and reporting the tax withheld from § 457(g) trust distributions must also follow the same option in filing the related information returns, such as Forms W-2 (in the case of distrib-

utions to participants or former participants) or 1099–R (in the case of distributions to beneficiaries). That is, the trustee, custodian, or insurance carrier must use the same name and EIN on Forms W-2 or 1099–R as that under which the tax was deposited and the quarterly return filed. The trustee, custodian, or insurance carrier must aggregate and deposit all taxes pursuant to § 31.6302–1 under the EIN chosen. The above-described options relate only to trusts, annuity contracts or custodial accounts established pursuant to section 457(g) for amounts deferred under § 457(a). For information on the remittance of social security, Medicare, and FUTA taxes by the employer, see section V-D below.

V. FICA AND FUTA TAXES AND REPORTING

A. Scope

The rules described in this notice relating to FICA (social security and Medicare) tax apply to employees of state and local governments only if they are subject to social security or Medicare tax under section 3121(u) (relating to Medicare), section 3121(b)(7)(E) (relating to agreements entered into pursuant to section 218 of the Social Security Act), or other provisions of the Code, such as section 3121(b)(7)(F) (relating to state and local government employees who are not members of a state or local retirement system). The FICA rules discussed in this notice generally apply to employees of tax-exempt organizations, unless a specific exclusion is applicable. The FICA tax discussed in this Section V includes the employer's share of the FICA tax imposed under section 3111 as well as the employee's share imposed under sections 3101 and 3102.

The rules described in this notice relating to the Federal Unemployment Tax Act (FUTA) do not apply to service for a state or local governmental entity because section 3306(c)(7) provides a FUTA exemption for service performed in the employ of a state or any political subdivision thereof or any instrumentality of any one or more of the foregoing. The rules described in this notice relating to FUTA apply to service for a tax-exempt organization other than a tax-exempt organization described in section 501(c)(3). See section 3306(c)(8).

B. Time Social Security, Medicare, and FUTA Taxes Imposed

Sections 3121(a) (relating to social security and Medicare) and 3306(b) (relating to FUTA) define "wages" as all remuneration for employment, unless specifically excluded (see section V-A, above). If social security, Medicare, or FUTA taxes apply, sections 3121(v)(2) and 3306(r)(2) contain special timing rules that apply in determining when amounts deferred under a nonqualified deferred compensation plan are required to be taken into account. Under these sections, an amount deferred under a nonqualified deferred compensation plan, including a § 457(b) plan, is required to be taken into account for purposes of social security, Medicare, and FUTA taxes as of the later of when the services are performed or when there is no substantial risk of forfeiture of the rights to such amount.

Thus, if a § 457(b) plan provides that annual deferrals are fully and immediately vested, annual deferrals are subject to social security, Medicare, and FUTA taxes at the time of deferral. However, if the annual deferrals are not fully and immediately vested, but are subject to a substantial risk of forfeiture, the annual deferrals (and earnings thereon) are generally taken into account for purposes of social security, Medicare, and FUTA at the time such amounts are no longer subject to a substantial risk of forfeiture. For purposes of social security, Medicare, and FUTA taxes, the determination of whether a substantial risk of forfeiture exists is made in accordance with the principles of section 83 and the regulations thereunder. See §§ 31.3121(v)(2)–1(e)(3) and 31.3306(r)(2)–1.

If amounts deferred under a § 457(b) plan are properly taken into account as social security, Medicare, and FUTA wages when deferred (or, if later, when they cease to be subject to a substantial risk of forfeiture), the amounts subsequently paid or made available to a participant or beneficiary under the § 457(b) plan are not subject to social security, Medicare, or FUTA taxes. See §§ 3121(v)(2)(B) and 3306(r)(2)(B) and § 31.3121(v)(2)–1(a)(2)(iii) and 31.3121(v)(2)–1(d)(2). If an amount deferred for a period is not properly taken into account, distributions attributable to that amount, including income on the amounts deferred, may be wages for FICA purposes when paid or made available. See § 31.3121(v)(2)–1(d)(1)(ii). Additional special rules apply to § 457(b) plans other than plans where benefits are based on a participant's account balance. See § 31.3121(v)(2)–1(e)(4).

C. Examples

The application of social security and Medicare tax is illustrated by the following examples:

Example 1. (i) State R's § 457(b) plan provides for elective deferrals from current salary, as well as a one percent of salary nonelective contribution for each employee who participates in the plan and who is employed with State R during the plan year. All employees who participate in the plan are covered by an agreement under section 218 of the Social Security Act. All deferrals and contributions, including the state's contribution, are fully and immediately vested.

(ii) Because these contributions are not subject to a substantial risk of forfeiture (and the services to which they relate have already been performed), the elective deferrals are required to be taken into account as wages at the time of the deferral and State R's nonelective contribution is required to be taken into account as wages at the time of the contribution for purposes of the social security and Medicare tax.

Example 2. (i) Assume the same facts as in Example 1, except that the plan has three-year vesting for State R's nonelective contribution. Therefore, an employee's rights to the nonelective contributions (and the associated earnings) are subject to a substantial risk of forfeiture until the employee has been employed by State R for three years.

(ii) State R's nonelective contributions (and earnings thereon) are not wages for purposes of the social security and Medicare tax until the employee has completed three years of service. At that time, the aggregate amount of State R's nonelective contributions, plus earnings thereon, is required to be taken into account as wages for purposes of the social security and Medicare tax. Once an individual has met the vesting requirements, future nonelective contributions by State R are required to be taken into account as wages for purposes of the social security and Medicare tax at the time of the contribution.

D. Deposit and Reporting of Social Security, Medicare and FUTA Taxes

The employer must aggregate and deposit social security and Medicare taxes associated with a § 457(b) plan (including the employer's share of social security and Medicare taxes under section 3111) with all other social security, and

Medicare taxes and withheld income taxes paid on behalf of its employees in accordance with § 31.6302–1 and must report these taxes on Form 941. Employers subject to FUTA must aggregate and deposit FUTA amounts associated with a § 457(b) plan with all other FUTA amounts paid on behalf of its employees in accordance with § 31.6302(c)–3 and must report these payments on Form 940.

VI. ANNUAL REPORTING FOR § 457 PLANS

A. Section 457(b) Plans of Tax-Exempt Organizations

Annual deferrals and payments to certain participants in a § 457(b) plan of a tax-exempt organization are reported on the organization's Form 990 in the manner described in the instructions to that form.

B. § 457(g) Trusts

A trust described in § 457(g) is not required to file Form 990, Return of Organization Exempt From Income Tax, Form 1041, U.S. Income Tax Return for Estates and Trusts, Form 1120, U.S. Corporation Income Tax Return, or Form 5500, Annual Return/Report of Employee Benefits Plans. See, for example, Rev. Proc. 95–48, 1995–2 C.B. 418, which provides that governmental units and affiliates of governmental units that are exempt from federal income tax under § 501(a) are not required to file annual information returns on Form 990, Return of Organization Exempt From Income Tax. A trust described in § 457(g) may be required to file Form 990–T, Exempt Organization Business Income Tax Return. See §§ 1.6012–2(e) and 1.6012–3(a)(5) for the requirements for filing Form 990–T.

VII. OTHER INFORMATION AVAILABLE

Further information regarding the reporting, payment and deposit of employment taxes such as social security, Medicare, FUTA, and withheld income tax can be found in Publication 15, Circular E, Employer's Tax Guide; Publication 15-A, Employer's Supplemental Tax Guide; and Publication 963, Federal-State Reference Guide: Social Security Coverage and FICA Reporting by State and Local Government Employers. These publications will be revised, as appropriate, to reflect the proper treatment of trusts under section 457(g).

VIII. EFFECTIVE DATE

This notice is applicable with respect to deferrals and distributions made after December 31, 2001. Plan sponsors, plan administrators and taxpayers may rely on this Notice for distributions and deferrals before January 1, 2002.

IX. REQUEST FOR COMMENTS

The Internal Revenue Service requests comments concerning this notice, and welcomes comments on any other useful approaches the Service might consider regarding the administration of § 457(b) plans, including alternatives to Form W-2 reporting. Comments can be addressed to the Internal Revenue Service, Office of Associate Chief Counsel, CC:TEGE:EB:QP2, Room 5201, 1111 Constitution Avenue, Washington, D.C. 20224. In addition, comments may be submitted electronically via the Internet by sending them in an e-mail to: *joel.s.rutstein@m1.irscounsel.treas.gov* and specifying that the comments concern Notice 2000–38.

DRAFTING INFORMATION

The principal author of this notice is John Tolleris of the Office of the Associate Chief Counsel/Division Counsel (Tax Exempt/ Government Entities). However, other personnel from the IRS and Treasury participated in its development. For further information regarding this notice, contact John Tolleris at (202) 622-6060 (not a toll-free number).

IRS Releases New Form 8872, *Political Organization Report of Contributions and Expenditures*

Notice 2000–41

The Internal Revenue Service on July 17, 2000, announced the release of the new form that section 527 political organizations must use to provide details about contributions and expenditures. The agency also extended the filing deadline until July 31, 2000, for groups required to file this month.

Form 8872, *Political Organization Report of Contributions and Expenditures*, will require groups to list contributors of $200 or more annually and expenditures of $500 or more annually.

This marks the second new IRS form covering section 527 organizations. This follows a new law approved in June 2000 by Congress and signed July 1, 2000, by President Clinton that creates a new set of rules for political organizations established under section 527 of the Internal Revenue Code. Under the new law, these 527 groups will be required to publicly disclose details about their organization, contributors, expenditures, annual returns and other information.

"The IRS continues moving forward with this important project as quickly as possible," IRS Commissioner Charles O. Rossotti said. "Putting these new rules in place is a top priority."

Form 8872 and related instructions are now available at the IRS web site, www.irs.gov, under the "Forms and Pubs" section. Look under "What's Hot in Tax Forms." Form 8872 can be downloaded at ftp.fedworld.gov/pub/irs-fill/f8872.pdf. The Form 8872 instructions are available at ftp.fedworld.gov/pub/irs-pdf/i8872.pdf.

The new form requires 527 organizations to list the name, address, employer and occupation of contributors who give $200 or more annually to the organization. Similar information will be listed for groups or individuals receiving $500 or more annually from 527 organizations. The disclosure covers contributions received and expenditures made after July 1, 2000.

The due dates for filing Form 8872 vary depending on whether it is an election or non-election year. In non-election years, the forms must be filed semi-annually or monthly. In election years, the forms must be filed quarterly or monthly and in connection to election dates. A complete listing of these filing periods can be found in the Form 8872 instructions.

Some organizations potentially face July 2000 filing deadlines for pre-election reports. However, the IRS realizes many 527 organizations may not yet be aware of this deadline, so the agency has decided to extend the deadline for any July 2000 filings of Form 8872 until July 31, 2000.

The IRS made the decision to give groups additional time to learn about the new requirements.

This follows a similar IRS decision to set July 31, 2000, as the deadline for these organizations to file Form 8871, *Political Organization Notice of Section 527 Status*. This notice of organization is also available at the IRS web site in the "Forms and Pubs" section. See Notice 2000–36, page 173, for more information about Form 8871.

Generally, section 527 organizations must file Form 8872 if they accept contributions or make expenditures during a calendar year. However, organizations do not file Form 8872 if:

- The organization is not required to file Form 8871, or
- They are the state or local committee of a political party or the political committee of a state or local candidate.

However, the IRS wants to alert many other state and local political organizations that they may need to file Forms 8871 and 8872. The new law generally covers 527 organizations active in state and local political campaigns as well as 527 organizations active in federal elections.

The IRS will assess penalties if an organization fails to file Form 8872 by the due date. Penalties will also be assessed if the organization fails to report all of the information required on the form or reports incorrect information. The penalty is 35 percent of the total amount of contributions and expenditures not properly reported.

Organizations must make copies of filed Forms 8872 and 8871 available for public inspection. In addition, the IRS is working on procedures to make these available for public inspection.

"We are doing everything we can to make information from these groups publicly available as soon as possible," Rossotti said.

The IRS also is in the process of determining which forms will be used as annual returns by 527 organizations with gross receipts of $25,000 or more. These returns also will be available for public review.

DRAFTING INFORMATION

The principal author of this notice is John Francis Reilly of the Exempt Organizations Division. For further information regarding this announcement contact John Francis Reilly on (202) 622-7352 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Loans From a Qualified Employer Plan to Plan Participants or Beneficiaries

REG–116495–99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed Income Tax Regulations relating to loans made from a qualified employer plan to plan participants or beneficiaries. These regulations affect administrators of, participants in, and beneficiaries of qualified employer plans that permit participants or beneficiaries to receive loans from the plan, including loans from section 403(b) contracts and other contracts issued under qualified employer plans.

DATES: Written and electronic comments and requests for a public hearing must be received by October 31, 2000.

ADDRESSES: Send submissions to: CC:MSP:RU (REG–116495–99), 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: MSP:RU (REG–116495–99), 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/regslist.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Vernon S. Carter, (202) 622-6070; concerning submissions Sonya Cruse (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 72 of the Internal Revenue Code of 1986 (Code).

Explanation of Provisions

Section 72(p)(1)(A) provides that a loan from a qualified employer plan (including a contract purchased under a qualified employer plan) by a participant or beneficiary is treated as received as a distribution from the plan for purposes of section 72 (a deemed distribution). Section 72(p)(1)(B) provides that an assignment or pledge of (or an agreement to assign or pledge) any portion of a participant's or beneficiary's interest in a qualified employer plan is treated as a loan from the plan.

Section 72(p)(2) provides that section 72(p)(1) does not apply to the extent certain conditions are satisfied. Specifically, under section 72(p)(2), a loan from a qualified employer plan to a participant or beneficiary is not treated as a distribution from the plan if the loan satisfies requirements relating to the term of the loan and the repayment schedule, and to the extent the loan satisfies certain limitations on the amount loaned.

Section 1704(n) of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755), added section 414(u) of the Code. Section 414(u)(4) provides that if a plan suspends the obligation to repay a loan made to an employee from the plan for any part of a period during which the employee is performing service in the uniformed services, that suspension is not to be taken into account for purposes of section 72(p).[1] The proposed regulations provide a rule clarifying that, under section 414(u)(4), if a plan provides for the suspension of a participant's obligation to repay a loan for any part of any leave of absence for a period of military service (as defined in chapter 43 of title 38, United States Code), the suspension will not cause the loan to be deemed distributed, even if the leave exceeds one year, as long as loan repayments resume upon the completion of the military service, the amount then remaining due on the loan is repaid in substantially level installments thereafter, and the loan is fully repaid by the end of the period equal to the original term of the loan plus the period of the military service.

Regulations were proposed in 1995[2] with respect to many of the issues arising under section 72(p)(2). The preamble to the 1995 proposed regulations requested comments on whether further guidance should be provided on issues that were not addressed and how the issues should be resolved, including (1) the effect of a deemed distribution on the tax treatment of subsequent distributions from a plan (such as whether a participant has basis), (2) the application of the $50,000 limitation to multiple loan arrangements, and (3) the application of section 72(p)(2) to a refinancing and to multiple loan arrangements. Following publication of the 1995 proposed regulations, various comments were received and a public hearing was held on June 28, 1996. After reviewing the written comments and comments made at the public hearing, proposed regulations generally addressing the first issue were published in the **Federal Register** (63 F.R. 42) on January 2, 1998 (REG–209476–82, 1998–1 C.B. 594).

Final regulations for the issues addressed in the 1995 and 1998 proposed regulations are being published in T.D. 8894, page 162. These proposed regulations address the remaining issues on which comments were requested in the preamble to the 1995 proposed regulations, namely, situations in which a loan is refinanced or more than one loan is made.

These proposed regulations provide that if a loan is deemed distributed to a participant or beneficiary and has not been repaid, then no payment made thereafter to the participant or beneficiary will be treated as a loan for purposes of section 72(p)(2), unless certain conditions are satisfied. Specifically, there must be an arrangement among the plan, the participant or beneficiary, and the employer, enforceable under applicable law, under which repayments will be made by payroll withholding or the plan must receive adequate security for the additional loan

[1] Rev. Proc. 96–49 (1996–2 C.B. 369), includes a model amendment that may be used to reflect section 414(u)(4).

[2] Proposed §1.72(p)–1 was published in the **Federal Register** (60 F.R. 66233) on December 21, 1995.

(in addition to the participant's accrued benefit under the plan).[3]

The proposed regulations also provide that while a loan can be refinanced and additional amounts may be borrowed, the refinancing and multiple loan arrangements must satisfy the requirements in section 72(p)(2)(B) and (C) that each loan be repaid in level installments, not less often than quarterly, over five years (or longer for certain home loans). Under the proposed regulations, a refinancing is, in effect, treated as a new loan that is then applied to repay a prior loan if the new loan both replaces a prior loan and has a later repayment date. Thus, the transaction will result in a deemed distribution if the amount of the new loan plus the prior outstanding loan exceeds the amount limitations of section 72(p)(2)(A). This rule does not apply to a refinancing loan under which the amount of the prior loan is to be repaid by the original repayment date of the prior loan. These standards are illustrated in examples.[4]

In addition, a participant may borrow more than once from the plan under section 72(p)(2), but, in order to ensure that additional loans are not used to circumvent the requirements of section 72(p), a deemed distribution of a loan will occur if two loans have previously been made from the plan to the participant or beneficiary during the year.

Electronic Signatures Act

The Electronic Signatures in Global and National Commerce Act (114 Stat. 464) (the Electronic Signatures Act) was signed on June 30, 2000. Title I of the Electronic Signatures Act, which is generally effective October 1, 2000, applies to certain electronic records and signatures in commerce. Comments are requested on the impact of the Electronic Signatures Act on the final regulations under section 72(p) that appear in the Federal Register and on any future guidance that may be needed on the application of the Electronic Signatures Act to plan loan transactions.

Proposed Effective Date

The regulations are proposed to be effective with respect to loans made on or after the first January 1 that is at least six months after publication as final regulations. However, Q&A-19(b)(2) of the proposed regulations would not apply to loans, whenever made, under an insurance contract that is in effect before a date that is 12 months after publication as final regulations if the insurance carrier is required under the insurance contract to offer loans to contractholders that are not secured (other than being secured by the participant's or beneficiary's benefit under the contract).

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 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 (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 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 Vernon S. Carter, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). 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 1.72(p)–1 is amended as follows:

1. Q&A-9(b) and (c), Q&A-19 and Q&A-20 are revised.

2. Q&A-22 is amended by adding new paragraph (d).

The revisions and addition read as follows:

§1.72(p)–1 Loans treated as distributions.

* * * * *

[3]The Department of Labor (DOL) has advised the IRS that, with respect to plans covered by Title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829) (ERISA), the administration of a participant loan program involves the management of plan assets. Therefore, fiduciary conduct undertaken in the administration of such a loan program must conform to the rules that govern transactions involving plan assets. In particular, a loan program must be administered in a prudent manner, solely in the interest of the participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries. See, generally, ERISA sections 403, 404, and 406. In the view of DOL, it is questionable whether a participant loan program of a plan covered by Title I of ERISA that does not provide for timely repayment of loans (through payroll withholding or otherwise), regular and effective collection efforts following a default, and adequate security for the plan in the event of default would be in compliance with the rules applicable under Title I of ERISA to transactions involving plan assets. In the view of DOL, it is also questionable whether such a program would qualify for the relief provided under section 408(b)(1) of ERISA. See Preamble to 29 CFR 2550.408b–1, (54 F.R. 30520, 30521) (July 20, 1989). Further, a plan may make a second loan to a defaulting participant whose prior loan remains unpaid only if such a loan would be in accordance with the applicable standards of Title I. A fiduciary must take steps to ensure, inter alia, that such a loan is bona fide and not a mere transfer of plan assets, that the loan is adequately secured, and that the plan's assets will be preserved in the event of default. See Preamble to 29 CFR 2550.408b–1, (54 F.R. at 30521).

[4]The examples in the new proposed regulations are based on the same assumptions described in §1.72(p)–1 introductory text of the final regulations.

A-9: * * *

(b) *Military service.* In accordance with section 414(u)(4), if a plan suspends the obligation to repay a loan made to an employee from the plan for any part of a period during which the employee is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code), whether or not qualified military service, such suspension shall not be taken into account for purposes of section 72(p) or this section. Thus, if a plan suspends loan repayments for any part of a period during which the employee is performing military service described in the preceding sentence, such suspension shall not cause the loan to be deemed distributed even if the suspension exceeds one year and even if the term of the loan is extended. However, the loan will not satisfy the repayment term requirement of section 72(p)(2)(B) and the level amortization requirement of section 72(p)(2)(C) unless loan repayments resume upon the completion of such period of military service, the frequency of the periodic installments due during the period beginning when the military service ends and ending when the loan is repaid in full, and the amount of each periodic installment, is not less than the frequency and amount of the periodic installments required under the terms of the original loan, and the loan is repaid in full (including interest that accrues during the period of military service) by the end of the period equal to the original term of the loan plus the period of such military service.

(c) *Examples.* The following examples illustrate the rules of paragraph (a) and (b) of this Q&A-9 and are based upon the assumptions described in the introductory text of this section:

Example 1. (i) On July 1, 2001, a participant with a nonforfeitable account balance of $80,000 borrows $40,000 to be repaid in level monthly installments of $825 each over 5 years. The loan is not a principal residence plan loan. The participant makes 9 monthly payments and commences an unpaid leave of absence that lasts for 12 months. The participant was not performing military service during this period. Thereafter, the participant resumes active employment and resumes making repayments on the loan until the loan is repaid. The amount of each monthly installment is increased to $1,130 in order to repay the loan by June 30, 2006.

(ii) Because the loan satisfies the requirements of section 72(p)(2), the participant does not have a deemed distribution. Alternatively, section 72(p)(2) would be satisfied if the participant continued the monthly installments of $825 after resuming active employment and on June 30, 2006 repaid the full balance remaining due.

Example 2. (i) The facts are the same as in *Example 1*, except the participant was on leave of absence performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code) for two years. After the military service ends on April 2, 2004, the participant resumes active employment on April 19, 2004, continues the monthly installments of $825 thereafter, and on June 30, 2008 repays the full balance remaining due ($10,527).

(ii) Because the loan satisfies the requirements of section 72(p)(2) and paragraph (b) of this Q&A-9, the participant does not have a deemed distribution. Alternatively, section 72(p)(2) would also be satisfied if the amount of each monthly installment after April 19, 2004, is increased to $983 in order to repay the loan by June 30, 2008 (without any balance remaining due then).

* * * * *

Q-19: If there is a deemed distribution under section 72(p), is the interest that accrues thereafter on the amount of the deemed distribution an indirect loan for income tax purposes and what effect does the deemed distribution have on subsequent loans?

A-19: (a) *General rule.* Except as provided in paragraph (b) of this Q&A-19, a deemed distribution of a loan is treated as a distribution for purposes of section 72. Therefore, a loan that is deemed to be distributed under section 72(p) ceases to be an outstanding loan for purposes of section 72, and the interest that accrues thereafter under the plan on the amount deemed distributed is disregarded for purposes of applying section 72 to the participant or the beneficiary. Even though interest continues to accrue on the outstanding loan (and is taken into account for purposes of determining the tax treatment of any subsequent loan in accordance with paragraph (b) of this Q&A-19), this additional interest is not treated as an additional loan (and, thus, does not result in an additional deemed distribution) for purposes of section 72(p). However, a loan that is deemed distributed under section 72(p) is not considered distributed for all purposes of the Internal Revenue Code. See Q&A-16 of this section.

(b) *Effect on subsequent loans*—(1) *Application of section 72(p)(2)(A).* A loan that is deemed distributed under section 72(p) (including interest accruing thereafter) and that has not been repaid (such as by a plan loan offset) is considered outstanding for purposes of applying section 72(p)(2)(A) to determine the maximum amount of any subsequent loan to the participant or beneficiary.

(2) *Additional security for subsequent loans.* If a loan is deemed distributed to a participant or beneficiary under section 72(p) and has not been repaid (such as by a plan loan offset), then no payment made thereafter to the participant or beneficiary shall be treated as a loan for purposes of section 72(p)(2) unless the loan otherwise satisfies section 72(p)(2) and this section and either of the following conditions is satisfied:

(i) There is an arrangement among the plan, the participant or beneficiary, and the employer, enforceable under applicable law, under which repayments will be made by payroll withholding. For this purpose, an arrangement will not fail to be enforceable merely because a party has the right to revoke the arrangement prospectively.

(ii) The plan receives adequate security from the participant or beneficiary that is in addition to the participant's or beneficiary's accrued benefit under the plan.

(3) *Condition no longer satisfied.* If, following a deemed distribution that has not been repaid, a payment is made to a participant or beneficiary that satisfies the conditions in paragraph (b)(2) of this Q&A-19 for treatment as a plan loan and, subsequently, before repayment of the second loan, the conditions in paragraph (b)(2) of this Q&A-19 are no longer satisfied with respect to the second loan (for example, if the loan recipient revokes consent to payroll withholding), the amount then outstanding on the second loan is treated as a deemed distribution under section 72(p).

Q-20: May a participant refinance an outstanding loan or have more than one loan outstanding from a plan?

A-20: (a) *Refinancings and multiple loans*—(1) *General rule.* A participant who has an outstanding loan that satisfies section 72(p)(2) and this section may refinance that loan or borrow additional amounts, if, under the facts and

circumstances, the loans collectively satisfy the amount limitations of section 72(p)(2)(A) and the prior loan and the additional loan each satisfy the requirements of section 72(p)(2)(B) and (C) and this section. For this purpose, a refinancing includes any situation in which one loan replaces another loan.

(2) *Loans that repay a prior loan and have a later repayment date.* For purposes of section 72(p)(2) and this section (including paragraph (a)(3) of this Q&A-20 and the amount limitations of section 72(p)(2)(A)), if a loan that satisfies section 72(p)(2) is replaced by a loan (a replacement loan) and the term of the replacement loan ends after the term of the loan it replaces (the replaced loan), the replacement loan and the replaced loan are both treated as outstanding on the date of the transaction. For purposes of the preceding sentence, the term of the replaced loan is determined under the terms of that loan as in effect immediately prior to the making of the replacement loan. Thus, for example, the replacement loan results in a deemed distribution if the sum of the amount of the replacement loan plus the outstanding balance of all other loans on the date of the transaction, including the replaced loan, fails to satisfy the amount limitations of section 72(p)(2)(A). This paragraph (a)(2) of this Q&A-20 does not apply to a replacement loan if the terms of the replacement loan would satisfy section 72(p)(2) and this section determined as if the replacement loan consisted of two separate loans, the replaced loan (amortized in substantially level payments over a period ending not later than the last day of the term of the replaced loan) and a new loan based on the difference between the amount of the replacement loan and the amount of the replaced loan.

(3) *Multiple loans.* For purposes of section 72(p)(2) and this section, a loan to a participant or beneficiary shall be treated as a deemed distribution if two or more loans have previously been made from the plan to the participant or beneficiary during the year. This limitation applies on the basis of a calendar year unless the plan applies this limit on the basis of the plan year or another consistent 12-month period.

(b) *Examples.* The following examples illustrate the rules in paragraph (a) of this Q&A-20 and are based on the assumptions described in the introductory text of this section:

Example 1. (i) A participant with a vested account balance that exceeds $100,000 borrows $40,000 from a plan on January 1, 2003, to be repaid in 20 quarterly installments of $2,491 each. Thus, the term of the loan ends on December 31, 2007. On January 1, 2004, when the outstanding balance on the loan is $33,322, the loan is refinanced and is replaced by a new $40,000 loan from the plan to be repaid in 20 quarterly installments. Under the terms of the refinanced loan, the loan is to be repaid in level quarterly installments (of $2,491 each) over the next 20 quarters. Thus, the term of the new loan ends on December 31, 2008.

(ii) Under section 72(p)(2)(A), the amount of the new loan, when added to the outstanding balance of all other loans from the plan, must not exceed $50,000 reduced by the excess of the highest outstanding balance of loans from the plan during the 1-year period ending on December 31, 2003 over the outstanding balance of loans from the plan on January 1, 2004, with such outstanding balance to be determined immediately prior to the new $40,000 loan. Because the term of the new loan ends later than the term of the loan it replaces, both the new loan and the loan it replaces must be taken into account for purposes of applying section 72(p)(2), including the amount limitations in section 72(p)(2)(A). The amount of the new loan is $40,000, the outstanding balance on January 1, 2004 of the loan it replaces is $33,322 and the highest outstanding balance of loans from the plan during 2003 was $40,000. Accordingly, under section 72(p)(2)(A), the sum of the new loan and the outstanding balance on January 1, 2004 of the loan it replaces must not exceed $50,000 reduced by $6,678 (the excess of the $40,000 maximum outstanding loan balance during 2003 over the $33,322 outstanding balance on January 1, 2004, determined immediately prior to the new loan) and thus, must not exceed $43,322. The sum of the new loan ($40,000) and the outstanding balance on January 1, 2004 of the loan it replaces ($33,322) is $73,322. Since $73,322 exceeds the $43,322 limit under section 72(p)(2)(A) by $30,000, there is a deemed distribution of $30,000 on January 1, 2004.

(iii) However, no deemed distribution would occur if, under the terms of the refinanced loan, the amount of the first 16 installments on the refinanced loan were equal to $2,907, which is the sum of the $2,491 originally scheduled quarterly installment payment amount under the first loan, plus $416 (which is the amount required to repay, in level quarterly installments over five years beginning on January 1, 2004, the excess of the refinanced loan over the January 1, 2004 balance of the first loan ($40,000 minus $33,322 equals $6,678)), and the amount of the 4 remaining installments were equal to $416. The refinancing would not be subject to paragraph (a)(2) of this Q&A-20 because the terms of the new loan would satisfy section 72(p)(2) and this section (including the substantially level amortization requirements of section 72(p)(2)(B) and (C)) determined as if the new loan consisted of two loans, one of which is in the amount of the first loan ($33,322) and is amortized in substantially level payments over a period ending December 31, 2007 (the last day of the term of the first loan) and the other of which is in the additional amount ($6,678) borrowed under the new loan. Similarly, the transaction also would not result in a deemed distribution (and would not be subject to paragraph (a)(2) of this Q&A-20) if the terms of the refinanced loan provided for repayments to be made in level quarterly installments (of $2,990 each) over the next 16 quarters.

Example 2. (i) The facts are the same as in *Example 1*, except that the applicable interest rate used by the plan when the loan is refinanced is significantly lower due to a reduction in market rates of interest and, under the terms of the refinanced loan, the amount of the first 16 installments on the refinanced loan is equal to $2,848 and the amount of the next 4 installments on the refinanced loan is equal to $406. The $2,848 amount is the sum of $2,442 to repay the first loan by December 31, 2007 (the term of the first loan), plus $406 (which is the amount to repay, in level quarterly installments over five years beginning on January 1, 2004, the $6,678 excess of the refinanced loan over the January 1, 2004 balance of the first loan).

(ii) The transaction does not result in a deemed distribution (and is not subject to paragraph (a)(2) of this Q&A-20) because the terms of the new loan would satisfy section 72(p)(2) and this section (including the substantially level amortization requirements of section 72(p)(2)(B) and (C)) determined as if the new loan consisted of two loans, one of which is in the amount of the first loan ($33,322) and is amortized in substantially level payments over a period ending December 31, 2007 (the last day of the term of the first loan) and the other of which is in the additional amount ($6,678) borrowed under the new loan. The transaction would also not result in a deemed distribution (and not be subject to paragraph (a)(2) of this Q&A-20) if the terms of the new loan provided for repayments to be made in level quarterly installments (of $2,931 each) over the next 16 quarters.

Example 3. (i) A participant with a vested account balance that exceeds $100,000 borrows $20,000 from a plan on January 1, 2005 to be repaid in 20 quarterly installments of $1,245 each. On March 31, 2005, when the first installment is due, the participant receives a second loan equal to $1,245, with that March loan to be repaid in 20 quarterly installments of $78 each. On June 30, 2005, when the second installment is due on the January loan and the first installment is due on the March loan, the participant receives a third loan equal to $1,323 (which is the sum of the $1,245 installment and the $78 installment then due), with that June loan to be repaid in 20 quarterly installments of $82 each. On September 30, 2005, when the third installment is due on the January loan, the second installment is due on the March loan, and the first installment is due on the June loan, the participant receives a fourth loan equal to $1,405 (which is the sum of the $1,245 installment, the $78 installment and the $82 installment then due), with that September loan to be repaid in 20 quarterly installments of $88 each. On December 31, 2005, when the fourth installment is due on the January loan, the third installment is due on the March loan, the second installment is due on the June loan, and the first installment is due on the September loan, the participant receives a fifth loan equal to $1,493 (which is the sum of the $1,245 installment, the $78 installment, the $82 installment, and the $88 installment then due), with that December loan to be repaid in 20 quarterly installments of $93 each.

(ii) Under paragraph (a)(3) of this Q&A-20, the participant has deemed distributions on June 30, 2005 equal to $1,323 (which is the amount of the June loan), on September 30, 2005 equal to $1,405 (which is the amount of the September loan), and on December 31, 2005 equal to $1,493 (which is the amount of the December loan) because on each of these dates the participant had previously received two loans from the plan during the year.

* * * * *

A-22: * * *

(d) *Effective date for Q&A-19(b)(2) and Q&A-20.* Paragraph (b)(2) of Q&A-19 and Q&A-20 of this section apply to loans made on or after the first January 1 that is at least 6 months after publication of final regulations in the **Federal Register**, except that paragraph (b)(2) of Q&A-19 of this section does not apply to loans, whenever made, under an insurance contract that is in effect before the date that is 12 months after publication of final regulations in the **Federal Register** under which the insurance carrier is required to offer loans to contractholders that are not secured (other than being secured by the participant's or beneficiary's benefit under the contract).

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on July 28, 2000, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2000, 65 F.R. 46677)

Deletions From Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 2000–69

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 August 14, 2000, 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, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Dayspring Group Home a/k/a Dayspring Group, Inc.
San Bernardino, CA

Ecologically Aware, Inc.
National City, CA

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 2000 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, 2000.

Rev. Rul. 2000–39

The following Department Store Inventory Price Indexes for June 2000 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, 2000.

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 1999	June 2000	Percent Change from June 1999 to June 2000[1]
1. Piece Goods	555.1	496.1	-10.6
2. Domestics and Draperies	630.1	615.8	-2.3
3. Women's and Children's Shoes	645.1	626.5	-2.9
4. Men's Shoes	876.9	926.1	5.6
5. Infants' Wear	610.1	642.2	5.3
6. Women's Underwear	561.4	568.3	1.2
7. Women's Hosiery	322.8	334.2	3.5
8. Women's and Girls' Accessories	549.3	538.3	-2.0
9. Women's Outerwear and Girls' Wear	392.0	385.0	-1.8
10. Men's Clothing	624.1	613.5	-1.7
11. Men's Furnishings	630.4	621.5	-1.4
12. Boys' Clothing and Furnishings	488.9	491.7	0.6
13. Jewelry	961.2	924.3	-3.8
14. Notions	747.4	768.3	2.8
15. Toilet Articles and Drugs	968.8	971.1	0.2
16. Furniture and Bedding	682.9	670.6	-1.8
17. Floor Coverings	602.7	607.9	0.9
18. Housewares	801.4	780.7	-2.6
19. Major Appliances	235.7	233.6	-0.9
20. Radio and Television	66.3	59.8	-9.8
21. Recreation and Education[2]	98.7	93.0	-5.8
22. Home Improvements[2]	127.6	128.2	0.5
23. Auto Accessories[2]	106.7	106.3	-0.4
Groups 1 - 15: Soft Goods	599.9	592.9	-1.2
Groups 16 - 20: Durable Goods	452.2	438.1	-3.1
Groups 21 - 23: Misc. Goods[2]	104.1	100.2	-3.7
Store Total[3]	545.0	534.9	-1.9

[1] Absence of a minus sign before the percentage change in this column signifies a 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 Associate 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 2001.—Imposition and Rate of Tax

26 CFR 20.2001–1: Valuation of adjusted taxable gifts and section 2701(d) taxable events.

If a taxpayer does not submit the information required under section 301.6501(c)–1(f) of the Procedure and Administrative Regulations to adequately disclose a gift on the initial gift tax return filed for the calendar year in which the gift was made, what procedure must the taxpayer follow to submit the required information in order to commence the running of the period of limitations on assessment of the gift tax for the purpose of determining the amount of adjusted taxable gifts? See Rev. Proc. 2000–34, page 186.

Section 2504.—Taxable Gifts for Preceding Calendar Periods

26 CFR 25.2504–2: Determination of gifts for preceding calendar periods.

If a taxpayer does not submit the information required under section 301.6501(c)–1(f) of the Procedure and Administrative Regulations to adequately disclose a gift on the initial gift tax return filed for the calendar year in which the gift was made, what procedure must the taxpayer follow to submit the required information in order to commence the running of the period of limitations on assessment of the gift tax for the purpose of determining the correct amount of taxable gifts for the preceding calendar periods? See Rev. Proc. 2000–34, page 186.

Section 6501.—Limitations on Assessment and Collection

26 CFR 301.6501(c)–1: Exceptions to general period of limitations on assessment and collection.

If a taxpayer does not submit the information required under section 301.6501(c)–1(f) of the Procedure and Administrative Regulations to adequately disclose a gift on the initial gift tax return filed for the calendar year in which the gift was made, what procedure must the taxpayer follow to submit the required information in order to commence the running of the period of limitations on assessment of the gift tax? See Rev. Proc. 2000–34, page 186.

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, §§ 2001, 2504, 6501; 20.2001-1, 25.2504-2, 301.6501(c)-1.)

Rev. Proc. 2000-34

SECTION 1. PURPOSE

This revenue procedure provides guidance for submitting the information required under § 6501(c)(9) of the Internal Revenue Code and § 301.6501(c)-1(f) of the Procedure and Administration Regulations to adequately disclose a gift if the information was not initially submitted with a gift tax return filed for the calendar year in which the gift was made. The period of limitations on assessment under § 6501(a) will commence to run with respect to such a gift when the taxpayer adequately discloses the gift on an amended gift tax return filed pursuant to this revenue procedure. The period of assessment will generally expire 3 years after the date such amended return is filed.

SECTION 2. BACKGROUND

Under § 6501(c)(9), as amended by the Taxpayer Relief Act of 1997, 1997-4 (Vol. 1) C.B. 1, 69, and the Internal Revenue Restructuring and Reform Act of 1998, P.L. 105-206, 112 Stat. 685, if the value of a gift is required to be shown on a gift tax return but is not disclosed on the return, or on a statement attached to the return, in a manner adequate to apprise the Internal Revenue Service of the nature of the transfer, the period of limitations on assessment of gift tax with respect to the gift will not begin to run. If the transfer is adequately disclosed on the gift tax return and the period of limitations on assessment of gift tax has expired, then, under § 2504(c), the value of the gift cannot be adjusted for purposes of determining "prior taxable gifts" and the current gift tax liability and, under § 2001(f), the value of the gift cannot be adjusted for purposes of determining "adjusted taxable gifts" and the estate tax liability.

Section 301.6501(c)-1(f)(2) provides that a transfer is adequately disclosed on a return only if it is reported in a manner adequate to apprise the Service of the nature of the gift and the basis for the value reported. Section 301.6501(c)-1(f)(2)(i) through (v) sets forth the information that must be disclosed on the gift tax return, or on a statement attached to the return, to adequately apprise the Service of the nature of the gift and its value.

The period of limitations on assessment of gift tax with respect to a gift will commence to run only if the donor submits the information required under § 301.6501(c)-1(f)(2) to adequately disclose that gift. The general rule under § 6501(a), that gift tax must be assessed within 3 years of the later to occur of the date the gift tax return is filed or due (except as otherwise provided under §§ 6501(c) and(e)), applies from the date the donor submits all the required information for that gift, if that information was not originally submitted with the gift tax return.

SECTION 3. SCOPE

This revenue procedure applies where the donor filed a federal gift tax return (Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return) for the appropriate calendar year but failed to adequately disclose a gift because the gift was not reported on the return or because the information required under § 301.6501(c)-1(f)(2) for the gift was not submitted with the return. This revenue procedure does not apply in any situation where § 6501(c)(1), (c)(2), or (c)(3) applies.

SECTION 4. PROCEDURE

To commence the running of the period of limitations on assessment with respect to a gift that was not adequately disclosed on a federal gift tax return, the donor must file an amended gift tax return for the calendar year in which the gift was made. The amended return must identify the transfer and provide all of the information required under § 301.6501(c)-1(f)(2) that was not previously submitted with the original gift tax return. The amended return must be filed with the same Internal Revenue Service Center where the donor previously filed the gift tax return for the calendar year. The top of the first page of the amended return must have the words "Amended Form 709 for gift(s) made in **[insert the calendar year that the gift was made]** - In accordance with Rev. Proc. 2000-34, 2000-34 I.R.B. 186."

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective with respect to amended returns filed to comply with § 301.6501(c)-1(f)(2) after August 21, 2000. Submissions filed on or before this date to comply with the adequate disclosure requirements under the statute and regulations will be accepted by the Service as effective to commence the running of the period of limitations as of the date filed, provided the submission contains sufficient information to constitute adequate disclosure under § 301.6501(c)-1(f)(2). The taxpayer is not required to conform submissions filed on or before this date to the requirements of this revenue procedure.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is William L. Blodgett of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Mr. Blodgett on (202) 622-3090 (not a toll free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates

REG–108522–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 684 of the Internal Revenue Code relating to recognition of gain on certain transfers to certain foreign trusts and estates. The proposed regulations affect United States persons who transfer property to foreign trusts and estates. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by November 6, 2000. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for November 8, 2000, must be submitted by October 18, 2000.

ADDRESSES: Send submissions to: CC:MSP:RU (REG–108522–00), room 5226, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:MSP:RU (REG–108522–00), 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 3313, Internal Revenue Building, 1111 Constitution Ave., NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Karen A. Rennie Quarrie at (202) 622-3880; concerning the submissions and hearing, Sonya M. Cruse at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 684 of the Internal Revenue Code (Code) was added by Section 1131(b) of the Taxpayer Relief Act of 1997 (the Act), Public Law 105-34 (111 Stat. 788) (August 5, 1997). The addition affects the transfer of property by United States persons to certain foreign trusts and foreign estates.

1. *Prior Law*

Prior to the enactment of section 684, section 1491, with certain exceptions, imposed a 35-percent excise tax on transfers of property by a United States person to a foreign trust or estate. Section 1491 applied to all transfers of appreciated property whether or not at fair market value and whether or not the transfer was made with donative intent. The excise tax was intended to curtail transfers of appreciated property to foreign trusts, because a foreign trust could dispose of the property and invest the proceeds of the sale outside the United States without incurring any U.S. tax. If the excise tax applied, the foreign trust could not increase the basis of the property contributed to the trust. Under section 1492(3), the U.S. transferor could make an election under section 1057 to treat a transfer of appreciated property to a foreign trust as a sale or exchange of such property and pay an income tax instead of an excise tax on the gain.

2. *Overview of Changes*

Section 1131 of the Act repealed sections 1491 through 1494 and section 1057 of the Code and enacted section 684. In so doing, Congress eliminated the excise tax on transfers of appreciated property to foreign trusts and foreign estates in favor of an income tax on transfers of appreciated property to foreign trusts and foreign estates. Unlike previous law, however, Congress provided explicit regulatory authority to make exceptions to the mandatory tax on such transfers. These regulations explain the application of section 684 and provide certain exceptions from its application.

Pursuant to section 684(a) of the Code, any transfer of property by a U.S. person to a foreign trust or estate is treated as a taxable disposition of the property, except to the extent provided in regulations. Such a transfer is treated as a sale or exchange of the property for its fair market value. The U.S. transferor must immediately recognize gain equal to the excess of the property's fair market value over its adjusted basis in the hands of the U.S. transferor.

Pursuant to section 684(b), a U.S. person will not be required to recognize gain on the transfer of property to a foreign trust if the U.S. transferor (or other person) is considered to be the owner of the trust under section 671.

Pursuant to section 684(c), if a domestic trust becomes a foreign trust, all trust assets are considered to be transferred to a foreign trust. Thus, appreciated property owned by the trust will be deemed sold on the date that the trust status changes from domestic to foreign, and gain must be recognized on that date.

Explanation of Provisions

§1.684–1 Recognition of gain on transfers to certain foreign trusts and estates

Subject to certain exceptions discussed below, the proposed regulations provide a general rule of immediate recognition of gain when a U.S. person transfers appreciated property to a foreign trust or estate. This immediate gain recognition applies even if the U.S. transferor might otherwise have been eligible to defer gain recognition under another provision of the Code. Losses are not permitted to be recognized under the provision. Moreover, if multiple assets are transferred, the U.S. transferor may not offset losses in some property against gains in other property under the provision.

A U.S. person who transfers property to a foreign trust must comply with the reporting requirements set forth in section 6048 of the Code. See Notice 97–34 (1997–1 C.B. 422), which provides guidance regarding the foreign trust reporting requirements under section 6048.

§1.684–2 Transfers

The proposed regulations define the term *transfer* broadly to mean any direct,

indirect or constructive transfer. The determination of whether an indirect or constructive transfer has occurred is made under the rules set forth in proposed regulation §1.679–3(c) and §1.679–3(d), respectively, published in REG–209038–89 on page 191.

The proposed regulations provide that, if a U.S. person is considered the owner of any portion of a trust, a transfer of property from that portion of the trust will be considered a transfer by the U.S. person that owns that portion of the trust. Thus, for example, a U.S. person cannot avoid the application of section 684 by first transferring property to a trust which he is treated as owning under the grantor trust rules, then having that trust transfer the property to a foreign trust that he is not treated as owning.

§1.684–3 Exceptions to the general rule of gain recognition

Under the proposed regulations, certain types of transfers are excepted from the general rule of gain recognition set forth in §1.684–1. A U.S. person who transfers property to a foreign trust will not be required to recognize gain on the transfer to the extent such trust is considered owned by any person. For example, if a U.S. person transfers property to a foreign trust that is treated as having a U.S. beneficiary under section 679 and the U.S. person is treated as the owner of the trust under that section, the general rule of gain recognition will not apply at that time. If, however, the trust subsequently ceases to be treated as owned by the U.S. person, §1.684–2(e) provides that the U.S. person will be treated as having transferred the assets of the trust to a foreign trust immediately before the U.S. person ceases to be considered the owner of the original trust. As a result, the U.S. person will be subject to the general rule of gain recognition at that time (unless another exception, such as the exception for certain transfers on death, applies).

A transfer by a U.S. person to a trust which has received a ruling or determination letter from the IRS recognizing the trust's exempt status under section 501(c)(3) will be exempt from the general rule of gain recognition if the trust's ruling or determination letter has been neither revoked nor modified.

The proposed regulations also provide an exception for transfers by a U.S. person to a foreign trust at death if the property transferred is included in the U.S. person's gross estate for U.S. estate tax purposes and the basis of the property in the hands of the foreign trust is determined under section 1014(a) of the Code. For example, if a U.S. person previously transferred property to a foreign trust and was treated as the owner of the trust under section 679, for purposes of section 684 the cessation of ownership status upon the U.S. person's death is treated as a deemed transfer to the foreign trust by the decedent immediately before her death. If the person retained sufficient powers over the trust to cause the trust property to be included in her gross estate for estate tax purposes and the basis of the property in the hands of the foreign trust is determined under section 1014(a) of the Code, the general rule of gain recognition does not apply. However, to the extent the trust property is not included in her estate and the foreign trust does not receive a step-up in basis in the property under section 1014(a), the exception does not apply.

The proposed regulations also provide an exception to the general rule of gain recognition under §1.684–1 if property is transferred for fair market value to an unrelated foreign trust. The determination of whether a foreign trust is a related foreign trust is made under the principles set forth in §1.679–1(c)(5). Thus, for example, if a U.S. person sells property for fair market value to an unrelated foreign trust, the general rule of section 684 will not apply. However, if the sale is to a related foreign trust, immediate gain recognition is required (unless another exception applies), even if another provision of the Code would permit deferral of recognition.

Finally, the proposed regulations provide that the general rule does not apply to a distribution to a trust with respect to an interest held by the trust in a non-trust entity (e.g., a corporation or partnership), or an interest in certain commercial trusts. For example, if a foreign trust owns stock of a U.S. corporation and the U.S. corporation makes a distribution to the trust that is properly characterized as a dividend with respect to the trust's stock ownership, section 684 does not apply.

§1.684–4 Outbound migration of domestic trust

The proposed regulations provide that if a U.S. person transfers property to a domestic trust and, for any reason, the domestic trust becomes a foreign trust, the domestic trust will be deemed to have transferred all of its assets to a foreign trust. The domestic trust must immediately recognize gain unless an exception in §1.684–3 applies at that time (e.g., the U.S. person is living at the time of the trust's change in status and is treated as the owner of the trust under section 679). The domestic trust must also fulfill the reporting requirements set forth in section 6048 of the Code and Notice 97–34.

The proposed regulations incorporate the relief for inadvertent migrations set forth in §301.7701–7(d)(2). For example, if a trust's status changes from domestic to foreign because of an inadvertent change in the trustee, the trust will avoid the application of the general gain recognition rule if, within 12 months, it makes necessary changes to the trustee in order to remain a domestic trust.

§1.684–5 Effective dates

This section of the proposed regulations provides effective dates with respect to §§1.684–1 through 1.684–4. The rules apply with respect to transfers of property to foreign trusts or foreign estates made after August 7, 2000. The primary reason for this effective date is to immediately address taxpayer concerns with respect to the provision of regulatory exceptions to the general rule of gain recognition under section 684(a). It should be noted, however, that the Internal Revenue Service is not restricted from applying general income tax principles to transactions prior to the effective dates of the proposed regulations to determine, for example, that a U.S. person has made a transfer to a foreign trust.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, 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 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 businesses.

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 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 8, 2000, at 10 a.m. in room 3313, 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 start of the hearing.

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 November 6, 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 October 18, 2000.

A period of ten (10) minutes will be allocated to each person for making comments.

An agenda showing the scheduling to 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 Karen A. Rennie Quarrie of the 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 1 is proposed to be 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 1.684–1 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–2 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–3 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–4 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–5 also issued under 26 U.S.C. 643(a)(7) and 684(a). * * *

Par. 2. Sections 1.684–1, 1.684–2, 1.684–3, 1.684–4 and 1.684–5 are added under the undesignated centerheading "Miscellaneous" to read as follows:

§1.684–1 Recognition of gain on transfers to certain foreign trusts and estates.

(a) *Immediate recognition of gain*—(1) *In general.* Any U.S. person who transfers property to a foreign trust or foreign estate shall be required to recognize gain at the time of the transfer equal to the excess of the fair market value of the property transferred over the adjusted basis (for purposes of determining gain) of such property in the hands of the U.S. transferor unless an exception applies under the provisions of §1.684–3. The amount of gain recognized is determined on an asset-by-asset basis.

(2) *No recognition of loss.* Under this section a U.S. person may not recognize loss on the transfer of an asset to a foreign trust or foreign estate. A U.S. person may not offset gain realized on the transfer of an appreciated asset to a foreign trust or foreign estate by a loss realized on the transfer of a depreciated asset to the foreign trust or foreign estate.

(b) *Definitions.* The following definitions apply for purposes of this section:

(1) *U.S. person.* The term U.S. person means a United States person as defined in section 7701(a)(30), and includes a nonresident alien individual who elects under section 6013(g) to be treated as a resident of the United States.

(2) *U.S. transferor.* The term U.S. transferor means any U.S. person who makes a transfer (as defined in §1.684–2) of property to a foreign trust or foreign estate.

(3) *Foreign trust.* Section 7701(a)(31)(B) defines foreign trust.

(4) *Foreign estate.* Section 7701(a)(31)(A) defines foreign estate.

(c) *Reporting requirements.* A U.S. person who transfers property to a foreign trust or foreign estate must comply with the reporting requirements under section 6048.

(d) *Examples.* The following examples illustrate the rules of this section. In all examples, A is a U.S. person and FT is a foreign trust. The examples are as follows:

Example 1. Transfer to foreign trust. A transfers property that has a fair market value of 1000X to *FT*. *A*'s adjusted basis in the property is 400X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes gain at the time of the transfer equal to 600X.

Example 2. Transfer of multiple properties. A transfers property Q, with a fair market value of 1000X, and property R, with a fair market value of 2000X, to *FT*. At the time of the transfer, A's adjusted basis in property Q is 700X, and A's adjusted basis in property R is 2200X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes the 300X of gain attributable to property Q. Under paragraph (a)(2) of this section, *A* does not recognize the 200X of loss attributable to property R, and may not offset that loss against the gain attributable to property Q.

Example 3. Transfer for less than fair market value. A transfers property that has a fair market value of 1000X to *FT* in exchange for 400X of cash. *A*'s adjusted basis in the property is 200X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes gain at the time of the transfer equal to 800X.

Example 4. Exchange of property for private annuity. A transfers property that has a fair market value of 1000X to *FT* in exchange for *FT*'s obligation to pay *A* 50X per year for the rest of *A*'s life. The obligation has an issue price of 1000X. *A*'s adjusted basis in the property is 100X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. *A* is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though *A* might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code.

Example 5. Transfer of property to related foreign trust in exchange for qualified obligation. A transfers property that has a fair market value of 1000X to *FT* in exchange for *FT*'s obligation to make payments to A during the next four years. *FT*

is related to *A* as defined in §1.679–1(c)(5). The obligation, which has an issue price of 1000X, is treated as a qualified obligation within the meaning of §1.679–4(d), and no person is treated as owning any portion of *FT*. *A*'s adjusted basis in the property is 100X. *A* is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though *A* might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code. Section 1.684–3(d) provides rules relating to transfers for fair market value to unrelated foreign trusts.

§1.684–2 Transfers.

(a) *In general.* A transfer means a direct, indirect, or constructive transfer.

(b) *Indirect transfers*—(1) *In general.* Section 1.679–3(c) shall apply to determine if a transfer to a foreign trust or foreign estate, by any person, is treated as an indirect transfer by a U.S. person to the foreign trust or foreign estate.

(2) *Examples.* The following examples illustrate the rules of this paragraph (b). In all examples, A is a U.S. citizen, *FT* is a foreign trust, and I is *A*'s uncle, who is a nonresident alien. The examples are as follows:

Example 1. Principal purpose of tax avoidance. *A* creates and funds *FT* for the benefit of *A*'s cousin, who is a nonresident alien. *FT* has no U.S. beneficiary within the meaning of §1.679– 2, and no person is treated as owning any portion of *FT*. In 2004, *A* decides to transfer additional property with a fair market value of 1000X and an adjusted basis of 600X to *FT*. Pursuant to a plan with a principal purpose of avoiding the application of section 684, *A* transfers the property to I. I subsequently transfers the property to *FT*. Under paragraph (b) of this section and §1.679–3(c), *A* is treated as having transferred the property to *FT*.

Example 2. U.S. person unable to demonstrate that intermediary acted independently. *A* creates and funds *FT* for the benefit of *A*'s cousin, who is a nonresident alien. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. On July 1, 2004, *A* transfers property with a fair market value of 1000X and an adjusted basis of 300X to I, a foreign person. On January 1, 2007, at a time when the fair market value of the property is 1100X, I transfers the property to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, under §1.679–3(c)(2)(ii), that I acted independently of *A* in making the transfer to *FT*. Under this paragraph (b) and §1.679–3(c), *A* is treated as having transferred the property to *FT*. Under this paragraph (b) and §1.679–3(c)(3), I is treated as an agent of *A*, and the transfer is deemed to have been made on January 1, 2007. Under §1.684–1(a), *A* recognizes gain equal to 800X on that date.

(c) *Constructive transfers.* Section 1.679–3(d) shall apply to determine if a transfer to a foreign trust or foreign estate is treated as a constructive transfer by a U.S. person to the foreign trust or foreign estate.

(d) *Transfers by certain trusts*—(1) *In general.* If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Examples.* The following examples illustrate the rules of this paragraph (d). In all examples, *A* is a U.S. person, *DT* is a domestic trust, and *FT* is a foreign trust. The examples are as follows:

Example 1. Transfer by a domestic trust. On January 1, 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis of 200X to DT. A retains the power to revoke *DT*. On January 1, 2003, *DT* transfers property which has a fair market value of 500X and an adjusted basis of 100X to *FT*. At the time of the transfer, *FT* has no U.S. beneficiary as defined in §1.679–2 and no person is treated as owning any portion of *FT*. *A* is treated as having transferred the property to *FT* and is required to recognize gain of 400X, under §1.684–1, at the time of the transfer by *DT* to *FT*.

Example 2. Transfer by a foreign trust. On January 1, 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis of 200X to *FT1*. At the time of the transfer, *FT1* has a U.S. beneficiary as defined in §1.679–2 and *A* is treated as the owner of *FT1* under section 679. On January 1, 2003, *FT1* transfers property which has a fair market value of 500X and an adjusted basis of 100X to *FT2*. At the time of the transfer, *FT2* has no U.S. beneficiary as defined in §1.679–2 and no person is treated as owning any portion of *FT2*. *A* is treated as having transferred the property to *FT2* and is required to recognize gain of 400X, under §1.684–1, at the time of the transfer by *FT1* to *FT2*.

(e) *Transfers when foreign trust no longer treated as owned by a U.S. person*—(1) *In general.* If any portion of a foreign trust is treated as owned by a U.S. person under subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, and such portion ceases to be treated as owned by that person under such subpart, the U.S. person shall be treated as having transferred, immediately before the trust is no longer treated as owned by that U.S. person, the assets of such portion to a foreign trust.

(2) *Examples.* The following examples illustrate the rules of this paragraph (e). In all examples, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

Example 1. Loss of U.S. beneficiary. (i) On January 1, 2001, *A* transfers property, which has a fair market value of 1000X and an adjusted basis of 400X, to *FT*. At the time of the transfer, *FT* has a U.S. beneficiary within the meaning of §1.679–2, and *A* is treated as owning *FT* under section 679. Under §1.684–3(a), §1.684–1 does not cause A to recognize gain at the time of the transfer.

(ii) On July 1, 2003, *FT* ceases to have a U.S. beneficiary within the meaning of §1.679–2, and as of that date neither *A* nor any other person is treated as owning any portion of *FT*. On that date, the fair market value of the property is 1200X, and its adjusted basis equals 350X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* on July 1, 2003, and must recognize 850X of gain at that time under §1.684–1.

Example 2. Death of grantor. (i) The initial facts are the same as in paragraph (i) of *Example 1*.

(ii) On July 1, 2003, *A* dies, and as of that date no other person is treated as the owner of *FT*. On that date, the fair market value of the property is 1200X, and its adjusted basis equals 350X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* immediately before his death, and generally is required to recognize 850X of gain at that time under §1.684–1. However, an exception may apply under §1.684–3(c).

Example 3. Release of a power. (i) On January 1, 2001, *A* transfers property that has a fair market value of 500X and an adjusted basis of 200X to *FT*. At the time of the transfer, *FT* does not have a U.S. beneficiary within the meaning of §1.679–2. However, *A* retains the power to revoke the trust. *A* is treated as the owner of the trust under section 676 and, therefore, under §1.684–3(a), *A* is not required to recognize gain under §1.684–1 at the time of the transfer.

(ii) On January 1, 2007, *A* releases the power to revoke the trust and, as of that date, neither *A* nor any other person is treated as owning any portion of *FT*. On that date, the fair market value of the property is 900X, and its adjusted basis is 200X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* on January 1, 2007, and must recognize 700X of gain at that time.

(f) *Transfers to entities owned by a foreign trust.* Section 1.679–3(f) provides rules that apply with respect to transfers of property by a U.S. person to an entity in which a foreign trust holds an ownership interest.

§1.684–3 Exceptions to general rule of gain recognition.

(a) *Transfers to grantor trusts.* The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property by a U.S. person to a foreign trust to the extent that any person is treated as the owner of the trust under section 671. Section 1.684–2(e) provides rules regarding a subsequent change in the status of the trust.

(b) *Transfers to charitable trusts.* The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property to a foreign trust that has received a ruling or determination letter, which has been neither revoked nor modified, from the Internal Revenue Service

recognizing the trust's exempt status under section 501(c)(3).

(c) *Certain transfers at death.* The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property by reason of death of the U.S. transferor if such property is included in the gross estate of the U.S. transferor for Federal estate tax purposes and the basis of the property in the hands of the foreign trust is determined under section 1014(a).

(d) *Transfers for fair market value to unrelated trusts.* The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property for fair market value to a foreign trust that is not a related foreign trust as defined in §1.679–1(c)(5). Section §1.671–2(e)(2)(ii) defines fair market value.

(e) *Certain distributions to trusts.* For purposes of this section, a transfer does not include a distribution to a trust with respect to an interest held by such trust in an entity other than a trust or 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.

(f) *Examples.* The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

Example 1. Transfer to owner trust. In 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *FT*. At the time of the transfer, *FT* has a U.S. beneficiary within the meaning of §1.679–2, and *A* is treated as owning *FT* under section 679. Under paragraph (a) of this section, §1.684–1 does not cause *A* to recognize gain at the time of the transfer. See §1.684–2(e) for rules that may require *A* to recognize gain if the trust is no longer owned by *A*.

Example 2. Property included in U.S. transferor's estate at death. (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retained the power to revoke *FT*, thus, the value of all property owned by *FT* at *A*'s death is includible in *A*'s gross estate for U.S. estate tax purposes. Pursuant to paragraph (c) of this section, *A* is not required to recognize gain under §1.684–1 to the extent the property is included in *A*'s gross estate and the basis of the property in the hands of the foreign trust is determined under section 1014(a).

Example 3. Property not included in U.S. transferor's estate at death. (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retained no power over *FT* and the value of the property transferred to *FT* is not required to be included in *A*'s gross estate. Under §1.684–2(e)(1), *A* is treated as having transferred the property to *FT* immediately before his death, and must recognize 1100X of gain at that time under §1.684–1.

Example 4. Transfer of property for fair market value to an unrelated foreign trust. *A* sells a house with a fair market value of 1000X to *FT* in exchange for a 30-year note issued by *FT*. *A* is not related to *FT* as defined in §1.679–1(c)(5). The note has an issue price of 1000X. *FT* is not treated as owned by any person. Pursuant to paragraph (d) of this section, *A* is not required to recognize gain under §1.684–1.

§1.684–4 Outbound migrations of domestic trusts.

(a) *In general.* If a U.S. person transfers property to a domestic trust, and such trust becomes a foreign trust, the trust shall be treated for purposes of this section as having transferred all of its assets to a foreign trust and the trust is required to recognize gain on the transfer under §1.684–1(a). The trust must also comply with the rules of section 6048.

(b) *Date of transfer.* The transfer described in this section shall be deemed to occur immediately before, but on the same date that, the trust meets the definition of a foreign trust set forth in section 7701(a)(31)(B).

(c) *Inadvertent migrations.* In the event of an inadvertent migration, as defined in §301.7701(d)(2) of this chapter, a trust may avoid the application of this section by complying with the procedures set forth in §301.7701–7(d)(2) of this chapter.

(d) *Examples.* The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen, *B* is a U.S. citizen, *C* is a nonresident alien, *T* is a trust. The examples are as follows:

Example 1. Migration of domestic trust with U.S. beneficiaries. *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust, for the benefit of *A*'s children who are also United States citizens. *B* is the trustee of *T*. On January 1, 2001, while *A* is still alive, *B* resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701–7(d) of this chapter, *T* becomes a foreign trust. *T* has U.S. beneficiaries within the meaning of §1.679–2 and *A* is, therefore, treated as owning *FT* under section 679. Pursuant to §1.684–3(a), neither *A* nor *T* is required to recognize gain at the time of the migration. Section 1.684–2(e) provides rules that may require *A* to recognize gain upon a subsequent change in the status of the trust.

Example 2. Migration of domestic trust with no U.S. beneficiaries. *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust for the benefit of *A*'s mother who is not a citizen or resident of the United States. *B* is the trustee of *T*. On January 1, 2001, while A is still alive, *B* resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701–7(d) of this chapter, *T* becomes a foreign trust, *FT*. *FT* has no U.S. beneficiaries within the meaning of §1.679–2 and no person is treated as owning any portion of *FT*. *T* is required to recognize gain of 600X on January 1, 2001. Paragraph (c) of this section provides rules with respect to an inadvertent migration of a domestic trust.

§1.684–5 Effective date.

(a) Sections 1.684–1 through 1.684–4 apply to transfers of property to foreign trusts and foreign estates after August 7, 2000.

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 2, 2000, 1:04 p.m., and published in the issue of the Federal Register for August 7, 2000, 65 F.R. 48198)

Notice of Proposed Rulemaking and Notice of Public Hearing

Foreign Trusts That Have U.S. Beneficiaries

REG–209038–89

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 679 of the Internal Revenue Code relating to transfers of property by U.S. persons to foreign trusts having one or more United States beneficiaries. The proposed regulations affect United States persons who transfer property to foreign trusts. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by November 6, 2000. Requests to speak (with outlines of oral comments) to be discussed at the public hearing scheduled for November 8, 2000,

not cause that beneficiary to be treated as a U.S. person for purposes of determining whether there is a U.S. beneficiary until the year in which the beneficiary actually becomes a U.S. person. However, if that non-U.S. beneficiary becomes a U.S. person for the first time more than 5 years after the date of the transfer, that beneficiary is not treated as a U.S. person for purposes of the U.S.-beneficiary determination even after the beneficiary actually becomes a U.S. person.

Section 1.679–2(a)(4) makes it clear that a trust may be treated as having a U.S. beneficiary not only by reference to the trust instrument, but also by reference to all other written and oral agreements and understandings relating to the trust. Also, a trust may be treated as having a U.S. beneficiary based on possible amendments to the trust instrument, possible application of local law that would require a U.S. beneficiary (unless the law is not reasonably expected to be applied under the facts and circumstances), or actual or reasonably expected disregard of the terms of the trust instrument by the parties to the trust.

A foreign trust is treated as having a U.S. beneficiary if it can benefit a U.S. person indirectly. Section 1.679–2(b) provides that an amount is treated as paid or accumulated to or for the benefit of a U.S. person if it can be paid to or accumulated for the benefit of a controlled foreign corporation (as defined in section 957(a)); a foreign partnership, if a U.S. person is a partner of such partnership; or a foreign trust or estate, if such trust or estate has a U.S. beneficiary. In addition, a foreign trust is treated as having a U.S. beneficiary if a U.S. person can benefit indirectly from the foreign trust by receiving distributions from the trust through an intermediary, such as an agent or nominee, through the use of a debit or credit card, or any other means where a U.S. person may obtain an actual or constructive benefit from the trust.

The proposed regulations anticipate situations where a foreign trust's status as having a U.S. beneficiary changes. Section 1.679–2(c)(1) provides that if a foreign trust does not have a U.S. beneficiary initially, but subsequently acquires a U.S. beneficiary, the U.S. transferor is treated as having additional income in the first taxable year of the U.S. transferor in which the trust is treated as having a U.S. beneficiary. The amount of the additional income is equal to the trust's undistributed net income, as defined in section 665(a), at the end of the U.S. transferor's immediately preceding taxable year and is subject to the rules of section 668, providing for an interest charge on accumulation distributions from foreign trusts.

Section 1.679–2(c)(2) provides that if a trust to which a U.S. transferor transferred property is initially treated as having a U.S. beneficiary, but subsequently ceases to be treated as having a U.S. beneficiary, the U.S. transferor is no longer treated as the owner beginning in the following taxable year (unless the U.S. transferor is otherwise treated as the owner under the grantor trust rules). The U.S. transferor is treated as making a transfer to the foreign trust that may be subject to the gain recognition rules of section 684.

The rules of this section apply with respect to transfers to foreign trusts after August 7, 2000.

§1.679–3 Transfers

Section 1.679–3(a) of the proposed regulations broadly defines the term transfer as any direct, indirect, or constructive transfer by a U.S. person to a foreign trust. The rules are generally consistent with the rules for determining whether a person is considered to be a grantor of a trust under §1.671–2(e).

Section 1.679–3(b) provides that a transfer of property to a foreign trust from either a domestic or foreign trust that is owned by a U.S. person under sections 673 through 679 is treated as a transfer from the owner of the transferor trust. For example, if a U.S. person is treated as the owner of a domestic trust under section 676, and that domestic trust transfers property to a foreign trust, the U.S. person is treated as having transferred the property to the foreign trust.

Section 1.679–3(c) provides rules for determining when there is an indirect transfer. Under §1.679–3(c)(1), a transfer to a foreign trust by any person to whom a U.S. person transfers property (referred to as an intermediary) is treated as an indirect transfer by a U.S. person if the transfer is made pursuant to a plan one of the principal purposes of which is the avoidance of U.S. tax. Section 1.679–3(c)(2) deems a transfer to have been made pursuant to such a plan if the U.S. transferor is related to a U.S. beneficiary of the foreign trust, or has another relationship with the foreign trust that establishes a reasonable basis for concluding that the U.S. transferor would make a transfer to the foreign trust, and the U.S. person cannot demonstrate to the satisfaction of the Commissioner that:(i) the intermediary has a relationship with a U.S. beneficiary of the foreign trust that establishes a reasonable basis for concluding that the intermediary would make a transfer to the foreign trust, (ii) the intermediary acted independently of the U.S. transferor, (iii) the intermediary is not an agent of the U.S. transferor under generally applicable United States agency principles, and (iv) that the intermediary timely complied with the reporting requirements of section 6048 (including Notice 97–34), if applicable. This test is consistent with the legislative history of the 1976 Act. H.R. Rep. No. 658, 94th Cong., 1st Sess., at 209 (1975). This test is also similar to the test in §1.643(h)–1(a), although the presumption in the proposed regulations applies without regard to the period of time between the transfer from the U.S. person to the intermediary and from the intermediary to the foreign trust.

Section 1.679–3(c)(3) explains that if a transfer is treated as an indirect transfer, the intermediary generally is treated as an agent of the U.S. transferor, and the property is treated as transferred to the foreign trust by the U.S. transferor in the year the property is transferred, or made available, by the intermediary to the foreign trust. The fair market value of the property transferred generally is determined as of the date of the transfer by the intermediary to the foreign trust. Although the intermediary is not treated as having transferred that property to the foreign trust for purposes of section 679, the intermediary must comply with the reporting requirements of section 6048, if applicable.

Section 1.679–3(d) provides that a constructive transfer includes any assumption or satisfaction of a foreign trust's obligation. For example, a U.S. transferor's payment of a foreign trust's obligation to a third party is treated as a constructive transfer.

Congress anticipated that guarantees of a trust obligation would be treated as transfers. H.R. Rep. No. 658, 94th Cong., 1st

Sess., at 209 (1975). Section 1.679–3(e) provides rules regarding the treatment of guarantees as transfers. If a foreign trust borrows money or other property from either a U.S. or non-U.S. person who is not a related person with respect to the trust (referred to as the lender), and a U.S. person who is a related person with respect to the trust (referred to as the U.S. guarantor) guarantees the foreign trust's obligation, the U.S. guarantor is treated as having made a transfer to the foreign trust. The amount deemed transferred is the guaranteed portion of the adjusted issue price of the obligation plus any accrued but unpaid stated interest. Payments of principal by the trust with respect to the obligation are taken into account on and after the date of the payment in determining the portion of the trust attributable to the property deemed transferred.

Section 1.679–3(f) provides specific rules regarding transfers by a U.S. person to an entity owned by a foreign trust if the U.S. person is related to the foreign trust. The transfer is treated as a transfer from the U.S. person to the foreign trust, followed by a transfer from the foreign trust to the entity owned by the foreign trust, unless the U.S. person demonstrates to the satisfaction of the Commissioner that the transfer to the entity is properly attributable to the U.S. person's ownership interest in the entity.

Sections 1.679–3 applies to transfers after August 7, 2000.

§1.679–4 Exceptions to General Rule

Pursuant to sections 679(a)(1) and (a)(2), §1.679–4(a) provides the following four exceptions to the general rule of §1.679–1: (i) transfers to a foreign trust by reason of the death of the transferor; (ii) transfers to a foreign trust described in sections 402(b), 404(a)(4), or 404A; (iii) transfers to a foreign trust that has received a ruling or determination letter, which has been neither revoked nor modified, from the Internal Revenue Service recognizing the trust's tax exempt status under section 501(c)(3); and (iv) transfers to the extent they are for fair market value.

Section 1.679–4(b) provides rules for determining whether a transfer to a foreign trust is for fair market value. The rules generally follow the rules for determining fair market value under §1.671–2(e). For purposes of this determination, an interest in the trust is not considered to be property received from the trust. A distribution to a foreign trust with respect to an interest held by such trust in an entity other than a trust or in a trust described in §301.7701–4(c), (d), or (e) is considered to be a transfer for fair market value. For example, a dividend paid by a U.S. corporation to a foreign trust with respect to the foreign trust's stock ownership in the corporation is not a transfer that is subject to the general rule of section §1.679–1.

Section 679(a)(3) provides that in determining whether a transfer is for fair market value, obligations received from the trust or certain related persons are not taken into account, except to the extent provided in regulations. As noted above, this provision reflects Congress' concern that certain taxpayers may have attempted to take advantage of the fair market value exception to section 679 by transferring property to a foreign trust in exchange for obligations issued by the trust (or related persons) that might not be repaid. Congress intended Treasury and the IRS to exercise their regulatory authority to consider whether there is a reasonable expectation that an obligation of the trust would be repaid. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 335 (1996).

The proposed regulations, in exercising this authority, follow the approach in Notice 97–34 (1997–1 C.B. 422). The proposed regulations describe the circumstances under which an obligation of a foreign trust (or a person related to that trust) will be treated as a qualified obligation that is taken into account for purposes of determining whether a U.S. transferor received fair market value from a trust in exchange for a transfer by the U.S. transferor. If the U.S. transferor, in exchange for the property transferred, receives an obligation of the trust (or a related person) that is not a qualified obligation, the obligation is considered to have no value for purposes of determining whether the transferor received fair market value.

The term obligation is defined in §1.679–1(c)(6). Section 1.679–4(d) provides that to be treated as a qualified obligation, an obligation must be reduced to writing by an express written agreement. The obligation must have a term not in excess of five years. For purposes of determining an obligation's term, the obligation's maturity date is the last possible date it can be outstanding under the terms of the obligation. Accordingly, demand loans and private annuity transactions do not constitute qualified obligations. In addition, all payments on a qualified obligation must be denominated in U.S. dollars. The yield to maturity cannot be less than 100 percent of the applicable Federal rate and cannot be greater than 130 percent of the applicable Federal rate. The U.S. transferor must extend the period for assessment of any income or transfer tax attributable to the transfer and any consequential income tax changes for each year that the obligation is outstanding, to a date not earlier than three years after the maturity date of the obligation. The extension is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. transferor's taxable year and is paid within such period. Finally, the U.S. transferor must report the status of the loan, including principal and interest payments, on Form 3520 for every year that the loan is outstanding.

Section 1.679–4(d) also incorporates other rules regarding qualified obligations from Notice 97–34. For example, under certain circumstances, the issuance of additional obligations by the foreign trust or a person related to the foreign trust may cause an obligation that had been a qualified obligation to lose such status. Renegotiation of the terms of the loan is treated as a new loan. If an obligation loses its status as a qualified obligation, the U.S. transferor is treated as making a transfer to the trust that may be subject to §1.679–1. Principal repayments with respect to obligations that are not qualified obligations are taken into account on and after the date of the payment in determining the portion of the trust attributable to the property originally transferred.

The rules of this section generally apply with respect to transfers to foreign trusts after August 7, 2000. Special effective dates, based on the guidance set forth in Notice 97–34, are provided for the rules that apply to obligations.

§1.679–5 Pre–immigration Trusts

The 1996 Act added section 679(a)(4) to address the potential abuse of nonresi-

dent aliens establishing foreign trusts shortly before becoming U.S. persons. Section 1.679–5 provides that if a nonresident alien individual becomes a U.S. person and the individual has a residency starting date (as determined under section 7701(b)(2)(A)) within 5 years after directly or indirectly transferring property to a foreign trust, the individual is deemed to transfer the property to the trust on the residency starting date. The amount deemed transferred is the portion of the trust attributable to the property transferred by the individual in the original transfer. Section 1.679–5(b) provides that if the nonresident alien individual is treated under the grantor trust rules as the owner of any portion of the trust and the individual ceases to be so treated, the 5-year period begins on the date the individual ceases to be so treated.

The property deemed transferred to the foreign trust on the residency starting date includes undistributed net income, as defined in section 665(a), attributable to the property transferred. Undistributed net income for periods before the individual's residency starting date is taken into account only for purposes of determining the portion of the trust that is attributable to property transferred.

If an individual is treated as making a deemed transfer pursuant to this provision, the reporting requirements of section 6048 apply to the deemed transfer as of the residency starting date.

The rules of this section apply to persons whose residency starting date is after August 7, 2000.

§1.679–6 Outbound Migrations of Domestic Trusts

The proposed regulations implement section 679(a)(5), which addresses the situation where a trust that is a domestic trust becomes a foreign trust. If an individual who is a U.S. person transfers property to a trust that is not a foreign trust, and the trust becomes a foreign trust while the U.S. person is alive, the U.S. individual is treated as a U.S. transferor and is deemed to transfer the property to a foreign trust on the date the domestic trust becomes a foreign trust. The property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property previously transferred. Undistributed net income for periods prior to the trust migration is taken into account only for purposes of determining the portion of the trust that is attributable to the property transferred by the U.S. person.

If a U.S. person is treated as making a deemed transfer pursuant to this provision, the reporting requirements of section 6048 apply to the deemed transfer as of the date of the deemed transfer.

The rules of this section apply to trusts that become foreign trusts after August 7, 2000.

§1.679–7 Effective Dates.

This section of the proposed regulations provides effective dates with respect to §§1.679–1 through 1.679–6. These effective dates are discussed above in the context of each respective section. Notwithstanding the effective dates in the proposed regulations, the Internal Revenue Service may apply the effective dates that are applicable to section 679 of the Internal Revenue Code. In addition, the Internal Revenue Service is not restricted from applying general income tax principles to transactions prior to the effective dates of the proposed regulations to determine, for example, that a U.S. person has made a transfer to a foreign trust.

Certain Clarifications Regarding Section 958

The proposed regulations clarify that, under §1.958–1(b), a person who is treated as the owner of any portion of a trust under section 679 and the other grantor trust rules is treated as the owner of the stock owned by the trust with respect to that portion. This change is merely intended as a clarification of existing law.

Existing §1.958–2(c)(1)(ii)(b) provides that a person who is treated as the owner of any portion of a trust under sections 671 through 678 is treated as the owner of the stock owned by or for that portion of the trust for purposes of the constructive ownership rules of section 958(b). Because section 679 was not enacted until 1976, it is not referred to in the existing regulations, which were issued in 1966. The proposed regulations clarify that this treatment also applies to persons treated as the owner of any portion of a trust under section 679. This change is merely intended as a clarification of existing law.

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 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) that are submitted timely to the IRS. The IRS and Treasury 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 8, 2000, at 10 a.m. in room 3313, 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 November 6, 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 October 18, 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 Willard W. Yates of the 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 1 is proposed to be 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 1.679–1 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–2 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–3 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–4 also issued under 26 U.S.C. 643(a)(7), 679(a)(3) and 679(d).

Section 1.679–5 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–6 also issued under 26 U.S.C. 643(a)(7) and 679(d). * * *

Par. 2. Sections 1.679–1, 1.679–2, 1.679–3, 1.679–4, 1.679–5, 1.679–6, and 1.679–7 are added under the undesignated center heading "Grantors and others treated as substantial owners" to read as follows:

§1.679–1 U.S. transferor treated as owner of foreign trust.

(a) *In general.* A U.S. transferor who transfers property to a foreign trust is treated as the owner of the portion of the trust attributable to the property transferred if there is a U.S. beneficiary of any portion of the trust, unless an exception in §1.679–4 applies to the transfer.

(b) *Interaction with sections 673 through 678.* The rules of this section apply without regard to whether the U.S. transferor retains any power or interest described in sections 673 through 677. If a U.S. transferor would be treated as the owner of a portion of a foreign trust pursuant to the rules of this section and another person would be treated as the owner of the same portion of the trust pursuant to section 678, then the U.S. transferor is treated as the owner and the other person is not treated as the owner.

(c) *Definitions.* The following definitions apply for purposes of this section and §§1.679–2 through 1.679–7:

(1) *U.S. transferor.* The term *U.S. transferor* means any U.S. person who makes a transfer (as defined in §1.679–3) of property to a foreign trust.

(2) *U.S. person.* The term *U.S. person* means a United States person as defined in section 7701(a)(30), a nonresident alien individual who elects under section 6013(g) to be treated as resident of the United States, and an individual who is a dual resident taxpayer within the meaning of §301.7701(b)–7(a) of this chapter.

(3) *Foreign trust.* Section 7701(a)(31)(B) defines the term *foreign trust.*

(4) *Property.* The term *property* means any *property* including cash.

(5) *Related person.* A person is a *related person* if, without regard to the transfer at issue, the person is—

(i) A grantor of any portion of the trust (within the meaning of §1.671–2(e)(1));

(ii) An owner of any portion of the trust under sections 671 through 679;

(iii) A beneficiary of the trust; or

(iv) A person who is related (within the meaning of section 643(i)(2)(B)) to any grantor, owner or beneficiary of the trust.

(6) *Obligation.* The term *obligation* means any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness, and, to the extent not previously described, any annuity contract.

(d) *Examples.* The following examples illustrate the rules of paragraph (a) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s father, who is a resident alien, *D* is *A*'s uncle, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

Example 1. Interaction with section 678. A creates and funds *FT. FT* may provide for the education of *B* by paying for books, tuition, room and board. In addition, *C* has the power to vest the trust corpus or income in himself within the meaning of section 678(a)(1). Under paragraph (b) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred to *FT* by *A* and *C* is not treated as the owner thereof.

Example 2. U.S. person treated as owner of a portion of FT. D creates and funds *FT* for the benefit of *B. D* retains a power described in section 676 and §1.672(f)–3(a)(1). *A* transfers property to *FT.* Under sections 676 and 672(f), *D* is treated as the owner of the portion of *FT* attributable to the property transferred by *D.* Under paragraph (a) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred by *A.*

§1.679–2 Trusts treated as having a U.S. beneficiary.

(a) *Existence of U.S. beneficiary*—(1) *In general.* The determination of whether a foreign trust has a U.S. beneficiary is made on an annual basis. A foreign trust is treated as having a U.S. beneficiary unless during the taxable year of the U.S. transferor—

(i) No part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, directly or indirectly, a U.S. person; and

(ii) If the trust is terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of, directly or indirectly, a U.S. person.

(2) *Benefit to a U.S. person*—(i) *In general.* For purposes of paragraph (a)(1) of this section, income or corpus may be paid or accumulated to or for the benefit of a U.S. person during a taxable year of the U.S. transferor if during that year, directly or indirectly, income may be distributed to, or accumulated for the benefit of, a U.S. person, or corpus may be distributed to, or held for the future benefit of, a U.S. person. This determination is made without regard to whether income or corpus is actually distributed to a U.S. person during that year, and without regard to whether a U.S. person's interest in the trust income or corpus is contingent on a future event.

(ii) *Certain unexpected beneficiaries.* Notwithstanding paragraph (a)(2)(i) of this section, for purposes of paragraph (a)(1) of this section, a person who is not named as a beneficiary and is not a member of a class of beneficiaries as defined under the trust instrument is not taken into consideration if the U.S. transferor demonstrates to the satisfaction of the Commissioner that the person's contingent interest in the trust is so remote as to be negligible. The preceding sentence does not apply with respect to persons to whom distributions could be made pursuant to a grant of discretion to the trustee or any other person. A class of beneficia-

ries generally does not include heirs who will benefit from the trust under the laws of intestate succession in the event that the named beneficiaries (or members of the named class) have all deceased (whether or not stated as a named class in the trust instrument).

(iii) *Examples.* The following examples illustrate the rules of paragraphs (a)(1) and (a)(2) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

Example 1. Distribution of income to U.S. person. *A* transfers property to *FT*. The trust instrument provides that all trust income is to be distributed currently to *B*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary.

Example 2. *Income accumulation for the benefit of a U.S. person.* In 2001, *A* transfers property to *FT*. The trust instrument provides that from 2001 through 2010, the trustee of *FT* may distribute trust income to *C* or may accumulate the trust income. The trust instrument further provides that in 2011, the trust will terminate and the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust assets must be distributed to *C*. Because it is possible that income may be accumulated in each year, and that the accumulated income ultimately may be distributed to *B*, a U.S. person, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through 2011. This result applies even though no U.S. person may receive distributions from the trust during the tax years 2001 through 2010.

Example 3. Corpus held for the benefit of a U.S. person. The facts are the same as in *Example 2*, except that from 2001 through 2011, all trust income must be distributed to *C*. In 2011, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust corpus must be distributed to *C*. Because during each of *A*'s tax years from 2001 through 2011 trust corpus is held for possible future distribution to *B*, a U.S. person, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of those years. This result applies even though no U.S. person may receive distributions from the trust during the tax years 2001 through 2010.

Example 4. Distribution upon U.S. transferor's death. *A* transfers property to *FT*. The trust instrument provides that all trust income must be distributed currently to *C* and, upon *A*'s death, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*. Because *B* may receive a distribution of corpus upon the termination of *FT*, and *FT* could terminate in any year, *FT* is treated as having a U.S. beneficiary in the year of the transfer and in subsequent years.

Example 5. Distribution after U.S. transferor's death. The facts are the same as in *Example 4*, except the trust instrument provides that the trust will not terminate until the year following *A*'s death. Upon termination, the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. All trust assets are invested in the stock of *X*, a foreign corporation, and *X* makes no distributions to *FT*. Although no U.S. person may receive a distribution until the year after *A*'s death, and *FT* has no realized income during any year of its existence, during each year in which *A* is living corpus may be held for future distribution to *B*, a U.S. person. Thus, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through the year of *A*'s death.

Example 6. Constructive benefit to U.S. person. *A* transfers property to *FT*. The trust instrument provides that no income or corpus may be paid directly to a U.S. person. However, the trust instrument provides that trust corpus may be used to satisfy *B*'s legal obligations to a third party by making a payment directly to the third party. Under paragraphs (a)(1) and (2) of this section, *FT* is treated as having a U.S. beneficiary.

Example 7. U.S. person with negligible contingent interest. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *C*, and upon *C*'s death, all corpus is to be distributed to whomever of *C*'s three children is then living. All of *C*'s children are nonresident aliens. Under the laws of intestate succession that would apply to *FT*, if all of *C*'s children are deceased at the time of *C*'s death, the corpus would be distributed to *A*'s heirs. *A*'s living relatives at the time of the transfer consist solely of two brothers and two nieces, all of whom are nonresident aliens, and two first cousins, one of whom, *E*, is a U.S. citizen. Although it is possible under certain circumstances that *E* could receive a corpus distribution under the applicable laws of intestate succession, for each year the trust is in existence *A* is able to demonstrate to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that *E*'s contingent interest in *FT* is so remote as to be negligible. Provided that paragraph (a)(4) of this section does not require a different result, *FT* is not treated as having a U.S. beneficiary.

Example 8. U.S. person with non-negligible contingent interest. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. Under the laws of intestate succession that would apply to *FT*, *B* and *C* would share equally in the trust corpus if *D* is not living at the time of *A*'s death. *A* is unable to demonstrate to the satisfaction of the Commissioner that *B*'s contingent interest in the trust is so remote as to be negligible. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

Example 9. U.S. person as member of class of beneficiaries. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. If *D* is not then living, the corpus is to be distributed to *D*'s descendants. *D*'s grandson, *E*, is a resident alien. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

Example 10. Trustee's discretion in choosing beneficiaries. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of, any person who is pursuing the academic study of ancient Greek, in the trustee's discretion. Because it is possible that a U.S. person will receive distributions of income or corpus, or will have income accumulated for his benefit, *FT* is treated as having a U.S. beneficiary. This result applies even if, during a tax year, no distributions or accumulations are actually made to or for the benefit of a U.S. person. *A* may not invoke paragraph (a)(2)(ii) of this section because a U.S. person could benefit pursuant to a grant of discretion in the trust instrument.

Example 11. Appointment of remainder beneficiary. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute current income to *C*, or may accumulate income, and, upon termination of the trust, trust assets are to be distributed to *C*. However, the trust instrument further provides that *D*, *A*'s uncle, may appoint a different remainder beneficiary. Because it is possible that a U.S. person could be named as the remainder beneficiary, and because corpus could be held in each year for the future benefit of that U.S. person, *FT* is treated as having a U.S. beneficiary for each year.

Example 12. Trust not treated as having a U.S. beneficiary. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of *C*. Upon termination of the trust, all income and corpus must be distributed to *C*. Assume that paragraph (a)(4) of this section is not applicable under the facts and circumstances and that *A* establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Because no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, either directly or indirectly, a U.S. person, and if the trust is terminated no part of the income or corpus of the trust could be paid to or for the benefit of, either directly or indirectly, a U.S. person, *FT* is not treated as having a U.S. beneficiary.

Example 13. U.S. beneficiary becomes non-U.S. person. In 2001, *A* transfers property to *FT*. The trust instrument provides that, as long as *B* remains a U.S. resident, no distributions of income or corpus may be made from the trust to *B*. The trust instrument further provides that if *B* becomes a nonresident alien, distributions of income (including previously accumulated income) and corpus may be made to him. If *B* remains a U.S. resident at the time of *FT*'s termination, all accumulated income and corpus is to be distributed to *C*. In 2007, *B* becomes a nonresident alien and remains so thereafter. Because income may be accumulated during the years 2001 through 2007 for the benefit of a person who is a U.S. person during those years, *FT* is treated as having a U.S. beneficiary under paragraph (a)(1) of this section during each of those years. This result applies even though *B* cannot receive distributions from *FT* during the years he is a resident alien and even though *B* might remain a resident alien who is not entitled to any distribution from *FT*. Provided that paragraph (a)(4) of this section does not require a different result and that *A* establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no other U.S. persons

are reasonably expected to benefit from the trust, *FT* is not treated as having a U.S. beneficiary under paragraph (a)(1) of this section during tax years after 2007.

(3) *Changes in beneficiary's status*—(i) *In general.* For purposes of paragraph (a)(1) of this section, the possibility that a person that is not a U.S. person could become a U.S. person will not cause that person to be treated as a U.S. person for purposes of paragraph (a)(1) of this section until the tax year of the U.S. transferor in which that individual actually becomes a U.S. person. However, if a person who is not a U.S. person becomes a U.S. person for the first time more than 5 years after the date of a transfer to the foreign trust by a U.S. transferor, that person is not treated as a U.S. person for purposes of applying paragraph (a)(1) of this section with respect to that transfer.

(ii) *Examples.* The following examples illustrate the rules of paragraph (a)(3) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

Example 1. Non-U.S. beneficiary becomes U.S. person. In 2001, *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *C* and that, upon the termination of *FT*, all corpus is to be distributed to *C*. Assume that paragraph (a)(4) of this section is not applicable under the facts and circumstances and that A establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Under paragraph (a)(3)(i) of this section, *FT* is not treated as having a U.S. beneficiary during the tax years of *A* in which *C* remains a nonresident alien. If *C* first becomes a resident alien in 2004, *FT* is treated as having a U.S. beneficiary commencing in that year under paragraph (a)(3) of this section. See paragraph (c) of this section regarding the treatment of *A* upon *FT*'s acquisition of a U.S. beneficiary.

Example 2. Non-U.S. beneficiary becomes U.S. person more than 5 years after transfer. The facts are the same as in *Example 1*, except *C* first becomes a resident alien in 2007. *FT* is treated as not having a U.S. beneficiary under paragraph (a)(3)(i) of this section with respect to the property transfer. However, if *C* had previously been a U.S. person during any prior period, the 5-year exception in paragraph (a)(3)(i) of this section would not apply in 2007 because it would not have been the first time *C* became a U.S. person.

(4) *General rules*—(i) *Records and documents.* Even if, based on the terms of the trust instrument, a foreign trust is not treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the trust may nevertheless be treated as having a U.S. beneficiary pursuant to paragraph (a)(1) of this section based on the following—

(A) All written and oral agreements and understandings relating to the trust;

(B) Memoranda or letters of wishes;

(C) All records that relate to the actual distribution of income and corpus; and

(D) All other documents that relate to the trust, whether or not of any purported legal effect.

(ii) *Additional factors.* For purposes of determining whether a foreign trust is treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the following additional factors are taken into account–

(A) If the terms of the trust instrument allow the trust to be amended to benefit a U.S. person, all potential benefits that could be provided to a U.S. person pursuant to an amendment must be taken into account;

(B) If the terms of the trust instrument do not allow the trust to be amended to benefit a U.S. person, but the law applicable to a foreign trust may require payments or accumulations of income or corpus to or for the benefit of a U.S. person (by judicial reformation or otherwise), all potential benefits that could be provided to a U.S. person pursuant to the law must be taken into account, unless the U.S. transferor demonstrates to the satisfaction of the Commissioner that the law is not reasonably expected to be applied or invoked under the facts and circumstances; and

(C) If the parties to the trust ignore the terms of the trust instrument, or if it is reasonably expected that they will do so, all benefits that have been, or are reasonably expected to be, provided to a U.S. person must be taken into account.

(iii) *Examples.* The following examples illustrate the rules of paragraph (a)(4) of this section. In these examples, A is a resident alien, B is A's son, who is a resident alien, C is A's daughter, who is a nonresident alien, and FT is a foreign trust. The examples are as follows:

Example 1. Amendment pursuant to local law. *A* creates and funds *FT* for the benefit of *C*. The terms of *FT* (which, according to the trust instrument, cannot be amended) provide that no part of the income or corpus of *FT* may be paid or accumulated during the taxable year to or for the benefit of any U.S. person, either during the existence of *FT* or at the time of its termination. However, pursuant to the applicable foreign law, *FT* can be amended to provide for additional beneficiaries, and there is an oral understanding between *A* and the trustee that *B* can be added as a beneficiary. Under paragraphs (a)(1) and (a)(4)(ii)(B) of this section, *FT* is treated as having a U.S. beneficiary.

Example 2. Actions in violation of the terms of the trust. *A* transfers property to *FT*. The trust instrument provides that no U.S. person can receive income or corpus from *FT* during the term of the trust or at the termination of *FT*. Notwithstanding the terms of the trust instrument, a letter of wishes directs the trustee of *FT* to provide for the educational needs of *B*, who is about to begin college. The letter of wishes contains a disclaimer to the effect that its contents are only suggestions and recommendations and that the trustee is at all times bound by the terms of the trust as set forth in the trust instrument. Under paragraphs (a)(1) and (a)(4)(ii)(C) of this section, *FT* is treated as having a U.S. beneficiary.

(b) *Indirect U.S. beneficiaries*—(1) *Certain foreign entities.* For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of—

(i) A controlled foreign corporation, as defined in section 957(a);

(ii) A foreign partnership, if a U.S. person is a partner of such partnership; or

(iii) A foreign trust or estate, if such trust or estate has a U.S. beneficiary (within the meaning of paragraph (a)(1) of this section).

(2) *Other indirect beneficiaries.* For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of a U.S. person through an intermediary, such as an agent or nominee, or by any other means where a U.S. person may obtain an actual or constructive benefit.

(3) *Examples.* The following examples illustrate the rules of this paragraph (b). Unless otherwise noted, *A* is a U.S. resident alien. *B* is *A*'s son and is a resident alien. *FT* is a foreign trust. The examples are as follows:

Example 1. Trust benefitting foreign corporation. *A* transfers property to *FT*. The beneficiary of *FT* is *FC*, a foreign corporation. *FC* has outstanding solely 100 shares of common stock. *B* owns 49 shares of the *FC* stock and *FC2*, also a foreign corporation, owns the remaining 51 shares. *FC2* has outstanding solely 100 shares of common stock. *B* owns 49 shares of *FC2* and nonresident alien individuals own the remaining 51 *FC2* shares. *FC* is a controlled foreign corporation (as defined in section 957(a), after the application of section 958(a)(2)). Under paragraphs (a)(1) and (b)(1)(i) of this section, *FT* is treated as having a U.S. beneficiary.

Example 2. Trust benefitting another trust. *A* transfers property to *FT*. The terms of *FT* permit current distributions of income to *B*. *A* transfers property to another foreign trust, *FT2*. The terms of *FT2* provide that no U.S. person can benefit either as to income or corpus, but permit current distributions of income to *FT*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary and, under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT2* is treated as having a U.S. beneficiary.

Example 3. Trust benefitting another trust after transferor's death. *A* transfers property to *FT*. The terms of *FT* require that all income from *FT* be accumulated during *A*'s lifetime. In the year following *A*'s death, a share of *FT* is to be distributed to *FT2*, another foreign trust, for the benefit of *B*. Under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT* is treated as having a U.S. beneficiary beginning with the year of *A*'s transfer of property to *FT*.

Example 4. Indirect benefit through use of debit card. *A* transfers property to *FT*. The trust instrument provides that no U.S. person can benefit either as to income or corpus. However, *FT* maintains an account with *FB*, a foreign bank, and *FB* issues a debit card to *B* against the account maintained by *FT* and *B* is allowed to make withdrawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

Example 5. Other indirect benefit. *A* transfers property to *FT*. *FT* is administered by *FTC*, a foreign trust company. *FTC* forms *IBC*, an international business corporation formed under the laws of a foreign jurisdiction. *IBC* is the beneficiary of *FT*. *IBC* maintains an account with *FB*, a foreign bank. *FB* issues a debit card to *B* against the account maintained by *IBC* and *B* is allowed to make withdrawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

(c) *Treatment of U.S. transferor upon foreign trust's acquisition or loss of U.S. beneficiary*—(1) *Trusts acquiring a U.S. beneficiary.* If a foreign trust to which a U.S. transferor has transferred property is not treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) for any taxable year of the U.S. transferor, but the trust is treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) in any subsequent taxable year, the U.S. transferor is treated as having additional income in the first such taxable year of the U.S. transferor in which the trust is treated as having a U.S. beneficiary. The amount of the additional income is equal to the trust's undistributed net income, as defined in section 665(a), at the end of the U.S. transferor's immediately preceding taxable year and is subject to the rules of section 668, providing for an interest charge on accumulation distributions from foreign trusts.

(2) *Trusts ceasing to have a U.S. beneficiary.* If, for any taxable year of a U.S. transferor, a foreign trust that has received a transfer of property from the U.S. transferor ceases to be treated as having a U.S. beneficiary, the U.S. transferor ceases to be treated as the owner of the portion of the trust attributable to the transfer beginning in the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary (unless the U.S. transferor is treated as an owner thereof pursuant to sections 673 through 677). The U.S. transferor is treated as making a transfer of property to the foreign trust on the first day of the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary. The amount of the property deemed to be transferred to the trust is the portion of the trust attributable to the prior transfer to which paragraph (a)(1) of this section applied. For rules regarding the recognition of gain on transfers to foreign trusts, see section 684.

(3) *Examples.* The rules of this paragraph (c) are illustrated by the following examples. *A* is a U.S. resident alien, *B* is *A*'s son, and *FT* is a foreign trust. The examples are as follows:

Example 1. Trust acquiring U.S. beneficiary. (i) In 2001, *A* transfers stock with a fair market value of $100,000 to *FT*. The stock has an adjusted basis of $50,000 at the time of the transfer. The trust instrument provides that income may be paid currently to, or accumulated for the benefit of, *B* and that, upon the termination of the trust, all income and corpus is to be distributed to *B*. At the time of the transfer, *B* is a nonresident alien. *A* is not treated as the owner of any portion of *FT* under sections 671 through 677. *FT* accumulates a total of $30,000 of income during the taxable years 2001 through 2003. In 2004, *B* moves to the United States and becomes a resident alien. Assume paragraph (a)(4) of this section is not applicable under the facts and circumstances.

(ii) Under paragraph (c)(1) of this section, *A* is treated as receiving an accumulation distribution in the amount of $30,000 in 2004 and immediately transferring that amount back to the trust. The accumulation distribution is subject to the rules of section 668, providing for an interest charge on accumulation distributions.

(iii) Under paragraphs (a)(1) and (3) of this section, beginning in 2005, *A* is treated as the owner of the portion of *FT* attributable to the stock transferred by *A* to *FT* in 2001 (which includes the portion attributable to the accumulated income deemed to be retransferred in 2004).

Example 2. Trust ceasing to have U.S. beneficiary. (i) The facts are the same as in *Example 1*. In 2008, *B* becomes a nonresident alien. On the date *B* becomes a nonresident alien, the stock transferred by *A* to *FT* in 2001 has a fair market value of $125,000 and an adjusted basis of $50,000.

(ii) Under paragraph (c)(2) of this section, beginning in 2009, *FT* is not treated as having a U.S. beneficiary, and *A* is not treated as the owner of the portion of the trust attributable to the prior transfer of stock. For rules regarding the recognition of gain on the termination of ownership status, see section 684.

§1.679–3 Transfers.

(a) *In general.* A transfer means a direct, indirect, or constructive transfer.

(b) *Transfers by certain trusts*—(1) *In general.* If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Example.* The following example illustrates this paragraph (b):

Example. In 2001, *A*, a U.S. citizen, creates and funds *DT*, a domestic trust. *A* has the power to revest absolutely in himself the title to the property in *DT* and is treated as the owner of *DT* pursuant to section 676. In 2004, *DT* transfers property to *FT*, a foreign trust. *A* is treated as having transferred the property to *FT* in 2004 for purposes of this section.

(c) *Indirect transfers*—(1) *Principal purpose of tax avoidance.* A transfer to a foreign trust by any person (intermediary) to whom a U.S. person transfers property is treated as an indirect transfer by a U.S. person to the foreign trust if such transfer is made pursuant to a plan one of the principal purposes of which is the avoidance of United States tax.

(2) *Principal purpose of tax avoidance deemed to exist.* For purposes of paragraph (c)(1) of this section, a transfer is deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of United States tax if—

(i) The U.S. person is related (within the meaning of paragraph (c)(4) of this section) to a beneficiary of the foreign trust, or has another relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the U.S. transferor would make a transfer to the foreign trust; and

(ii) The U.S. person cannot demonstrate to the satisfaction of the Commissioner that—

(A) The intermediary has a relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the intermediary would make a transfer to the foreign trust;

(B) The intermediary acted independently of the U.S. person;

(C) The intermediary is not an agent of the U.S. person under generally applicable United States agency principles; and

(D) The intermediary timely complied with the reporting requirements of section 6048, if applicable.

(3) *Effect of disregarding intermediary*—(i) *In general.* Except as provided in paragraph (c)(3)(ii) of this section, if a transfer is treated as an indirect transfer pursuant to paragraph (c)(1) of this section, then the intermediary is treated as an agent of the U.S. person, and the property is treated as transferred to the foreign trust by the U.S. person in the year the property is transferred, or made available, by the intermediary to the foreign trust. The fair market value of the property transferred is determined as of the date of the transfer by the intermediary to the foreign trust.

(ii) *Special rule.* If the Commissioner determines, or if the taxpayer can demonstrate to the satisfaction of the Commissioner, that the intermediary is an agent of the foreign trust under generally applicable United States agency principles, the property will be treated as transferred to the foreign trust in the year the U.S. person transfers the property to the intermediary. The fair market value of the property transferred will be determined as of the date of the transfer by the U.S. person to the intermediary.

(iii) *Effect on intermediary.* If a transfer of property is treated as an indirect transfer under paragraph (c)(1) of this section, the intermediary is not treated as having transferred the property to the foreign trust.

(4) *Related parties.* For purposes of this paragraph (c), a U.S. transferor is treated as related to a U.S. beneficiary of a foreign trust if the U.S. transferor and the beneficiary are related for purposes of section 643(i)(2)(B), with the following modifications–

(i) 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

(ii) 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.

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

Example 1. Principal purpose of tax avoidance. *A*, a U.S. citizen, creates and funds *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. In 2004, *A* decides to transfer an additional 1000X to the foreign trust. Pursuant to a plan with a principal purpose of avoiding the application of section 679, A transfers 1000X to I, a foreign person. *I* subsequently transfers 1000X to *FT*. Under paragraph (c)(1) of this section, *A* is treated as having made a transfer of 1000X to *FT*.

Example 2. U.S. person unable to demonstrate that intermediary acted independently. *A*, a U.S. citizen, creates and funds *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. On July 1, 2004, *A* transfers XYZ stock to *D*, *A*'s uncle, who is a nonresident alien. *D* immediately sells the XYZ stock and uses the proceeds to purchase ABC stock. On January 1, 2007, *D* transfers the ABC stock to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that *D* acted independently of *A* in making the transfer to *FT*. Under paragraph (c)(1) of this section, *A* is treated as having transferred the ABC stock to *FT*. Under paragraph (c)(3) of this section, *D* is treated as an agent of *A*, and the transfer is deemed to have been made on January 1, 2007.

Example 3. Indirect loan to foreign trust. *A*, a U.S. citizen, previously created and funded *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. On July 1, 2004, *A* deposits 500X with *FB*, a foreign bank. On January 1, 2005, *FB* loans 450X to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that *FB* has a relationship with *FT* that establishes a reasonable basis for concluding that FB would make a loan to *FT* or that *FB* acted independently of *A* in making the loan. Under paragraph (c)(1) of this section, *A* is deemed to have transferred 450X directly to *FT* on January 1, 2005. Under paragraph (c)(3) of this section, *FB* is treated as an agent of *A*. For possible exceptions with respect to qualified obligations of the trust, see §1.679–4.

Example 4. Loan to foreign trust prior to deposit of funds in foreign bank. The facts are the same as in *Example 3*, except that *A* makes the 500X deposit with *FB* on January 2, 2005, the day after *FB* makes the loan to *FT*. The result is the same as in *Example 3*.

(d) *Constructive transfers*—(1) *In general.* For purposes of paragraph (a) of this section, a constructive transfer includes any assumption or satisfaction of a foreign trust's obligation to a third party.

(2) *Examples.* The rules of this paragraph (d) are illustrated by the following examples. In each example, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

Example 1. Payment of debt of foreign trust. *FT* owes 1000X to *Y*, an unrelated foreign corporation, for the performance of services by *Y* for *FT*. In satisfaction of *FT*'s liability to *Y*, *A* transfers to *Y* property with a fair market value of 1000X. Under paragraph (d)(1) of this section, *A* is treated as having made a constructive transfer of the property to *FT*.

Example 2. Assumption of liability of foreign trust. *FT* owes 1000X to *Y*, an unrelated foreign corporation, for the performance of services by *Y* for *FT*. *A* assumes *FT*'s liability to pay *Y*. Under paragraph (d)(1) of this section, *A* is treated as having made a constructive transfer of property with a fair market value of 1000X to *FT*.

(e) *Guarantee of trust obligations*—(1) *In general.* If a foreign trust borrows money or other property from any person who is not a related person (within the meaning of §1.679–1(c)(5)) with respect to the trust (lender) and a U.S. person (U.S. guarantor) that is a related person with respect to the trust guarantees (within the meaning of paragraph (e)(4) of this section) the foreign trust's obligation, the U.S. guarantor is treated for purposes of this section as a U.S. transferor that has made a transfer to the trust on the date of the guarantee in an amount determined under paragraph (e)(2) of this section. To the extent this paragraph causes the U.S. guarantor to be treated as having made a transfer to the trust, a lender that is a U.S. person shall not be treated as having transferred that amount to the foreign trust.

(2) *Amount transferred.* The amount deemed transferred by a U.S. guarantor described in paragraph (e)(1) of this section is the guaranteed portion of the adjusted issue price of the obligation (within the meaning of §1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273–1(c)).

(3) *Principal repayments.* If a U.S. person is treated under this paragraph (d) as having made a transfer by reason of the guarantee of an obligation, payments of principal to the lender by the foreign trust with respect to the obligation are taken into account on and after the date of the payment in determining the portion of the trust attributable to the property deemed transferred by the U.S. guarantor.

(4) *Guarantee.* For purposes of this section, the term guarantee–

(i) Includes any arrangement under which a person, directly or indirectly, assures, on a conditional or unconditional basis, the payment of another's obligation;

(ii) Encompasses any form of credit support, and includes a commitment to make a capital contribution to the debtor or otherwise maintain its financial viability; and

(iii) Includes an arrangement reflected in a comfort letter, regardless of whether the arrangement gives rise to a legally enforceable obligation. If an arrangement is contingent upon the occurrence of an event, in determining whether the arrangement is a guarantee, it is assumed that the event has occurred.

(5) *Examples.* The rules of this paragraph (e) are illustrated by the following examples. In all of the examples, *A* is a U.S. resident and *FT* is a foreign trust. The examples are as follows:

Example 1. Foreign lender. X, a foreign corporation, loans 1000X of cash to *FT* in exchange for *FT*'s obligation to repay the loan. *A* guarantees the repayment of 600X of *FT*'s obligation. Under paragraph (e)(2) of this section, *A* is treated as having transferred 600X to *FT*.

Example 2. Unrelated U.S. lender. The facts are the same as in *Example 1*, except *X* is a U.S. person that is not a related person within the meaning of §1.679–1(c)(5). The result is the same as in *Example 1*.

(f) *Transfers to entities owned by a foreign trust*—(1) *General rule.* If a U.S. person is a related person (as defined in §1.679–1(c)(5)) with respect to a foreign trust, any transfer of property by the U.S. person to an entity in which the foreign trust holds an ownership interest is treated as a transfer of such property by the U.S. person to the foreign trust followed by a transfer of the property from the foreign trust to the entity owned by the foreign trust, unless the U.S. person demonstrates to the satisfaction of the Commissioner that the transfer to the entity is properly attributable to the U.S. person's ownership interest in the entity.

(2) *Examples.* The rules of this paragraph (f) are illustrated by the following examples. In all of the examples, *A* is a U.S. citizen, *FT* is a foreign trust, and *FC* is a foreign corporation. The examples are as follows:

Example 1. A creates and funds *FT*. which is treated as having a U.S. beneficiary under §1.679–2. *FT* owns all of the outstanding stock of *FC*. *A* transfers property directly to *FC*. Because *FT* is the sole shareholder of *FC*, *A* is unable to demonstrate to the satisfaction of the Commissioner that the transfer is properly attributable to *A*'s ownership interest in *FC*. Accordingly, under this paragraph (f), *A* is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. Under §1.679–1(a), *A* is treated as the owner of the portion of *FT* attributable to the property treated as transferred directly to *FT*. Under §1.367(a)– 1T(c)(4)(ii), the transfer of property by *FT* to *FC* is treated as a transfer of the property by *A* to *FC*.

Example 2. The facts are the same as in *Example 1*, except that *FT* is not treated as having a U.S. beneficiary under §1.679– 2. Under this paragraph (f), *A* is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. *A* is not treated as the owner of *FT* for purposes of §1.679–1(a). For rules regarding the recognition of gain on the transfer, see section 684.

Example 3. A creates and funds *FT*. *FC* has outstanding solely 100 shares of common stock. *FT* owns 50 shares of *FC* stock, and *A* owns the remaining 50 shares. On July 1, 2001, *FT* and *A* each transfer 1000X to FC. *A* is able to demonstrate to the satisfaction of the Commissioner that *A*'s transfer to *FC* is properly attributable to *A*'s ownership interest in *FC*. Accordingly, under this paragraph (f), *A*'s transfer to *FC* is not treated as a transfer to *FT*.

§1.679–4 Exceptions to general rule.

(a) *In general.* Section 1.679–1 does not apply to—

(1) Any transfer of property to a foreign trust by reason of the death of the transferor;

(2) Any transfer of property to a foreign trust described in sections 402(b), 404(a)(4), or 404A;

(3) Any transfer of property to a foreign trust that has received a ruling or determination letter, which has been neither revoked nor modified, from the Internal Revenue Service recognizing the trust's tax exempt status under section 501(c)(3); and

(4) Any transfer of property to a foreign trust to the extent the transfer is for fair market value.

(b) *Transfers for fair market value*—(1) *In general.* For purposes of this section, 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. For purposes of this section, a distribution to a trust with respect to an interest held by such trust in an entity other than a trust or 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 is considered to be a transfer for fair market value.

(2) *Special rule*—(i) *Transfers for partial consideration.* For purposes of this section, if a person transfers property to a foreign trust in exchange for property having a fair market value that is less than the fair market value of the property transferred, the exception in paragraph (a)(4) of this section applies only to the extent of the fair market value of the property received.

(ii) *Example.* This paragraph (b) is illustrated by the following example:

Example. A, a U.S. citizen, transfers property that has a fair market value of 1000X to *FT*, a foreign trust, in exchange for 600X of cash. Under this paragraph (b), §1.679–1 applies with respect to the transfer of 400X (1000X less 600X) to *FT*.

(c) *Certain obligations not taken into account.* Solely for purposes of this section, in determining whether a transfer by a U.S. transferor that is a related person (as defined in §1.679–1(c)(5)) with respect to the foreign trust is for fair market value, any obligation (as defined in §1.679–1(c)(6)) of the trust or a related person (as defined in §1.679–1(c)(5)) that is not a qualified obligation within the meaning of paragraph (d)(1) of this section shall not be taken into account.

(d) *Qualified obligations*—(1) *In general.* For purposes of this section, an obligation is treated as a qualified obligation only if—

(i) The obligation is reduced to writing by an express written agreement;

(ii) The term of the obligation does not exceed five years (for purposes of determining the term of an obligation, the obligation's maturity date is the last possible date that the obligation can be outstanding under the terms of the obligation);

(iii) All payments on the obligation are denominated in U.S. dollars;

(iv) The yield to maturity is not less than 100 percent of the applicable Federal rate and not greater that 130 percent of the applicable Federal rate (the applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter));

(v) The U.S. transferor extends the period for assessment of any income or transfer tax attributable to the transfer and any consequential income tax changes for each year that the obligation is outstanding, to a date not earlier than three years after the maturity date of the obligation

(this extension is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. transferor's taxable year and is paid within such period); when properly executed and filed, such an agreement is deemed to be consented to for purposes of §301.6501(c)–1(d) of this chapter; and

(vi) The U.S. transferor reports the status of the loan, including principal and interest payments, on Form 3520 for every year that the loan is outstanding.

(2) *Additional loans.* If, while the original obligation is outstanding, the U.S. transferor or a person related to the trust (within the meaning of §1.679–1(c)(5)) directly or indirectly obtains another obligation issued by the trust, or if the U.S. transferor directly or indirectly obtains another obligation issued by a person related to the trust, the original obligation is deemed to have the maturity date of any such subsequent obligation in determining whether the term of the original obligation exceeds the specified 5-year term. In addition, a series of obligations issued and repaid by the trust (or a person related to the trust) is treated as a single obligation if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of this provision.

(3) *Obligations that cease to be qualified.* If an obligation treated as a qualified obligation subsequently fails to be a qualified obligation (e.g., renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. transferor is treated as making a transfer to the trust in an amount equal to the original obligation's adjusted issue price (within the meaning of §1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273–1(c)) as of the date of the subsequent event that causes the obligation to no longer be a qualified obligation. If the maturity date is extended beyond five years by reason of the issuance of a subsequent obligation by the trust (or person related to the trust), the amount of the transfer will not exceed the issue price of the subsequent obligation. The subsequent obligation is separately tested to determine if it is a qualified obligation.

(4) *Transfers resulting from failed qualified obligations.* In general, a transfer resulting from a failed qualified obligation is deemed to occur on the date of the subsequent event that causes the obligation to no longer be a qualified obligation. However, based on all of the facts and circumstances, the Commissioner may deem a transfer to have occurred on any date on or after the issue date of the original obligation. For example, if at the time the original obligation was issued, the transferor knew or had reason to know that the obligation would not be repaid, the Commissioner could deem the transfer to have occurred on the issue date of the original obligation.

(5) *Renegotiated loans.* Any loan that is renegotiated, extended, or revised is treated as a new loan, and any distribution of funds after such renegotiation, extension, or revision under a pre-existing loan agreement is treated as a transfer subject to this section.

(6) *Principal repayments.* The payment of principal with respect to any obligation that is not treated as a qualified obligation under this paragraph is taken into account on and after the date of the payment in determining the portion of the trust attributable to the property transferred.

(7) *Examples.* The rules of this paragraph (d) are illustrated by the following examples. In all of the examples, *A* is a U.S. resident and *FT* is a foreign trust. The examples are as follows:

Example 1. Demand loan. *A* transfers 500X to *FT* in exchange for a demand note that permits *A* to require repayment by *FT* at any time. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679–1 applies with respect to the full 500X transfer to *FT*.

Example 2. Private annuity. *A* transfers 4000X to *FT* in exchange for an annuity from the foreign trust that will pay *A* 100X per year for the rest of *A*'s life. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679–1 applies with respect to the full 4000X transfer to *FT*.

Example 3. Loan to unrelated foreign trust. *B* transfers 1000X to *FT* in exchange for an obligation of the trust. The term of the obligation is fifteen years. *B* is not a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because *B* is not a related person, the adjusted issue price of the obligation received by *B* is taken into account for purposes of determining whether *B*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section, even though the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section.

Example 4. Transfer for an obligation with term in excess of 5 years. *A* transfers property that has a fair market value of 5000X to *FT* in exchange for an obligation of the trust. The term of the obligation is ten years. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because the term of the obligation is greater than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679–1 applies with respect to the full 5000X transfer to *FT*.

Example 5. Transfer for a qualified obligation. The facts are the same as in *Example 4*, except that the term of the obligation is 3 years. Assuming the other requirements of paragraph (d)(1) of this section are satisfied, the obligation is a qualified obligation and its adjusted issue price is taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section.

Example 6. Effect of subsequent obligation on original obligation. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for an obligation that satisfies the requirements of paragraph (d)(1) of this section. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Two years later, *A* transfers an additional 2000X to *FT* and receives another obligation from *FT* that has a maturity date four years from the date that the second obligation was issued. Under paragraph (d)(2) of this section, the original obligation is deemed to have the maturity date of the second obligation. Under paragraph (a) of this section, *A* is treated as having made a transfer in an amount equal to the original obligation's adjusted issue price (within the meaning of §1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273–1(c)) as of the date of issuance of the second obligation. The second obligation is tested separately to determine whether it is a qualified obligation for purposes of applying paragraph (a) of this section to the second transfer.

§1.679–5 Pre-immigration trusts.

(a) *In general.* If a nonresident alien individual becomes a U.S. person and the individual has a residency starting date (as determined under section 7701(b)(2)(A)) within 5 years after transferring property to a foreign trust (the original transfer), the individual is treated as having transferred to the trust on the residency starting date an amount equal to the portion of the

trust attributable to the property transferred by the individual in the original transfer.

(b) *Special rules*—(1) *Change in grantor trust status.* For purposes of paragraph (a) of this section, if a nonresident alien individual who is treated as owning any portion of a trust under the provisions of subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, subsequently ceases to be so treated, the individual is treated as having made the original transfer to the foreign trust immediately before the trust ceases to be treated as owned by the individual.

(2) *Treatment of undistributed income.* For purposes of paragraph (a) of this section, the property deemed transferred to the foreign trust on the residency starting date includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred. Undistributed net income for periods before the individual's residency starting date is taken into account only for purposes of determining the amount of the property deemed transferred.

(c) *Examples.* The rules of this section are illustrated by the following examples:

Example 1. Nonresident alien becomes resident alien. On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. On January 1, 2006, *A* becomes a resident of the United States within the meaning of section 7701(b)(1)(A) and has a residency starting date of January 1, 2006, within the meaning of section 7701(b)(2)(A). Under paragraph (a) of this section, *A* is treated as a U.S. transferor and is deemed to transfer the property to *FT* on January 1, 2006. Under paragraph (b)(2) of this section, the property deemed transferred to *FT* on January 1, 2006, includes the undistributed net income of the trust, as defined in section 665(a), attributable to the property originally transferred.

Example 2. Nonresident alien loses power to revest property. On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. *A* has the power to revest absolutely in himself the title to such property transferred and is treated as the owner of the trust pursuant to sections 676 and 672(f). On January 1, 2008, the terms of *FT* are amended to remove *A*'s power to revest in himself title to the property transferred, and *A* ceases to be treated as the owner of *FT*. On January 1, 2010, *A* becomes a resident of the United States. Under paragraph (b)(1) of this section, for purposes of paragraph (a) of this section *A* is treated as having originally transferred the property to *FT* on January 1, 2008. Because this date is within five year's of *A*'s residency starting date, *A* is deemed to have made a transfer to the foreign trust on January 1, 2010, his residency starting date. Under paragraph (b)(2) of this section, the property deemed transferred to the foreign trust on January 1, 2010, includes the undistributed net income of the trust, as defined in section 665(a), attributable to the property deemed transferred.

§1.679–6 Outbound migrations of domestic trusts.

(a) *In general.* Subject to the provisions of paragraph (b) of this section, if an individual who is a U.S. person transfers property to a trust that is not a foreign trust, and such trust becomes a foreign trust while the U.S. person is alive, the U.S. individual is treated as a U.S. transferor and is deemed to transfer the property to a foreign trust on the date the domestic trust becomes a foreign trust.

(b) *Amount deemed transferred.* For purposes of paragraph (a) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property previously transferred. Undistributed net income for periods prior to the migration is taken into account only for purposes of determining the portion of the trust that is attributable to the property transferred by the U.S. person.

(c) *Example.* The following example illustrates the rules of this section. For purposes of the example, *A* is a U.S. resident alien, *B* is *A*'s son, who is a resident alien, and *DT* is a domestic trust. The example is as follows:

Example. Outbound migration of domestic trust. On January 1, 2002, *A* transfers property to *DT*, for the benefit of *B*. On January 1, 2003, *DT* acquires a foreign trustee who has the power to determine whether and when distributions will be made to *B*. Under section 7701(a)(3)(B) and §301.7701–7(d)(ii)(A), *DT* becomes a foreign trust on January 1, 2003. Under paragraph (a) of this section, *A* is treated as transferring property to a foreign trust on January 1, 2003. Under paragraph (b) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred.

§1.679–7 Effective dates.

(a) *In general.* Except as provided in paragraph (b) of this section, the rules of §§1.679–1, 1.679–2, 1.679–3, and 1.679–4 apply with respect to transfers after August 7, 2000.

(b) *Special rules.* (1) The rules of §1.679–4(c) and (d) apply to an obligation issued after February 6, 1995, whether or not in accordance with a pre-existing arrangement or understanding. For purposes of the rules of §1.679–4(c) and (d), if an obligation issued on or before February 6, 1995, is modified after that date, and the modification is a significant modification within the meaning of §1.1001–3, the obligation is treated as if it were issued on the date of the modification. However, the penalty provided in section 6677 applies only to a failure to report transfers in exchange for obligations issued after August 20, 1996.

(2) The rules of §1.679–5 apply to persons whose residency starting date is after August 7, 2000.

(3) The rules of §1.679–6 apply to trusts that become foreign trusts after August 7, 2000.

Par. 3. In §1.958–1, paragraph (b) is amended by adding a new sentence after the first sentence to read as follows:

§1.958–1 Direct and indirect ownership of stock.

* * * * *

(b) * * * For purposes of the preceding sentence, any person that is treated as the owner of any portion of a trust pursuant to sections 671 through 679 shall be treated as a beneficiary of the trust and shall be considered to own all of the stock owned directly or indirectly by or for such portion. * * *

* * * * *

§1.958–2 [Amended]

Par. 4. In §1.958–2, paragraph (c)(1)(ii)(b) is amended by removing the language "678" and adding "679" in its place.

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of Federal Register on August 2, 2000, 1:04 p.m., and published in the issue of the Federal Register for August 7, 2000, 65 F.R. 48185)

Foundations Status of Certain Organizations

Announcement 2000–70

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:

Ace Boxing Club, Inc., Milwaukee, WI
Advocates for Public Transportation of Monroe County, Stroudsburg, PA
African Health Foundation, Los Angeles, CA
American Civil Rights Defense Foundation, Orange, CA
American Culinary Federation Food Source Network, Inc., N. Myrtle Beach, SC
American River Alano, Folsom, CA
Angels Shelter Ranch, LTD., Lompoc, CA
Anishinabe Miikana Project, Inc., Bemidji, MN
1996 Anniversary Commission Celebrating Youngstown & Mahoning, Youngstown, OH
Awutu Effutu and Friends Association of Southern California, Los Angeles, CA
Azalea City Childrens Ballet, Mobile, AL
Blazing Angels, Inc., Langhorne, PA
Blue Water Area Land Conservancy, Port Huron, MI
Born Again Music Ministry, Inc., Duluth, GA
Camino Real Seven Point Charities, Inc., Houston, TX
Cassville Junior Football League, Cassville, MO
Central Western New York Youth Basketball Clubs, Newark, NY
Changing Perspectives, Incorporated, Mount Kisco, NY
Childrens Educational Foundation Charitable Trust, Concord, CA
Childrens Talent Unlimited, Inc., Brooklyn, NY
Citizens for Safe Libraries, Bountiful, UT
Commission for Desert Hot Springs Youth, Desert Hot Springs, CA
Community Impact, Inc., Durham, NC
Congregation B M Z, Inc., Brooklyn, NY
Cops and Cruisers, Oxnard, CA
Crossfade Productions, Inc., Belleville, NJ
The Disabled Traveler, Lapeer, MI
Dont Just Sit There, Inc., Atlanta, GA
Ekklesia Ministries, Rialto, CA
Emerson Playground Fund, Inc., Emerson, NJ
Encodings, Houston, TX
Foundation for Friends, Inc., Houston, TX
Friends of 60 Centre Street, Inc., New York, NY
Friends of Centennial Park, Inc., Nashville, TN
Friends of Fathers, Inc., W. Falmouth, MA
Friends of United Institutions of Arad, Inc., Brooklyn, NY
GMB Youth Motorsport Services, Inc., Boston, MA
Glendale Neighborhood Watch Advisory Board, Inc., Glendale, AZ
Godinger Lefkowitz Memorial Foundation, Ridgewood, NY
Greater Opportunities for Advancing Lifestyle, Inc., Torrance, CA
Hawaii International Music, Honolulu, HI
Hoya Human Development Corporation, Inc., Beaumont, TX
Hyde Park Tenant Association, Kansas City, MO
Island Alliance, Inc., Boston, MA
J NE Home Care Services, Missouri City, TX
Jefferson Institute, Philadelphia, PA
Kanawha Putnam Emergency Planning Committee, Charleston, WV
Keren Sara Chana, Inc., Brooklyn, NY
Keren Aram Soba Foundation, Inc., Brooklyn, NY
Know Casinos, Richmond, VA
Lewis-Bennett Neighborhood Association, Flint, MI
Living Water Ministries, Cloverport, KY
Los Angeles Harbor Housing, Los Angeles, CA
Loving Space, Inc., Riviera Beach, FL
Maine Toy Train Museum, Portland, ME
McCamey Medical Services Foundation, McCamey, TX
Medical Research Fundraisers for Leukemia, Inc., S. Windsor, CT
Metro Area Junior Golfers, Inc., Detroit, MI
Metsa MLK Ed Bluestein Tannehill Spingdale Airport Neighborhood Improvement Committee, Austin, TX
Middlesex Youth Soccer League, Inc., Woburn, MA
Mission Foundation, Agoura Hills, CA
Moms and Dads, Inc., Kent, WA
Nalamdana, Inc., Cambridge, MA
Namibia Early Childhood Education Fund, Inc., New York, NY
National Save-A-Pet Foundation, Inc., W. Palm Beach, FL
Norcross Charities, Inc., Phoenix, AZ
North Central Indiana Uganda Outreach, Inc., Fishers, IN
Northeast Georgia Homeless Coalition, Inc., Athens, GA
Olympic RHF Housing, Inc., Long Beach, CA
On The Youths Side, St. Louis, MO
Performing Arts & Humanities of Sandpoint, Inc., Sandpoint, ID
Possibilities Unlimited, Inc., St. Augustine, FL
Quest Foundation USA, Inc., Augusta, GA
Safe Outreach Foundation, Inc., Mt, Vernon, OH
Safehouse Ministries, Inc., St. Louis, MO
Salisbury Civil War Prison Foundation, Inc., Salisbury, NC
San Antonio Potters Guild, San Antonio, TX
Sereno W. and Doris L. Johnson Memorial Scholarship Foundation, Boston, MA
Southern Tier Volunteer Organization, Inc., Binghamton, NY
Stars Baseball Club Corporation, Lexington, KY
Success View Network, Inc., Brooklyn, NY
Suicide Anonymous Treatment, Beverly Hills, CA
Sunflower Economic Development Corp., Sunflower, MS
Teens of Tomorrow Foundation, Lisly, IL
Terrebonne 2000, Houma, LA
Texas Best, Midland, TX
Unifying Movement, Inc., Port Orange, FL
Vehicle of Life Foundation, Berkeley, CA
West Bend Haunted Manor, Inc., West Bend, WI
Yad Veizer Leyehudei Russia, Inc., Brooklyn, NY
Zeta Omega Scholarship Fund, Incorporated, Cleveland, OH

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 of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Stoppenhagen, Larry	Ft. Wayne, IN	CPA	April 14, 2000 to April 13, 2001
Chon, James	N. Hollywood, CA	CPA	May 22, 2000 to May 21, 2003
Bleyer, Stephen A.	Bala Cynwyd, PA	CPA	June 26, 2000 to December 25, 2000
Knutson, Owen	Ouray, CO	CPA	July 3, 2000 to January 2, 2003
Silverman, Richard E.	Fayetteville, NY	CPA	August 1, 2000 to March 31, 2004
Holt, Jeffrey	Little Rock, AR	Enrolled Agent	October 1, 2000 to March 31, 2003
Barbagallo, Joseph	Newton, PA	CPA	October 15, 2000 to October 14, 2004

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Luebben, William	Hot Springs, AR	CPA	February 11, 2000

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 rules for valuing non-commercial 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 2000 are set forth.

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
7/1/00 - 12/31/00	$34.57	Up to 500 miles = $.1891 per mile 501-1500 miles = $.1442 per mile Over 1500 miles = $.1386 per mile

DRAFTING INFORMATION

The principle author of this revenue ruling is Kathleen Edmondson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson on (202) 622-6040 (not a toll-free call).

Section 871.—Tax on Nonresident Alien Individuals

26 CFR 1.871–8: Taxation of nonresident alien individuals engaged in U.S. business or treated as having effectively connected income.

Rev. Rul. 2000–40

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 period 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 semi-annually.

The following chart sets forth the terminal charges and SIFL mileage rates:

Period During Which the Flight Is Taken	*Terminal Charge*	*SIFL Mileage Rates*
7/1/00 - 12/31/00	$34.57	Up to 500 miles = $.1891 per mile 501-1500 miles = $.1442 per mile Over 1500 miles = $.1386 per mile

What are the procedures to be followed to obtain a withholding certificate under section 1445 for the reduction of withholding tax under section 1445 on the disposition of U.S. real property interests by foreign persons? See Rev. Proc. 2000–35, page 211.

Section 882.—Tax on Income of Foreign Corporations Connected With United States Business

26CFR 1.882–2: Income of foreign corporation treated as effectively connected with U.S. business.

What are the procedures to be followed to obtain a withholding certificate under section 1445 for the reduction of withholding tax under section 1445 on the disposition of U.S. real property interests by foreign persons? See Rev. Proc. 2000–35, page 211.

Section 897.—Disposition of Investment in United States Real Property

26 CFR 1.897–1: Taxation of foreign investment in United States real property interests, definition of terms.

What are the procedures to be followed to obtain a withholding certificate under section 1445 for the reduction of withholding tax under section 1445 on the disposition of U.S. real property interests by foreign persons? See Rev. Proc. 2000–35, page 211.

Part III. Administrative, Procedural, and Miscellaneous

Comprehensive Case Resolution Pilot Program

Notice 2000–43

1. INTRODUCTION OF COMPREHENSIVE CASE RESOLUTION PILOT PROGRAM

This Notice announces a program under which large business taxpayers may request resolution of all years they have open under examination by the Large and Mid-Size Business Division (LMSB), in Appeals, and in docketed status before the United States Tax Court (Tax Court), through an Internal Revenue Service (IRS) team process. The purpose of the program is to enable taxpayers and the IRS to work together to resolve all open issues on all open years currently or previously under examination. The program is intended to reduce costs, burden and delays by expediting completion of these cases through a cooperative effort.

The program is jointly administered by LMSB, Appeals, and, if a taxpayer has a docketed case for any year, the Office of Chief Counsel (Chief Counsel). In the pilot phase, the program is available to large businesses that currently have at least one open year under examination in a Coordinated Examination and at least one prior year in Appeals (including docketed cases currently under Appeals' jurisdiction). Taxpayers interested in participating in the pilot program or with questions about the program should contact their Team Manager or the Comprehensive Case Resolution Pilot Coordinator to discuss their suitability for the program.

During the pilot phase of the program, LMSB, Appeals and, if there is a docketed case, Chief Counsel, plan to select eight to ten taxpayers from among those requesting participation in the program. Applications will be solicited through September 29, 2000, and the IRS will select participants by October 31, 2000. Taxpayers participating in the pilot program will be asked to assist in monitoring and evaluating the process. After evaluating the pilot cases, the IRS may then offer the program, with or without modification, on a permanent basis.

The IRS believes that the Comprehensive Case Resolution program offers significant potential benefits for taxpayers as well as the IRS, and invites large business taxpayers to participate.

2. DESCRIPTION OF THE COMPREHENSIVE CASE RESOLUTION PROGRAM

The goal of the program is to help taxpayers that have tax years under examination by LMSB and in Appeals (including docketed cases under Appeals jurisdiction) resolve all open issues in all such years through an IRS Comprehensive Case Resolution (CCR) process. In some situations it may also be appropriate to include tax years which are docketed before the Tax Court and not under Appeals' jurisdiction. The effect of this program will be to expedite the taxpayer's LMSB years, where the audit is substantially complete, into a resolution process. This process will be the taxpayer's formal administrative appeal for the LMSB years. The program's goal is to resolve all tax controversies, without litigation, on a basis that is fair and impartial to both the government and the taxpayer. The CCR process will plan aggressive timelines for completion, with a target of closing all years within six to twelve months. If agreement cannot be reached using this process, Appeals will not again consider the unagreed issues from the years under examination by LMSB.

Taxpayers with an LMSB Coordinated Examination that is substantially complete may request to participate in this program. "Substantially complete" means: (1) audit work on all significant issues is complete and the taxpayer has indicated agreement or disagreement with each proposed adjustment; and (2) all claims and affirmative issues have been raised by the taxpayer and audited. Interested taxpayers with questions as to whether audit work is sufficiently complete should consult with their Team Manager.

Each affected IRS function (LMSB, Appeals, and Chief Counsel) will independently recommend whether the taxpayer should be accepted into the program. When a taxpayer is accepted for the pilot program, the IRS will form a team representing LMSB, Appeals, and, if appropriate, Chief Counsel to work with the taxpayer to resolve outstanding unagreed issues.

For taxpayers accepted into the CCR pilot program, the IRS will not issue a notice of proposed deficiency, commonly called a "30-day letter," for the years currently under examination by LMSB upon commencement of the program. Accordingly, for those years, the accrual of increased interest on large corporate underpayments under § 6621(c) of the Internal Revenue Code will not begin at that time. However, if those years are not resolved within 12 months after the initial issue discussion conference is held under the CCR program, the IRS will issue a letter of proposed deficiency to begin the accrual of interest at the increased rate.

Taxpayers not accepted for the pilot program will continue to follow existing LMSB, Appeals, and, where relevant, Tax Court, procedures for resolution of their cases.

3. SUBJECT MATTER FOR THE COMPREHENSIVE CASE RESOLUTION PROGRAM

The CCR program is intended to expedite resolution of all disputed issues on all open tax years that have been or are being examined. Generally, all issues that could appropriately be considered by Appeals will be suitable for the program. To ensure fair treatment of the taxpayer, issues already agreed between the taxpayer and IRS in LMSB or Appeals generally will not be re-opened.

Certain issues may not be appropriate for this process. The IRS and the taxpayer may agree to exclude these issues but proceed with the program on the remaining issues. If the Office of Chief Counsel determines that it would be inappropriate to include some or all docketed years in the process, the IRS may proceed under the program with the remaining years with the taxpayer's concurrence. Further, the IRS may determine that certain issues will not be part of the process. Specific issues excluded from the program include:

(1) Issues that (for the taxpayer) involve a partnership item as defined in § 6231 of the Internal Revenue Code, or are subject to the procedures set forth in § 6221 through § 6233; and

(2) Issues that have been designated for litigation by Chief Counsel.

This list is not all-inclusive as situations may arise where other issues are determined inappropriate for the process.

4. PROCEDURES FOR REQUESTING COMPREHENSIVE CASE RESOLUTION PROCESS

Before initiating a formal request. Taxpayers interested in participating in the pilot program, or with questions about the program and its suitability for their cases, may contact the LMSB Team Manager for the year currently under examination. Taxpayers also may contact Cary Russ, the CCR Coordinator, at (202) 283-8330 (not a toll-free number), for further information about this pilot program.

Initiating the request for the CCR pilot. The taxpayer must submit its request to participate in the CCR pilot program in writing to the Team Manager on or before September 29, 2000. The CCR Coordinator and the Team Manager are available to assist the taxpayer in preparing its pilot request.

Contents of the request. A concise written statement requesting the CCR process should include:

(1) The taxpayer's name, EIN, and address and the name, title, address and telephone number of a person to contact.

(2) The tax years for which Comprehensive Case Resolution is sought, the IRS office considering each year, and the name of the IRS Appeals Officer and counsel of record handling any matter not under the jurisdiction of LMSB.

(3) For the years currently under LMSB examination, a list of all unagreed issue(s). The taxpayer should include copies of unagreed Forms 5701, Notice of Proposed Adjustment, or a short description of the unagreed issues if no Form 5701 has been issued. Although a formal protest is not required, the request must contain a brief explanation of the taxpayer's position regarding each issue. (If accepted into the program, a taxpayer will have an opportunity to present a more complete statement of its position at a later stage.)

(4) For the years in Appeals, the current status of each issue, including whether agreement (oral or written) has been reached.

(5) If docketed year(s) under Chief Counsel's jurisdiction are included, the current status of all unresolved issues, including whether agreement (oral or written) has been reached, the date calendared for trial, if any, and any other deadlines established by the Court.

(6) An acknowledgment that the taxpayer consents to *ex parte* communications between IRS Appeals Officers and any other IRS personnel in the context of the CCR process.

(7) An acknowledgment that participation in the CCR process constitutes the administrative appeal for all years under LMSB examination included in this application.

(8) A statement that the taxpayer will not file new claims or raise new affirmative issues for any year, regardless of jurisdiction, during the CCR process. Claims and affirmative issues must be raised and audit work completed before the CCR process begins.

(9) An acknowledgment that this is an expedited program in which the taxpayer will work with the IRS CCR team to establish accelerated timelines for completion of the process.

(10) A statement of the taxpayer's willingness to participate in a pilot program and to assist in monitoring and evaluating the process.

Perjury statement. A request for the CCR process must include a declaration, signed by a person currently authorized to sign the taxpayer's federal income tax return, in the following form:

> Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of the request for Comprehensive Case Resolution are true, correct and complete.

If the request is signed by an authorized representative, a copy of Form 2848, Power of Attorney and Declaration of Representative, must accompany the request.

5. SELECTION OF TAXPAYERS FOR THE PILOT PROGRAM

Team Manager's Role: The Team Manager will immediately forward a copy of the taxpayer's application to the CCR Coordinator, Appeals and, if appropriate, Chief Counsel. The Team Manager will assess the readiness of the LMSB years for the CCR process. This assessment will include whether the years are, or will be, substantially complete by October 31, 2000.

Appeals Management Role: Appeals management will assess the status of each issue and the anticipated completion date(s) of the years before Appeals (including docketed years in Appeals settlement jurisdiction).

Chief Counsel's Role: If years are docketed before the Tax Court, Chief Counsel will provide an assessment similar to Appeals of the status of those years. Chief Counsel may direct the CCR Pilot Coordinator not to include a docketed year or years in the CCR process.

CCR Pilot Coordinator Role: The CCR Pilot Coordinator will provide guidance to taxpayers and to IRS personnel on the program, will ensure that LMSB, Appeals and Chief Counsel timely provide information listed above, and will keep the CCR Pilot Executive informed of all program activity.

CCR Pilot Executive Role: The CCR Pilot Executive will provide general oversight for the program, interface with Appeals and Chief Counsel, lead in the training effort, and meet with taxpayers as appropriate. The CCR Pilot Executive will convene an evaluation team to include LMSB, Appeals and, if appropriate, Chief Counsel. The team will be responsible for determining whether the applicant meets the selection criteria.

Selection Criteria: In general, the team will evaluate the request using criteria that include the following:

General criteria:

(1) Application by September 29, 2000;

(2) Taxpayer under Coordinated Examination by LMSB and also in Appeals;

(3) LMSB examination years are substantially complete; and

(4) The Appeals years will not be settled before the first issue resolution conference is held.

Additional Pilot criteria:

(1) Having a cross-section of taxpayers of varying sizes, representing different industry lines, a geo-

graphical dispersion of cases, and a variety of issues;

(2) IRS resource availability in LMSB, Appeals and Chief Counsel;

(3) The likelihood of the case being resolved through this process; and

(4) In the case of a docketed year, the ability to comply with the Tax Court's procedures and deadlines.

Communication with taxpayer. The CCR Pilot Executive will advise taxpayers in writing on or about October 31, 2000, whether they will be included in the pilot program. A taxpayer may not appeal the decision that it not be included in the pilot program.

6. CONDUCTING THE COMPREHENSIVE CASE RESOLUTION PROCESS

Initial 60 days. Once a case is accepted into the pilot program, the IRS will form a resolution team composed of members from LMSB and Appeals (and Chief Counsel, if there is a docketed case). Within the first 30 days, the CCR team will contact the taxpayer to schedule an initial planning meeting. At the planning meeting, the parties will confirm the issues to be resolved, identify who will be involved in the process and their respective authorities, answer any questions about the process, and establish a timeline for resolution of all issues. Additionally, the team and the taxpayer will schedule the first issue resolution conference no later that 60 days after the case is accepted into the pilot.

Resolution process. Comprehensive Case Resolution constitutes the taxpayer's formal exercise of its appeal rights for the years under examination by LMSB. Therefore, conferences between the taxpayer and the IRS CCR team will follow existing Appeals procedures. If the IRS and taxpayer reach agreement, years will be closed using Appeals processes and closing documents. If the parties are unable to reach agreement on any issue(s), Appeals will issue a statutory notice of deficiency on the unagreed issue(s). Should any case be subject to review by U. S. Competent Authority or the Joint Committee on Taxation, the case will be closed after those approvals are obtained.

7. WITHDRAWAL FROM THE COMPREHENSIVE CASE RESOLUTION PROCESS

Taxpayers may withdraw from the CCR pilot by submitting a written request, but only within 30 days after acceptance into the program or 20 days after the initial planning meeting, whichever is later. Thereafter, with respect to the years under LMSB jurisdiction at the time of application for CCR, the process will be completed with a total or partial agreement or issuance of a statutory notice of deficiency.

A taxpayer's withdrawal from the CCR pilot returns each open year to the jurisdiction of the IRS function it was under prior acceptance into the program. Taxpayers will be afforded administrative appeal on the years under LMSB jurisdiction as if the taxpayer had not applied for CCR.

8. MISCELLANEOUS

Record keeping requirements. No aspect of the CCR process will affect the record keeping requirements imposed by any section of the Internal Revenue Code.

No user fee. There is no user fee for participating in the CCR program.

9. COMMENTS

The IRS invites interested persons to comment on this program. Send submissions to:

Internal Revenue Service
Att'n Cary Russ
Large and Mid-Size Business Division
LM:PFTG
Mint Building, 3rd Floor, M-3-312
1111 Constitution Avenue, NW
Washington, DC 20224

Submissions also may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to the Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Such submissions should be marked: Att'n Cary Russ, Large and Mid-Size Business Division LM:PFTG, Mint Building, 3rd Floor, M-3-312.

Alternatively, interested persons may submit comments via e-mail to:

PFTG1@irs.gov

These addresses are for comments on the pilot program. Requests by eligible taxpayers to participate in the pilot program should be submitted as describe in section 4 above.

10. FURTHER INFORMATION

For further information regarding this Notice, contact Cary Russ, the CCR Pilot Coordinator, at (202) 283-8330 (not a toll-free number), or the Team Manager for your current examination.

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26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 2000-35

SECTION 1. PURPOSE

This revenue procedure supersedes Rev. Proc. 88-23, 1988-1 C.B. 787, which provided the procedures to be followed to obtain a withholding certificate under sections 1.1445-3 and 1.1445-6 of the Income Tax Regulations.

SEC. 2. BACKGROUND

The Tax Reform Act of 1984, section 129, 1984-3 (Vol. 1) C.B. 163, added section 1445 to the Internal Revenue Code as a means of enforcing the tax imposed pursuant to section 897 on dispositions by foreign persons of investments in U.S. real property. Section 1445(a) provides that a transferee of a U.S. real property interest from a foreign person must deduct and withhold a tax equal to 10 percent of the amount realized by the foreign person on the disposition.

Section 1445(b) and the regulations thereunder provide several exceptions to this requirement, including an exemption from withholding for persons who purchase property for use as a residence for $300,000 or less. Other exemptions include cases where the transferor furnishes an affidavit of nonforeign status, where the property transferred is stock that is regularly traded on an established securities market, where the transferor is not required to recognize any gain or loss with respect to the transfer and the requirements of section 1.1445-2(d)(2) are met, and where a statement is obtained from the Internal Revenue Service that excuses withholding. Similarly, section 1445(c) provides that the amount required to be withheld can be reduced pursuant to a determination by the Service of the transferor's maximum tax liability upon the

disposition. Sections 1.1445-3 and 1.1445-6 of the regulations provide rules concerning the issuance by the Service of a withholding certificate that reduces or eliminates withholding.

Rev. Proc. 88-23 provided additional guidance concerning applications for withholding certificates. This revenue procedure supersedes Rev. Proc. 88-23, and provides additional guidance by way of modifications and clarifications to the provisions of former Rev. Proc. 88-23 concerning applications for withholding certificates.

SEC. 3. WITHHOLDING CERTIFICATES—IN GENERAL

.01 *Purpose of Withholding Certificate.* Withholding under section 1445 of the Code may be reduced or eliminated pursuant to a withholding certificate issued by the Service in accordance with the rules set forth in this revenue procedure. A withholding certificate may be issued by the Service in cases where reduced withholding is appropriate, where the transferor is exempt from U.S. tax, or where an agreement for the payment of tax is entered into with the Service. A withholding certificate that is obtained prior to a transfer notifies the transferee that no withholding is required or that reduced withholding is required. A withholding certificate that is obtained after a transfer has been made may authorize a normal refund or an early refund. *See* section 1.1445-3(g) of the regulations. A withholding certificate issued pursuant to the provisions of this revenue procedure serves to fulfill the requirements, as applicable, of section 1445(b)(4) concerning qualifying statements, section 1445(c)(1) concerning the transferor's maximum tax liability, or section 1445(c)(2) concerning the Secretary's authority to prescribe reduced withholding.

.02 *Limited Effect of a Withholding Certificate.* A withholding certificate serves only to adjust withholding obligations to correspond as closely as possible to the probable tax liability arising out of a transfer. Therefore, all determinations that are made by the Service in connection with the issuance of a withholding certificate apply solely for the limited purpose of determining withholding obligations under section 1445 of the Code, and do not necessarily represent the Service's final view with respect to any substantive issue that may arise in connection with a transfer. Similarly, the Service's acceptance in connection with the issuance of a withholding certificate of any evidence provided or any representation made by a taxpayer is made only for that purpose, is not binding for any other purpose, and does not constitute a final determination of the truth or accuracy of any such evidence or representation.

.03 *Types of Withholding Certificates Available.* Pursuant to section 1.1445-3 of the regulations, a withholding certificate may be issued on the basis of any of the following:

1. A determination by the Service that reduced withholding is appropriate because either:
   (a) The amount otherwise required to be withheld would exceed the transferor's maximum tax liability; or
   (b) Withholding of a reduced amount would not jeopardize collection of the tax.
2. The exemption from U.S. tax of all gain realized by the transferor; or
3. An agreement entered into by the transferee or transferor for the payment of tax providing security for the tax liability.

SEC. 4. APPLICATIONS FOR WITHHOLDING CERTIFICATES

.01 *General rules.* An application for a withholding certificate must be submitted to the Internal Revenue Service Center, P.O. Box 21086, Drop Point 8731 FIRPTA Unit, Philadelphia, PA 19114-0586. Either a transferee or a transferor may apply for a withholding certificate, but only a transferor may apply for a blanket withholding certificate. The Service ordinarily will act upon an application not later than the 90th day after all information necessary for the Service to make a determination is received. However, in the case of an application for a certificate described in section 4.03(6) below, or in unusually complicated cases, the Service may be unable to provide a withholding certificate by the 90th day. In such a case, the Service will notify the applicant by the 45th day after all information necessary for the Service to make a determination is received that additional processing time will be necessary. The Service's notice may request additional information or explanation concerning particular aspects of the application and will provide a target date for final action (contingent upon the applicant's timely submission of any requested information).

If an application for a withholding certificate is submitted before or on the date of a transfer and on the date of the transfer the application remains pending with the Service, the amount required to be withheld by the transferee is not required to be reported and paid over immediately. Similarly, if an application for a blanket withholding certificate is submitted before or on the date of the first transfer covered by the application, and on the date of the first transfer the application remains pending with the Service, the amount required to be withheld by the transferee is not required to be reported and paid over immediately. Instead, that amount (or such other amount as is appropriate) must be reported and paid over by the 20th day following the day upon which a copy of the withholding certificate or notice of denial is mailed by the Service. If the application is not submitted before or on the date of the transfer, or in the case of a blanket withholding certificate application, before or on the date of the first transfer, the transferee must report and pay over any tax withheld by the 20th day after the date of the transfer. Treas. Reg. § 1.1445-1(c)(1).

.02 *Required signatures.* An application for a withholding certificate must be signed by a responsible officer in the case of a corporation, by a general partner in the case of a partnership, by a trustee, executor, or equivalent fiduciary in the case of a trust or estate, and, in the case of an individual, by that individual. In addition, an application may be signed by an agent authorized to do so by a power of attorney. Form 2848 may be used for this purpose. The person signing the application must verify under penalties of perjury that all representations made in connection with the application are true, correct, and complete to the best of that person's knowledge and belief. To the extent that an application is premised in whole or in part on information provided by another party to the transaction, this information is to be supported by a written verification attached to that application signed under penalties of perjury by the party to whom it pertains. The application must follow the format set forth in section 4.04 below.

.03 *Categorizing of applications.* To facilitate the processing of applications for withholding certificates, this revenue procedure divides all applications into six basic categories as follows:

1. Applications for withholding certificates based on a claim that the transferor is entitled to nonrecognition treatment or is exempt from tax;

2. Applications for withholding certificates based solely on a calculation of the transferor's maximum tax liability;

3. Applications for withholding certificates under the special installment sales rules of section 7 of this revenue procedure;

4. Applications for withholding certificates based on an agreement for the payment of tax with conforming security;

5. Applications for blanket withholding certificates under section 9 of this revenue procedure; and

6. Applications for withholding certificates on any other basis.

.04 *Format for application.* All applications for withholding certificates must provide the following information in paragraphs labeled to correspond with the numbers and letters set forth below. Place "N/A" in the relevant space if the information requested is not applicable to the application being submitted.

1. (a) State which category of section 4.03, above, describes the application;

(b) In the case of category 4 applications (agreement for the payment of tax with conforming security):

(1) State whether the proposed agreement secures (A) the transferor's maximum tax liability, or (B) the amount that would otherwise be required to be withheld; and

(2) State whether the proposed agreement and security instrument conform to the standard formats set forth in this revenue procedure.

2. (a) Provide the name, taxpayer identification number (to the extent required in regulations), and home address (for an individual) or office address (for an entity) of the person applying for the withholding certificate. A mailing address should also be included if different.

(b) State whether the applicant is the transferee or transferor.

(c) Provide the name, address, and taxpayer identification number (to the extent required in regulations) of all other transferees and transferors (specifying whether such party is a transferee or transferor) of the U.S. real property interest with respect to which the withholding certificate is sought. The applicant must determine if a taxpayer identification number exists for each party concerned and if none exists for a particular party the application must so state. Any application that is combined with the transferor's request for an early refund must include the transferor's taxpayer identification number.

3. Provide the following information concerning the U.S. real property interest with respect to which the withholding certificate is sought:

(a) Type of interest (that is, interest in real property, in associated personal property, or in a domestic U.S. real property holding corporation);

(b) The contract price;

(c) Date of transfer;

(d) In the case of an interest in real property, its location and a general description of the property (for example, "10-story, 100 unit luxury apartment building"); and

(e) In the case of an interest in a U.S. real property holding corporation, the class or type and amount of the interest.

(f) Whether in the three preceding taxable years: (1) U.S. income tax returns were filed relating to the U.S. real property interest, and if so, when and where those returns were filed, and if not, why returns were not filed; and (2) whether U.S. income taxes were paid relating to the U.S. real property interest, and if so, the amount of the tax paid.

4. Provide full information concerning the basis for the issuance of the withholding certificate, in accordance with the rules of sections 4.05 through 4.11 below. Although the information to be included in this section of the application will necessarily vary from case to case, the rules set forth below provide general guidelines for the inclusion of appropriate information with respect to each category of application.

5. The use of Form 8288-B to apply for a withholding certificate under categories 1 through 3 will expedite the application process. An application that is not substantially complete when submitted will be rejected. For example, an application without a specific or estimated date of transfer will not be considered to be substantially complete.

.05 *Information concerning category 1 applications (nonrecognition or exempt transfer).* If a withholding certificate is sought on the basis of a claim that the transaction is entitled to nonrecognition treatment or is exempt from U.S. taxation, provide the following:

1. A brief description of the transfer;

2. A brief summary of the law and facts supporting the claim of nonrecognition or exemption;

3. Evidence that the transferor has no unsatisfied withholding liability, as described in section 4.06(3); and

4. The contract price (if any), or if no contract price is available, the most recent assessed value, for state or local property tax purposes, of the U.S. real property interest to be transferred, or, if such assessed value is not available, then the good faith estimate of its fair market value (no supporting evidence concerning the value of the property need be supplied).

.06 *Information concerning category 2 applications (determination of maximum tax liability).*

1. *In general.* If a withholding certificate is sought on the basis of a determination of the transferor's maximum tax liability, information must be provided to establish the two elements of that liability: (a) the maximum tax that may be imposed on the disposition, and (b) the transferor's unsatisfied withholding liability. Paragraphs 4.06(2) and .06(3), below, provide guidelines for the furnishing of such information. For further information concerning the determination of the transferor's maximum tax liability, see section 1.1445-3(c) of the regulations.

2. *Maximum tax on disposition.* (a) The applicant must provide a calculation of the maximum tax that may be imposed on the disposition, including the following information:

(1) The amount to be realized by the transferor plus evidence confirming this amount, such as a copy of the signed contract relating to the transfer;

(2) Adjusted basis of the property plus evidence confirming the basis claimed, such as schedules of depreciation for tax purposes (if no depreciation schedules are provided, the application must state the nature of the use of the property and why depreciation was not allowed);

(3) Amounts to be recaptured with respect to depreciation, investment tax credit, or other items subject to recapture;

(4) Maximum capital gain and/or ordinary income tax rates applicable to the transfer;

(5) Tentative tax owed;

(6) Amount of any increase or reduction of tax to which the transferor is subject, including any reduction to which the transferor is entitled under a provision of a U.S. income tax treaty as well as evidence supporting the adjustment claimed. *See* section 1.1445-3(c)(2) of the regulations.

(b) For purposes of calculating the maximum tax that may be imposed upon a disposition, unused credit carryovers shall not be taken into account, and net operating loss carry-overs (NOLs) (see section 172 of the Code) may be taken into account only if:

(1) The transferor claiming the NOL has been engaged in a trade or business in the U.S. during the three preceding tax years and has timely filed an income tax return for each of those years (copies of which should be attached);

(2) The claimed NOL has been reflected on previously-filed returns (no anticipated loss with respect to current year operations may be considered);

(3) The claimed NOL is not currently the subject of an examination by or a dispute with the Service;

(4) The transferor agrees that, if the amount of gain that the transferor claimed would be offset by the NOL exceeds the amount of the gain actually recognized and offset by the claimed NOL when the transferor files its tax return for the current tax year, the transferor will pay interest upon the excess of the amount that should have been subject to withholding over the amount, if any, actually withheld, which interest will be computed:

(A) At the rates and in the manner prescribed by sections 6621 and 6622 of the Code; and

(B) With respect to the period between the date on which withholding would otherwise have been required and the date on which payment is made (for purposes of determining whether gain recognized on the disposition was in fact offset by the claimed NOL, the NOL is deemed first to offset income from sources other than the disposition of U.S. real property interests, and then to offset gain from such dispositions with respect to which a withholding certificate was issued in the order to which such dispositions occurred);

(5) The claimed NOL has not previously been used to reduce withholding upon other dispositions of U.S. real property interests or to reduce the amount of any other obligation or liability under U.S. internal revenue laws; and

(6) As part of the application, the transferor represents that:

(A) At least 80 percent of its gross income subject to U.S. taxation in the taxable year of disposition will be derived from U.S. real property interests; and

(B) In calculating the maximum tax that may be imposed on the disposition, the application calculates the NOL in the manner prescribed by the provisions of this section 4.06(2)(b), and the NOL is taken into account only to the extent permitted by such provisions.

3. *Transferor's unsatisfied withholding liability.* The applicant must provide a calculation of the transferor's unsatisfied withholding liability or evidence that it does not exist. That liability is the amount of any tax that the transferor was required to but did not withhold and pay over under section 1445 of the Code upon the acquisition of the subject U.S. real property interest or a predecessor interest. The transferor's unsatisfied withholding liability is included in the calculation of maximum tax liability so that such prior withholding liability may be satisfied by the transferee's withholding upon the current transfer. For purposes of this paragraph 3, a predecessor interest is one that was exchanged for the subject U.S. real property interest in a transaction in which the transferor was not required to recognize the full amount of the gain or loss realized upon the transfer. For further information, see section 1.1445-3(c)(3) of the regulations. Evidence that the transferor has no unsatisfied withholding liability includes any one of the following items:

(a) Evidence that the transferor acquired the subject or predecessor

U.S. real property interest before January 1, 1985;

(b) A copy of the Form 8288 that was filed by the transferor, and proof of payment of the amount shown due thereon, with respect to the transferor's acquisition of the subject or predecessor U.S. real property interest;

(c) A copy of a withholding certificate issued with respect to the transferor's acquisition of the subject or predecessor U.S. real property interest, plus a copy of Form 8288 and proof of payment with respect to any withholding required under that certificate;

(d) A copy of the nonforeign certificate (see Treas. Reg. §1.1445-2(b)(2))furnished by the person from whom the subject U.S. real property interest was acquired, executed at the time of that acquisition;

(e) Evidence that the transferor purchased the subject or predecessor U.S. real property interest for $300,000 or less and a statement, signed by the transferor under penalties of perjury, that the transferor purchased the property for use as a residence within the meaning of section 1.1445-2(d)(1);

(f) Evidence that the person from whom the transferor acquired the subject or predecessor U.S. real property interest fully paid any tax imposed on that transaction pursuant to section 897;

(g) A copy of a notice of nonrecognition treatment provided to the transferor pursuant to section 1.1445-2(d)(2) by the person from whom the transferor acquired the subject or predecessor U.S. real property interest; and

(h) A statement, signed by the transferor under penalties of perjury, setting forth the facts and circumstances that support the transferor's conclusion that no withholding was required under section 1445(a) with respect to the transferor's acquisition of the subject or predecessor U.S. real property interest.

.07 *Information concerning category 3 applications (installment sales).* See section 7 of this revenue procedure.

.08 *Information concerning category 4 applications (agreement for the payment of tax with conforming security).* If a withholding certificate is sought on the basis of an agreement for the payment of tax, the application must include:

1. Information establishing:
   (a) The transferor's maximum tax liability, in accordance with section 4.06; or
   (b) The amount otherwise required to be withheld pursuant to section 1445(a) of the Code;
2. A signed copy of the agreement proposed by the applicant; and
3. A copy of the security instrument proposed by the applicant. For further information concerning agreements for the payment of tax and security instruments, see sections 5 and 6 of this revenue procedure and section 1.1445-3 of the regulations.

.09 *Information concerning category 5 applications (blanket withholding certificate).* See section 9 of this revenue procedure.

.10 *Information concerning Category 6 applications (non-standard applications).*

1. *Agreement for payment of tax with nonconforming security.* If the applicant seeks to enter into an agreement for the payment of tax, but wishes to provide a nonconforming type of security, the application must include:
   (a) The information required by section 4.08 concerning category 4 applications;
   (b) A description of the nonconforming security proposed by the applicant; and
   (c) A memorandum of law and facts establishing that the proposed security is valid and enforceable and that it adequately protects the government's interest.

2. *Other non-standard applications.* An application for a withholding certificate not otherwise described in this revenue procedure must explain in detail the proposed basis for the issuance of the certificate and set forth the reasons justifying the issuance of a certificate on that basis.

.11 *Information submitted by foreign governments.* In addition to the information required in Sec. 4.04 and Sec. 4.05, a foreign government submitting an application on the basis that the subject U.S. real property is used by the foreign government for a diplomatic mission should submit the following information:

1. Information identifying the diplomatic property;
2. Information establishing that the property is used by the foreign government for a diplomatic mission; and
3. Information describing whether the property has been recognized by the State Department as being diplomatic property subject to the Foreign Missions Act, § 202, 22 U.S.C. § 4305 (1982).

.12 *Availability of records.* The applicant shall make available to the Commissioner, within the time prescribed by the Commissioner, all information that may be required by the Commissioner in order to verify that representations relied upon by the Commissioner in accepting the agreement are accurate, and that the obligations assumed by the applicant will be performed pursuant to the agreement. Failure to provide requested information promptly will usually result in rejection of the application. Instead of such rejection, the Commissioner, in his discretion, may also consider extension of an established target date for issuing a withholding certificate. The parties shall agree that the review of books and records pursuant to the agreement shall not constitute an examination for purposes of section 7605(b) of the Code.

SEC. 5. AGREEMENT FOR THE PAYMENT OF TAX

.01 *In general.* The Service will issue a withholding certificate that excuses withholding or that permits a transferee to withhold a reduced amount if either the transferor or the transferee enters into an agreement for the payment of tax. An agreement for the payment of tax is a contract between the Service and any other person that consists of two necessary elements. Those elements are:

1. A detailed description of the rights and obligations of each; and
2. A security instrument or other form of security acceptable to the Commissioner.

.02 *Contents of agreement—In general.* An agreement for the payment of tax must either provide adequate security for the payment of the tax in accordance with section 6 of this revenue procedure or provide

for the payment of the tax through a combination of security and withholding of tax by the transferee. The agreement must cover an amount described in subdivision (a) or (b) of this paragraph.

(a) *Tax that would otherwise be withheld.* An agreement for the payment of tax may cover the tax that would otherwise be required to be withheld pursuant to section 1445(a) of the Code. In addition to securing the amount computed pursuant to section 1445(a), the agreement must provide that the applicant will pay interest upon that amount, at the rates and in the manner prescribed by section 6621 and 6622, with respect to the period between the date on which the tax imposed by section 1445(a) would otherwise be due (i.e., the 20th day after the date of transfer) and the date on which the transferor's payment of tax with respect to the disposition will be due. Interest and additions with respect to the tax also must be secured. In most instances, payments of interest and additions to tax may be secured by the same agreement that secures payment of taxes. At the discretion of the Commissioner, however, separate security agreements may be required.

(b) *Maximum tax liability.* An agreement for the payment of tax may provide for the payment of the transferor's maximum tax liability, determined in accordance with section 4.06(2) of this revenue procedure. The agreement must also provide for the payment of an additional amount equal to 25 percent of the amount determined under section 4.06(2). This additional amount secures the interest and additions to tax that would accrue between the date of a failure to file a return and pay tax with respect to the disposition and the date on which the Service collects the tax pursuant to the agreement.

.03 *Parties to the agreement.* All agreements for the payment of tax will be between the Commissioner and the applicant furnishing the security or personally guaranteeing payment of any tax later determined to be due. In addition, the Commissioner may require as a signatory any other party deemed to be appropriate. The Commissioner may require such other terms and conditions, or vary the format as appropriate in the particular case, to provide adequate security.

.04 *Contents of agreement—Stated purpose and warranties.* The agreement for the payment of tax should state the purpose and basis of the agreement. It should also recite any warranties or representations upon which the Commissioner will be required to place material reliance in accepting the agreement.

.05 *Contents of agreement—Identification of security.* The agreement for the payment of tax must set forth in detail the obligations to be assumed and identify the nature of the security that is being offered. To the extent that the security is embodied in an instrument or document collateral to the agreement, such instrument or document must be incorporated by reference in the agreement.

.06 *Sample agreement.* The following example sets forth the language of an agreement for the payment of tax that in most circumstances will be acceptable to the Service:

1. This agreement is entered into pursuant to the provisions of section 1445 of the Internal Revenue Code (the "Code") and the regulations thereunder.

The signatories warrant that they are authorized under applicable law to enter into the agreement and undertake the actions and obligations specified herein.

2. _____(name) warrants that (s)he/it will make timely payment of any liability (including tax, penalties, interest, and additions to tax) that may become lawfully due and owing under the Code as a result of the disposition or distribution by _____ of the interest, or any part thereof, described in Exhibit(s) _____ [the "subject interest(s)"] giving rise to tax liability by reason of the operation of sections 871(b), 882, and/or 897 of the Code. The related security secures payment of such amounts. Security for the payment of such liability is provided in the amount of _____, in accordance with the requirements of section 1.1445-3(e)(2) of the Income Tax Regulations. The computation of the proper amount of security to be provided is set forth in Exhibit _____ and such computation is hereby incorporated by reference.

3. The provisions of this agreement shall be construed as binding upon all signatories to this agreement, unless the intent to exclude any one or more signatories is clearly set forth in the provisions or is clearly implicit in the terms hereof.

4. The amount of each deposit of estimated tax that will be required with respect to the amount recognized on the subject disposition may be collected by levy upon or recourse to the security as of the date following the date on which each such deposit is due (unless such deposit is timely made).

5. The entire amount of the liability may be collected by levy upon or recourse to the security at any time during the nine months following the date on which the payment of tax with respect to the subject disposition is due, subject to release of the security upon the full payment of the tax and any interest and penalties due. If the transferor requests an extension of time to file a return with respect to the disposition, the Commissioner may require that the term of the security instrument be extended until the date that is nine months after the filing deadline as extended.

6. The applicant shall make available to the Commissioner within 30 days of a request from the Commissioner all information that may be required by the Commissioner in order to verify that representations relied upon by the Commissioner in accepting the agreement are accurate, and that the obligations assumed by the applicant are performed pursuant to this agreement.

7. The parties agree that the review of books and records pursuant to this agreement shall not constitute an examination for purposes of section 7605(b) of the Code.

8. Nothing in this agreement shall limit the Commissioner from performing the obligations imposed upon or delegated to him under the law.

9. Upon the occurrence of any default by the applicant under the applicable provisions of this agreement, in addition to any and all other rights and remedies which the Commissioner may have hereunder, or under any other applicable law, or otherwise, the Commissioner may reduce the claim to judgment, otherwise enforce the security interests by any available judicial procedure, and exercise any other rights and remedies the Commissioner may have at law, or in equity, or otherwise, including, but not limited to the right to apply toward payment of the obligations hereunder, without notice to the applicant, any sums which may then be held by the Commissioner for said applicant.

10. For purposes of this agreement, the term "default" means a material misrepresentation of material fact or a failure to honor an obligation or warranty agreed to herein.

11. Except as otherwise provided in this agreement, no provision of this agreement shall be deemed to constitute a waiver of any right that any party may have to recover any amount in accordance with the laws, statutes, and regulations of the United States, nor shall any provision of the agreement be deemed to be an admission by any person, whether or not a party hereto, that such person is liable for any federal income tax, or, if a foreign corporation or nonresident alien, that such person is subject to the taxing jurisdiction of the United States, or if the Commissioner, that the facts upon which this agreement is based are true and accurate.

12. This agreement and all of its terms and conditions shall inure to the benefit of, and be binding upon, the Commissioner and the applicant, and their respective successors.

13. All notices, instructions and other communications ("Notices") required or permitted to be given, forwarded, or transmitted hereunder or necessary or convenient in connection herewith shall be in writing and addressed to:

Internal Revenue Service Center
P.O. Box 21086
DP 8731 FIRPTA Unit
Philadelphia, PA 19144-0586

or

To [the applicant: the applicant's address etc]. and shall be deemed to have been given only when delivered personally or by private delivery service as designated by the Internal Revenue Service under I.R.C. §7502(f) (see Notice 99-41, 1999-35 I.R.B. 325, or its successor for a listing of private delivery services); or sent by first class U.S. mail (postage pre-paid, by registered or certified mail, return receipt requested); or sent by cable, telex, telegram or facsimile transmission (for example, telecopier) and confirmed by letter mailed the same day to the party receiving the notice. Any notice sent by mail to or from a place outside the continental United States shall be sent by air mail. Any notice sent by cable, telegram, or telex may be addressed to any published cable, telegram, or telex address that the addressee may have specified by notice to all the signatories. Any signatory may change the address or addresses to which communications are to be directed to it by giving written notice of such change to the persons above specified in the manner provided above, provided, however, that [the applicant] may establish or change an address to which notices are to be directed only if the new address is the address of [the applicant] itself or the address of a person with power of attorney to act for [the applicant] with respect to the disposition or distribution described in paragraph 2.

14. This agreement may not be amended, modified, superseded, or canceled and none of the terms hereof may be waived, except by a written instrument executed by the Commissioner and the other party or parties hereto sought to be charged thereby. In the case of a waiver of the breach of any term contained in this agreement in any one or more instances, the waiver shall be neither deemed to be nor construed as a further or continuing waiver of any such breach or term or any other term contained in this agreement.

15. This agreement may be in any number of counterparts with all the counterparts together constituting one and the same agreement.

16. The term "Commissioner" as used herein also shall include any successors in office, and any and all agents or employees thereof duty authorized for the purpose.

17. This agreement shall not be binding upon any signatory hereto until it has been signed by the Commissioner and the Commissioner has received counterparts thereof duly executed by each of the signatories whose names appear at the end of this agreement.

18. No provision of this agreement shall relieve any party or person of any obligation or liability under the internal revenue laws of the United States, except as specifically provided in this agreement.

19. This agreement is made without prejudice to the assertion and/or collection of tax liabilities other than for any tax imposed by section 871(b)(1) or 882(a)(1) of the Code on any gain realized by the transferor on the disposition of the subject United States real property interest.

20. This agreement shall be governed, construed, and enforced in accordance with the laws of the United States of America and, where applicable, the laws of the State of [insert applicable local jurisdiction.]

21. It is agreed that nothing herein shall be construed to increase, decrease, or otherwise affect in any way the substantive tax liability of the taxpayer under any other provision of the Code.

22. The Commissioner will not, in part or in full, release, subordinate, or return the security held with respect to this agreement except upon the payment of any liability determined to be due or upon the deposit of an acceptable amount of estimated tax or upon a showing to the satisfaction of the Commissioner that the liability is zero.

I accept this Agreement	Under penalties of perjury, I declare that I have examined this Agreement, related exhibits, schedules and statements and to the best of my knowledge and belief it is true, correct and complete.
Signature	Signature of Signatory/Power of Attorney
Title [Commissioner or person acting on behalf of the Commissioner]	

SEC. 6. SECURITY

.01 *Major types of security.* There are four major types of security acceptable to the Service. These are:

1. *Bond with surety or guarantor.*

The Service may accept as security with respect to a transferor's tax liability a bond that is executed with a satisfactory surety or guarantor. Only the following persons may act as surety or guarantor for this purpose:

(a) A surety company holding a certificate of authority from the Secretary as an acceptable surety on Federal bonds, as listed in Treasury Department Circular No. 570, published annually in the Federal Register on the first working day in July and as supplemented from time to time thereafter;

(b) A person who is engaged within or without the United States in the conduct of a banking, financing, or similar business under the principles of section 1.864-4(c)(5) of the regulations, and who is subject to U.S. or foreign (local or national) regulation of such business, if that person is otherwise acceptable to the Service; and

(c) A person who is engaged within or without the United States in the conduct of an insurance business that is subject to U.S. or foreign (local or national) regulation, if that person is otherwise acceptable to the Service.

2. *Bond with collateral.* The Service may accept as security with respect to a transferor's tax liability a bond that is secured by acceptable collateral. All collateral must be deposited with a responsible financial institution acting as escrow agent, or in the Service's discretion, with the Service. Only the following types of collateral are acceptable:

(a) Bonds, notes, or other public debt obligations of the United States, in accordance with the rules of 31 CFR Part 225; and

(b) A certified, cashier's, or treasurer's check, drawn on an entity acceptable to the Service that is engaged within or without the United States in the conduct of a banking, financing, or similar business under the principles of section 1.864-4(c)(5) of the regulations and that is subject to U.S. or foreign (local or national) regulation of such business.

3. *Letter of credit.* The Service may accept as security with respect to a transferor's tax liability an irrevocable letter or credit issued by an entity acceptable to the Service that is engaged within or without the United States in the conduct of a banking, financing, or similar business under the principles of section 1.864-4(c)(5) of the regulations and that is subject to U.S. or foreign (local or national) regulation of such business. The Service will accept a letter of credit from an entity that is not engaged in a trade or business in the United States only if such letter may be drawn on an advising bank within the United States.

4. *Guarantee.* The Service may accept as security with respect to a corporate transferor's tax liability a guarantee of the payment of such liability. The Service will accept such a guarantee only if (a) the corporation providing the guarantee is a corporation, foreign or domestic, any class of the stock of which is regularly traded on an established securities market on the date of the transfer; (b) the corporation providing the guarantee (1) is the transferor or holds, directly or indirectly, more than 80 percent of the voting stock of the transferor and (2) is engaged in a trade or business within the United States; and (c) the corporation providing the guarantee has net assets in the United States at least $25 million in excess of the value of the U.S. real property interest which is being disposed of.

5. *Other forms of security.* The Service, at its discretion, may in unusual circumstances accept any additional form of security that it finds to be adequate.

.02 *Sample Forms.* Listed below are sample forms of security instruments that in most circumstances are acceptable to the Service, to be used when requesting a withholding certificate pursuant to section 1.1445-3 of the regulations.

1. BOND WITH SURETY/GUARANTOR

OBLIGATION. The undersigned, _____ , the Guarantor(s), is (or if more than one, jointly and severally are) irrevocably held and firmly bound to pay the Internal Revenue Service the following portion of any tax (including any penalties, interest, and additions to tax) lawfully due and owing by any person listed below as a specified taxpayer as a result of the disposition or distribution of all or part of the subject interest in U.S. real property listed below as the subject interest(s):

* * *

CONDITIONS OF THIS OBLIGATION. The Internal Revenue Service may demand payment of the secured liability or any portion thereof at any time and for any reason. If the secured liability or requested portion is paid when requested by the Internal Revenue Service, this Guarantee shall be released to the extent so paid; otherwise, it shall remain in full force and effect until released in writing by the Internal Revenue Service.

SUBJECT INTEREST(S):
SPECIFIED TAXPAYER(S):
SIGNED, SEALED, AND DATED THIS _____ day of _____ 20____,

_____
Guarantor [Seal]

_____
Guarantor [Seal]

Corporate Guarantor

(Corporate Seal)
Attest:

By:_____ [Corporate Seal]

Surety/Guarantor

_____
Secretary

By:_____ [Corporate Seal]
Title

2. BOND WITH COLLATERAL

OBLIGATION: The undersigned, _____ the Guarantor(s) (or if more than one, jointly and severally are) irrevocably held and firmly bound to pay the Internal Revenue Service the following portion of any tax (including any penalties, interest, and additions to tax) lawfully due and owing by any person listed below as a specified taxpayer as a result of the disposition or distribution of all or part of the subject interest in U.S. real property listed below as the subject interest(s):

SECURITY: The above-bound Guarantor(s), in order to more fully secure the Internal Revenue Service in the payment of this obligation, hereby pledge(s) as security therefor the following collateral:

* * *

CONDITIONS OF THE OBLIGATION. The Internal Revenue Service may demand payment of the secured liability or any portion thereof at any time and for any reason. If the Guarantor(s) fail(s) to pay the amount requested by the Internal Revenue Service. The Commissioner and his designates are authorized and empowered, in their sole discretion, in whole or in part, to exercise the power of attorney, contemporaneously executed and delivered to collect, sell, transfer, or assign the above described security and apply the funds so received in full or partial satisfaction of any liability for taxes, interest, penalties, or additions to tax secured hereby. If the secured liability or portion requested is paid by the Guarantor(s) when requested by the Internal Revenue Service, this security shall be released to the extent so paid; otherwise, this obligation shall remain in full force and effect until released in writing by the Internal Revenue Service.

SUBJECT INTEREST(S):
SPECIFIED TAXPAYER(S):
SIGNED, SEALED, AND DATED THIS _____ day of _____ 20____,

_____
Guarantor [Seal]

_____
Guarantor [Seal]

_____
Corporate Guarantor

By:_____
Title [Corporate Seal]

(Corporate Seal)
Attest:

_____
Secretary

Individual's power of attorney

3. POWER OF ATTORNEY

I (we)... do hereby constitute and appoint the Commissioner (and his/her designate) as attorney for me (us) and in my (our) name to collect, sell, assign, and transfer the following:

* * *

which has been deposited by me (us) as security for the faithful performance of my (our) bond, which is attached and incorporated by reference, and I (we) agree that, in case of any default in the performance of any of the conditions and stipulations of the bond, my (our) said attorney shall have full power to collect said security or any part thereof, or to sell, assign to another for the purposes

of effecting either public or private sale, free from any equity of redemption and without appraisal or valuation notice and right to redeem being waived, and the proceeds of such sale for collection, in whole or in part, to be applied to the satisfaction of the liability secured by the bond in such manner as may be deemed in the best interest of the United States. I (We) further agree that the authority herein granted is irrevocable.

And for myself (ourselves), my (our several) administrators, executors, and assigns, I (we) hereby ratify and confirm whatever my (our) said attorney shall do by virtue of this power of attorney.

In witness whereof, I (we), herein above named, have executed this instrument and affixed my (our) seal this _____day of _____, 20___.

_____ [SEAL]

State of _____)

ss

County of _____)

Before me, the undersigned, a notary public within and for the said county and State, personally appeared... [name(s) of Guarantor(s)], and acknowledged the execution of the foregoing power of attorney.

Witness my hand and notarial seal this _____day of _____ , 20___.

_____

Notary Public

My Commission expires _____

Corporation's power of attorney

4. POWER OF ATTORNEY

_____, a corporation duly incorporated under the laws of the State of and having its principal office in the city of _____, State of _____ in pursuance of a resolution of the Board of Directors, of said corporation passed on the day of _____, 20 ___, a duly certified copy of which resolution is attached hereto, does hereby constitute and appoint the Commissioner (and his designates) as attorney for said corporation, for and in the name of said corporation, to collect or to sell, assign, and transfer the following:

* * *

which has been deposited by it as security for the faithful performance of the bond, a copy of which is attached, and which is incorporated by reference, and the undersigned agrees that, in case of any default in the performance of any of the conditions and stipulations of the bond, its said attorney shall have full power to collect said security or any part thereof, or to sell, assign, and transfer said security or any part thereof without notice, at public or private sale, or to transfer or assign to another for the purpose of effecting either public or private sale, free from any equity of redemption and without appraisal or valuation, notice and right to redeem being waived, and the proceeds of such sale for collection, in whole or in part, to be applied to the satisfaction of the liability secured by the bond, in such manner as may be deemed in the best interests of the United States. The undersigned further agrees that the authority granted is irrevocable.

And said corporation, hereby for itself, its successors and assigns, ratifies and confirms whatever its said attorney shall do by virtue of this power of attorney.

In witness whereof, _____, the corporation above named, by _____(Name and title of officer), duly authorized to execute this instrument has caused the seal of the corporation to be affixed hereto this day of _____ 20 ___.

Attest:

_____

(Corporate seal) Secretary

By: _____

Title

State of _____)

ss

County of _____)

Before me, the undersigned, a notary public within and for the said county and State, personally appeared _____ (name and title of officer), and for and in behalf of said _____ corporation, acknowledged the execution of the foregoing power of attorney.

Witness my hand and notarial seal this _____ day of _____, 20___.

[Notarial seal]

Notary Public

My Commission expires _____

5. LETTER OF CREDIT

Place: Cable Address:
Date:

IRREVOCABLE STANDBY LETTER OF CREDIT	All drafts must be marked: Drawn under credit no.	Advising bank reference to
Advising bank	For account of	

To beneficiary
Internal Revenue Service

950 L'Enfant Plaza South, S.W.
Washington, DC 20224

Attention: Collection

Expiration date

This refers to preliminary cable advice of this credit

Gentlemen:

We hereby establish our irrevocable letter of credit in your favor available by your drafts drawn at SIGHT and accompanied by documents specified below: NONE

We hereby engage with you that all drafts drawn under and in compliance with the terms of this credit will be duly honored if drawn and presented for payment at this office on or before the expiration date of this credit. The advising bank is requested to notify the beneficiary without adding their confirmation.	Advising bank's notification Place, date, name, and signature of the advising bank

Sincerely yours,
Authorized counter signature
Authorized signature

6. GUARANTEE

OBLIGATION: The undersigned, _____, the Guarantor(s), is (or if more than one, jointly and severally are) irrevocably held and firmly bound to pay the Internal Revenue Service the following portion of any tax (including any penalties, interest, and additions to tax) lawfully due and owing by any person listed below as a specified taxpayer as a result of any disposition or distribution taxable by reason of sections 871(b)(1), 882(a)(1), and/or 897 of the Code as to all or part of the subject interest in U.S. real property listed below as the subject interest:

CONDITIONS OF THIS OBLIGATION: The Internal Revenue Service may demand payment of the secured liability or any portion thereof at any time and for any reason. If the secured liability or requested portion is paid when requested by the Internal Revenue Service, this Guarantee shall be released to the extent so paid; otherwise, it shall remain in full force and effect until released in writing by the Internal Revenue Service.

SUBJECT INTEREST(S):

SPECIFIED TAXPAYER(S):
SIGNED, SEALED, AND DATED THIS _____ day of _____ 20____,

_____
Guarantor [Seal]

_____
Corporate Guarantor

By:_____
[Corporate Seal]

Attest:

_____
Secretary

SEC. 7. INSTALLMENT SALES

01. *In general.* A transferee as a result of a disposition of a U.S. real property interest occurring after December 31, 1984, is required to satisfy its withholding obligation based on the amount realized regardless of the amount of the payment by the transferee. If the transferor is a person other than a dealer and will report gain from the disposition under section 453 of the Code, a withholding certificate that permits the transferee to withhold at a reduced rate may be obtained under the rules of this section. Any withholding certificate must provide for payment of the interest on the deferred tax liability under section 453A(c) of the Code when applicable. No refund of the amount withheld will be made unless such a withholding certificate is obtained.

.02 *Withholding certificate requests.* With respect to installment sales subject to withholding under section 1445(a) of the Code, the Service will entertain requests for certificates based on the transferee's agreement to do the following:

1. Withhold and pay over 10 percent, or such lesser amount as determined by the Commissioner, of any down payment, including any liabilities of the transferor assumed by the transferee or liabilities to which the subject U.S. real property interest was subject immediately before and after the transfer;

2. Withhold 10 percent, or such lesser amount as may be determined by the Commissioner, of each subsequent payment and the interest on the deferred tax liability under section 453A(c) of the Code (these amount are in addition to any other amount required to be withheld under section 1441 or 1442);

3. Pay over all amounts withheld using Forms 8288 and 8288-A, including thereon the taxpayer identification number of the transferor; and

4. Notify the Commissioner prior to the disposition or encumbrance of the subject U.S. real property interest, and upon such disposition or encumbrance pay over to the Service the amount remaining to be withheld pursuant to section 1445(a).

5. If the transferor pledges the installment obligation in exchange for all or a portion of the proceeds due on the installment obligation and includes in gross income under section 453A(d) of the Code the net proceeds of the secured indebtedness, the transferee's obligation to withhold under a reduced withholding certificate nevertheless continues until an amended withholding certificate is issued even though the transferor includes the proceeds in gross income.

SEC. 8. APPLICATION FOR WITHHOLDING CERTIFICATES FOR AMOUNTS REQUIRED TO BE WITHHELD UNDER SECTION 1445(e)

.01 *In general.* Pursuant to the provisions of sections 1.1445-5(c), (d), and (e) of the regulations, withholding under section 1445(e) of the Code may be reduced or eliminated pursuant to a withholding certificate issued by the Service in accordance with the rules of section 1.1445-6. A withholding certificate may be issued in cases where adjusted withholding is appropriate, where the relevant taxpayers are exempt from U.S. tax, or where an agreement for the payment of tax is entered into with the Service. If a domestic partnership's transfer of a U.S. real property interest is subject to both section 1445(e)(1) and section 1446, a withholding certificate will not be issued. *See* Rev. Proc. 89-31, 1989-1 C.B. 899. The term "relevant taxpayer" shall mean any foreign person that will bear substantive income tax liability by reason of a transaction upon which withholding is required under section 1445(e).

.02 *Applications. An* application for a withholding certificate pursuant to section 1.1445-6 of the regulations must follow the format set forth in section 4.04 of this revenue procedure and provide the information described in sections 4.05 through 4.10, with the following adjustments:

1. The application must include a preliminary item stating that it relates to withholding under section 1445(e) of the Code and specifying the applicable provisions of that section;

2. Item 2(b) of section 4.04 must state whether the applicant is a relevant taxpayer or a person required to withhold (and in what capacity that person is required to withhold; for example, as trustee);

3. Item 2(c) of section 4.04 must provide the required information with respect to each relevant taxpayer with respect to which adjusted withholding is sought; and

4. Information concerning the basis for the issuance of the certificate must be provided with respect to each relevant taxpayer.

.03 *Installment sales.* With respect to installment sales subject to withholding under section 1445(e) of the Code, the Service will entertain requests for withholding certificates based on the entity's or the fiduciary's agreement to do the following:

1. Withhold and pay over a portion, in an amount determined appropriate under section 1445(e) by the Commissioner, of any down payment received, in-

cluding any liabilities of the entity assumed by the transferee or liabilities to which the subject U.S. real property interest was subject immediately before and after the transfer;

2. Withhold a portion, in an amount determined appropriate under section 1445(e) by the Commissioner, of each subsequent payment received (this amount is in addition to any other amount required to be withheld under sections 1441 or 1442);

3. Pay over all amounts withheld using Forms 8288 and 8288-A, including thereon the taxpayer identification number of the interest holder subject to withholding; and

4. Notify the Commissioner, prior to the disposition or encumbrance of the subject installment obligation, and upon such disposition or encumbrance pay over to the Service the amount remaining to be withheld under section 1445(e).

SEC. 9. BLANKET WITHHOLDING CERTIFICATE

.01 *In general.* The Commissioner may issue a withholding certificate (blanket withholding certificate) that excuses withholding with respect to multiple dispositions of U.S. real property interests by the transferor or the transferor's legal representative during a period of no more than 12 months. A blanket withholding certificate may be issued if the transferor holding the U.S. real property interests provides a letter of credit as specified in paragraph 1 of this subsection .01 or a guarantee as specified in paragraph 2 of this subsection .01 and enters into an agreement with the Service that meets the requirements of paragraphs 3 and 4 of this subsection .01.

1. For dispositions not subject to section 1445(e) of the Code, the transferor must provide an irrevocable letter of credit in an amount equal to the greater of (i) $100,000 or (ii) 10 percent of the amount to be realized on the projected dispositions covered by the certificate. For dispositions subject to section 1445(e), the transferor must provide an irrevocable letter of credit in an amount equal to the greater of (i) $100,000 or (ii) the tax that section 1445(e) would require to be withheld. The letter of credit must meet the requirements of paragraph 3 of subsection 6.01 of this revenue procedure and otherwise must be acceptable to the Commissioner. In addition, the letter of credit by its terms must be valid until at least the last day of the ninth month following the date (including extensions of time) on which a return will be required to be filed with respect to the tax year in which the 12th month covered by the withholding certificate falls. A letter of credit in the form specified in subsection 6.02(5) in most circumstances will be acceptable to the Service when requesting a blanket withholding certificate.

2. Alternatively, the Service may accept as security for a blanket withholding certificate with respect to a corporate transferor's tax liability a guarantee of the payment of such liability. The Service will accept such a guarantee only if (a) the corporation providing the guarantee is a corporation, foreign or domestic, any class of the stock of which is regularly traded on an established securities market on the date of the transfer; (b) the corporation providing the guarantee (1) is the transferor or holds, directly or indirectly, more than 80 percent of the voting stock of the transferor and (2) is engaged in a trade or business within the United States; and (c) has gross assets in the United States at least $25 million in excess of the U.S. real property interest being disposed of.

Additionally, the transferor corporation must have filed United States corporate income tax returns for the prior consecutive three years and the guarantee otherwise must be acceptable to the Commissioner. The guarantee by its terms must be valid until at least the last day of the ninth month following the date (including extensions of time) on which a return will be required to be filed with respect to the tax year in which the 12th month covered by the withholding certificate falls. A guarantee in the form specified in subsection 6.02(6) will be acceptable to the Service in most circumstances when requesting a blanket withholding certificate.

3. The transferor must provide with the letter of credit described in paragraph 1 of this subsection or the guarantee described in paragraph 2 of this subsection an executed tax payment and security agreement securing the payment of tax with respect to the projected dispositions covered by the blanket withholding certificate. The agreement must generally meet the requirements of subsections 5.02 through 5.05 of this revenue procedure as modified to take account of this subsection 9.01 and otherwise must be acceptable to the Commissioner. The agreement must also list all the U.S. real property interests covered by the agreement and give a brief description of each interest. In addition, the agreement must contain the terms as to notification of specific dispositions required by paragraph 4 of this subsection 9.01 and must provide that, in the event of a failure by the transferor to provide such notification or to file a return in a timely manner, deposit estimated tax in a timely manner, or to pay tax in a timely manner, with respect to the gain on one or more of the dispositions covered by the certificate, the Commissioner may draw upon the letter of credit or demand payment under the guarantee to satisfy the transferor's liability for any tax imposed by 871(b)(1) or 882(a)(1) of the Code, plus interest and penalties, if any, on any one or more dispositions covered by the certificate.

4. The agreement required by paragraph 3 of this subsection must state that the transferor agrees to notify the Commissioner before or on the date of any disposition of a U.S. real property interest covered by the blanket certificate. The notice shall include the following information:

(a) The name, legal address, and taxpayer identification number (to the extent required in regulations) of the transferor or the name and legal address of a legal representative of the transferor with the power to bind the transferor with respect to the disposition;

(b) The name, legal address, and taxpayer identification number (to the extent required in regulations) of the transferee or the name and legal address of a legal representative of the transferee with the power to bind the transferee with respect to the disposition:

(c) A description of the U.S. real property interest to be transferred and the anticipated date of the transfer;

(d) The amount that would otherwise have been required to be withheld on the transfer (10

percent of the amount realized unreduced by the maximum tax calculation or for any other reason);

(e) The cumulative total of amounts that would otherwise have been required to be withheld with respect to dispositions (i) which have already taken place or are scheduled to take place prior to the disposition with respect to which notice is being given and (ii) with respect to which the Commissioner has not sent the notice described in subsection .02(1) below;

(f) The amount of the original letter of credit provided or the amount the guarantor is bound to pay the Service under the guarantee; and

(g) A copy of the transferor's withholding certificate, or if the application is pending, a copy of the withholding certificate application.

An agreement in the form prescribed by subsection 5.06 of this revenue procedure in most cases will be acceptable to the Service for purposes of paragraphs 3 and 4 of this subsection 9.01, with the following modifications: (i) The form should reflect and describe, as the "subject interests," the projected dispositions to be covered by the blanket withholding certificate to which the agreement will relate, (ii) paragraph 2 of the form should be modified to state that the agreement is entered into in connection with an application for a blanket withholding certificate and will extend to all dispositions covered by the blanket withholding certificate, (iii) the third sentence of paragraph 2 should be revised to read "Security for the payment of such liability is provided by an irrevocable letter of credit in the amount of __ in accordance with the requirements of subsection 9.01(1) of Rev. Proc. 2000–35 or by a guarantee in accordance with the requirements of subsection 9.01(2) of Rev. Proc. 2000–35, (iv) a new paragraph should be added to the form (designated as paragraph 3, with the other paragraphs being renumbered accordingly), containing the terms of paragraph 4 of this subsection 9.01, and (v) paragraph 5 of the form (paragraph 6 as renumbered) should be revised to read:

"6. In the event of any failure by the transferor or the transferor's legal representative (i) to notify the Commissioner properly, in accordance with paragraph 4, of a disposition of a U.S. real property interest covered by this agreement and the blanket withholding certificate to which it relates, or (ii) to file a return in a timely manner, to deposit estimated tax in a timely manner, or to pay tax in a timely manner, with respect to the gain on one or more dispositions covered by this agreement and such certificate, the Commissioner may draw upon the letter of credit provided or the guarantee as related security under this agreement in full to the extent of the tax imposed by section 871(b)(1) or section 882(a)(1) of the Code on any one or more dispositions covered by this agreement and such certificate, plus interest and additions to tax, if any. This amount shall be in addition to any other civil or criminal penalties that may apply with respect to the applicant's use of the withholding certificate in violation of the terms thereof."

.02 *Withholding certificates—Provisions.* A withholding certificate issued by the Commissioner under this section will state that no withholding is required with respect to any disposition of a U.S. real property interest by the applicant provided that (1) before the date of the transfer, the Commissioner does not provide notice to the person who would otherwise be required to withhold (discussed in paragraph 1 below) that such withholding is required, and (2) the person who would otherwise be required to withhold timely provides the information and material described in paragraph 2 below and the disposition as consummated does not materially fail to correspond to the information so provided.

1. If one of the following conditions occurs, the Commissioner will provide notice to the applicant, and to the person required to withhold, that withholding is required despite the prior issuance of a withholding certificate:

(a) The applicant's letter of credit or amount under the guarantee, in light of prior dispositions, is not sufficient to cover the amount otherwise required to be withheld on the transfer, or

(b) The applicant has otherwise violated the provisions of this section.

2. To be exempt from withholding tax liability, the person that would otherwise be required to withhold must, before or on the day of the closing of a transaction, provide a statement to the Commissioner containing the following information and material:

(a) The name, legal address, and taxpayer identification number (to the extent required in regulations) of the transferee or the name and legal address of a legal representative of the transferee with the power to bind the transferee with respect to the acquisition;

(b) The name, legal address, and taxpayer identification number (to the extent required in regulations) of the transferor or the name and legal address of a legal representative of the transferor with the power to bind the transferor with respect to the acquisition;

(c) A description of the acquired U.S. real property interest and the anticipated date of the acquisition;

(d) The total contract price of the acquired U.S. real property interest; the amount of liabilities, if any, to be assumed by the transferee; and the amount of liabilities, if any, to which the property is to be acquired is subject; and

(e) A copy of the transferor's withholding certificate.

.03 *Copy of security agreement.* The Commissioner will, upon request, provide the transferor with a copy of a security agreement submitted pursuant to paragraph 9.01(2) executed by the Commissioner, but such an executed copy is not needed to establish the validity of the blanket withholding certificate for purposes of the subject disposition. Provided that notice is not given by the Commissioner under section 9.02(1), and provided that the transferee timely provides the required information and materials, the withholding certificate remains valid.

.04 *Consequences of failure to notify.* In the event of any failure by the trans-

feror or the transferor's legal representative to notify the Commissioner properly, in accordance with section 9.01(3), of a disposition of a U.S. real property interest, or to file a return in a timely manner, to deposit estimated tax in a timely manner, or to pay tax in a timely manner, with respect to the gain on one or more dispositions covered by the blanket withholding certificate, the letter of credit provided under section 9.01(1) or the guarantee provided under section 9.01(2) may be drawn upon in full to the extent of the tax imposed by section 871(b)(1) or section 882(a)(1) of the Code, plus interest and additions to tax, if any, on any one or more dispositions covered by the blanket withholding certificate. This amount shall be in addition to any other civil or criminal penalties that may apply with respect to the applicant's use of the withholding certificate in violation of the terms thereof.

SEC. 10. AUTHORIZED REPRESENTATIVE

In any situation covered by this revenue procedure in which a person acts for or is designated as a legal representative of either a transferor or a transferee, such person must be authorized to so act by a power of attorney on file with the Commissioner. Form 2848 may be used for this purpose.

SEC. 11. INQUIRIES

Address all inquiries to:

Internal Revenue Service Center
P.O. Box 21086
Drop Point 8731 FIRPTA Unit
Philadelphia, PA 19114-0586

SEC. 12. EFFECTIVE DATE

This revenue procedure is effective for all applications for withholding certificates submitted after September 27, 2000.

SEC. 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 88-23, 1988-1 C.B. 787, is superseded as of the date Rev. Proc. 2000-35 is effective.

SEC. 14. 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 1545-1697.

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 are contained in sections 4 through 9 of this revenue procedure. This information will be used to enable the Commissioner to determine whether to issue a withholding certificate to an applicant which reduces or eliminates withholding under section 1445 of the Code. The likely respondents are individuals, corporations, partnerships, and foreign governments.

The estimated total annual reporting and/or recordkeeping burden is 60,000 hours.

The estimated average annual burden per applicant is 10 hours. The estimated number of applicants is 6,000.

The estimated number of responses is on occasion.

Books and 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 Sharon J. Bomgardner, formerly of the Office of Associate Chief Counsel (International), and Robert W. Lorence, of the Office of Associate Chief Counsel (International). For further information, contact Tom Logan of Foreign Payments, Pre-filing and Technical Guidance at (202) 283-8410 (not a toll-free number).

Part IV. Items of General Interest

Reporting Requirements for Section 527 Organizations

Announcement 2000–72

The Internal Revenue Service is considering the issuance of a revenue ruling addressing questions concerning the reporting requirements for political organizations described in § 527 of the Internal Revenue Code.

BACKGROUND

On July 1, 2000, Pub. L. 106–230 was enacted, amending § 527 of the Code. The new law imposes three reporting and disclosure requirements on political organizations described in § 527: (1) an initial notice of status, (2) periodic reports of contributions and expenditures, and (3) annual returns.

The following proposed revenue ruling provides questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. Because the new law was effective upon enactment, § 527 organizations may rely upon this proposed revenue ruling until the revenue ruling is finalized and issued.

The Service is soliciting public comment on the proposed revenue ruling. The Service asks for comments not only on the questions and answers posed in the proposed revenue ruling, but also on other questions concerning the reporting requirements for § 527 organizations.

Public comments should be submitted in writing on or before September 8, 2000. The Service plans to finalize the revenue ruling as soon as possible after this date. Comments should be sent to the following address:

Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224
Attn: Judith E. Kindell
T:EO:RA:T:P, Room 6033

Comments may also be sent electronically via the Internet to *TE/GE-Exempt-1@irs.gov.

DRAFTING INFORMATION

The principal author of this announcement is Judith E. Kindell of the Exempt Organizations Technical Division. For further information regarding this announcement contact Judith E. Kindell on (202) 622-6494 (not a toll-free call).

PROPOSED REVENUE RULING ISSUES

On July 1, 2000, Pub. L. 106-230 was enacted, amending § 527 of the Code. The new law imposes three reporting and disclosure requirements on political organizations described in § 527: (1) an initial notice of status, (2) periodic reports of contributions and expenditures, and (3) annual returns. This revenue ruling provides questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527.

QUESTIONS AND ANSWERS

I. *Notice of Status*

1. Q. What is the notice of status requirement for an organization described in § 527?

A. Under § 527(i)(1)(A), a political organization is required to give notice both electronically and in writing to the Service that it is a political organization described in § 527.

2. Q. What is the required notice form?

A. The required notice form is Form 8871, Political Organization Notice of Section 527 Status.

3. Q. Are all political organizations required to file the Form 8871 notice?

A. No. Under § 527(i)(5) and § 527(i)(6), three types of organizations are not required to file the Form 8871 notice:

(a) Persons required to report under the Federal Election Campaign Act of 1971 (FECA) as a political committee (see 2 U.S.C. § 431(4));

(b) Organizations that reasonably anticipate that their annual gross receipts will always be less than $25,000; and

(c) Organizations described in § 501(c) that are subject to § 527(f)(1) because they have made an "exempt function" expenditure.

All other political organizations, including state and local candidate committees, are required to file the notice.

4. Q. Is an organization that finances both federal and non-federal election activity required to file the Form 8871 notice?

A. As a general rule, any political organization (whether or not separately incorporated) that is organized and operated for an exempt function under § 527(e)(2) (see Q&A-15) must file Form 8871 unless it meets one of the exceptions discussed above (see Q&A-3), one of which is being required to report under FECA as a political committee. An organization that finances election activity (within the meaning of FECA) for both federal and non-federal elections may establish a political committee to receive contributions and make expenditures for both federal and non-federal election activity. In that case, the organization must register as a political committee and comply with the FECA contribution limitations and reporting requirements. 11 C.F.R. 102.5(a)(1)(ii). Such an organization is, therefore, not required to file Form 8871.

If, however, the organization sets up separate accounts to conduct its federal election activity and its non-federal election activity, the federal account is treated as a separate political committee that is required to register and report under FECA. 11 C.F.R. 102.5(a)(1)(i). The treatment of the federal account as a separate committee is consistent with the organizational requirements for political organizations under § 527, as discussed below in Q&A-10. Accordingly, the separate federal account is not required to file Form 8871. However, a separate non-federal account is not required to register and report under FECA as a political committee. Therefore, a separate non-federal account that is described in § 527(e)(1) is required to file Form 8871.

5. Q. Are political organizations that are required to report to state or local election agencies excepted from the notice requirement?

A. Section 527(i) does not except political organizations that file reports with state or local election agencies from the notice of status requirement. Therefore, unless the political organization meets one of the exceptions discussed above in Q&A-3, it must file Form 8871 with the Service.

6. Q. When must the organization file Form 8871?

A. Form 8871 must be filed within 24 hours after the date on which the organization was established. See Notice 2000–36, 2000–33 I.R.B. 173, for information about filing requirements for organizations in existence before July 30, 2000.

7. Q. What are the methods of filing Form 8871?

A. Section 527(i)(1)(A) requires that the organization file Form 8871 both electronically and in writing. Therefore, the methods for filing Form 8871 are as follows:

(a) Electronically via the Internal Revenue Service Internet Web Site (IRS Web Site) at www.irs.gov./bus_info/eo/pol-file.html, and

(b) In writing by sending a signed copy of Form 8871 to the Internal Revenue Service Center, Ogden, UT 84201. An organization can fill in and print out the form from the IRS Web Site.

8. Q. Must an organization take any additional steps before filing Form 8871?

A. Before filing Form 8871, the political organization must have its own employer identification number (EIN) even if it has no employees. To obtain an EIN, an organization must file Form SS-4, Application for Employer Identification Number, with the Service. The organization may obtain the EIN either by telephone or by mail. If the organization applies by telephone, it can obtain the EIN immediately.

9. Q. What information must be provided in the Form 8871 notice?

A. Under § 527(i)(3), an organization must provide in its Form 8871 notice its name and address (including any business address, if different) and electronic mailing address; its purpose; the names and addresses of its officers, highly compensated employees, contact person, custodian of records, and members of its Board of Directors; and the name and address of, and relationship to, any related entities (within the meaning of § 168(h)(4)).

10. Q. Does § 527(i) change the organizational requirements for § 527 organizations?

A. No. Section 527 does not require an organization to have formal organizational documents, such as articles of incorporation. Under § 1.527–2(a)(2) of the Income Tax Regulations, a political organization meets the organizational test if it is organized for the primary purpose of carrying on exempt function activities as defined in § 527. The regulation specifically states that the organization need not be formally chartered or established as a corporation, trust, or association. For example, a separate bank account in which political campaign funds are deposited and disbursed only for political campaign expenses can qualify as a political organization. See Rev. Rul. 79–11, 1979–1 C.B. 207.

The requirement that a § 527 organization include the names and addresses of its officers, highly compensated employees, and members of its Board of Directors does not change the organizational test for § 527. Section 527(i) does not require political organizations to be organized with Boards of Directors, officers and highly compensated employees. It merely requires the organization to provide their names and addresses if it is so organized.

11. Q. What is a "related entity" for this purpose?

A. An entity is a "related entity" within the meaning of § 168(h)(4), which provides that an organization is related to another entity as follows:

(a) The two entities have (i) significant common purposes and substantial common membership or (ii) directly or indirectly substantial common direction or control; or

(b) Either entity owns (directly or through one or more entities) a 50 percent or greater interest in the capital or profits of the other. For this purpose, entities treated as related entities under (a) above shall be treated as one entity.

12. Q. What are "highly compensated employees" for this purpose?

A. Highly compensated employees for this purpose are the five employees (other than officers and directors) who are expected to have the highest annual compensation over $50,000. Compensation includes both cash and noncash amounts, whether paid currently or deferred, for the 12-month period that began with the date the organization was formed (if the organization was formed after June 30, 2000). If the organization was already in existence on June 30, 2000, it must use the accounting period that includes July 1, 2000.

13. Q. What if an organization described in § 527(e)(1) does not file the Form 8871 notice?

A. An organization described in § 527(e)(1) must file Form 8871 unless it is an organization described in § 527(i)(5) or § 527(i)(6) (see Q&A-3). If the organization fails to file Form 8871 on a timely basis, § 527(i)(4) provides that, for any period during which the organization fails to satisfy the notice requirement, the taxable income of the organization includes its exempt function income (including contributions received, membership dues, and political fundraising receipts), minus any deductions directly connected with the production of that income. For purposes of computing its taxable income, the organization may not deduct its exempt function expenditures because § 162(e) denies a deduction for political campaign expenditures.

Under § 527(b), the tax is computed by multiplying the organization's taxable income (including its net investment income) by the highest corporate tax rate, currently 35 percent. The organization must file a Form 1120-POL to report the income and pay the tax.

14. Q. When is an organization described in § 527(e)(1)?

A. An organization is described in § 527(e)(1) if it meets both the organizational and operational tests, that is, it must be organized and operated primarily for the purpose of accepting contributions or making expenditures for an exempt function under § 527(e)(2). See § 1.527–2(a).

15. Q. What is an "exempt function" under § 527(e)(2)?

A. "Exempt function" means, under § 527(e)(2), influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

16. Q. Is the Form 8871 notice publicly available?

A. Yes. Under § 6104(d), Form 8871 (including any supporting papers), and any letter or other document the Service issues with regard to Form 8871, will be open to public inspection. Copies of

Form 8871 that have been filed are currently available at the IRS Web Site. In addition, the organization is required to make a copy of these materials available for public inspection during regular business hours at the organization's principal office and at each of its regional or district offices having at least three paid employees in the same manner as applications for exemption of § 501(c) organizations are made available.

17. Q. What is the penalty on the organization for failure to comply with the public inspection requirement?

A. Under § 6652(c)(1)(D), a penalty of $20 per day will be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues.

II. *Periodic Reporting Requirements*

18. Q. What are the periodic reporting requirements imposed upon political organizations?

A. Under § 527(j), a political organization is required to periodically report contributions to the organization and expenditures made by the organization.

19. Q. What is the required periodic reporting form?

A. The required periodic reporting form is Form 8872, Political Organization Report of Contributions and Expenditures.

20. Q. When are political organizations required to file periodic reports on Form 8872?

A. Under § 527(j)(2), political organizations that accept contributions or make expenditures for an exempt function under § 527 (see Q&A-15) during a calendar year are required to file periodic reports on Form 8872, beginning with the first month or quarter in which they accept contributions or make expenditures. In addition, organizations that make contributions or expenditures with respect to an election for federal office (as defined in § 527(j)(6)) may be required to file pre-election reports for that election.

21. Q. Are all political organizations required to file periodic reports on Form 8872?

A. No, § 527(j)(5) provides that some organizations are not subject to this requirement. The organizations excepted from the filing requirements are as follows:

a) Organizations excepted from the requirement to file a Form 8871 (see Q&A-3);
b) Political committees of a state or local candidate; and
c) State and local committees of political parties.

All other political organizations, including other state and local political organizations, are subject to the reporting requirements of § 527(j), even if they file reports with state or local election agencies.

22. Q. How often must the Form 8872 be filed?

A. Political organizations subject to the periodic reporting requirement may choose to file Form 8872 on a monthly basis or on a quarterly/semi-annual basis, but it must file on the same basis for the entire calendar year.

23. Q. When is Form 8872 due in a non-election year when organizations elect to file on a monthly basis?

A. Pursuant to § 527(j)(2)(B), political organizations that choose to file monthly must file Form 8872 reports not later than the 20th day after the end of the month, which must be complete as of the last day of the month. The monthly report for the December activity is included in the year-end report due not later than January 31 of the following year. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the report on the next business day.

24. Q. When is Form 8872 due during an election year when organizations elect to file on a monthly basis?

A. Pursuant to § 527(j)(2)(B), in any year in which a regularly scheduled general election is held, the organization shall not file the reports regularly due in November and December (i.e., the monthly reports for activity in October and November). Instead, the organization must file a Form 8872 report not later than 12 days before the general election (or 15 days before the general election if posted by registered or certified mail) that contains information through the 20th day before the general election. The organization must also file a report no more than 30 days after the general election which shall contain information through the 20th day after the election. The monthly report for the December activity is included in the year-end report due not later than January 31 of the following year. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the report on the next business day.

25. Q. When is Form 8872 due in a non-election year when organizations elect to file on a quarterly/semi-annual basis?

A. Pursuant to § 527(j)(2)(A), political organizations that choose not to file monthly must file semi-annual reports in non-election years. These reports are due not later than July 31 for the first half of the year and, for the second half of the year, not later than January 31 of the following year. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the report on the next business day.

26. Q. When is Form 8872 due during an election year when organizations elect to file on a quarterly/semi-annual basis?

A. Pursuant to § 527(j)(2)(A), in an election year, these organizations must file quarterly reports due not later than the 15th day after the last day of the quarter, except that the return for the final quarter shall be due not later than January 31 of the following year. In addition, the organization must file pre-election reports for any election for federal office with respect to which the organization makes a contribution or expenditure. These reports shall be filed not later than 12 days before the election (15 days before if posted by registered or certified mail) and must contain information through the 20th day before the election. The organizations must also file a post-general election report due not later than 30 days after the general election and containing information through the 20th day after the election. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the report on the next business day.

27. Q. What is an election for purposes of the reporting deadlines under § 527(j)?

A. For purposes of determining what is an election year and what elections trigger the pre-election and post-general election reports, § 527(j)(6) provides that an "election" is a general, special, primary, or runoff election for a federal office; a convention or caucus of a political party with authority to nominate a candidate for

federal office; a primary election to select delegates to a national nominating convention of a political party; or a primary election to express a preference for the nomination of individuals for election to the office of President. Thus, an election for purpose of these reporting deadlines does not include elections that are purely state or local elections. When an election involves both candidates for federal office and candidates for state or local offices, it is an election for purposes of the reporting deadlines, but only those organizations that make contributions or expenditures with respect to the candidates for federal office are required to file the pre-election reports for those elections under § 527(j)(2)(A)(i)(II). However, all reports filed under § 527(j) must contain information about the contributions and expenditures within the reporting period, regardless of whether they were accepted or made with respect to candidates for federal, state or local office.

28. Q. What is a general election?

A. A general election is either one of the following:

a) an election for federal office held in even numbered years on the Tuesday following the first Monday in November or

b) an election held to fill a vacancy in a federal office (i.e., a special election) that is intended to result in the final selection of a single individual to the office at stake. See 11 C.F.R. 100.2(b).

29. Q. How will "election" under § 527(j)(6) be interpreted?

A. The definition of "election" under § 527(j)(6) is virtually identical to the definition of "election" under FECA (2 U.S.C. § 431(1)). Organizations may rely on FEC interpretation of the FECA definition in the absence of further guidance from the Service. The FEC publishes reporting dates for pre-election reports on its Web Site at http://www.fec.gov/pages/refer.htm.

30. Q. What must the Form 8872 reports contain?

A. The reports must include the name, address, and (if an individual) the occupation and employer, of any person to whom expenditures are made that aggregate $500 or more in a calendar year and the amount of such expenditure. The reports must also include the name, address, and (if an individual) the occupation and employer, of any person that contributes in the aggregate $200 or more in a calendar year and the amount of such contribution. However, organizations are not required to report independent expenditures as defined in § 301 of FECA. Only expenditures made or contributions received after July 1, 2000, that are not made or received pursuant to binding contracts entered into before July 2, 2000, must be reported.

31. Q. What is an independent expenditure under § 301 of FECA?

A. An independent expenditure is an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate for federal office which is made without cooperation or consultation with any candidate for federal office, or any authorized committee or agent of such candidate, and which is not made in concert with, or at the request or suggestion of, any candidate for federal office, or authorized committee or agent of such candidate. See 2 U.S.C. § 431(17).

32. Q. Where is the Form 8872 filed?

A. The report is filed by sending a signed copy of Form 8872 to the Internal Revenue Service Center, Ogden, UT 84201. The form must be signed by an official authorized by the organization to sign the report.

33. Q. What if a political organization does not file the required Form 8872?

A. Under § 527(j)(1), a political organization that does not file the required Form 8872 or which fails to include the information required on the Form 8872 is subject to a tax equal to the amount not disclosed multiplied by the highest corporate tax rate, currently 35 percent.

34. A. Is the Form 8872 filed by political organizations publicly available?

A. Yes. Under § 6104(b) and § 6104(d)(6), Form 8872 will be made available for public inspection by the Service. In addition, under § 6104(d)(1)(A), the organization is required to make a copy of these reports available for public inspection during regular business hours at the organization's principal office and at each of its regional or district offices having at least three paid employees in the same manner as applications for exemption of § 501(c) organizations are made available. Pursuant to § 6104(b) and § 6104(d)(3)(A), contributor information must be disclosed to the public.

35. Q. What if the political organization does not make its Form 8872 publicly available?

A. Under § 6652(c)(1)(C), a penalty of $20 per day will be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one report is $10,000.

III. *Annual Return Requirements*

36. Q. What political organizations are required to file annual income tax returns?

A. Political organizations that have taxable income in excess of the $100 specific deduction allowed under § 527 are required to file an annual income tax return, the Form 1120-POL. In addition, for taxable years beginning after June 30, 2000, political organizations that have $25,000 or more in gross receipts for the taxable year are also required to file the Form 1120-POL, without regard to whether they have taxable income.

37. Q. When is the Form 1120-POL due?

A. The Form 1120-POL is due on or before the 15th day of the third month after the close of the organization's taxable year. § 6072(b). Thus, for a calendar year taxpayer, Form 1120-POL is due on March 15 of the following year. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the return on the next business day.

38. Q. What political organizations are required to file an annual information return?

A. Political organizations that are required under § 6012(a)(6) to file an income tax return are also required to file Form 990 for taxable years beginning after June 30, 2000. § 6033(g). Organizations with gross receipts less than $100,000 and assets of less than $250,000 may file Form 990-EZ. Organizations with gross receipts of less than $25,000 are not required to file Form 990 or Form 990-EZ.

39. Q. When is the Form 990 due?

A. The Form 990 (or Form 990-EZ) is due on or before the 15th day of the fifth month after the close of the organization's taxable year. Thus, for a calendar year

taxpayer, Form 990 is due on May 15 of the following year. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the return on the next business day.

40. Q. What if the political organization fails to file Form 1120-POL or Form 990?

A. A political organization that fails to file a required Form 1120-POL or Form 900 or fails to include required information on those returns is subject to a penalty of $20 per day for every day such failure continues. The maximum penalty imposed regarding any one return is the lesser of $10,000 or 5 percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding $1,000,000 for any year, the penalty is increased to $100 per day with a maximum penalty of $50,000. § 6652(c)(1)(A).

41. Q. Are the Form 1120-POL and Form 990 filed by political organizations publicly available?

A. Yes, the Form 1120-POL and the Form 990 filed for taxable years beginning after June 30, 2000 will be made available for public inspection by the Service. § 6104(b). The political organization must make a copy of its returns available for public inspection during regular business hours at its principal office and any regional or district offices having three employees or more in the same manner as annual information returns of § 501(c) organizations are made available. It must also provide a copy of the returns to any person requesting a copy in person or in writing without charge other than a reasonable charge for reproduction and postage in the same manner that § 501(c) organizations provide copies of their annual returns. § 6104(d)(1). If an organization's returns are widely available under § 301.6104(d)–3 of the Procedure and Administration Regulations (such as on the Internet), the organization need not respond to requests for copies. Returns only need to be made available for three years after filing. § 6104(d)(2). Contributor information must be disclosed to the public. § 6104(d)(3)(A).

42. Q. What if the political organization does not make its Form 1120-POL and Form 990 publicly available?

A. A penalty of $20 per day will be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one report is $10,000. § 6652(c)-(1)(C).

IV. *General*

43. Q. Where can organizations get copies of the various forms?

A. The various forms (Form 8871, Form 8872, Form 1120-POL, and Form 990) and their instructions are available by calling 1-800-TAX-FORM (1-800-829-3676) or via the Internet at the IRS Web Site at www.irs.gov in the "Forms and Publications" section. For more information, organizations may call the Customer Service Center at 1-877-829-5500.

Consolidated Returns—Limitations on the Use of Certain Credits; Correction

Announcement 2000–73

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains a correction to final regulations (T.D. 8884, 2000–24 I.R.B. 1250) that were published in the Federal Register on Thursday, May 25, 2000 (65 F.R. 33753) relating to consolidated returns-limitations on the use of certain credits.

DATES: This correction is effective May 25, 2000.

FOR FURTHER INFORMATION CONTACT: Marie C. Milnes-Vasquez (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are the subject of this correction are under section 1502 of the Internal Revenue Code.

Need for Correction

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

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 8884), that were the subject of F.R. Doc. 00-11901, is corrected as follows:

§1.1502–3 [Corrected]

On page 33758, column 1, §1.1502–3(d)(5), paragraph (iv) of the *Example*, line 6 from the bottom of the paragraph, the language "contributions to the consolidated section" is corrected to read "contribution to the consolidated section".

LaNita Van Dyke,
Acting Chief, Regulations Unit
Office of Special Counsel
(Modernization and Strategic Planning).

(Filed by the Office of the Federal Register on August 7, 2000, 8:45 a.m., and published in the issue of the Federal Register for August 8, 2000, 65 F.R. 48379)

New Technologies in Retirement Plans; Correction

Announcement 2000–74

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations, (T.D. 8873, 2000–9 I.R.B. 713) which were published in the Federal Register Tuesday, February 8, 2000 (65 F.R. 6001), relating to amendments to the regulations governing certain notices and consents required in connection with distributions from retirement plans.

DATES: This correction is effective February 8, 2000.

FOR FURTHER INFORMATION CONTACT: Catherine Livingston Fernandez at (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under sections 402(f), 411(a)(11) and 3405(e)(10)(B) of the Internal Revenue Code.

Need for Correction

As published, the final regulations (T.D. 8873) 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. 8873), which were the subject of F.R. Doc. 00-1897, is corrected as follows:

1. On page 6004, column 2, line 24 from the top of the column, the language "I.R.B.) provides that, pending" is corrected to read "I.R.B. 413) provides that, pending".

Sec. 35.3405–1 [Corrected]

2. On page 6008, column 1, Sec. 35.3405–1 d-35, lines 4 and 5 of A, the language, "and the annual notice described in d-31) to a payee either on a written paper" is corrected to read "of Sec. 35.3405–1T and the annual notice described in d-31 of Sec. 35.3405–1T) to a payee either on a written paper".

3. On page 6008, column 2, Sec. 35.3405–1 d-36 A., the first line of Example 5, the language, "Example 5. (I) Same facts as Example 1," is corrected to read "Example 5. (i) Same facts as Example 1,".

4. On page 6008, column 2, Sec. 35.3405–1 d-36A., the first line of Example 5 (ii), the language, "(ii) In this Example 5, Plan A does not" is corrected to read "(ii) In this Example 5, the plan administrator does not".

Sec. 602.101 [Corrected]

5. On page 6008, column 3, instructional Par. 7. and the table in Sec. 602.101(b) are corrected to read as follows:

Par. 7. In Sec. 602.101, paragraph (b) is amended by revising the entries for 1.402(f)–1 and 1.411(a)–11 in the table to read as follows:

Sec. 602.101 OMB Control numbers.

* * * * *

(b) * * *

Dale D. Goode,
Federal Register Liaison,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on March 30, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 31, 2000, 65 F.R. 17148)

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.402(f)–1	1545-1341
	1545-1632
* * * * *	
1.411(a)–11	1545-1471
	1545-1632
* * * * *	

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Stoppenhagen, Larry	Ft. Wayne, IN	CPA	April 14, 2000 to April 13, 2001
Chon, James	N. Hollywood, CA	CPA	May 22, 2000 to May 21, 2003
Bleyer, Stephen A.	Bala Cynwyd, PA	CPA	June 26, 2000 to December 25, 2000
Knutson, Owen	Ouray, CO	CPA	July 3, 2000 to January 2, 2003
Silverman, Richard E.	Fayetteville, NY	CPA	August 1, 2000 to March 31, 2004
Holt, Jeffrey	Little Rock, AR	Enrolled Agent	October 1, 2000 to March 31, 2003
Barbagallo, Joseph	Newton, PA	CPA	October 15, 2000 to October 14, 2004

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Luebben, William	Hot Springs, AR	CPA	February 11, 2000

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organization listed below has recently filed a timely declaratory judgment suit under section 7428 of the Code, challenging revocation of its status as an eligible donee 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.

Living Truth Ministries
Austin, TX

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 September 2000. See Rev. Rul. 2000–41, page 248.

Section 61.—Gross Income

26 CFR 1.61–12: Income from discharge of indebtedness.

This revenue procedure provides guidance on whether an acquisition of corporate debt by a beneficiary of the decedent creditor's estate or by a beneficiary of a revocable trust that became irrevocable upon the creditor's death is a direct acquisition within the meaning of § 1.108–2(b) of the Regulations. See §§ 1.61–12(a), 1.108–2(a) and 1.108–2(b) regarding income from the discharge of indebtedness by a person related to the debtor, and certain exceptions that may be provided by Revenue Procedure or other published guidance.

See Rev. Proc. 2000–33, page 257.

Section 108.—Income From Discharge of Indebtedness

26 CFR 1.108–2: Acquisition of indebtedness by a person related to the debtor.

This revenue procedure provides guidance on whether an acquisition of corporate debt by a beneficiary of the decedent creditor's estate or by a beneficiary of a revocable trust that became irrevocable upon the creditor's death is a direct acquisition within the meaning of § 1.108–2(b) of the regulations. See §§ 1.61–12(a), 1.108–2(a) and 1.108–2(b) regarding income from the discharge of indebtedness by a person related to the debtor, and certain exceptions that may be provided by Revenue Procedure or other published guidance.

See Rev. Proc. 2000–33, page 257.

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

26 CFR 1.263A–4: Rules for property produced in a farming business.

T.D. 8897

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Rules for Property Produced in a Farming Business

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the application of section 263A of the Internal Revenue Code to property produced in the trade or business of farming. These regulations also provide guidance regarding the election available to certain taxpayers to not have section 263A apply to any plant produced by the electing taxpayers in each taxpayer's farming trade or business. These regulations affect taxpayers engaged in the trade or business of farming.

DATES: *Effective Date*: These regulations are effective August 21, 2000.

Applicability Date: For dates of applicability, see §1.263A–4(f) of these regulations.

FOR FURTHER INFORMATION CONTACT: Grant D. Anderson, (202) 622-4970 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

On March 30, 1987, the IRS published in the **Federal Register** a notice of proposed rulemaking (LR–168–86, 1987–1 C.B. 808 [52 F.R. 10118]) by cross reference to temporary regulations published the same day (T.D. 8131, 1987–1 C.B. 98 [52 F.R. 10052]). Amendments to the notice of proposed rulemaking and temporary regulations were published in the **Federal Register** on August 7, 1987, by a notice of proposed rulemaking (LR–37–87, 1987–2 C.B. 1054 [52 F.R. 29391]) that cross referenced to temporary regulations published the same day (T.D. 8148, 1987–2 C.B. 70 [52 F.R. 29375]). Notice 88–24 (1988–1 C.B. 491) provided that forthcoming regulations would modify the proposed regulations and the regulations under §1.471–6. Notice 88–86 (1988–2 C.B. 401) provided that forthcoming regulations would clarify the definition of *members of family* for purposes of the election out of section 263A. In addition, Notice 88–86 provided that forthcoming regulations would provide that certain taxpayers could elect to use the simplified production method for property used in the trade or business of farming. On August 5, 1994, the temporary regulations relating to property produced in a farming business were reissued and published in the **Federal Register** (T.D. 8559, 1994–2 C.B. 32 [59 F.R. 39958]). On August 22, 1997, proposed and revised temporary regulations were issued and published in the **Federal Register** (T.D. 8729, 1997–2 C.B. 35 [62 F.R. 44542]). A public hearing was held on November 19, 1997.

Written comments responding to the notice of proposed rulemaking were received. After consideration of all the public comments, the regulations are adopted as revised by this Treasury decision and the corresponding temporary regulations are withdrawn.

Explanation of Provisions and Summary of Comments

Section 263A provides uniform capitalization rules that govern the treatment of costs incurred in the production of property or the acquisition of property for resale. Section 263A generally requires taxpayers to capitalize the direct costs and an allocable portion of indirect costs of producing property in a farming business (including both plants and animals). However, taxpayers that are neither required to use an accrual method by section 447 nor prohibited by section 448(a)(3) from using the cash receipts and disbursements method (qualified taxpayers) are eligible for two exceptions provided in section 263A(d). First, under section 263A(d)(1), section 263A does not apply to a qualified taxpayer's cost of producing plants with a preproductive period of two years or less or animals in a farming business. Second, pursuant to section 263A(d)(3), a qualified taxpayer may elect to have section 263A not apply to the cost of producing plants in a farming business.

Property Produced in a Farming Business

Consistent with sections 263A(d)(1)(A) and 263A(d)(3)(A), the proposed regulations provided that the special rules of section 263A(d) apply only to property produced by a taxpayer in a farming business. The term *farming business* means the cultivation of land or the raising or harvesting

of any agricultural or horticultural commodity. Examples include operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the raising of ornamental trees (other than evergreen trees that are more than 6 years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals.

The proposed regulations explained that taxpayers engaged in contract harvesting, reselling of plants or animals that are not produced by the taxpayer, and processing that is not incident to growing, raising, or harvesting of agricultural or horticultural commodities, are not producing property in a farming business. Several commentators requested that the final regulations permit some of these taxpayers to use the special rules of section 263A(d). However, sections 263A(d)(1)(A) and 263A(d)(3)(A) limit the special rules of section 263A(d) to property *produced* by the taxpayer in a farming business. As discussed below, the IRS and Treasury Department continue to believe that taxpayers that merely contract harvest, resell plants or animals that they do not raise or grow, or engage in processing agricultural or horticultural commodities that is not incident to growing, raising, or harvesting of these commodities, are not producing property in a farming business and therefore do not meet this requirement. Accordingly, the final regulations do not adopt these suggestions.

The proposed regulations provided that, for purposes of the definition of farming business, harvesting, does not include contract harvesting of an agricultural or horticultural commodity that is not grown or raised by the taxpayer. Some commentators were concerned that this language may be used to disqualify otherwise legitimate farmers who make arrangements with their neighbors to harvest each others crops. First, the IRS and Treasury Department believe that whether and to what extent a taxpayer is engaged in a farming business is to be determined based on all the facts and circumstances. No inference is intended that merely because a taxpayer engages in nonfarm activities, such as contract harvesting, in addition to farm activities, that such taxpayer is not engaged in a farming business. Further, the exception under section 263A(d) is relevant only to taxpayers whose costs are otherwise subject to capitalization under section 263A. Thus, for example, while taxpayers that grow plants are generally subject to section 263A with respect to that production activity, taxpayers that contract harvest horticultural commodities are not, because they are engaged in a service activity. A taxpayer that harvests crops grown by the taxpayer and contract harvests crops grown by another is subject to section 263A (and the exception contained in section 263A(d)), but only for the costs of harvesting its own crops. Accordingly, the final regulations do not adopt the commentators' suggestion to include contract harvesting in the special rules of section 263A(d).

Similarly, the proposed regulations provided that the special rules of section 263A(d) do not apply to a taxpayer that merely buys and resells plants or animals grown or raised by another taxpayer. The preamble to the proposed regulations indicated that in evaluating whether the taxpayer is engaged in the production, or merely the resale, of plants or animals, it is anticipated that consideration will be given to factors including: the length of time between the taxpayer's acquisition of a plant or animal and the time the plant or animal is made available for sale to the taxpayer's customers, and, in the case of plants, whether plants acquired by the taxpayer are planted in the ground or kept in temporary containers.

Many commentators expressed concern that the proposed regulations' concept of "merely buying and reselling plants grown by another" could be interpreted to mean that only taxpayers growing a plant from seed would be regarded as engaged in a farming business. For example, the commentators were concerned that a taxpayer that buys a partially grown plant, grows the plant to a larger size, and then sells the plant would not be engaged in a farming business. The final regulations clarify that a taxpayer is engaged in the production of property in a farming business, rather than the mere resale of plants or animals, if the plant or animal is held for further cultivation and development prior to sale. In addition, the final regulations include an example illustrating that a taxpayer that buys plants, grows them, and sells them, is producing property in a farming business; whereas a taxpayer that buys plants and, without further cultivation and development, resells them is not producing property in a farming business. The example also illustrates that a taxpayer engaged in both farming activities and resale activities is not required to capitalize costs under section 263A with respect to the resale activities if the taxpayer has average annual gross receipts of less than $10 million. See also, Ann. 97–120 (1997–50 I.R.B. 61) (confirming that nursery growers using the farming exception may deduct the costs of young plants purchased for further development and cultivation prior to sale as well as the costs of growing the plants).

Some commentators suggested that the final regulations disregard whether a plant is kept in its container out of concern that taxpayers who grow plants in containers would not be considered to be producing property in a farming business. The IRS and Treasury Department continue to believe that this is a factor to be considered in addition to all the other facts and circumstances. Accordingly, the final regulations retain this factor. However, the final regulations have been clarified to explain that a plant that is *grown* by a taxpayer in a container is regarded as a plant produced in a farming business.

One commentator requested that the value added to a plant or animal by a taxpayer also be a factor in determining whether a taxpayer is engaged in the production, or the mere resale, of plants or animals. The final regulations provide that a taxpayer's addition of value to plants or animals through agricultural or horticultural processes is a factor to be considered in evaluating whether a taxpayer is producing property in a farming business.

Some commentators requested that the list of factors contained in the preamble be included in the regulations. In response to these comments, the final regulations contain a list of factors, modified as discussed above, to assist in the determination of whether a plant or animal is held for further cultivation and development prior to sale or merely held for resale.

One commentator expressed concern that under the proposed regulations a farming business only includes processing activities that are normally incident to the growing, raising, or harvesting of

agricultural or horticultural commodities. This commentator also suggested that farmers are engaging in processing activities as the result of new technology and changes in the market for agricultural or horticultural products. The IRS and Treasury Department believe that processing activities that are not normally incident to the growing, raising, or harvesting of agricultural or horticultural products, such as the canning of an agricultural product or the combination of an agricultural product with other ingredients to produce a different edible item, are not farming activities. Accordingly, the final regulations, like the proposed regulations, include in the definition of farming business only those processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products, such as the washing, inspecting, and packaging of those products.

Exceptions to Section 263A for Certain Property

Taxpayers generally must capitalize direct costs and an allocable portion of indirect costs of producing all plants (without regard to the length of the preproductive period) and animals. Qualified taxpayers, however, are eligible for an exception to this general rule. Under this exception, qualified taxpayers are not required to capitalize under section 263A the costs of producing plants that have a preproductive period of 2 years or less or with respect to animals. Thus, under this exception, qualified taxpayers are required to capitalize only those costs of producing plants that have a preproductive period in excess of 2 years.

A few commentators suggested that, for purposes of determining the application of section 263A, the preproductive period of a plant should be determined with reference to the length of time a particular taxpayer grows a plant rather than with reference to how long it takes the plant to reach a productive stage. The commentators suggested this method would, in essence, supplant the nationwide weighted average preproductive period used for plants grown in commercial quantities in the United States and the reasonable estimate of the preproductive period used for all other plants. For example, a qualified taxpayer grows bushes that have a preproductive period of 3 years and 3 months. If the taxpayer purchases and plants the bushes when they are 2 years old, the commentators suggest that the preproductive period of the bushes should be regarded as 2 years or less (and the taxpayer would, therefore, not be required to capitalize the costs associated with growing the bushes) because this taxpayer grows the bushes for only 15 months before the bushes become productive in marketable quantities. If, however, another qualified taxpayer purchased the same type of bushes when the bushes were 14 months old and grew them for 2 years and 1 month, the preproductive period of the bushes would be regarded as in excess of 2 years, and this taxpayer would be required to capitalize the costs of growing the bushes.

The final regulations do not adopt this recommendation. First, the statute requires that the preproductive period of a plant grown in commercial quantities in the United States be based on the nationwide weighted average preproductive period of the plant. *See Pelaez and Sons, Inc., et al. v. Commissioner*, 114 T.C. No. 28 (No. 18049–97 May 30, 2000). Further, the IRS and Treasury Department continue to believe that, for purposes of determining whether section 263A applies, the preproductive period of a plant not grown in commercial quantities in the United States also should be determined on a plant-by-plant basis rather than on a taxpayer-by-taxpayer basis.

In the case of a plant that is not produced in commercial quantities in the United States, the proposed regulations provided that, at or before the time the seed or plant is acquired or planted, the taxpayer is required to reasonably estimate whether the plant has a preproductive period in excess of 2 years. One commentator suggested that the regulations provide that if the United States Department of Agriculture (USDA) or a state department of agriculture certifies that a plant is not grown in commercial quantities in the United States, the plant will be deemed to have a preproductive period of 2 years or less. The effect of this suggestion would be to provide an exemption from section 263A for all qualified taxpayers growing plants that are not grown in commercial quantities in the United States. The IRS and Treasury Department believe that such a rule would be inconsistent with the statutory language of section 263A. Accordingly, the final regulations do not adopt this suggestion.

The proposed regulations provided that, for purposes of determining whether a plant has a preproductive period in excess of 2 years, in the case of a plant grown in commercial quantities in the United States, the nationwide weighted average preproductive period of such plant is used. One commentator requested that a list of plants with nationwide weighted average preproductive periods in excess of 2 years be published and kept current as needed. Notice 2000–45, page 256, issued contemporaneously with the publication of these final regulations, provides a list of plants grown in commercial quantities in the United States that have a nationwide weighted average preproductive period in excess of 2 years. Notice 2000–45 will be modified and superseded as needed.

Tax shelters, within the meaning of section 448(a)(3), are not qualified taxpayers and are therefore not eligible for the special rules of section 263A(d). A tax shelter, for purposes of section 448(a)(3), means a farming business that is a farming syndicate as defined under section 464(c) or any partnership, entity, plan or arrangement that is a tax shelter within the meaning of section 6662(d)(2)(C)(iii) (that is, its principal purpose is to avoid or evade Federal income tax). See §1.448–1T(b)(1)(iii). There is a presumption under section 448 that marketed arrangements, in which persons carry on farming activities using the services of a common managerial or administrative service, will fall within the meaning of a tax shelter if a substantial portion of farming expenses are prepaid with borrowed funds. See §1.448–1T(b)(4). The proposed regulations repeated the text of §1.448–1T(b)(1)(iii) and (4) to explain which farming businesses are tax shelters.

A commentator suggested that the marketed arrangement presumption set forth in §1.448–1T(b)(4) and the proposed regulations is too broad in scope and should be modified. The commentator is concerned that this provision of the regulations will cause taxpayers participating in farming cooperatives to be treated as tax shelters and, therefore, require them to use an accrual method of accounting and

to capitalize the direct costs and an allocable portion of indirect costs of producing all plants and animals. The commentator explained that such a result is unwarranted with respect to individual farmers and farming businesses that join together to form farming cooperatives for non-tax reasons, such as to obtain supplies at lower prices and have a steady market for their farm products.

The IRS and Treasury Department believe that the marketed arrangement presumption is necessary to preclude taxpayers from investing in farming operations in order to generate losses, often without making economic outlays, that may be used to shelter income from other sources. However, the IRS and Treasury Department do not believe that the marketed arrangement presumption, as described in the temporary Income Tax Regulations under section 448 and the proposed section 263A regulations, would cause a taxpayer producing property in a farming business to be regarded as a tax shelter merely because the taxpayer joined a farming cooperative. Therefore, the marketed arrangement presumption is not modified in the final regulations.

Preparatory and Preproductive Period Costs

The IRS and Treasury Department believe that, in general, section 263A does not change the rules under section 263 regarding the need to capitalize preparatory costs (that is, costs incurred prior to raising agricultural or horticultural commodities or that otherwise enable a farmer to begin the farming process). Thus, the proposed regulations clarified that, as under prior law, taxpayers generally must capitalize preparatory expenditures (for example, the cost of seeds, seedlings, and animals; clearing, leveling and grading land; drilling and equipping wells; irrigation systems; budding trees, *etc.*). However, because section 263A requires the capitalization of certain additional costs, the amount of preparatory expenditures capitalized to property that is subject to section 263A may be greater than under prior law. By requiring the capitalization of all the direct costs and the allocable portion of indirect costs incurred during the preparatory period, section 263A ensures that the income from farming will be appropriately matched with all of the costs of producing property in a farming business.

Section 263A expanded the circumstances under which costs that were once termed *developmental expenditures* or *cultural practices expenditures* (that is, costs incurred by a taxpayer so that the growing process can continue in the desired manner) must be capitalized. The proposed regulations clarified that these costs are included in the category of preproductive period costs that are required to be capitalized under section 263A. Thus, the proposed regulations provided that all appropriate costs incurred during the preproductive period of property subject to section 263A must be capitalized, including the costs of certain soil and water conservation expenditures and fertilizing incurred during the preproductive period.

One commentator requested that expenditures for soil and water conservation, described in section 175, and fertilizer, described in section 180, be excepted from capitalization under section 263A. However, the legislative history of former section 447(b) indicates that Congress believed that soil and water conservation expenditures incurred during the preproductive period were required to be capitalized into the basis of the plants produced. See H.R. Rep. No. 658, 94th Cong., 1st Sess. 95 (1975), 1976–3 (Vol. 2) C.B. 787. See also, Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, H.R. Rep. No. 10612, 94th Cong., 2nd Sess. 55 (1976), 1976–3 (Vol. 2) C.B. 67. In addition, the legislative history to section 464 indicates that Congress believed that the costs of fertilizer incurred during the preproductive period was capitalized under former section 278. See Senate Report No. 938, 94th Cong., 2nd Sess. 62 (1976), 1976–3 (Vol. 3) C.B. 100. See also, Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, H.R. Rep. No. 10612, 94th Cong., 2nd Sess. 49 (1976), 1976–3 (Vol. 2) C.B. 61. Because section 263A was intended to continue the principles of sections 447 and 278, the IRS and Treasury Department believe that expenditures for soil and water conservation and fertilizer incurred during the preproductive period are costs of producing those plants. Further, the IRS and Treasury Department believe that providing a single rule regarding when expenditures for soil and water conservation and fertilizer incurred during the preproductive period must be capitalized is consistent with the intent of Congress to provide uniform capitalization rules. Accordingly, the final regulations retain the proposed regulations' provision that these costs incurred during the preproductive period are included in the category of costs that are required to be capitalized under section 263A. However, the IRS and Treasury Department do not believe that Congress intended to require capitalization of expenditures for soil and water conservation deductible under section 175 and fertilizer deductible under section 180 that are not incurred during the preproductive period. Accordingly, the final regulations clarify that these expenditures are not subject to capitalization under section 263A except to the extent they are required to be capitalized as a preproductive period cost.

Capitalization Period

Preproductive period costs (for example, irrigating, fertilizing, real estate taxes) are capitalized during the actual preproductive period of a plant or animal. A taxpayer that grows a plant that will have more than 1 crop or yield is engaged in the production of two types of property, the plant and the crop or yield of the plant (for example, the orange tree and the orange). The proposed regulations clarified the capitalization period for plants that will have more than 1 crop or yield, for crops or yields of plants that will have more than 1 crop or yield, and for other plants.

The proposed regulations provided that the preproductive period of a plant generally begins when a taxpayer first incurs costs with respect to the plant, for example, when the plant is acquired or the seed is planted. In the case of crops or yields of a plant that has more than 1 crop or yield, the preproductive period of the crop or yield begins when the plant has become productive in marketable quantities and the crop or yield first appears, whether in the form of a sprout, bloom, blossom, bud, *etc.*

One commentator suggested that the preproductive period for crops or yields that require several years of growth (for example, biennial crops) begins upon first appearance of the crop in the year the

crop actually develops. For example, a biennial plant produces fruit buds in the first year, but the buds do not develop until the second year. In the second year, the plant produces blossoms, which subsequently grow into an edible food product that is harvested and sold in that year. However, if weather conditions are harsh, the buds produced in the first year may not blossom and develop in the second year. The commentator suggests that the preproductive period begin not when the buds first appear in the first year but when the blossoms appear in the second year as that is the first sign of actual development. The IRS and Treasury Department are concerned that the suggested rule would be difficult to apply because a taxpayer may not know in any case whether the appearance of a crop will actually develop. Accordingly, the final regulations do not adopt this suggestion.

In the case of a plant that will have more than 1 crop or yield, the preproductive period of the plant ends when the plant becomes productive in marketable quantities. In the case of the crop or yield of a plant that has more than 1 crop or yield that has become productive in marketable quantities, the preproductive period of the crop or yield ends when the crop or yield is disposed of. Finally, in the case of other plants, the preproductive period ends when the plant is disposed of.

One commentator requested that the proper tax treatment of field costs (such as the costs of irrigating, fertilizing, *etc.*) that are incurred after a crop or yield is harvested but before the crop or yield is disposed of, which do not benefit and are unrelated to the crop or yield that has been harvested, be clarified. The commentator is concerned that the proposed regulations subject such field costs to capitalization under the general principles of section 263A. The IRS and Treasury Department agree with the commentator's concerns. Accordingly, the final regulations provide that field costs incurred after a crop or yield is harvested but before the crop or yield is disposed of do not have to be capitalized to the harvested crop or yield because such costs relate to the plant or a future crop or yield rather than to the harvested crop or yield.

One commentator requested that the definition of when a plant that will have more than 1 crop or yield becomes productive in marketable quantities be clarified. Under the proposed regulations such a plant becomes productive in marketable quantities when it is (or would be considered) placed in service for purposes of section 168 (without regard to the applicable convention). The commentator noted that some taxpayers regard a plant as being placed in service for purposes of depreciation at the time the preproductive period ends for purposes of section 263A. The commentator requested that the final regulations adopt a rule that provides more guidance with respect to the end of the preproductive period.

The IRS and Treasury Department agree with the commentator's concerns. Accordingly, the final regulations provide that a plant becomes productive in marketable quantities once a crop or yield is produced in sufficient quantities to be harvested and marketed in the ordinary course of the taxpayer's business. Factors that are relevant in determining whether the crop or yield is produced in sufficient quantities to be harvested and marketed in the ordinary course include: whether a crop or yield is harvested that is more than *de minimis*, although it may be less than expected at the maximum bearing stage, based on a comparison of the quantities per acre harvested in the year in question to the quantities per acre expected to be harvested when the plant reaches full maturity; and whether the sales proceeds exceed the costs of harvest and make a reasonable contribution to an allocable share of farm expenses.

Election not to Capitalize Costs

Qualified taxpayers may elect not to capitalize under section 263A the costs of producing certain plants even though such plants have a preproductive period in excess of 2 years and would otherwise be subject to the capitalization requirements of section 263A. Taxpayers making this election may continue to deduct (subject to other limitations of the Internal Revenue Code) the costs that were deductible under the rules in effect before the enactment of section 263A.

A taxpayer may make this election automatically on its original federal income tax return for the first taxable year in which the taxpayer would otherwise be required to capitalize costs under section 263A. The final regulations provide that if a taxpayer does not make this election in this first taxable year, the taxpayer may make this election by filing Form 3115, "Application for Change in Accounting Method," using the appropriate procedures that govern the filing of the Form 3115.

A taxpayer and any person related to the taxpayer (including a member of the taxpayer's family) electing to not capitalize costs under section 263A for certain plants are required to use the alternative depreciation system of section 168(g)(2) for any property used predominantly in a farming business that is placed in service in a taxable year for which the election is in effect. In Notice 88–86, the IRS noted that commentators had suggested that guidance be provided clarifying the definition of members of a family. This guidance was provided in the proposed regulations. One commentator suggested that this proposed guidance be modified so that elections made by some family members do not bind other family members. The statutory language provides that an election affects family members and defines family members for this purpose. Thus, the IRS and Treasury Department believe that Congress's intent was to bind all family members when one member makes an election not to capitalize costs under section 263A. Accordingly, the final regulations do not adopt the suggestion.

Casualty Loss Exception

Section 263A(d)(2) provides an exception from capitalization under section 263A for costs incurred with respect to plants that are replacing certain plants that were lost by reason of certain casualties. The proposed regulations clarified that this exception does not apply to preparatory expenditures or the costs of capital assets. In addition, the regulations clarified that the casualty loss exception applies whether the plants are replanted on the same parcel of land as the plants destroyed by casualty or a parcel of land of the same acreage in the United States. The regulations additionally clarified that the exception applies to all plants replanted on such acreage, even if the plants are replanted in greater density than the plants destroyed by the casualty.

One commentator requested that the casualty loss exception be expanded to allow a current deduction for the expendi-

tures incurred for replacing capital assets. The final regulations do not adopt this recommendation. Prior to the enactment of section 263A, preparatory expenditures as well as acquisition costs incurred during the preparatory period were generally capitalized under section 263. Also, prior to the enactment of section 263A, certain preproductive period costs were capitalized under former sections 447(b) and 278. Former section 278(c) provided an exception to the capitalization of preproductive period costs where such costs were incurred to replant a grove, orchard, or vineyard which had been lost or destroyed by reason of a casualty. However, this exception only applied to preproductive period costs capitalized under former section 278 and did not apply to preparatory expenditures and acquisition costs capitalized under section 263. The special exception in section 263A(d)(2) was intended to be a continuation, as modified to include all plants bearing an edible crop for human consumption, of the exception found in former section 278(c). Nothing in the statute or legislative history of section 263A indicates an intention to expand the exception to include other costs, such as the costs of replacing capital assets, in addition to the preproductive period costs.

Unit Livestock Price Method

The unit livestock price method provides for the valuation of different classes of animals in inventory at a standard unit price for each animal within a class. A taxpayer who elects to use the unit livestock price method must apply it to all livestock raised, whether for sale or for draft, breeding, or dairy purposes. In Notice 88–24, the IRS indicated that forthcoming regulations would modify the rule contained in §1.471–6 and require that taxpayers adjust the unit prices upward, from time to time as specified by those regulations, to reflect increases in costs taxpayers experience in raising livestock. Contemporaneous with the section 263A proposed regulations published August 22, 1997, §1.471–6 was modified to require a taxpayer to annually reevaluate the unit livestock prices and adjust the prices upward to reflect increases in the costs of raising livestock. Under this regulation, the consent of the Commissioner is not required to make such upward adjustments; however, consent is required to make any other change in animal classification or unit prices.

One commentator expressed concern that if taxpayers are required to annually reevaluate their unit prices, they should be able to both increase and decrease the unit price to reflect all changes in the cost of raising livestock. In addition, this commentator suggested that the unit livestock price method should be modified to allow a taxpayer to remove from inventory animals that have been raised for use in the taxpayer's trade or business (such as a breeding cow) and depreciate the inventory value of the animal.

Although these comments are outside the scope of this regulation, the IRS and Treasury Department understand the commentator's concerns. In addition, the IRS and Treasury Department recognize a broader concern that the requirement to annually reevaluate unit prices may have eliminated much of the simplicity of the unit livestock price method, especially for farmers neither required to use an accrual method by section 447 nor prohibited from using the cash method by section 448(a)(3). Accordingly, the IRS and Treasury Department intend to study the unit livestock price method to determine whether the method may be made simpler to apply and will take into account the commentator's suggestions as part of this study.

Record Keeping Requirements

Pursuant to 26 U.S.C. 7805(f)(1), copies of the 1997 notice of proposed rulemaking and temporary rule were provided to the Chief Counsel for Advocacy of the Small Business Administration for comment. The Chief Counsel for Advocacy submitted comments requesting that the IRS conduct a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) (RFA) on how the notice of proposed rulemaking would affect recordkeeping burdens imposed on small business taxpayers engaged in a farming business.

Under the RFA, the IRS is required to prepare a regulatory flexibility analysis if the proposed rule imposes a collection of information requirement (including a recordkeeping requirement) on small entities and that requirement is likely to have a significant economic impact on a substantial number of small entities (5 U.S.C 603(a)). The RFA defines a *recordkeeping requirement* as "a requirement imposed by an agency on persons to maintain specified records" (5 U.S.C. 601(7) and (8)). Since neither the proposed nor final regulation contain a collection of information requirement (including a requirement that persons maintain specified records), an analysis is not required by the RFA.

Effective Date And Method Changes

The final regulations provide that, in the case of property that is not inventory in the hands of the taxpayer, the regulations are applicable to costs incurred after August 21, 2000, in taxable years ending after August 21, 2000. In the case of inventory property, the final regulations are applicable to taxable years beginning after August 21, 2000.

For property that is not inventory, a taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with the provisions of these final regulations for costs incurred after August 21, 2000, provided the change is made for the first taxable year ending after August 21, 2000. For inventory property, a taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with the provisions of these final regulations for the first taxable year beginning after August 21, 2000. To make such a change, a taxpayer must follow the automatic consent procedures in Rev. Proc. 99–49 (1999–52 I.R.B. 725) (see §601.601(d)(2) of this chapter), as modified by these regulations.

Effect on Other Documents

The following publications are obsolete as of August 22, 2000: Notice 87–76 (1987–2 C.B. 384); Notice 88–24 (1988–1 C.B. 491); and section V of Notice 88–86 (1988–2 C.B. 401).

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 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, 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 their impact on small business.

Drafting Information

The principal authors of these final regulations are Jan Skelton and Richard C. Farley, Jr. previously of the Office of the Associate 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 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 1.162–12 is amended by revising the ninth sentence of paragraph (a) to read as follows:

§1.162–12 Expenses for farmers.

(a) * * * For rules regarding the capitalization of expenses of producing property in the trade or business of farming, see section 263A of the Internal Revenue Code and §1.263A–4. * * *

* * * * *

Par. 3. Section 1.263A–0 is amended by revising the introductory text and adding entries for §1.263A–4 to read as follows:

§1.263A–0 Outline of regulations under section 263A.

This section lists the paragraphs in §§1.263A–1 through 1.263A–4 and §§1.263A–7 through 1.263A–15 as follows:

* * * * *

§1.263A–4 Rules for property produced in a farming business.

(a) Introduction.
(1) In general.
(2) Exception.
(i) In general.
(ii) Tax shelter.
(A) In general.
(B) Presumption.
(iii) Examples.
(3) Costs required to be capitalized or inventoried under another provision.
(4) Farming business.
(i) In general.
(A) Plant.
(B) Animal.
(ii) Incidental activities.
(A) In general.
(B) Activities that are not incidental.
(iii) Examples.
(b) Application of section 263A to property produced in a farming business.
(1) In general.
(i) Plants.
(ii) Animals.
(2) Preproductive period.
(i) Plant.
(A) In general.
(B) Applicability of section 263A.
(C) Actual preproductive period.
(*1*) Beginning of the preproductive period.
(*2*) End of the preproductive period.
(*i*) In general.
(*ii*) Marketable quantities.
(D) Examples.
(ii) Animal.
(A) Beginning of the preproductive period.
(B) End of the preproductive period.
(C) Allocation of costs between animal and first yield.
(c) Inventory methods.
(1) In general.
(2) Available for property used in a trade or business.
(3) Exclusion of property to which section 263A does not apply.
(d) Election not to have section 263A apply.
(1) Introduction.
(2) Availability of the election.
(3) Time and manner of making the election.
i. Automatic election.
ii. Nonautomatic election.
(4) Special rules.
(i) Section 1245 treatment.
(ii) Required use of alternative depreciation system.
(iii) Related person.
(A) In general.
(B) Members of family.
(5) Examples.
(e) Exception for certain costs resulting from casualty losses.
(1) In general.
(2) Ownership.
(3) Examples.
(4) Special rule for citrus and almond groves.
(i) In general.
(ii) Example.
(f) Effective date and change in method of accounting.
(1) Effective date.
(2) Change in method of accounting.

* * * * *

§1.263A–0T [Removed]

Par. 4. Section 1.263A–0T is removed.

Par. 5. Section 1.263A–1 is amended as follows:

1. The last sentence of paragraph (b)(3) is revised.

2. The last sentence of paragraph (b)(4) is revised.

The revisions read as follows:

§1.263A–1 Uniform capitalization of costs.

* * * * *

(b) * * *

(3) * * * See §1.263A–4 for specific rules relating to taxpayers engaged in the trade or business of farming.

(4) * * * See §1.263A–4, however, for rules relating to taxpayers producing certain trees to which section 263A applies.

* * * * *

Par. 6. Section 1.263A–4 is revised to read as follows:

§1.263A–4 Rules for property produced in a farming business.

(a) *Introduction*—(1) *In general.* This section provides guidance with respect to the application of section 263A to property produced in a farming business as defined in paragraph (a)(4) of this section. Except as otherwise provided by the rules of this section, the general rules of §§1.263A–1 through 1.263A–3 and §§1.263A–7 through 1.263A–15 apply to property produced in a farming business. A taxpayer that engages in the raising or growing of

any agricultural or horticultural commodity, including both plants and animals, is engaged in the production of property. Section 263A generally requires the capitalization of the direct costs and an allocable portion of the indirect costs that directly benefit or are incurred by reason of the production of this property. The direct and indirect costs of producing plants or animals generally include preparatory costs allocable to the plant or animal and preproductive period costs of the plant or animal. Except as provided in paragraphs (a)(2) and (e) of this section, taxpayers must capitalize the costs of producing all plants and animals unless the election described in paragraph (d) of this section is made.

(2) *Exception*—(i) *In general.* Section 263A does not apply to the costs of producing plants with a preproductive period of 2 years or less or the costs of producing animals in a farming business, if the taxpayer is not—

(A) A corporation or partnership required to use an accrual method of accounting (accrual method) under section 447 in computing its taxable income from farming; or

(B) A tax shelter prohibited from using the cash receipts and disbursements method under section 448(a)(3).

(ii) *Tax shelter*—(A) *In general.* A farming business is considered a tax shelter, and thus a taxpayer prohibited from using the cash method under section 448(a)(3), if the farming business is—

(*1*) A farming syndicate as defined in section 464(c); or

(*2*) A tax shelter, within the meaning of section 6662(d)(2)(C)(iii).

(B) *Presumption.* Marketed arrangements in which persons carry on farming activities using the services of a common managerial or administrative service will be presumed to have the principal purpose of tax avoidance, within the meaning of section 6662(d)(2)(C)(iii), if such persons prepay a substantial portion of their farming expenses with borrowed funds.

(iii) *Examples.* The following examples illustrate the provisions of this paragraph(a)(2):

Example 1. Farmer A grows trees that have a preproductive period in excess of 2 years, and that produce an annual crop. Farmer A is not required by section 447 to use an accrual method or prohibited by section 448(a)(3) from using the cash method. Accordingly, Farmer A qualifies for the exception described in this paragraph (a)(2). Since the trees have a preproductive period in excess of 2 years, Farmer A must capitalize the direct costs and an allocable portion of the indirect costs that directly benefit or are incurred by reason of the production of the trees. Since the annual crop has a preproductive period of 2 years or less, Farmer A is not required to capitalize the costs of producing the crops.

Example 2. Assume the same facts as *Example 1*, except that Farmer A is required by section 447 to use an accrual method or prohibited by 448(a)(3) from using the cash method. Farmer A does not qualify for the exception described in this paragraph (a)(2). Farmer A is required to capitalize the direct costs and an allocable portion of the indirect costs that directly benefit or are incurred by reason of the production of the trees and crops.

(3) *Costs required to be capitalized or inventoried under another provision.* The exceptions from capitalization provided in paragraphs (a)(2), (d) and (e) of this section do not apply to any cost that is required to be capitalized or inventoried under another Internal Revenue Code or regulatory provision, such as section 263 or 471.

(4) *Farming business*—(i) *In general.* A farming business means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. Examples include the trade or business of operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the raising of ornamental trees (other than evergreen trees that are more than 6 years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals. For purposes of this section, the term harvesting does not include contract harvesting of an agricultural or horticultural commodity grown or raised by another. Similarly, merely buying and reselling plants or animals grown or raised entirely by another is not raising an agricultural or horticultural commodity. A taxpayer is engaged in raising a plant or animal, rather than the mere resale of a plant or animal, if the plant or animal is held for further cultivation and development prior to sale. In determining whether a plant or animal is held for further cultivation and development prior to sale, consideration will be given to all of the facts and circumstances, including: the value added by the taxpayer to the plant or animal through agricultural or horticultural processes; the length of time between the taxpayer's acquisition of the plant or animal and the time that the taxpayer makes the plant or animal available for sale; and in the case of a plant, whether the plant is kept in the container in which purchased, replanted in the ground, or replanted in a series of larger containers as it is grown to a larger size.

(A) *Plant.* A plant produced in a farming business includes, but is not limited to, a fruit, nut, or other crop bearing tree, an ornamental tree, a vine, a bush, sod, and the crop or yield of a plant that will have more than one crop or yield raised by the taxpayer. Sea plants are produced in a farming business if they are tended and cultivated as opposed to merely harvested.

(B) *Animal.* An animal produced in a farming business includes, but is not limited to, any stock, poultry or other bird, and fish or other sea life raised by the taxpayer. Thus, for example, the term animal may include a cow, chicken, emu, or salmon raised by the taxpayer. Fish and other sea life are produced in a farming business if they are raised on a fish farm. A fish farm is an area where fish or other sea life are grown or raised as opposed to merely caught or harvested.

(ii) *Incidental activities*—(A) *In general.* A farming business includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products. For example, a taxpayer in the trade or business of growing fruits and vegetables may harvest, wash, inspect, and package the fruits and vegetables for sale. Such activities are normally incident to the raising of these crops by farmers. The taxpayer will be considered to be in the trade or business of farming with respect to the growing of fruits and vegetables and the processing activities incident to their harvest.

(B) *Activities that are not incidental.* Farming business does not include the processing of commodities or products beyond those activities that are normally incident to the growing, raising, or harvesting of such products.

(iii) *Examples.* The following examples illustrate the provisions of this paragraph (a)(4):

Example 1. Individual A operates a retail nursery. Individual A has three categories of plants. The first category is comprised of plants that Individual A grows from seeds or cuttings. The second category is comprised of plants that Individual A purchases in containers and grows for a period of from several months to several years. Individual A replants some of these plants in the ground. The others are replanted in a series of larger containers as they grow. The third category is comprised of plants that are purchased by Individual A in containers. Individual A does not grow these plants to a larger size before making them available for resale. Instead, Individual A makes these plants available for resale,

in the container in which purchased, shortly after receiving them. Thus, no value is added to these plants by Individual A through horticultural processes. Individual A also sells soil, mulch, chemicals, and yard tools. Individual A is producing property in the farming business with respect to the first two categories of plants because these plants are held for further cultivation and development prior to sale. The plants in the third category are not held for further cultivation and development prior to sale and, therefore, are not regarded as property produced in a farming business for purposes of section 263A. Accordingly, Individual A must account for the third category of plants, along with the soil, mulch, chemicals, and yard tools, as property acquired for resale. If Individual A's average annual gross receipts are less than $10 million, Individual A will not be required to capitalize costs with respect to its resale activities under section 263A.

Example 2. Individual B is in the business of growing and harvesting wheat and other grains. Individual B also processes grain that Individual B has harvested in order to produce breads, cereals, and other similar food products, which Individual B then sells to customers in the course of its business. Although Individual B is in the farming business with respect to the growing and harvesting of grain, Individual B is not in the farming business with respect to the processing of such grain to produce the food products.

Example 3. Individual C is in the business of raising poultry and other livestock. Individual C also operates a meat processing operation in which the poultry and other livestock are slaughtered, processed, and packaged or canned. The packaged or canned meat is sold to Individual C's customers. Although Individual C is in the farming business with respect to the raising of poultry and other livestock, Individual C is not in the farming business with respect to the slaughtering, processing, packaging, and canning of such animals to produce the food products.

(b) *Application of section 263A to property produced in a farming business*—(1) *In general.* Unless otherwise provided in this section, section 263A requires the capitalization of the direct costs and an allocable portion of the indirect costs that directly benefit or are incurred by reason of the production of any property in a farming business (including animals and plants without regard to the length of their preproductive period). Section 1.263A–1(e) describes the types of direct and indirect costs that generally must be capitalized by taxpayers under section 263A and paragraphs (b)(1)(i) and (ii) of this section provide specific examples of the types of costs typically incurred in the trade or business of farming. For purposes of this section, soil and water conservation expenditures that a taxpayer has elected to deduct under section 175 and fertilizer that a taxpayer has elected to deduct under section 180 are not subject to capitalization under section 263A, except to the extent these costs are required to be capitalized as a preproductive period cost of a plant or animal.

(i) *Plants.* The costs of producing a plant typically required to be capitalized under section 263A include the costs incurred so that the plant's growing process may begin (preparatory costs), such as the acquisition costs of the seed, seedling, or plant, and the costs of planting, cultivating, maintaining, or developing the plant during the preproductive period (preproductive period costs). Preproductive period costs include, but are not limited to, management, irrigation, pruning, soil and water conservation (including costs that the taxpayer has elected to deduct under section 175), fertilizing (including costs that the taxpayer has elected to deduct under section 180), frost protection, spraying, harvesting, storage and handling, upkeep, electricity, tax depreciation and repairs on buildings and equipment used in raising the plants, farm overhead, taxes (except state and Federal income taxes), and interest required to be capitalized under section 263A(f).

(ii) *Animals.* The costs of producing an animal typically required to be capitalized under section 263A include the costs incurred so that the animal's raising process may begin (preparatory costs), such as the acquisition costs of the animal, and the costs of raising or caring for such animal during the preproductive period (preproductive period costs). Preproductive period costs include, but are not limited to, management, feed (such as grain, silage, concentrates, supplements, haylage, hay, pasture and other forages), maintaining pasture or pen areas (including costs that the taxpayer has elected to deduct under sections 175 or 180), breeding, artificial insemination, veterinary services and medicine, livestock hauling, bedding, fuel, electricity, hired labor, tax depreciation and repairs on buildings and equipment used in raising the animals (for example, barns, trucks, and trailers), farm overhead, taxes (except state and Federal income taxes), and interest required to be capitalized under section 263A(f).

(2) *Preproductive period*—(i) *Plant*—(A) *In general.* The preproductive period of property produced in a farming business means—

(*1*) In the case of a plant that will have more than one crop or yield (for example, an orange tree), the period before the first marketable crop or yield from such plant;

(*2*) In the case of the crop or yield of a plant that will have more than one crop or yield (for example, the orange), the period before such crop or yield is disposed of; or

(*3*) In the case of any other plant, the period before such plant is disposed of.

(B) *Applicability of section 263A.* For purposes of determining whether a plant has a preproductive period in excess of 2 years, the preproductive period of plants grown in commercial quantities in the United States is based on the nationwide weighted average preproductive period for such plant. The Commissioner will publish a noninclusive list of plants with a nationwide weighted average preproductive period in excess of 2 years. In the case of other plants grown in commercial quantities in the United States, the nationwide weighted average preproductive period must be determined based on available statistical data. For all other plants, the taxpayer is required, at or before the time the seed or plant is acquired or planted, to reasonably estimate the preproductive period of the plant. If the taxpayer estimates a preproductive period in excess of 2 years, the taxpayer must capitalize the costs of producing the plant. If the estimate is reasonable, based on the facts in existence at the time it is made, the determination of whether section 263A applies is not modified at a later time even if the actual length of the preproductive period differs from the estimate. The actual length of the preproductive period will, however, be considered in evaluating the reasonableness of the taxpayer's future estimates. The nationwide weighted average preproductive period or the estimated preproductive period is only used for purposes of determining whether the preproductive period of a plant is greater than 2 years.

(C) *Actual preproductive period.* The plant's actual preproductive period is used for purposes of determining the period during which a taxpayer must capitalize preproductive period costs with respect to a particular plant.

(*1*) *Beginning of the preproductive period.* The actual preproductive period of a plant begins when the taxpayer first incurs costs that directly benefit or are incurred by reason of the plant. Generally, this occurs when the taxpayer plants the

seed or plant. In the case of a taxpayer that acquires plants that have already been permanently planted, or plants that are tended by the taxpayer or another prior to permanent planting, the actual preproductive period of the plant begins upon acquisition of the plant by the taxpayer. In the case of the crop or yield of a plant that will have more than one crop or yield, the actual preproductive period begins when the plant has become productive in marketable quantities and the crop or yield first appears, for example, in the form of a sprout, bloom, blossom, or bud.

(2) *End of the preproductive period—* (*i*) *In general.* In the case of a plant that will have more than one crop or yield, the actual preproductive period ends when the plant first becomes productive in marketable quantities. In the case of any other plant (including the crop or yield of a plant that will have more than one crop or yield), the actual preproductive period ends when the plant, crop, or yield is sold or otherwise disposed of. Field costs, such as irrigating, fertilizing, spraying and pruning, that are incurred after the harvest of a crop or yield but before the crop or yield is sold or otherwise disposed of are not required to be included in the preproductive period costs of the harvested crop or yield because they do not benefit and are unrelated to the harvested crop or yield.

(*ii*) *Marketable quantities.* A plant that will have more than one crop or yield becomes productive in marketable quantities once a crop or yield is produced in sufficient quantities to be harvested and marketed in the ordinary course of the taxpayer's business. Factors that are relevant to determining whether a crop or yield is produced in sufficient quantities to be harvested and marketed in the ordinary course include: whether the crop or yield is harvested that is more than *de minimis*, although it may be less than expected at the maximum bearing stage, based on a comparison of the quantities per acre harvested in the year in question to the quantities per acre expected to be harvested when the plant reaches full maturity; and whether the sales proceeds exceed the costs of harvest and make a reasonable contribution to an allocable share of farm expenses.

(D) *Examples.* The following examples illustrate the provisions of this paragraph (b)(2):

Example 1. (i) Farmer A, a taxpayer that qualifies for the exception in paragraph (a)(2) of this section, grows plants that will have more than one crop or yield. The plants are grown in commercial quantities in the United States. Farmer A acquires 1 year-old plants by purchasing them from an unrelated party, Corporation B, and plants them immediately. The nationwide weighted average preproductive period of the plant is 4 years. The particular plants grown by Farmer A do not begin to produce in marketable quantities until 3 years and 6 months after they are planted by Farmer A.

(ii) Since the plants are deemed to have a preproductive period in excess of 2 years, Farmer A is required to capitalize the costs of producing the plants. See paragraphs (a)(2) and (b)(2)(i)(B) of this section. In accordance with paragraph (b)(2)(i)(C)(*1*) of this section, Farmer A must begin to capitalize the preproductive period costs when the plants are planted. In accordance with paragraph (b)(2)(i)(C)(*2*) of this section, Farmer A must continue to capitalize preproductive period costs to the plants until the plants begin to produce in marketable quantities. Thus, Farmer A must capitalize the preproductive period costs for a period of 3 years and 6 months (that is, until the plants are 4 years and 6 months old), notwithstanding the fact that the plants, in general, have a nationwide weighted average preproductive period of 4 years.

Example 2. (i) Farmer B, a taxpayer that qualifies for the exception in paragraph (a)(2) of this section, grows plants that will have more than one crop or yield. The plants are grown in commercial quantities in the United States. The nationwide weighted average preproductive period of the plant is 2 years and 5 months. Farmer B acquires 1 month-old plants by purchasing them from an unrelated party, Corporation B. Farmer B enters into a contract with Corporation B under which Corporation B will retain and tend the plants for 7 months following the sale. At the end of 7 months, Farmer B takes possession of the plants and plants them in the permanent orchard. The plants become productive in marketable quantities 1 year and 11 months after they are planted by Farmer B.

(ii) Since the plants are deemed to have a preproductive period in excess of 2 years, Farmer B is required to capitalize the costs of producing the plants. See paragraphs (a)(2) and (b)(2)(i)(B) of this section. In accordance with paragraph (b)(2)(i)(C)(*1*) of this section, Farmer B must begin to capitalize the preproductive period costs when the purchase occurs. In accordance with paragraph (b)(2)(i)(C)(*2*) of this section, Farmer B must continue to capitalize the preproductive period costs to the plants until the plants begin to produce in marketable quantities. Thus, Farmer B must capitalize the preproductive period costs of the plants for a period of 2 years and 6 months (the 7 months the plants are tended by Corporation B and the 1 year and 11 months after the plants are planted by Farmer B), that is, until the plants are 2 years and 7 months old, notwithstanding the fact that the plants, in general, have a nationwide weighted average preproductive period of 2 years and 5 months.

Example 3. (i) Assume the same facts as in *Example 2*, except that Farmer B acquires the plants by purchasing them from Corporation B when the plants are 8 months old and that the plants are planted by Farmer B upon acquisition.

(ii) Since the plants are deemed to have a preproductive period in excess of 2 years, Farmer B is required to capitalize the costs of producing the plants. See paragraphs (a)(2) and (b)(2)(i)(B) of this section. In accordance with paragraph (b)(2)(i)(C)(*1*) of this section, Farmer B must begin to capitalize the preproductive period costs when the plants are planted. In accordance with paragraph (b)(2)(i)(C)(*2*) of this section, Farmer B must continue to capitalize the preproductive period costs to the plants until the plants begin to produce in marketable quantities. Thus, Farmer B must capitalize the preproductive period costs of the plants for a period of 1 year and 11 months.

Example 4. (i) Farmer C, a taxpayer that qualifies for the exception in paragraph (a)(2) of this section, grows plants that will have more than one crop or yield. The plants are grown in commercial quantities in the United States. Farmer C acquires 1 month-old plants from an unrelated party and plants them immediately. The nationwide weighted average preproductive period of the plant is 2 years and 3 months. The particular plants grown by Farmer C begin to produce in marketable quantities 1 year and 10 months after they are planted by Farmer C.

(ii) Since the plants are deemed to have a nationwide weighted average preproductive period in excess of 2 years, Farmer C is required to capitalize the costs of producing the plants, notwithstanding the fact that the particular plants grown by Farmer C become productive in less than 2 years. See paragraph (b)(2)(i)(B) of this section. In accordance with paragraph (b)(2)(i)(C)(*1*) of this section, Farmer C must begin to capitalize the preproductive period costs when it plants the plants. In accordance with paragraph (b)(2)(i)(C)(*2*) of this section, Farmer C properly ceases capitalization of preproductive period costs when the plants become productive in marketable quantities (that is, 1 year and 10 months after they are planted, which is when they are 1 year and 11 months old).

Example 5. (i) Farmer D, a taxpayer that qualifies for the exception in paragraph (a)(2) of this section, grows plants that will have more than one crop or yield. The plants are not grown in commercial quantities in the United States. Farmer D acquires and plants the plants when they are 1 year old and estimates that they will become productive in marketable quantities 3 years after planting. Thus, at the time the plants are acquired and planted Farmer D reasonably estimates that the plants will have a preproductive period of 4 years. The actual plants grown by Farmer D do not begin to produce in marketable quantities until 3 years and 6 months after they are planted by Farmer D.

(ii) Since the plants have an estimated preproductive period in excess of 2 years, Farmer D is required to capitalize the costs of producing the plants. See paragraph (b)(2)(i)(B) of this section. In accordance with paragraph (b)(2)(i)(C)(*1*) of this section, Farmer D must begin to capitalize the preproductive period costs when it acquires and plants the plants. In accordance with paragraph (b)(2)(i)(C)(2) of this section, Farmer D must continue to capitalize the preproductive period costs until the plants begin to produce in marketable quantities. Thus, Farmer D must capitalize the preproductive period costs of the plants for a period of 3 years and 6 months (that is, until the plants are 4 years and 6 months old), notwithstanding the fact that Farmer D estimated

that the plants would become productive after 4 years.

Example 6. (i) Farmer E, a taxpayer that qualifies for the exception in paragraph (a)(2) of this section grows plants from seed. The plants are not grown in commercial quantities in the United States. The plants do not have more than 1 crop or yield. At the time the seeds are planted Farmer E reasonably estimates that the plants will have a preproductive period of 1 year and 10 months. The actual plants grown by Farmer E are not ready for harvesting and disposal until 2 years and 2 months after the seeds are planted by Farmer E.

(ii) Because Farmer E's estimate of the preproductive period (which was 2 years or less) was reasonable at the time made based on the facts, Farmer E will not be required to capitalize the costs of producing the plants under section 263A, notwithstanding the fact that the actual preproductive period of the plants exceeded 2 years. See paragraph (b)(2)(i)(B) of this section. However, Farmer E must take the actual preproductive period of the plants into consideration when making future estimates of the preproductive period of such plants.

Example 7. (i) Farmer F, a calendar year taxpayer that does not qualify for the exception in paragraph (a)(2) of this section, grows trees that will have more than one crop. Farmer F acquires and plants the trees in April, Year 1. On October 1, Year 6, the trees become productive in marketable quantities.

(ii) The costs of producing the plant, including the preproductive period costs incurred by Farmer F on or before October 1, Year 6, are capitalized to the trees. Preproductive period costs incurred after October 1, Year 6, are capitalized to a crop when incurred during the preproductive period of the crop and deducted as a cost of maintaining the tree when incurred between the disposal of one crop and the appearance of the next crop. See paragraphs (b)(2)(i)(A), (b)(2)(i)(C)(*1*) and (b)(2)(i)(C)(2) of this section.

Example 8. (i) Farmer G, a taxpayer that qualifies for the exception in paragraph (a)(2) of this section, produces fig trees on 10 acres of land. The fig trees are grown in commercial quantities in the United States and have a nationwide weighted average preproductive period in excess of 2 years. Farmer G acquires and plants the fig trees in their permanent grove during Year 1. When the fig trees are mature, Farmer G expects to harvest 10x tons of figs per acre. At the end of Year 4, Farmer G harvests .5x tons of figs per acre that it sells for $100x. During Year 4, Farmer G incurs expenses related to the fig operation of: $50x to harvest the figs and transport them to market and other direct and indirect costs related to the fig operation in the amount of $1000x.

(ii) Since the fig trees have a preproductive period in excess of 2 years, Farmer G is required to capitalize the costs of producing the fig trees. See paragraphs (a)(2) and (b)(2)(i)(B) of this section. In accordance with paragraph (b)(2)(i)(C)(2) of this section, Farmer G must continue to capitalize preproductive period costs to the trees until they become productive in marketable quantities. The following factors weigh in favor of a determination that the fig trees did not become productive in Year 4: the quantity of harvested figs is *de minimis* based on the fact that the yield is only 5 percent of the expected yield at maturity and the proceeds from the sale of the figs are sufficient, after covering the costs of harvesting and transporting the figs, to cover only a negligible portion of the allocable farm expenses. Based on these facts and circumstances, the fig trees did not become productive in marketable quantities in Year 4.

(ii) *Animal.* An animal's actual preproductive period is used to determine the period that the taxpayer must capitalize preproductive period costs with respect to a particular animal.

(A) *Beginning of the preproductive period.* The preproductive period of an animal begins at the time of acquisition, breeding, or embryo implantation.

(B) *End of the preproductive period.* In the case of an animal that will be used in the trade or business of farming (for example, a dairy cow), the preproductive period generally ends when the animal is (or would be considered) placed in service for purposes of section 168 (without regard to the applicable convention). However, in the case of an animal that will have more than one yield (for example, a breeding cow), the preproductive period ends when the animal produces (for example, gives birth to) its first yield. In the case of any other animal, the preproductive period ends when the animal is sold or otherwise disposed of.

(C) *Allocation of costs between animal and yields.* In the case of an animal that will have more than one yield, the costs incurred after the beginning of the preproductive period of the first yield but before the end of the preproductive period of the animal must be allocated between the animal and the yield using any reasonable method. Any depreciation allowance on the animal may be allocated entirely to the yield. Costs incurred after the beginning of the preproductive period of the second yield, but before the first yield is weaned from the animal must be allocated between the first and second yield using any reasonable method. However, a taxpayer may elect to allocate these costs entirely to the second yield. An allocation method used by a taxpayer is a method of accounting that must be used consistently and is subject to the rules of section 446 and the regulations thereunder.

(c) *Inventory methods*—(1) *In general.* Except as otherwise provided, the costs required to be allocated to any plant or animal under this section may be determined using reasonable inventory valuation methods such as the farm-price method or the unit-livestock-price method. See §1.471–6. Under the unit-livestock-price method, unit prices must include all costs required to be capitalized under section 263A. A taxpayer using the unit-livestock-price method may elect to use the cost allocation methods in §1.263A–1(f) or 1.263A–2(b) to allocate its direct and indirect costs to the property produced in the business of farming. In such a situation, section 471 costs are the costs taken into account by the taxpayer under the unit-livestock-price method using the taxpayer's standard unit price as modified by this paragraph (c)(1). Tax shelters, as defined in paragraph (a)(2)(ii) of this section, that use the unit-livestock-price method for inventories must include in inventory the annual standard unit price for all animals that are acquired during the taxable year, regardless of whether the purchases are made during the last 6 months of the taxable year. Taxpayers required by section 447 to use an accrual method or prohibited by section 448(a)(3) from using the cash method that use the unit-livestock-price method must modify the annual standard price in order to reasonably reflect the particular period in the taxable year in which purchases of livestock are made, if such modification is necessary in order to avoid significant distortions in income that would otherwise occur through operation of the unit-livestock-price method.

(2) *Available for property used in a trade or business.* The farm-price method or the unit-livestock-price method may be used by any taxpayer to allocate costs to any plant or animal under this section, regardless of whether the plant or animal is held or treated as inventory property by the taxpayer. Thus, for example, a taxpayer may use the unit-livestock-price method to account for the costs of raising livestock that will be used in the trade or business of farming (for example, a breeding animal or a dairy cow) even though the property in question is not inventory property.

(3) *Exclusion of property to which section 263A does not apply.* Notwithstanding a taxpayer's use of the farm-price method with respect to farm property to which the provisions of section 263A apply, that taxpayer is not required, solely by such use, to use the farm-price method

with respect to farm property to which the provisions of section 263A do not apply. Thus, for example, assume Farmer A raises fruit trees that have a preproductive period in excess of 2 years and to which the provisions of section 263A, therefore, apply. Assume also that Farmer A raises cattle and is not required to use an accrual method by section 447 or prohibited from using the cash method by section 448(a)(3). Because Farmer A qualifies for the exception in paragraph (a)(2) of this section, Farmer A is not required to capitalize the costs of raising the cattle. Although Farmer A may use the farm-price method with respect to the fruit trees, Farmer A is not required to use the farm-price method with respect to the cattle. Instead, Farmer A's accounting for the cattle is determined under other provisions of the Code and regulations.

(d) *Election not to have section 263A apply*—(1) *Introduction.* This paragraph (d) permits certain taxpayers to make an election not to have the rules of this section apply to any plant produced in a farming business conducted by the electing taxpayer. The election is a method of accounting under section 446, and once an election is made, it is revocable only with the consent of the Commissioner.

(2) *Availability of the election.* The election described in this paragraph (d) is available to any taxpayer that produces plants in a farming business, except that no election may be made by a corporation, partnership, or tax shelter required to use the accrual method under section 447 or prohibited from using the cash method by section 448(a)(3). Moreover, the election does not apply to the costs of planting, cultivation, maintenance, or development of a citrus or almond grove (or any part thereof) incurred prior to the close of the fourth taxable year beginning with the taxable year in which the trees were planted in the permanent grove (including costs incurred prior to the permanent planting). If a citrus or almond grove is planted in more than one taxable year, the portion of the grove planted in any one taxable year is treated as a separate grove for purposes of determining the year of planting.

(3) *Time and manner of making the election*—(i) *Automatic election.* A taxpayer makes the election under this paragraph (d) by not applying the rules of section 263A to determine the capitalized costs of plants produced in a farming business and by applying the special rules in paragraph (d)(4) of this section on its original return for the first taxable year in which the taxpayer is otherwise required to capitalize section 263A costs. Thus, in order to be treated as having made the election under this paragraph (d), it is necessary to report both income and expenses in accordance with the rules of this paragraph (d) (for example, it is necessary to use the alternative depreciation system as provided in paragraph (d)(4)(ii) of this section). For example, a farmer who deducts costs that are otherwise required to be capitalized under section 263A but fails to use the alternative depreciation system under section 168(g)(2) for applicable property placed in service has not made an election under this paragraph (d) and is not in compliance with the provisions of section 263A. In the case of a partnership or S corporation, the election must be made by the partner, shareholder, or member.

(ii) *Nonautomatic election.* A taxpayer that does not make the election under this paragraph (d) as provided in paragraph (d)(3)(i) must obtain the consent of the Commissioner to make the election by filing a Form 3115, Application for Change in Method of Accounting, in accordance with §1.446–1(e)(3).

(4) *Special rules.* If the election under this paragraph (d) is made, the taxpayer is subject to the special rules in this paragraph (d)(4).

(i) *Section 1245 treatment.* The plant produced by the taxpayer is treated as section 1245 property and any gain resulting from any disposition of the plant is recaptured (that is, treated as ordinary income) to the extent of the total amount of the deductions that, but for the election, would have been required to be capitalized with respect to the plant. In calculating the amount of gain that is recaptured under this paragraph (d)(4)(i), a taxpayer may use the farm-price method or another simplified method permitted under these regulations in determining the deductions that otherwise would have been capitalized with respect to the plant.

(ii) *Required use of alternative depreciation system.* If the taxpayer or a related person makes an election under this paragraph (d), the alternative depreciation system (as defined in section 168(g)(2)) must be applied to all property used predominantly in any farming business of the taxpayer or related person and placed in service in any taxable year during which the election is in effect. The requirement to use the alternative depreciation system by reason of an election under this paragraph (d) will not prevent a taxpayer from making an election under section 179 to deduct certain depreciable business assets.

(iii) *Related person*—(A) *In general.* For purposes of this paragraph (d)(4), related person means—

(*1*) The taxpayer and members of the taxpayer's family;

(*2*) Any corporation (including an S corporation) if 50 percent or more of the stock (in value) is owned directly or indirectly (through the application of section 318) by the taxpayer or members of the taxpayer's family;

(*3*) A corporation and any other corporation that is a member of the same controlled group (within the meaning of section 1563(a)(1)); and

(*4*) Any partnership if 50 percent or more (in value) of the interests in such partnership is owned directly or indirectly by the taxpayer or members of the taxpayer's family.

(B) *Members of family.* For purposes of this paragraph (d)(4)(iii), the terms "members of the taxpayer's family," and "members of family" (for purposes of applying section 318(a)(1)), means the spouse of the taxpayer (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance) and any of the taxpayer's children (including legally adopted children) who have not reached the age of 18 as of the last day of the taxable year in question.

(5) *Examples.* The following examples illustrate the provisions of this paragraph (d):

Example 1. (i) Farmer A, an individual, is engaged in the trade or business of farming. Farmer A grows apple trees that have a preproductive period greater than 2 years. In addition, Farmer A grows and harvests wheat and other grains. Farmer A elects under this paragraph (d) not to have the rules of section 263A apply to the costs of growing the apple trees.

(ii) In accordance with paragraph (d)(4) of this section, Farmer A is required to use the alternative depreciation system described in section 168(g)(2) with respect to all property used predominantly in

any farming business in which Farmer A engages (including the growing and harvesting of wheat) if such property is placed in service during a year for which the election is in effect. Thus, for example, all assets and equipment (including trees and any equipment used to grow and harvest wheat) placed in service during a year for which the election is in effect must be depreciated as provided in section 168(g)(2).

Example 2. Assume the same facts as in *Example 1*, except that Farmer A and members of Farmer A's family (as defined in paragraph (d)(4)(iii)(B) of this section) also own 51 percent (in value) of the interests in Partnership P, which is engaged in the trade or business of growing and harvesting corn. Partnership P is a related person to Farmer A under the provisions of paragraph (d)(4)(iii) of this section. Thus, the requirements to use the alternative depreciation system under section 168(g)(2) also apply to any property used predominantly in a trade or business of farming which Partnership P places in service during a year for which an election made by Farmer A is in effect.

(e) *Exception for certain costs resulting from casualty losses*—(1) *In general.* Section 263A does not require the capitalization of costs that are attributable to the replanting, cultivating, maintaining, and developing of any plants bearing an edible crop for human consumption (including, but not limited to, plants that constitute a grove, orchard, or vineyard) that were lost or damaged while owned by the taxpayer by reason of freezing temperatures, disease, drought, pests, or other casualty (replanting costs). Such replanting costs may be incurred with respect to property other than the property on which the damage or loss occurred to the extent the acreage of the property with respect to which the replanting costs are incurred is not in excess of the acreage of the property on which the damage or loss occurred. This paragraph (e) applies only to the replanting of plants of the same type as those lost or damaged. This paragraph (e) applies to plants replanted on the property on which the damage or loss occurred or property of the same or lesser acreage in the United States irrespective of differences in density between the lost or damaged and replanted plants. Plants bearing crops for human consumption are those crops normally eaten or drunk by humans. Thus, for example, costs incurred with respect to replanting plants bearing jojoba beans do not qualify for the exception provided in this paragraph (e) because that crop is not normally eaten or drunk by humans.

(2) *Ownership.* Replanting costs described in paragraph (e)(1) of this section generally must be incurred by the taxpayer that owned the property at the time the plants were lost or damaged. Paragraph (e)(1) of this section will apply, however, to costs incurred by a person other than the taxpayer that owned the plants at the time of damage or loss if—

(i) The taxpayer that owned the plants at the time the damage or loss occurred owns an equity interest of more than 50 percent in such plants at all times during the taxable year in which the replanting costs are paid or incurred; and

(ii) Such other person owns any portion of the remaining equity interest and materially participates in the replanting, cultivating, maintaining, or developing of such plants during the taxable year in which the replanting costs are paid or incurred. A person will be treated as materially participating for purposes of this provision if such person would otherwise meet the requirements with respect to material participation within the meaning of section 2032A(e)(6).

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

Example 1. (i) Farmer A grows cherry trees that have a preproductive period in excess of 2 years and produce an annual crop. These cherries are normally eaten by humans. Farmer A grows the trees on a 100 acre parcel of land (parcel 1) and the groves of trees cover the entire acreage of parcel 1. Farmer A also owns a 150 acre parcel of land (parcel 2) that Farmer A holds for future use. Both parcels are in the United States. In 2000, the trees and the irrigation and drainage systems that service the trees are destroyed in a casualty (within the meaning of paragraph (e)(1) of this section). Farmer A installs new irrigation and drainage systems on parcel 1, purchases young trees (seedlings), and plants the seedlings on parcel 1.

(ii) The costs of the irrigation and drainage systems and the seedlings must be capitalized. In accordance with paragraph (e)(1) of this section, the costs of planting, cultivating, developing, and maintaining the seedlings during their preproductive period are not required to be capitalized by section 263A.

Example 2. (i) Assume the same facts as in *Example 1* except that Farmer A decides to replant the seedlings on parcel 2 rather than on parcel 1. Accordingly, Farmer A installs the new irrigation and drainage systems on 100 acres of parcel 2 and plants seedlings on those 100 acres.

(ii) The costs of the irrigation and drainage systems and the seedlings must be capitalized. Because the acreage of the related portion of parcel 2 does not exceed the acreage of the destroyed orchard on parcel 1, the costs of planting, cultivating, developing, and maintaining the seedlings during their preproductive period are not required to be capitalized by section 263A. See paragraph (e)(1) of this section.

Example 3. (i) Assume the same facts as in *Example 1* except that Farmer A replants the seedlings on parcel 2 rather than on parcel 1, and Farmer A additionally decides to expand its operations by growing 125 rather than 100 acres of trees. Accordingly, Farmer A installs new irrigation and drainage systems on 125 acres of parcel 2 and plants seedlings on those 125 acres.

(ii) The costs of the irrigation and drainage systems and the seedlings must be capitalized. The costs of planting, cultivating, developing, and maintaining 100 acres of the trees during their preproductive period are not required to be capitalized by section 263A. The costs of planting, cultivating, maintaining, and developing the additional 25 acres are, however, subject to capitalization under section 263A. See paragraph (e)(1) of this section.

(4) *Special rule for citrus and almond groves*—(i) *In general.* The exception in this paragraph (e) is available with respect to replanting costs of a citrus or almond grove incurred prior to the close of the fourth taxable year after replanting, notwithstanding the taxpayer's election to have section 263A not apply (described in paragraph (d) of this section).

(ii) *Example.* The following example illustrates the provisions of this paragraph (e)(4):

Example. (i) Farmer A, an individual, is engaged in the trade or business of farming. Farmer A grows citrus trees that have a preproductive period of 5 years. Farmer A elects, under paragraph (d) of this section, not to have section 263A apply. This election, however, is unavailable with respect to the costs of producing a citrus grove incurred within the first 4 years beginning with the year the trees were planted. See paragraph (d)(2) of this section. In year 10, after the citrus grove has become productive in marketable quantities, the citrus grove is destroyed by a casualty within the meaning of paragraph (e)(1) of this section. In year 10, Farmer A acquires and plants young citrus trees in the same grove to replace those destroyed by the casualty.

(ii) Farmer A must capitalize the costs of producing the citrus grove incurred before the close of the fourth taxable year beginning with the year in which the trees were permanently planted. As a result of the election not to have section 263A apply, Farmer A may deduct the preproductive period costs incurred in the fifth year. In year 10, Farmer A must capitalize the acquisition cost of the young trees. However, the costs of planting, cultivating, developing, and maintaining the young trees that replace those destroyed by the casualty are exempted from capitalization under this paragraph (e).

(f) *Effective date and change in method of accounting*—(1) *Effective date.* In the case of property that is not inventory in the hands of the taxpayer, this section is applicable to costs incurred after August 21, 2000, in taxable years ending after August 21, 2000. In the case of inventory property, this section is applicable to taxable years beginning after August 21, 2000.

(2) *Change in method of accounting.* Any change in a taxpayer's method of accounting necessary to comply with this section is a change in method of accounting to

which the provisions of sections 446 and 481 and the regulations thereunder apply. For property that is not inventory in the hands of the taxpayer, a taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with the provisions of this section for costs incurred after August 21, 2000, provided the change is made for the first taxable year ending after August 21, 2000. For inventory property, a taxpayer is granted the consent of the Commissioner to change its method of accounting to comply with the provisions of this section for the first taxable year beginning after August 21, 2000. A taxpayer changing its method of accounting under this paragraph (f)(2) must file a Form 3115, "Application for Change in Accounting Method," in accordance with the automatic consent procedures in Rev. Proc. 99–49 (1999–52 I.R.B. 725) (see §601.601(d)(2) of this chapter). However, the scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply, provided the taxpayer's method of accounting for property produced in a farming business is not an issue under consideration within the meaning of section 3.09 of Rev. Proc. 99–49. If the taxpayer is under examination, before an appeals office, or before a federal court at the time that a copy of the Form 3115 is filed with the national office, the taxpayer must provide a duplicate copy of the Form 3115 to the examining agent, appeals officer, or counsel for the government, as appropriate, at the time the copy of the Form 3115 is filed. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent, appeals officer, or counsel for the government, as appropriate. Further, in the case of property that is not inventory in the hands of the taxpayer, a change under this paragraph (f)(2) is made on a cutoff basis as described in section 2.06 of Rev. Proc. 99–49 and without the audit protection provided in section 7 of Rev. Proc. 99–49. However, a taxpayer may receive such audit protection for non-inventory property by taking into account any section 481(a) adjustment that results from the change in method of accounting to comply with this section. A taxpayer that opts to determine a section 481(a) adjustment (and, thus, obtain audit protection) for non-inventory property must take into account only additional section 263A costs incurred after December 31, 1986, in taxable years ending after December 31, 1986. Any change in method of accounting that is not made for the taxpayer's first taxable year ending or beginning after August 21, 2000, whichever is applicable, must be made in accord with the procedures in Rev. Proc. 97–27 (1997–1 C.B. 680) (see §601.601(d)(2) of this chapter).

§1.263A–4T [Removed]

Par. 7. Section 1.263A–4T is removed.

Par. 8. Section 1.471–6 is amended as follows:

1. The third sentence of paragraph (d) is revised.

2. The last sentence of paragraph (f) is revised.

The revisions read as follows:

§1.471–6 Inventories of livestock raisers and other farmers.

* * * * *

(d) * * * However, see §1.263A–4(c)(3) for an exception to this rule. * * * * * * * *

(f) * * * See §1.263A–4 for rules regarding the computation of costs for purposes of the unit-livestock-price-method. * * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 10, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 18, 2000, 8:45 a.m., and published in the issue of the Federal Register for August 21, 2000, 65 F.R. 50638)

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, page 248.

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 September 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, page 248.

Section 642.—Speical Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, 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.)

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 2000.

Rev. Rul. 2000–41

This revenue ruling provides various prescribed rates for federal income tax purposes for September 2000 (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. 2000–41 TABLE 1
Applicable Federal Rates (AFR) for September 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	6.33%	6.23%	6.18%	6.15%
110% AFR	6.97%	6.85%	6.79%	6.75%
120% AFR	7.62%	7.48%	7.41%	7.37%
130% AFR	8.26%	8.10%	8.02%	7.97%
Mid-Term				
AFR	6.22%	6.13%	6.08%	6.05%
110% AFR	6.85%	6.74%	6.68%	6.65%
120% AFR	7.50%	7.36%	7.29%	7.25%
130% AFR	8.13%	7.97%	7.89%	7.84%
150% AFR	9.41%	9.20%	9.10%	9.03%
175% AFR	11.02%	10.73%	10.59%	10.50%
Long-Term				
AFR	6.09%	6.00%	5.96%	5.93%
110% AFR	6.71%	6.60%	6.55%	6.51%
120% AFR	7.33%	7.20%	7.14%	7.09%
130% AFR	7.95%	7.80%	7.73%	7.68%

REV. RUL. 2000–41 TABLE 2
Adjusted AFR for September 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.38%	4.33%	4.31%	4.29%
Mid-term adjusted AFR	4.67%	4.62%	4.59%	4.58%
Long-term adjusted AFR	5.41%	5.34%	5.30%	5.28%

REV. RUL. 2000-41 TABLE 3 Rates Under Section 382 for September 2000	
Adjusted federal long-term rate for the current month	5.41%
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.)	5.79%

REV. RUL. 2000-41 TABLE 4 Appropriate Percentages Under Section 42(b)(2) for September 2000	
Appropriate percentage for the 70% present value low-income housing credit	8.44%
Appropriate percentage for the 30% present value low-income housing credit	3.62%

REV. RUL. 2000-41 TABLE 5 Rate Under Section 7520 for September 2000	
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	7.6%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2000. See Rev. Rul. 2000–41, page 248.

Section 6111.—General Requirement of Return, Statement, or List

26 CFR 6011–4T: Requirement of statement disclosing participation in certain transactions by corporate taxpayers (Temporary).

T.D. 8896

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 301

Modification of Tax Shelter Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: These temporary regulations modify the rules relating to the filing by certain corporate taxpayers of a statement with their Federal corporate income tax returns under section 6011(a), the registration of confidential corporate tax shelters under section 6111(d), and the maintenance of lists of investors in potentially abusive tax shelters under section 6112. These regulations provide the public with additional guidance needed to comply with the disclosure rules, the registration requirement, and the list maintenance requirement applicable to tax shelters. The temporary regulations affect corporations participating in certain reportable transactions, persons responsible for registering confidential corporate tax shelters, and organizers of potentially abusive tax shelters. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in REG–103735–00, REG–110311–98, and REG–103736–00 on page 258.

DATES: *Effective Date*: These temporary regulations are effective August 11, 2000.

Applicability Date: For dates of applicability, see §§1.6011–4T(g), 301.6111–2T(h), and 301.6112–1T, A-22.

FOR FURTHER INFORMATION CONTACT: Catherine Moore, (202) 622-3080, (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these regulations previously have been reviewed and approved by the Office of Management and Budget under control numbers 1545-1685 and 1545-1686. No material changes to these collections of information are made by these regulations.

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.

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 amends 26 CFR parts 1 and 301 to provide modified rules relating to the disclosure of certain tax shelters by corporate investors on their Federal corporate income tax returns under section 6011, the registration of confidential corporate tax shelters under section 6111, and the maintenance of lists of investors in potentially abusive tax shelters under section 6112.

On February 28, 2000, the IRS issued temporary and proposed regulations regarding section 6011 (T.D. 8877, 2000–11 I.R.B. 747; REG–103735–00, 2000–11 I.R.B. 770), section 6111 (T.D. 8876, 2000–11 I.R.B. 753; REG–110311–98,

2000–11 I.R.B. 767), and section 6112 (T.D. 8875, 2000–11 I.R.B. 761; REG–103736–00, 2000–11 I.R.B. 768). The regulations were published in the **Federal Register** (65 F.R. 11205, 65 F.R. 11215, 65 F.R. 11211) on March 2, 2000.

Based on comments that have been received, the IRS and Treasury have determined that certain interim changes to the temporary and proposed regulations are warranted. The changes in the proposed rules are published in REG–103735–00, REG–110311–98, and REG–103736–00 on page 258. The interim changes are intended to clarify certain provisions of the regulations, address certain practical problems relating to compliance with the regulations, and make certain other changes relating to the scope of the regulations.

It is anticipated that other changes will be made in the final regulations. The IRS and Treasury have determined that additional time is needed to evaluate a number of the comments and recommendations. The IRS and Treasury continue to invite comments on all provisions of the temporary and proposed regulations, including provisions modified by this document. Furthermore, to the extent that taxpayers or other persons believe that there are specific types of transactions for which disclosure is required under the regulations, and that such disclosure is not consistent with the purposes of the regulations, the IRS and Treasury solicit comments that identify such types of transactions and explain those concerns. Such comments will be taken into account in establishing the scope of the final regulations and will also assist the IRS and Treasury in determining whether there are classes of transactions that should be specifically excepted from disclosure under the final regulations.

Explanation of Provisions

1. *Disclosure Statement Required for Certain Corporate Taxpayers*

The temporary regulations under section 6011 provide that every taxpayer that is required to file a return for a taxable year with respect to any tax imposed under section 11 and that has participated, directly or indirectly, in a reportable transaction shall attach a disclosure statement to its return for each taxable year for which the taxpayer's Federal income tax liability is affected by its participation in the reportable transaction. It has come to the attention of the IRS and Treasury that the temporary regulations under section 6011 may have technically failed to include insurance companies and mutual savings banks conducting life insurance business. The IRS and Treasury intended those corporations to be subject to the disclosure requirement in the regulations. The regulations are amended accordingly.

2. *Record Retention Requirement for Certain Reportable Transactions*

The temporary regulations under section 6011 provide that a taxpayer must retain all documents relating to a reportable transaction until the expiration of the statute of limitations for the first taxable year for which a disclosure statement is filed with the taxpayer's tax return.

The IRS and Treasury seek to clarify the record retention requirement. As modified, the temporary regulations provide that a taxpayer must retain a copy of all documents and other records related to a transaction subject to disclosure under this section that are material to an understanding of the facts of the transaction, the expected tax treatment of the transaction, or the corporation's decision to participate in the transaction.

3. *Confidentiality*

Under section 6111(d), a confidential corporate tax shelter must be registered. In describing *confidentiality*, the temporary regulations under section 6111(d) provide that if an offeree's disclosure of the structure or tax aspects of the transaction is limited in any way by an express or implied understanding or agreement with or for the benefit of any tax shelter promoter, an offer is considered made under conditions of confidentiality, whether or not such understanding or agreement is legally binding. An offer will also be considered made under conditions of confidentiality in the absence of any such understanding or agreement if any tax shelter promoter knows or has reason to know that the transaction is protected from disclosure or use in any other manner. However, unless the facts and circumstances clearly indicate otherwise, an offer is not considered made under conditions of confidentiality if the tax shelter promoter enters into a written agreement with each person who participates or discusses participation in the transaction and such agreement expressly authorizes such persons to disclose every aspect of the transaction with any and all persons, without limitation of any kind.

The IRS and Treasury understand that, in certain circumstances, limitations on disclosure of the structure or tax aspects of a transaction may be considered necessary to comply with Federal or state securities laws. Consequently, the temporary regulations under section 6111(d) are modified to provide an exception for restrictions on disclosure of the structure or tax aspects of the transaction reasonably necessary to comply with those securities laws.

The IRS and Treasury received comments inquiring whether an exclusivity agreement (i.e., an agreement requiring the offeree to pay a fee to a promoter if the offeree engages in the transaction, whether or not the offeree uses the services of that promoter) is a condition of confidentiality. It is the view of the IRS and Treasury that an exclusivity agreement is within the scope of section 6111(d)(2)(B) because it is a limitation on use, and the temporary regulations have been clarified to so provide. However, the regulations have also been clarified to provide that an exclusivity arrangement ordinarily will not result in an offer being treated as made under conditions of confidentiality if the tax shelter promoter provides express written authorization for disclosure. As modified, the written authorization rule is applicable if the promoter expressly authorizes each offeree to disclose the structure and tax aspects of the transaction to any and all persons, without limitation of any kind on such disclosure.

In addition, the temporary regulations are modified to provide that, under section 6111(d)(2)(B), limitations on disclosure or use create a condition of confidentiality only if the limitations relate to the structure or tax aspects of the transaction and such limitations are for the benefit of any person other than the offeree.

4. *Tax Shelter Promoter*

The temporary regulations under section 6111(d) provide that the term *tax shelter promoter* includes a tax shelter or-

ganizer under section 6111(e)(1) and §301.6111–1T(Q&A-26 through Q&A-32) and any other person who participates in the organization, management or sale of a tax shelter (other than a person who merely performs services of the kind described in §301.6111–1T Q&A-33) or any person related (within the meaning of section 267 or 707) to such tax shelter organizer or such other person.

The IRS and Treasury recognize that the definition of a promoter as currently worded implies that a person can be a promoter by participating in the organization, management or sale of a tax shelter in a way other than as described in section 6111(e)(1) and §301.6111–1T(Q&A-26 through Q&A-32). The regulations under section 6111(d) are amended to clarify that a person is a promoter only if the person participates in the organization, management or sale of a tax shelter under the rules in section 6111(e)(1) and §301.6111–1T(Q&A-26 through Q&A-33), or is related to such person under section 267 or 707(b).

The regulations are also modified to clarify that only promoters that are classified as organizers under section 6111(e)(1) are required to register tax shelters.

5. *Investor List Requirement of Section 6112*

Any person who organizes or sells an interest in a confidential corporate tax shelter must maintain a list of persons who were sold an interest in the tax shelter and such other information as required by section 6112. See §301.6112–1T. The temporary regulations under section 6112 require that, in addition to the lists required for confidential corporate tax shelters, lists must also be maintained with respect to transactions for which the avoidance or evasion of Federal income tax is considered to be a significant purpose of the structure of the transaction, as determined in section 6111(d)(1)(A) and §301.6111–2T(b), whether or not the transactions are offered under conditions of confidentiality.

Section 6111(d)(1)(A) provides that the term *tax shelter* includes any entity, plan, arrangement, or transaction a significant purpose of the structure of which is the avoidance or evasion of Federal income tax for a direct or indirect participant which is a corporation. The temporary regulations cross-reference section 6111(d)(1)(A) to provide the standard for determining whether the structure of a transaction has a significant purpose of avoidance or evasion of Federal income tax. The temporary regulations are amended to provide that a transaction may be subject to the list maintenance requirement whether or not the transaction is offered to corporate investors. Thus, a list of noncorporate investors will be required to be maintained whether or not the transaction is ever offered to a corporate investor. However, as discussed below, the temporary regulations are modified to include fee and tax reduction thresholds for list maintenance.

Two additional modifications are made to the temporary regulations. First, the definitions of organizer and seller are clarified for purposes of section 6112. Second, the procedure for designating a person to maintain the list under section 6112 is modified for transactions other than section 6111(c) shelters and projected income investments.

6. *Tax Reduction and Fee Thresholds for Investor List Requirement of Section 6112*

The temporary regulations under section 6112 do not limit the investors who must be included on the list. In response to comments, the IRS and Treasury have determined that in certain cases organizers and sellers of interests in potentially abusive tax shelters should be required to include on the list only investors that meet fee and tax reduction thresholds. Accordingly, the temporary regulations under section 6112 are amended to provide that, for a potentially abusive tax shelter that is not required to be registered under section 6111, is not a listed transaction described in §301.6111–2T(b)(2), and is not a projected income investment as described in §301.6111–1T A-57A, an organizer or seller of an interest in a shelter may, but is not required to, list an investor if the total consideration paid to all organizers and sellers with respect to such investor's acquisition of the interest is less than $25,000, or if the organizer reasonably believes that such investor's acquisition of the interest will not result in a reduction of the Federal income tax liability of any corporation or corporations that exceeds, or exceeds in the aggregate, $1 million in any single taxable year or a total of $2 million for any combination of taxable years and will not result in a reduction of the Federal income tax liability of any noncorporate taxpayer or taxpayers that exceeds, or exceeds in the aggregate, $250,000 in any single taxable year or a total of $500,000 for any combination of taxable years.

7. *Effective Date*

The regulations are applicable August 11, 2000. However, in general, taxpayers may rely on the regulations after February 28, 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 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. Because these regulations impose no new collection of information on small entities, 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, 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 these regulations is Catherine Moore, Office of the Associate 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 parts 1 and 301 are 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 1.6011–4T is amended as follows:

1. The first sentence of paragraph (a) is revised.

2. Paragraph (d)(1), second sentence, is amended by removing the language "LM:PF" and adding "LM:PFTG:OTSA" in its place.

3. Paragraphs (e) and (g) are revised.

The revisions read as follows:

§1.6011–4T Requirement of statement disclosing participation in certain transactions by corporate taxpayers (Temporary).

(a) *In general.* Every taxpayer that is required to file a return for a taxable year with respect to a tax imposed under section 11, 594, 801, or 831 and that has participated, directly or indirectly, in a reportable transaction within the meaning of paragraph (b) of this section must attach to its return for the taxable year described in paragraph (d) of this section a disclosure statement in the form prescribed by paragraph (c) of this section. * * *

* * * * *

(e) *Retention of documents.* The taxpayer must retain a copy of all documents and other records related to a transaction subject to disclosure under this section that are material to an understanding of the facts of the transaction, the expected tax treatment of the transaction, or the corporation's decision to participate in the transaction. Such documents must be retained until the expiration of the statute of limitations applicable to the first taxable year for which disclosure of the transaction was made in accordance with the requirements of this section. (This document retention requirement is in addition to any document retention requirements that section 6001 generally imposes on the taxpayer.) Such documents generally include, but are not limited to, the following: marketing materials related to the transaction; written analyses used in decision-making related to the transaction; correspondence and agreements between the taxpayer and any promoter, advisor, lender, or other party to the reportable transaction that relate to the transaction; documents discussing, referring to, or demonstrating the tax benefits arising from the reportable transaction; and documents, if any, referring to the business purposes for the reportable transaction.

* * * * *

(g) *Effective date.* This section applies to Federal corporate income tax returns filed after February 28, 2000. However, paragraphs (a) and (e) of this section apply to Federal corporate income tax returns filed after August 11, 2000 and to documents and other records that the taxpayer acquires, prepares, or has in its possession on or after August 11, 2000. Taxpayers may rely on the rules in paragraphs (a) and (e) of this section for Federal corporate income tax returns filed after February 28, 2000, and for documents and other records that the taxpayer acquires, prepares, or has in its possession on or after February 28, 2000. Otherwise, the rules that apply with respect to Federal corporate income tax returns filed after February 28, 2000, and records that the taxpayer acquires, prepares, or has in its possession prior to August 11, 2000, are contained in §1.6011–4T in effect prior to August 11, 2000 (see 26 CFR part 1 revised as of April 1, 2000).

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

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

Par. 4. Section 301.6111–2T is amended as follows:

1. Paragraph (b)(3)(ii) is amended by removing the word "corporate".

2. Paragraph (c) is amended as follows:

a. The last two sentences of paragraph (c)(1) are revised.

b. Paragraph (c)(2) is revised.

c. Paragraph (c)(3) is added.

3. Paragraphs (f) and (g)(1) are revised.

4. Paragraph (h) is amended by adding three sentences at the end of the paragraph.

The revisions and additions read as follows:

§301.6111–2T Confidential corporate tax shelters (temporary).

* * * * *

(c) * * * (1) * * * Pursuant to section 6111(d)(2)(B), an offer will also be considered made under conditions of confidentiality in the absence of any such understanding or agreement if any tax shelter promoter knows or has reason to know that the offeree's use or disclosure of information relating to the structure or tax aspects of the transaction is limited for the benefit of any person other than the offeree in any other manner, such as where the transaction is claimed to be proprietary or exclusive to the tax shelter promoter or any party other than the offeree. An offeree's privilege to maintain the confidentiality of a communication relating to a tax shelter in which the offeree might participate or has agreed to participate, including an offeree's confidential communication with the offeree's attorney, is not itself a condition of confidentiality.

(2) *Securities law exception.* An offer is not considered made under conditions of confidentiality if disclosure of the structure or tax aspects of the transaction is subject to restrictions reasonably necessary to comply with federal or state securities laws and such disclosure is not otherwise limited.

(3) *Presumption.* Unless facts and circumstances clearly indicate otherwise, an offer is not considered made under conditions of confidentiality if the tax shelter promoter provides express written authorization to each offeree permitting the offeree (and each employee, representative, or other agent of such offeree) to disclose the structure and tax aspects of the transaction to any and all persons, without limitation of any kind on such disclosure.

* * * * *

(f) *Definition of tax shelter promoter.* For purposes of section 6111(d)(2) and this section, the term *tax shelter promoter* includes a tax shelter organizer and any other person who participates in the organization, management or sale of a tax shelter (as those persons are described in section 6111(e)(1) and §301.6111–1T (Q&A-26 through Q&A-33) or any person related (within the meaning of section 267 or 707) to such tax shelter organizer or such other person.

(g) *Person required to register*—(1) *Tax shelter promoters.* The rules in section 6111(a) and (e) and §301.6111–1T (Q&A-34 through Q&A-39) determine who is required to register a confidential corporate tax shelter. A promoter of a confidential corporate tax shelter must register the tax shelter only if it is a person required to register under the rules in section 6111(a) and (e) and §301.6111–1T (Q&A-34 through Q&A-39).

* * * * *

(h) * * * However, paragraphs (b)(3)(ii), (c)(1),(2) and (3), (f), and (g)(1)

of this section apply to confidential corporate tax shelters in which any interests are offered for sale after August 11, 2000. The rules in paragraphs (b)(3)(ii), (c)(1),(2) and (3), (f), and (g)(1) of this section may be relied upon for confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000. Otherwise, the rules that apply to confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000, are contained in §301.6111–2T in effect prior to August 11, 2000 (see 26 CFR part 301 revised as of April 1, 2000).

Par. 5. Section 301.6112–1T is amended as follows:

1. A-4(a) is revised.

2. The last two sentences of A-5 are removed and a new sentence is added in their place.

3. A-6 is amended as follows:

a. Paragraph (b) is amended by removing the language "and" at the end of the paragraph.

b. Paragraph (c) is amended by removing the period at the end of the paragraph and adding "; and" in its place.

c. Paragraph (d) is added immediately after paragraph (c).

4. The last sentence of A-7 is revised.

5. A-8 is amended as follows:

a. In A-8, introductory text and paragraphs (a) through (e) are redesignated as paragraph (a) introductory text and paragraphs (a)(1) through (a)(5), respectively.

b. New paragraph (b) is added immediately after *Example (2)* in newly designated paragraph (a)(5).

6. The last two sentences of A-9 are amended by removing the language "paragraph (e)" and adding "paragraph(a)(5)" in its place.

7. One sentence is added at the end of A-10.

8. A-11 is amended as follows:

a. In A-11, introductory text and paragraphs (a) and (b) are redesignated as paragraph (a) introductory text and paragraphs (a)(1) and (a)(2), respectively.

b. New paragraph (b) is added.

9. A-17 is amended as follows:

a. Paragraph (a)(3) is revised.

b. Paragraph (c) is added.

10. The first and second sentences of A-19 are amended by removing the language "paragraph (d) or paragraph (e)" and adding "paragraph (a)(4) or (5)" in its place.

11. A-22 is amended by adding three sentences before the last sentence.

The additions and revisions read as follows:

§301.6112–1T Questions and answers relating to the requirement to maintain a list of investors in potentially abusive tax shelters (temporary).

* * * * *

A-4.(a) Yes; for purposes of the list requirement, a tax shelter includes any tax shelter that is a projected income investment, as defined in §301.6111–1T A-57A, and any transaction a significant purpose of the structure of which is the avoidance or evasion of Federal income tax within the meaning of section 6111(d)(1)(A) and §301.6111–2T(b) (whether or not offered to any direct or indirect corporate participant). For this purpose, as under §301.6111–2T, the term *transaction* includes all of the factual elements necessary to support the tax benefits that are expected to be claimed with respect to any entity, plan, or arrangement, including any series of related steps carried out as part of a prearranged plan.

* * * * *

A-5. * * * In addition, an organizer is any other person who participates in the organization or management of the tax shelter within the meaning of §301.6111–1T A-28 or A-29, except those persons whose activities do not constitute participation in the organization or management of a tax shelter under §301.6111–1T A-30 or A-33.

* * * * *

A-6. * * *

(d) Any other person who receives consideration in connection with another person's right to participate in a tax shelter, for services necessary to the organization or structure of such tax shelter (other than services that do not constitute participation in the organization or management of a tax shelter under §301.6111–1T A-30 or A-33), or for information that is integral to participation in such tax shelter.

* * * * *

A-7. * * * In addition, in any case in which a person has directly or indirectly paid consideration to an organizer or seller for the right to participate in a tax shelter, for services necessary to the organization or structure of such tax shelter (other than services that do not constitute participation in the organization or management of a tax shelter under §301.6111–1T A-30 or A-33), or for information that is integral to participation in such tax shelter, the participant shall be considered to have acquired an interest in the tax shelter and to have been sold an interest in the tax shelter by the organizer or seller.

* * * * *

A-8. * * *

(b) An organizer may, but is not required to, list a person that acquired an interest in a potentially abusive tax shelter if the shelter is not subject to registration under section 6111, is not a listed transaction described in §301.6111–2T(b)(2), and is not a projected income investment described in §301.6111–1T A-57A, if the total consideration paid to all organizers and sellers with respect to such person's acquisition of the interest is less than $25,000, or if the organizer reasonably believes that such person's acquisition of the interest will not result in a reduction of the Federal income tax liability of any corporation or corporations that exceeds, or exceeds in the aggregate, $1 million in any single taxable year or a total of $2 million for any combination of taxable years and will not result in a reduction of the Federal income tax liability of any noncorporate taxpayer or taxpayers that exceeds, or exceeds in the aggregate, $250,000 in any single taxable year or a total of $500,000 for any combination of taxable years. For purposes of this paragraph (b), the fees paid by or to, and the tax savings of, persons related within the meaning of section 267 or section 707(b) are aggregated.

* * * * *

A-10. * * * However, a seller may, but is not required to, list a person that is described in A-8(b) of this section.

* * * * *

A-11. * * *

(b) In the case of a confidential corporate tax shelter under section 6111(d) and §301.6111–2T or a tax shelter described in Q&A-4 of this section (other than one required to be registered under section 6111(c) or a projected income investment as described in §301.6111–1T A-57A), the rules contained in A-11(a)(1), A-13(a)(2), the second sentence of A-13(b), A-13(c) and A-14 of this section do not apply.

* * * * *

A-17. (a) * * *

(3) The name, address, and TIN (as defined in section 7701(a)(41)) of each person who is required to be included on the list under A-8 or A-10 of this section and, in the case of a tax shelter that is a transaction described in section 6111(d)(1)(A) and §301.6111–2T(b) whether or not the direct or indirect participant is a corporation, the name, address, and TIN of each investor and any indirect corporate participant in the shelter if known to the organizer or seller;

* * * * *

(c) No information needs to be included on a list with regard to any tax shelter for which no person is an investor required to be included on the list under A-8(b) or A-10 of this section.

* * * * *

A-22. * * * However, the rules in A-4(a), A-5, A-6(d), A-7, A-8(b), A-10, A-11(b), and A-17(a)(3) and (c) of this section apply to any interest acquired by an investor (within the meaning of paragraph (c) of A-6 of this section) in a potentially abusive tax shelter after August 11, 2000. The rules in A-4(a), A-5, A- 6(d), A-7, A-8(b), A-10, A-11(b), and A-17(a)(3) and (c) of this section may be relied upon for any interest acquired by an investor (within the meaning of paragraph (c) of A-6 of this section) in a potentially abusive tax shelter after February 28, 2000. Otherwise, the rules that apply with respect to interests acquired in potentially abusive tax shelters after February 28, 2000, are contained in §301.6112–1T in effect prior to August 11, 2000 (see 26 CFR part 301 revised as of April 1, 2000).

* * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 8, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 11, 2000, 8:45 a.m., and published in the issue of the Federal Register for August 16, 2000, 65 F.R. 49909)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2000. See Rev. Rul. 2000–41, page 248.

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 2000. See Rev. Rul. 2000–41, page 248.

Part III. Administrative, Procedural, and Miscellaneous

Tax Avoidance Using Artificially High Basis

Notice 2000–44

In Notice 99–59, 1999–52 I.R.B. 761, the Internal Revenue Service and the Treasury Department described certain transactions that were being marketed to taxpayers for the purpose of generating artificial tax losses. This notice concerns other similar transactions that purport to generate tax losses for taxpayers.

As stated in Notice 99–59, 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*, 526 U.S. 1017 (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. Commissioner*, 77 F.2d 446, 448 (8th Cir. 1935) (to be deductible, a loss must be "actual and real"); § 1.165–1(b) of the Income Tax Regulations ("Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.").

Notice 99–59 describes an arrangement that purported to give rise to deductible losses on disposition of stock by applying the rules relating to distributions of encumbered property to shareholders in order to create artificially high basis in the stock. The Service and the Treasury have become aware of similar arrangements that have been designed to produce noneconomic tax losses on the disposition of partnership interests. These arrangements purport to give taxpayers artificially high basis in partnership interests and thereby give rise to deductible losses on disposition of those partnership interests.

One variation involves a taxpayer's borrowing at a premium and a partnership's subsequent assumption of that indebtedness. As an example of this variation, a taxpayer may receive $3,000X in cash from a lender under a loan agreement that provides for an inflated stated rate of interest and a stated principal amount of only $2,000X. The taxpayer contributes the $3,000X to a partnership, and the partnership assumes the indebtedness. The partnership thereafter engages in investment activities. At a later time, the taxpayer sells the partnership interest.

Under the position advanced by the promoters of this arrangement, the taxpayer claims that only the stated principal amount of the indebtedness, $2,000X in this example, is considered a liability assumed by the partnership that is treated as a distribution of money to the taxpayer that reduces the basis of the taxpayer's partnership interest under § 752 of the Internal Revenue Code. Therefore, disregarding any additional amounts the taxpayer may contribute to the partnership, transaction costs, and any income realized or expenses incurred at the partnership level, the taxpayer purports to have a basis in the partnership interest equal to the excess of the cash contributed over the stated principal amount of the indebtedness, even though the taxpayer's net economic outlay to acquire the partnership interest and the value of the partnership interest are nominal or zero. In this example, the taxpayer purports to have a basis in the partnership interest of $1,000X (the excess of the cash contributed ($3,000X) over the stated principal amount of the indebtedness ($2,000X)). On disposition of the partnership interest, the taxpayer claims a tax loss with respect to that basis amount, even though the taxpayer has incurred no corresponding economic loss.

In another variation, a taxpayer purchases and writes options and purports to create substantial positive basis in a partnership interest by transferring those option positions to a partnership. For example, a taxpayer might purchase call options for a cost of $1,000X and simultaneously write offsetting call options, with a slightly higher strike price but the same expiration date, for a premium of slightly less than $1,000X. Those option positions are then transferred to a partnership which, using additional amounts contributed to the partnership, may engage in investment activities.

Under the position advanced by the promoters of this arrangement, the taxpayer claims that the basis in the taxpayer's partnership interest is increased by the cost of the purchased call options but is not reduced under § 752 as a result of the partnership's assumption of the taxpayer's obligation with respect to the written call options. Therefore, disregarding additional amounts contributed to the partnership, transaction costs, and any income realized and expenses incurred at the partnership level, the taxpayer purports to have a basis in the partnership interest equal to the cost of the purchased call options ($1,000X in this example), even though the taxpayer's net economic outlay to acquire the partnership interest and the value of the partnership interest are nominal or zero. On the disposition of the partnership interest, the taxpayer claims a tax loss ($1,000X in this example), even though the taxpayer has incurred no corresponding economic loss.

The purported losses resulting from the transactions described above do not represent bona fide losses reflecting actual economic consequences as required for purposes of § 165. The purported losses from these transactions (and from any similar arrangements designed to produce noneconomic tax losses by artificially overstating basis in partnership interests) are not allowable as deductions for federal income tax purposes. The purported tax benefits from these transactions may also be subject to disallowance under other provisions of the Code and regulations. In particular, the transactions may be subject to challenge under § 752, or under § 1.701–2 or other anti-abuse rules. In addition, in the case of individuals, these transactions may be subject to challenge under § 165(c)(2). See *Fox v. Commissioner*, 82 T.C. 1001 (1984). Furthermore, tax losses from similar transactions designed to produce noneconomic tax losses by artificially overstating basis in corporate stock or other property are not allowable as deductions for federal income tax purposes.

Appropriate penalties may be imposed 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.

Transactions that are the same as or substantially similar to the transactions described in this Notice 2000–44 are identified as "listed transactions" for the purposes of § 1.6011–4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111– 2T(b)(2) of the Temporary Procedure and Administration Regulations. See also § 301.6112–1T, A-4. It should be noted that, independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), the transactions described in this Notice 2000–44 may already be subject to the tax shelter registration and list maintenance requirements of §§ 6111 and 6112 under the regulations issued in February 2000 (§§ 301.6111–2T and 301.6112–1T, A-4), as well as the regulations issued in 1984 and amended in 1986 (§§ 301.6111–1T and 301.6112–1T, A-3). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under § 6707(a) and to the penalty under § 6708(a) if the requirements of § 6112 are not satisfied.

In addition, the Service and the Treasury have learned that certain persons who have promoted participation in transactions described in this notice have encouraged individual taxpayers to participate in such transactions in a manner designed to avoid the reporting of large capital gains from unrelated transactions on their individual income tax returns (Form 1040). Certain promoters have recommended that taxpayers participate in these transactions through grantor trusts and use the same grantor trusts as vehicles to realize the capital gains. Further, although each separate capital gain and loss attributable to a portion of a trust that is treated as owned by a grantor under the grantor trust provisions of the Code (§ 671 and following) is properly reported as a separate item on the grantor's individual income tax return (see § 1.671–2(c) and the Instructions to Form 1041, U.S. Income Tax Return for Estates and Trusts), the Service and the Treasury understand that these promoters have advised that the capital gains and losses from these transactions may be netted, so that only a small net capital gain or loss is reported on the taxpayer's individual income tax return. In addition to other penalties, any person who willfully conceals the amount of capital gains and losses in this manner, or who willfully counsels or advises such concealment, may be guilty of a criminal offense under §§ 7201, 7203, 7206, or 7212(a) or other provisions of federal law.

The principal authors of this notice are David A. Shulman of the Office of Associate Chief Counsel (Passthroughs and Special Industries) and Victoria S. Balacek of the Office of Associate Chief Counsel (Financial Instruments and Products). For further information regarding this notice, contact Mr. Shulman at (202) 622-3080 or Ms. Balacek at (202) 622-3930 (not toll free calls).

List of Plants, Grown in Commercial Quantities in the United States, Having a Preproductive Period in Excess of Two Years Based on the Nationwide Weighted Average Preproductive Period for Such Plant

Notice 2000–45

PURPOSE

This notice provides guidance to taxpayers engaged in the trade or business of farming in determining whether a plant has a preproductive period in excess of 2 years for purposes of § 263A(d) of the Internal Revenue Code. This guidance is derived from the nationwide weighted average preproductive period for various plants grown in commercial quantities in the United States.

BACKGROUND

Section 263A requires generally that the direct costs and an allocable share of indirect costs of real or tangible personal property produced by a taxpayer be capitalized. Under § 263A, taxpayers generally are required to capitalize the costs of producing property in a farming business (including animals and plants without regard to the length of their preproductive period).

Sections 263A(d) and (e) set forth special rules for property produced in the trade or business of farming. Under § 263A(d)(1) and § 1.263A–4(a)(2) of the Income Tax Regulations, taxpayers neither required by § 447 to use an accrual method nor prohibited by § 448(a)(3) from using the cash method ("qualified taxpayers") are not required to capitalize the costs of producing plants that have a preproductive period of 2 years or less or animals. In addition, under § 263A(d)(3) and § 1.263A–4(d), a qualified taxpayer may elect to have § 263A not apply to the cost of producing plants in a farming business. Thus, unless an election is made to have § 263A not apply in accordance with § 263A(d)(3), qualified taxpayers generally are required to capitalize the costs of producing plants that have a preproductive period in excess of 2 years.

Section 263A(e)(3)(B) and § 1.263A–4(b)(2)(i)(B) provide that, for purposes of determining whether a plant has a preproductive period in excess of 2 years, the preproductive period of plants grown in commercial quantities in the United States must be based on the nationwide weighted average preproductive period for such plants. The legislative history of § 263A explains that Congress expected the Treasury Department to periodically publish a list of the preproductive periods of various plants based on the nationwide weighted averages for such plants. *See* H.R. Rep. No. 426, 99th Cong., 1st Sess. 628 (1985), 1986–3 (Vol. 2) C.B. 628. A proposed list was included in the preamble of the proposed § 1.263A–4 regulations (62 FR 44542). The Internal Revenue Service and Treasury Department received and considered comment letters relating to this proposed list.

Based upon information provided by the United States Department of Agriculture, the Service Treasury Department have determined that plants producing the following crops or yields have a nationwide weighted average preproductive period in excess of 2 years:

almonds, apples, apricots, avocados, blackberries, blueberries, cherries, chestnuts, coffee beans, currants, dates, figs, grapefruit, grapes, guavas, kiwifruit, kumquats, lemons, limes, macadamia nuts, mangoes, nectarines, olives, oranges, papayas, peaches, pears, pecans, persimmons, pistachio nuts, plums, pomegranates, prunes, raspberries, tangelos, tangerines, tangors, and walnuts.

This guidance is not an all-inclusive list of plants that have a nationwide weighted average preproductive period in excess of 2 years. In the case of other plants grown in commercial quantities in the United States, the nationwide weighted average preproductive period must be determined based on available statistical data. The Service and Treasury Department intend to update this guidance periodically as needed.

DRAFTING INFORMATION

The principal author of this notice is Richard C. Farley, Jr. previously of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice contact Grant D. Anderson at (202) 622-4970 (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, §§ 61, 108; 1.61-12, 1.108-2).

Rev. Proc. 2000–33

SECTION 1. PURPOSE

This revenue procedure provides guidance on whether an acquisition of corporate debt by a beneficiary of the decedent creditor's estate or by a beneficiary of a revocable trust that became irrevocable upon the creditor's death is a direct acquisition within the meaning of § 1.108–2(b) of the Income Tax Regulations.

SECTION 2. BACKGROUND

Section 61(a)(12) of the Internal Revenue Code provides that gross income includes income from the discharge of indebtedness.

Section 108(e)(4) provides that for purposes of determining the income of the debtor from discharge of indebtedness, to the extent provided in regulations prescribed by the Secretary, the acquisition of outstanding indebtedness by a person bearing a relationship to the debtor specified in § 267(b) or § 707(b)(1) from a person who does not bear such a relationship to the debtor shall be treated as the acquisition of such indebtedness by the debtor.

Section 1.108–2(a) provides that the acquisition of outstanding indebtedness by a person related to the debtor from a person who is not related to the debtor results in the realization by the debtor of income from discharge of indebtedness. The rules of that paragraph apply if indebtedness is acquired directly by a person related to the debtor in a direct acquisition or if a holder of indebtedness becomes related to the debtor in an indirect acquisition.

Section 1.108–2(b) provides in part that an acquisition of outstanding indebtedness is a direct acquisition if a person related to the debtor acquires the indebtedness from a person who is not related to the debtor. That paragraph further provides that notwithstanding the foregoing, the Commissioner may provide by Revenue Procedure or other published guidance that certain acquisitions of indebtedness described in the preceding sentence are not direct acquisitions for purposes of this section.

SECTION 3. SCOPE

This revenue procedure applies to any acquisition of corporate debt by a beneficiary of a decedent creditor's estate or by a beneficiary of a revocable trust that became irrevocable upon the creditor's death where the beneficiary of the estate is related to the corporate debtor, the decedent creditor was also related to the corporate debtor, but the estate or trust is not related to the corporate debtor.

SECTION 4. APPLICATION

The acquisition of a debt in the situation described in section 3 is not a direct acquisition within the meaning of § 1.108–2(b).

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective August 16, 2000. However, the Service will not challenge a taxpayer's application of the rule provided in section 4 of this revenue procedure in prior years to an acquisition of an indebtedness, provided the rule is applied consistently with respect to that indebtedness by the taxpayer and any relevant related parties in all affected years.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Vincent Daly of the Office of the Associate Chief Counsel (Corporate). For further information regarding this revenue procedure contact Mr. Daly on (202) 622-7770 (not a toll free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Modification of Tax Shelter Rules

REG–103735–00; REG–110311–98; REG–103736–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Cross-reference notice of proposed rulemaking.

SUMMARY: These proposed rules relate to the modification of tax shelters under sections 6011, 6111, and 6112. The proposed rules provide the public with additional guidance needed to comply with the disclosure rules, the registration requirement, and the list maintenance requirement applicable to tax shelters. The proposed rules affect corporations participating in certain reportable transactions, persons responsible for registering confidential corporate tax shelters, and organizers of potentially abusive tax shelters. The IRS is issuing temporary regulations, T.D. 8896 on page 249, modifying the rules relating to the requirement that certain corporate taxpayers file a statement with their Federal corporate income tax returns under section 6011(a), the registration of confidential corporate tax shelters under section 6111(d), and the maintenance of lists of investors in potentially abusive tax shelters under section 6112. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by November 14, 2000.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–103735–00; REG–110311–98; REG–103736–00), 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:M&SP:RU (REG–103735–00; REG–110311–98; REG–103736– 00), 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.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Catherine Moore, (202) 622-3070; concerning submissions, Guy Traynor, (202) 622-7180.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking previously have 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)). No material changes to these collections of information are proposed in these regulations.

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

The temporary regulations in T.D. 8896 on page 249 amend the Income Tax Regulations (26 CFR part 1) regarding rules relating to the filing and records requirements for certain corporate taxpayers under section 6011. The temporary regulations also amend the temporary procedure and administration regulations (26 CFR part 301) regarding the registration of confidential corporate tax shelters under section 6111 and the maintenance of lists of investors in potentially abusive tax shelters under section 6112.

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 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. Because these regulations impose no new collection of information on small entities, 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 Requests for a 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) or electronically generated comments that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Catherine Moore, Office of the Associate 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 parts 1 and 301, which were proposed to be amended on

August 29, 1984, and March 2, 2000, are proposed to be further 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 1.6011–4 as proposed to be added at 65 F.R. 11271 (March 2, 2000) is amended as follows:

1. The first sentence of paragraph (a) is revised.

2. Paragraph (d)(1), second sentence, is amended by removing the language "LM:PF" and adding "LM:PFTG:OTSA" in its place.

3. Paragraphs (e) and (g) are revised.

The revisions read as follows:

§1.6011–4 Requirement of statement disclosing participation in certain transactions by corporate taxpayers.

[The text of the amendments to this proposed section is the same as the text of the amendments to §1.6011–4T published in T.D. 8896.]

PART 301— PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

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

Par. 4. Section 301.6111–2 as proposed to be added at 65 F.R. 11274 (March 2, 2000) is amended as follows:

1. Paragraph (b)(3)(ii) is amended by removing the word "corporate".

2. Paragraph (c) is amended as follows:

a. The last two sentences of paragraph (c)(1) are revised.

b. Paragraph (c)(2) is revised.

c. Paragraph (c)(3) is added.

3. Paragraphs (f) and (g)(1) are revised.

4. Paragraph (h) is amended by adding three sentences at the end of the paragraph.

The revisions and additions read as follows:

§301.6111–2 Confidential corporate tax shelters.

[The text of the amendments to this proposed section is the same as the text of the amendments to §301.6111–2T published in T.D. 8896.]

Par. 5. Section 301.6112–1 as proposed to be added at 49 F.R. 34246 (August 29, 1984) and 65 F.R. 11272 (March 2, 2000) is amended as follows:

0. The section heading is added.

1. A-4(a) is revised.

2. The last two sentences of A-5 are removed and a new sentence is added in their place.

3. A-6 is amended as follows:

a. Paragraph (b) is amended by removing the language "and" at the end of the paragraph.

b. Paragraph (c) is amended by removing the period at the end of the paragraph and adding "; and" in its place.

c. Paragraph (d) is added immediately after paragraph (c).

4. The last sentence of A-7 is revised.

5. A-8 is amended as follows:

a. In A-8,introductory text and paragraphs (a) through (e) are redesignated as paragraph (a) introductory text and paragraphs (a)(1) through (a)(5), respectively.

b. New paragraph (b) is added immediately after *Example (2)* in newly designated paragraph (a)(5).

6. The last two sentences of A-9 are amended by removing the language "paragraph (e)" and adding "paragraph (a)(5)" in its place.

7. One sentence is added at the end of A-10.

8. A-11 is amended as follows:

a. In A-11, introductory text and paragraphs (a) and (b) are redesignated as paragraph (a) introductory text and paragraphs (a)(1) and (a)(2), respectively.

b. New paragraph (b) is added.

9. A-17 is amended as follows:

a. Paragraph (a)(3) is revised.

b. Paragraph (c) is added.

10. The first and second sentences of A-19 are amended by removing the language "paragraph (d) or paragraph (e)" and adding "paragraph (a)(4) or (5)" in its place.

11. A-22 is amended by adding three sentences before the last sentence.

The additions and revisions read as follows:

§301.6112-1 Questions and answers relating to the requirement to maintain a list of investors in potentially abusive tax shelters.

[The text of the amendments to this proposed section is the same as the text of the amendments to §301.6112-1T published in T.D. 8896.]

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on August 11, 2000, 8:45 a.m., and published in the issue of the Federal Register for August 16, 2000, 65 F.R. 49955)

Availability of the Revised Forms W-2 and W-3

Announcement 2000–76

Background	Based on recommendations from the Information Reporting Program Advisory Committee (IRPAC), the Social Security Administration (SSA), and others, the Internal Revenue Service (IRS) initiated plans to revise Form W-2, Wage and Tax Statement, and Form W-3, Transmittal of Wage and Tax Statements, for 2001 to be filed in 2002. An April 26, 2000, announcement on the IRS Web Site requested comments on proposed changes to the 2001 Forms W-2 and W-3. Current drafts of the forms on the web site include adopted comments from the public.
Purpose	The purpose of this announcement is to provide guidance on when the 2001 Forms W-2 and W-3 containing all planned changes will be available.
Planned Changes to Forms W-2 and W-3	The IRS expects to post the 2001 Forms W-2 and W-3 containing all planned changes on the IRS Web Site by mid-October 2000. Access the latest drafts of Forms W-2 and W-3 on the IRS Web Site at http://www.irs.gov. Follow the links for "Tax Info for Business" / "Tax Professionals' Corner" / "Early Release DRAFTS of Forms."

Determination Letter Applications for Volume Submitter Plans

Announcement 2000–77

Purpose

The purpose of this announcement is to assist practitioners and plan sponsors in filing determination letter applications for volume submitter plans where the volume submitter specimen plan has not received an advisory letter that considers all the changes in the qualification requirements made by GUST. The announcement provides guidance on the types of plan amendments that may be needed to obtain a favorable determination letter. It also discusses certain procedural requirements related to the application process.

Background

Rev. Proc. 2000–27, 2000–26 I.R.B. 1272, provides that determination letter applications for individually-designed plans, including volume submitter plans, that are filed with the Service on or after June 26, 2000, will generally be reviewed taking into account all the changes in the qualification requirements made by GUST. (GUST is an acronym for the Uruguay Round Agreements Act (GATT), the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the Small Business Job Protection Act of 1996 (SBJPA), the Taxpayer Relief Act of 1997 (TRA '97) and the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98).) A letter that takes into account all of the requirements of GUST is referred to as a GUST II letter.

Prior to June 26, 2000, plan sponsors could not request complete GUST letters except for terminating plans. Rather, they had the option of requesting one of two limited scope determination letters: a letter that excludes consideration of any of the qualification changes made by GUST, or a letter that generally considers GUST but excludes consideration of certain qualification changes effective after 1998. These letters are referred to as pre-GATT and GUST I letters, respectively. Until further notice, plan sponsors will continue to have the option of requesting either of these limited scope letters, except, of course, in the case of terminating plans. However, unless the plan sponsor requests a limited scope review in the cover letter for its application, a determination letter application for an individually-designed plan, including a volume submitter plan, that is filed on or after June 26, 2000, will be reviewed taking into account all of the requirements of GUST. *See* section 3.01 of Rev. Proc. 2000–27.

Volume submitter practitioners have been able to obtain GUST II advisory letters for their volume submitter specimen plans since March 8, 2000. However, as of now, the latest advisory letter issued for most specimen plans is either a pre-GATT letter or a GUST I letter.

General Guidelines for Determination Letter Applications for Volume Submitter Plans That Have Not Received GUST II Advisory Letters

The guidelines that follow are intended to ensure that volume submitter determination letter applications are processed efficiently and correctly. Practitioners and plan sponsors should note that failure to follow these guidelines may result in processing delays, unnecessary taxpayer contacts, requests for plan restatement, new applications or additional user fees, and possible issuance of incorrect letters.

The effect of Rev. Proc. 2000–27 on the review of applications for determination letters for volume submitter plans that are filed on or after June 26, 2000, is as follows: These applications will be reviewed as GUST II applications in all cases, even if the latest advisory letter for the specimen plan is a GUST I or pre-GATT letter, unless the application or cover letter specifically requests a GUST I or pre-GATT determination letter.

Consequently, practitioners and plan sponsors who will be filing determination letter applications for volume submitter plans where a GUST II advisory letter has

not been issued for the specimen plan should carefully consider the requirements that may have to be satisfied in order to receive a GUST II determination letter. In addition to necessary plan amendments, these requirements may entail plan restatement, the filing of Form 5300 instead of Form 5307 and the payment of a higher user fee. These requirements, including certain plan amendments that may be needed, are discussed below under ***Specific Guidelines for Determination Letter Applications for Volume Submitter Plans That Have Not Received GUST II Advisory Letters.***

In addition, practitioners and plan sponsors are reminded that until proposed regulations under § 411(d)(6) of the Code are finalized, the Service will not issue a favorable determination letter for a plan that is amended to eliminate or reduce benefits in a manner that is not permitted under regulations now in effect. Therefore, plan sponsors who are considering submitting determination letter applications before the proposed regulations under § 411(d)(6) are finalized should also be aware that they may have to submit another application and pay another user fee if they wish to adopt plan amendments as a result of the final regulations. In view of the foregoing, plan sponsors may wish to consider deferring their requests for determination letters until the final § 411(d)(6) regulations have been issued and a GUST II letter has been issued for the volume submitter specimen plan. Also *see* section 19 of Rev. Proc. 2000–20, 2000–6 I.R.B. 553, and section 4 of Rev. Proc. 2000–27 regarding the remedial amendment period for volume submitter plan sponsors.

If the plan sponsor desires a GUST II letter, the determination letter application should include all necessary GUST amendments as well as any other permissible amendments the plan sponsor wishes to make. The practitioner and plan sponsor are also urged to include a cover letter stating that the application is for a GUST II determination letter. In accordance with section 9.08(2)(e) of Rev. Proc. 2000–6, 2000–1 I.R.B. 187, the application must also include a statement by the practitioner identifying and describing each deviation from the language of the approved specimen plan.

If the plan sponsor does not desire a GUST II letter, it must indicate on the application or in a cover letter whether it is requesting a pre-GATT or GUST I determination letter.

Specific Guidelines for Determination Letter Applications for Volume Submitter Plans That Have Not Received GUST II Advisory Letters

The following guidelines address the plan amendments that may be needed to obtain a GUST II determination letter where the specimen plan's latest advisory letter is a GUST I letter. The guidelines also address the situations in which a request for a GUST II determination letter may require plan restatement, use of Form 5300 instead of Form 5307 and payment of a higher user fee.

1. Where the latest advisory letter for the specimen plan is a GUST I letter:

A. If the plan is not intended to satisfy the safe harbors under § 401(k)(12) and § 401(m)(11), the plan amendments that may be needed for a GUST II determination letter should in most cases be limited. These include amendments related to the repeal of the combined plan limitation of § 415(e) and, for § 401(k), profit-sharing and stock bonus plans, amendments related to the addition of § 402(c)(4)(C) which changed the definition of eligible rollover distribution. *See* Notice 99–44, 1999–35 I.R.B. 326, Notice 99–5, 1999–3 I.R.B. 10, and Notice 2000–32, 2000–26 I.R.B. 1274, regarding these changes. These amendments should usually be minor and should not, of themselves, either require plan restatement or affect the plan sponsor's ability to use Form 5307.

B. If the plan is adding the safe harbors under § 401(k)(12) and § 401(m)(11), the plan must be restated and the plan sponsor cannot use Form 5307 but must instead use Form 5300 and pay the user fee for an individually-designed plan that is not a volume submitter plan.

2. Where the latest advisory letter for the specimen plan is a pre-GATT letter:

A. Except as provided in B., below, the plan must be restated and the plan sponsor cannot use Form 5307 but must instead use Form 5300 and pay the user fee for an individually-designed plan that is not a volume submitter plan.

B. If the plan is a defined contribution plan under which the only contributions are nonelective employer contributions, then the plan does not have to be restated and the plan sponsor can use Form 5307.

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Stoppenhagen, Larry	Ft. Wayne, IN	CPA	April 14, 2000 to April 13, 2001
Chon, James	N. Hollywood, CA	CPA	May 22, 2000 to May 21, 2003
Bleyer, Stephen A.	Bala Cynwyd, PA	CPA	June 26, 2000 to December 25, 2000
Knutson, Owen	Ouray, CO	CPA	July 3, 2000 to January 2, 2003
Silverman, Richard E.	Fayetteville, NY	CPA	August 1, 2000 to March 31, 2004
Holt, Jeffrey	Little Rock, AR	Enrolled Agent	October 1, 2000 to March 31, 2003
Barbagallo, Joseph	Newton, PA	CPA	October 15, 2000 to October 14, 2004

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Luebben, William	Hot Springs, AR	CPA	February 11, 2000

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 2000 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, 2000.

Rev. Rul. 2000–47

The following Department Store Inventory Price Indexes for July 2000 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, 2000.

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 1999	July 2000	Percent Change from July 1999 to July 2000[1]
1.	Piece Goods	551.4	519.6	-5.8
2.	Domestics and Draperies	632.6	630.3	-0.4
3.	Women's and Children's Shoes	635.4	613.6	-3.4
4.	Men's Shoes	874.8	896.4	2.5
5.	Infants' Wear	615.1	629.5	2.3
6.	Women's Underwear	560.8	561.4	0.1
7.	Women's Hosiery	321.3	335.1	4.3
8.	Women's and Girls' Accessories	532.8	528.2	-0.9
9.	Women's Outerwear and Girls' Wear	367.0	364.0	-0.8
10.	Men's Clothing	616.1	602.8	-2.2
11.	Men's Furnishings	618.8	608.8	-1.6
12.	Boys' Clothing and Furnishings	470.9	478.6	1.6
13.	Jewelry	962.1	945.5	-1.7
14.	Notions	794.3	780.8	-1.7
15.	Toilet Articles and Drugs	967.1	965.7	-0.1
16.	Furniture and Bedding	685.0	689.2	0.6
17.	Floor Coverings	602.2	609.8	1.3
18.	Housewares	792.6	783.5	-1.1
19.	Major Appliances	235.0	232.9	-0.9
20.	Radio and Television	65.7	59.1	-10.0
21.	Recreation and Education[2]	98.1	92.6	-5.6
22.	Home Improvements[2]	128.1	127.9	-0.2
23.	Auto Accessories[2]	106.5	106.5	0.0
	Groups 1 - 15: Soft Goods	588.1	583.3	-0.8
	Groups 16 - 20: Durable Goods	449.3	439.9	-2.1
	Groups 21 - 23: Misc. Goods[2]	103.7	100.0	-3.6
	Store Total[3]	536.7	529.2	-1.4

[1] Absence of a minus sign before the percentage change in this column signifies a 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 Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (202) 622-4970 (not a toll-free call).

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 2000–46

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 2000 is 5.85 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	2000	5.98	5.38 to 6.28	5.38 to 6.57

Drafting Information

The principal author of this notice is Todd Newman of the 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).

Optional *Per Diem* Rates for Employees, Self-employed Individuals, and Other Taxpayers Used in Computing Deductible Costs

Notice 2000–48

This notice informs taxpayers that the U.S. General Services Administration will change the *per diem* rates for travel by federal employees as of October 1, 2000. These rates ("GSA rates") are incorporated by reference in Rev. Proc. 2000–9, 2000–2 I.R.B. 280, which allows their use in substantiating the amount of certain travel expenses, and are set forth in full in Publication 1542. However, as provided below, taxpayers may either use the new GSA rates or choose to continue to treat the current GSA rates as the federal *per diem* rates for travel expenses paid or incurred through the end of calendar year 2000. Also, comments are requested concerning application of the October 1 annual GSA rate changes in future years.

GSA *PER DIEM* RATES

Rev. Proc. 2000–9 generally provides that, for travel within the continental United States ("CONUS"), the federal meal and incidental expense ("M&IE") rates and the federal *per diem* rates published by GSA may be used to substantiate certain travel expenses. GSA has recently announced its intention to update these rates annually effective October 1, rather than January 1, to match the federal government's fiscal year. The GSA rates will be available on the GSA website at www.policyworks.gov/perdiem. Accordingly, for purposes of Rev. Proc. 2000–9, the updated GSA rates will apply as of October 1, 2000, to determine the amount of the CONUS travel expenses paid or incurred on or after that date, unless a taxpayer uses the transition rule described below. Consequently, the April 2000 revision of Pub. 1542, Per Diem Rates (For Travel Within the Continental United States), which reprints the GSA rates made effective January 1, 2000, will not be effective for travel on or after October 1, 2000, unless the election described below is in effect.

TRANSITION RULE

To ease the transition to the GSA rates that will be updated as described above, the Internal Revenue Service will allow taxpayers, in applying Rev. Proc. 2000–9, to use the GSA rates in effect for the first 9 months of 2000 ("current rates") for expenses of CONUS travel while away from home that are paid or incurred before January 1, 2001, in lieu of the updated GSA rates. A taxpayer must consistently use either the current GSA rates or the updated GSA rates for the period of October 1, 2000, through December 31, 2000. During this period, a taxpayer may not use the current GSA rates for some travel and the updated GSA rates for other travel.

SPECIAL RATES PROVIDED IN REV. PROC. 2000–9

Rev. Proc. 2000–9 provides two optional methods that may be used in lieu of the use of the GSA rates to substantiate the amount of certain travel expenses. Section 5 provides a simplified High-Low Substantiation Method for employers to substantiate the amount of employees' lodging, meal, and incidental expenses, and section 4.04 provides special M&IE rates for the transportation industry as an alternative to the M&IE rates published by GSA. Rev. Proc. 2000–9 provides that the use of these optional substantiation methods must be consistent throughout the 2000 calendar year. When the rates for these optional methods ("special rates") are updated in the next *per diem* revenue procedure (expected to be published in September 2000), the Service will permit taxpayers using the optional methods for travel in calendar year 2000 to use either the updated special rates, or the current special rates, for the last 3 months of the 2000 calendar year. However, such taxpayers may not use the GSA rates instead of the special rates for that period.

REQUEST FOR COMMENTS

The Treasury Department and the Service invite comments on this notice and on future *per diem* revenue procedures. In particular, comments are requested on whether, in future years, the High-Low

Substantiation Method and the special transportation industry rates should be updated to match the October 1 effective date of the GSA rates or should continue to apply on a calendar-year basis. Also, comments are requested on whether, in future years, the revenue procedure should continue to make the substantiation rules effective as the rates are announced by GSA or should maintain consistent rates on a calendar-year basis by disregarding GSA's annual update (for employers other than federal employers) until the beginning of the next calendar year. Written comments should be submitted by October 27, 2000. An original and eight copies of written comments should be sent to:

Internal Revenue Service
Attn: CC:MSP:R (Notice 2000–48)
Room 5228 (IT&A:Br2)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044.

or hand delivered between the hours of 8 a.m. and 5 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:MSP:R (Notice 2000–48)
Room 5228 (IT&A:Br2)
1111 Constitution Avenue, NW
Washington, D.C.

Alternatively, comments may be submitted electronically at the following address:

Joel.S.Rutstein@m1.irscounsel.treas.gov.

DRAFTING INFORMATION

The principal author of this notice is Edwin B. Cleverdon of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice contact Mr. Cleverdon at (202) 622-4920 (not a toll-free call).

Clarification of Schedule P (Form 1120-FSC)

Notice 2000–49

This notice clarifies the availability of tabular schedules as alternative reporting formats on Schedule P of Form 1120-FSC, filed by foreign sales corporations, for 1999 and prior taxable years.

SECTION I. BACKGROUND

Foreign sales corporations (FSCs) use Schedule P, "Transfer Price or Commission," of Form 1120-FSC, "U.S. Income Tax Return of a Foreign Sales Corporation," to compute the transfer price to charge a FSC or the commission to pay to a FSC under the FSC administrative pricing rules of section 925 of the Internal Revenue Code. The transfer price or commission allocates foreign trading gross receipts from the sale of export property and certain services between a FSC and its related supplier.

Under the administrative pricing rules, each transaction generating foreign trading gross receipts is reportable on Schedule P. Under Temp. Treas. Reg. § 1.925 (a)–1T(c)(8), a FSC and its related supplier may elect to group transactions on a product or product line basis and must make the election for each group on Schedule P. Item B of Schedule P provides checkboxes for a FSC to indicate whether the Schedule P is filed on a "Transaction-by-transaction" basis or with respect to a "Group of transactions."

In the 1999 version of Schedule P ("1999 Schedule P"), applicable to calendar year 1999 and other taxable years beginning during 1999, item B also permits FSCs that choose to report on a transaction-by-transaction basis to check either of two subsidiary checkboxes representing alternative reporting formats for filing Schedule P. If the FSC chooses an "aggregate" format, the instructions to Schedule P specify that the FSC may combine on a single Schedule P all transactions in a product or product line to which the same administrative pricing method is applied. Where not all aggregated transactions fall within the same product or product line, or where the FSC uses more than one pricing method, the instructions require the FSC to file additional Schedules P, so that a separate Schedule P is filed for each combination of product or product line and pricing method, *i.e.*, for each aggregate. To be eligible for the aggregate reporting format, the FSC and its related supplier must maintain a supporting schedule containing all information that would be reported if a separate Schedule P were filed for each transaction.

The other alternative reporting format for which the 1999 Schedule P provides a checkbox for reporting on a transaction-by-transaction basis is a tabular schedule in spreadsheet or similar format. The type of tabular schedule represented by this checkbox does not aggregate transactions but rather reports as a separate line item all Schedule P information for each transaction.

For taxable years beginning before January 1, 1999, item B of Schedule P permitted an aggregate reporting format that differed in some respects from the aggregate reporting format permitted on the 1999 Schedule P. Unlike the 1999 Schedule P, the former versions of Schedule P permitted an aggregate Schedule P to be filed not only for transaction-by-transaction reporting but also for groups of transactions consisting of products or product lines using the FSC administrative pricing rules. Also, unlike the 1999 Schedule P, the former versions of Schedule P did not expressly prescribe any form of tabular schedule as an alternative reporting format. *See generally* Notice 99–23, 1999– 20 I.R.B. 73.

During the filing season for 1999 FSC income tax returns, several taxpayers and practitioners have asked the Service to clarify whether FSCs filing 1999 Schedule P and its predecessors may use a tabular schedule under the aggregate reporting format, reporting each aggregate of transactions (or, as permitted for taxable years beginning before January 1, 1999, each aggregate of groups) as a line item.

SECTION II. CLARIFICATIONS TO SCHEDULE P AND INSTRUCTIONS

The Service will accept a tabular schedule in spreadsheet or similar format as the equivalent of aggregate Schedules P for taxable years beginning before January 1, 2000, notwithstanding the absence of a specific checkbox for such a tabular schedule, provided that (1) the tabular schedule accompanies a partially completed Schedule P indicating the FSC's name and employer identification number (EIN); (2) the accompanying Schedule P shows a check mark in the appropriate checkbox for aggregation in item B (box 1a on 1999 Schedule P, or box 3 on prior years' Schedules P); (3) the tabular schedule reports all information as if a separate Schedule P were filed for each permitted aggregate of transactions or groups of transactions; (4) the tabular schedule is formatted in columns that correspond to item A, item C, and each line

item in Parts I, II and III of Schedule P; (5) each column is totaled; and (6) each page contains a page number and the FSC's name and EIN.

FSCs filing aggregate tabular schedules in accordance with this notice should enter "FILED UNDER NOTICE 2000–49" across the top of the tabular schedule and the accompanying Schedule P.

SECTION III. 2000 SCHEDULE P

The Service intends to incorporate these clarifications into the version of Schedule P and corresponding instructions to be issued for taxable years beginning during 2000 ("2000 Schedule P"). In the 2000 Schedule P, the Service expects to refine the "Aggregate" checkbox for transaction-by-transaction reporting by providing two checkboxes in its place, one for aggregation on Schedules P and one for aggregation on a tabular schedule as an alternative reporting format. The existing checkbox for a tabular schedule of transactions without aggregation (generally used by FSCs engaging in a small number of transactions) will remain as a third alternative reporting format for transaction-by-transaction reporting. Unchanged will be the checkbox for grouping of transactions, where aggregation is not permitted and FSCs are generally required to use a tabular schedule as the reporting format.

SECTION IV. DRAFTING INFORMATION

The principal author of this notice is Douglas Giblen of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Giblen at (202) 874-1490 (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, §§ 42; 1.42-14.)

Rev. Proc. 2000–36

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 2000.

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 2000.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 2000 is as follows:

Qualified State	Amount Allocated
Alabama	$ 21,268
Alaska	3,015
Arizona	23,256
California	161,319
Colorado	19,741
Delaware	3,668
Florida	73,547
Georgia	37,906
Idaho	6,092
Illinois	59,030
Indiana	28,924
Iowa	13,966
Kansas	12,917
Maryland	25,171
Massachusetts	30,055
Michigan	48,008
Minnesota	23,243
Mississippi	13,475
Missouri	26,615
Nebraska	8,109
Nevada	8,806
New Hampshire	5,846
New Jersey	39,635
New York	88,564
North Carolina	37,237
Ohio	54,787
Oregon	16,140
Pennsylvania	58,376
Puerto Rico	18,930
Rhode Island	4,822
Tennessee	26,689
Texas	97,556
Utah	10,366
Vermont	2,890
Virginia	33,451
West Virginia	8,794
Wisconsin	25,554

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 2000.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christopher J. Wilson of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Wilson at (202) 622-3040 (not a toll-free call).

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 2000–75

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:

Aids-Free Foundation, Bay St. Louis, MS
Algiers Community Improvement Association, New Orleans, LA
American Community Assistance League, Hannibal, MO
American Friends of Shavei Golah Jerusalem College for Russian Jews, Brooklyn, NY
American Gift Foundation, Inc., Gaithersburg, MD
Appalachian Wilderness Program, Inc., Doraville, GA
Association of Women Psychiatrists, New York, NY
Ateres Chaim, Inc., Monsey, NY
Auburn Youth Hockey Association, Inc., Auburn, ME
Auxiliary of Twin Lakes Center, Burlington, NC
Baltimore Bicentennial Celebration, Inc., Baltimore, MD
Barrington Horse Show, Inc., Barrington Hills, IL
Baytown Citizen Police Academy Alumni Association, Inc., Barry, IL
Beechwood Center of New Jersey, Inc., Langhorne, PA
Berks Regional Training Institute, West Lawn, PA
Big Horn Lenape Fed, Martinsville, OH
Boston United Soccer, Inc., Boston, MA
Caddo & Bossier Zoological Association, Inc., Shreveport, LA
Cambridge Chinese Choral Society, Inc., Boston, MA
Camp Lake County, Inc., Lakeview, OR
Caribbean American Steel Pan Education Center, Brooklyn, MA
Cecils Historic District, Inc., Frederick, MD
Center for Hearing Impaired Technologies, Cleveland, OH
Center for the Advancement for the Physically and Mentally Challenged, Saddle Brook, NJ
Center for Victim Services, Georgetown, TX
Central East Austin Caregivers of Austin Texas, Austin, TX
Ceramic Arts Foundation, Inc., New York, NY
Chateau Genesis, Sedona, AZ
Cheeta, Inc./Coalition Hoosiers Encouraging, Etc., Indianapolis, IN
Cherokee Christian Childrens Ranch, Ten Mile, TN
Childrens Bread, Columbus, OH
Christian Homeless Rehabilitation Center, Inc., Damascus, MD
College Station Rotary Club Charities, College Station, TX
Colorado Open Systems Consortium, Highlands Ranch, CO
Columbus Music Awards, Inc., Columbus, OH
Combined Alcohol & Drug Prevention Treatment, Inc., Collinsville, AL
Come Alive Ministry, Akron, OH
Conflict Resolution & Mediation, Inc., New York, NY
Cops, Cons and Kids, Inc., East Orange, NJ
Cor Jesu Hermitage Foundation, Inc., Louisville, KY
Cranston Crime Stoppers, Inc., Cranston, RI
Craven County Future, New Bern, NC
Daniel D. Tompkins Masonic Historical Society, Staten Island, NY
Dwelling Place, Inc., Bethel, CT
East Lansing Pinecrest Neighborhood Association, Lansing, MI
Edinburg Housing Opportunity Corporation, Edinburg, TX
Empowerment Zone Ecumenical Council EZEC, Detroit, MI
ESP of Jamaica Plain, E. Boston, MA
Eye of the Tiger Booster Club, Tucson, AZ
Faith, Inc., Phoenix, AZ
Fall Classic, Inc., Lancaster, PA
Feeding All Children Ministries, Mesquite, TX
For all People There is Hope, Fresno, CA
Foundation for Louisiana Drug Free Use, Baton Rouge, LA
Foundation II of the American College of Trial Lawyers, Inc., Irvine, CA
Franklin County Step Ahead Council, Inc., Brookville, IN
Free, Inc., Chicago, IL
Friends of Belmont High School Soccer, Belmont, MA
Friends of Lindsey Steele Foundation, Inc., Oakland, ME
Friends of the Border Foudation, San Antonio, TX
Friends of the Guymon Public Library, Inc., Guymon, OK
Future Youth, Inc., Rochester, NY
General Medical Foundation, Richmond, VA
Global Partnership for Education, Hale, MI
Hartwell Sober Living, Inc., Santa Ana, CA
Healing Environments, Palo Alto, CA
Innercity Management Works Incorporated, Houston, TX
International Association for Support of Privatization, Washington, DC
Jewish Community Endowment Associates, Bangor, ME
Jewish Legacy Foundation, New York, NY
Junior Auxiliary of Caruthersville Missouri, Inc., Caruthersville, MO
Junior Auxiliary of Jasper Alabama, Inc., Jasper, AL
Just Another Meal Jam, Inc., North Charleston, NC
Justus Foundation, Inc., Lorenzo, TX
Kentucky Natural Lands Trust, Inc., Berea, KY
Keren Aharon, Inc., Brooklyn, NY
Kick Karate, Lockport, IL
Kids at the Crossroads, Inc., Austin, TX
Kindred Spirits Foundation, Inc., New York, NY
Kirkwood Childrens Chorale, Inc., Kirkwood, MO
Koyoty Transit Corporation, Burkesville, KY

L. Francis Griffin Foundation, Inc., Farmville, VA
Lamp Lighters Christian Radio of Pierre, Inc., Pierre, SD
Land of Lincoln Conservation, Inc., Gilberts, IL
LEAP, Inc., Carson, CA
Lemoyne-Owen College Community Development Corp., Memphis, TN
Life Management Services, Inc., Pittsfield, MA
Linda's Food Cupboard, Bradley, ME
Long Island Seaport & Ecocenter, Inc., Port Jefferson, NY
Marietta Chamber Orchestra, Vincent, OH
Merrill Township Firefighters Association, Bitely, MI
Miracle Victory Ministries, Inc., East Orange, NJ
Montgomery Junior Tennis Association, Inc., Montgomery, AL
National Ceramic Center Foundation, Inc., Boulder, CO
Native American Ministries, Galesburg, IL
New Paltz Rescue Squad, Inc., New Paltz, NY
Nix Foundation, Inc., Washington, LA
No Power to Drugs Foundation, Inc., PMBK Pines, FL
Ohel Avrohom Elimelech, Inc., Brooklyn, NY
Oklahoma Junior Chianina, Anadarko, OK
Paradise Village Children's Home, Inc., Bastrop, LA
Parkville Fine Arts Association, Inc., Parkville, MO
Photography Preservation Society, St. Louis, MO
Planes of Fames East, Inc., Minneapolis, MN
Plant a Tree Help a Kid Foundation, Inc., Kansas City, MO
Play Pyramid, Lady Lake, FL
Public Improvements Corporation, Greenwood Villiage, CO
Recreation-Academic Program, Inc., South Orange, NJ
Reggie Dabbs Ministries, Inc., Fort Myers, FL
Reno Ballet, Inc., Carson City, NV
Rockwood Care Center, Inc., Palm Beach Gardens, FL
Rudolf Walther Foundation, Inc., Norcross, GA
Saginaw Area Episcopal Urban Cluster, Saginaw, MI
Scholarship Resource Finders and Counseling Services, Inc., Lauderhill, FL
Second Thursday Network, Inc., New York, NY
Sigma Omega Foundation, Chicago, IL
Slick Boys Youth Foundation, Inc., Chicago, IL
Society for Ultrastructural Pathology, Inc., Birmingham, AL
Spirit of Life Dance Theater, Chicago, IL
St. James Community Choir, Washington, DC
Take Heart, Inc., Denison, TX
Texas Logistics Education Foundation, Dallas, TX
Tony Brock Tennis Foundation, Inc., Cincinnati, OH
Transportation Research Institute, New Orleans, LA
Union Colony Estates, Greeley, CO
United States Amateur Boxing of Pontoon Beach, Inc., Pontoon Beach, IL
Valley Arts Society, Puyallup, WA
Verrazano Babe Ruth League, Staten Island, NY
Village Center of Poppleton, Baltimore, MD
Violence Intervention Prevention Coalition, Fort Worth, TX
VSL Association, San Marino, CA
Wisconsin State Equity Corporation, Madison, WI
Wisdom Bridge Theatre Foundation, Chicago, IL
Womad Foundation of North America, Inc., New York, NY
Womens Resource Center of El Paso, Inc., El Paso, TX
Young Organizers Uniting Teenage Harmony, Inc., Brooklyn, NY
Zichron Yitzchok, Inc., Bedford Hills, NY
Zion Hill Foundation of Rochester, Inc., Rochester, 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.

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Stoppenhagen, Larry	Ft. Wayne, IN	CPA	April 14, 2000 to April 13, 2001
Chon, James	N. Hollywood, CA	CPA	May 22, 2000 to May 21, 2003
Bleyer, Stephen A.	Bala Cynwyd, PA	CPA	June 26, 2000 to December 25, 2000
Knutson, Owen	Ouray, CO	CPA	July 3, 2000 to January 2, 2003
Silverman, Richard E.	Fayetteville, NY	CPA	August 1, 2000 to March 31, 2004
Holt, Jeffrey	Little Rock, AR	Enrolled Agent	October 1, 2000 to March 31, 2003
Barbagallo, Joseph	Newton, PA	CPA	October 15, 2000 to October 14, 2004

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Luebben, William	Hot Springs, AR	CPA	February 11, 2000

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

Section 110.—Qualified Lessee Construction Allowances for Short-Term Leases

26 CFR 1.110–1: Qualified lessee construction allowances.

T.D. 8901

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

Qualified Lessee Construction Allowances for Short-Term Leases

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final 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 final 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 final 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.

DATES: *Effective Date*: These regulations are effective October 5, 2000.

Date of Applicability: For date of applicability of §1.110–1, see §1.110–1(d).

FOR FURTHER INFORMATION CONTACT: Paul Handleman, (202) 622-3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have 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 1545-1661. Responses to these collections 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 control number.

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.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens 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

On September 20, 1999, the IRS published proposed regulations (REG–106010–98, 1999–40 I.R.B. 493) in the **Federal Register** (64 F.R. 50783) inviting comments under section 110. A public hearing was held January 19, 2000. Numerous comments have been received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

Public Comments

In accordance with section 110(a), the proposed regulations provided that 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. The proposed regulations defined a qualified lessee construction allowance as 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, provided the purpose and expenditure requirements are met.

Expenditure Requirement

The proposed regulations required that a qualified lessee construction allowance be 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 the retail space. However, the proposed regulations deemed an amount 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 8 1/2 months after the close of that taxable year.

Several commentators maintained that the proposed rule prescribing a time limit for making the expenditure is not required by the statute or the legislative history and should be eliminated. One commentator, for example, pointed out the absence of an explicit expenditure requirement in section 110 like the one found in section 118(c)(2)(B), which requires that an expenditure relating to a nontaxable contribution in aid of construction be made before the end of the second taxable year after the year in which such amount was received.

Section 110 does not provide an explicit expenditure time limit, but it also does not toll the statute of limitations until the taxpayer notifies the Secretary that the amount has been expended as does section 118. The lack of a statute of limitation tolling provision in section 110 would be troublesome if there was no limitation on the time period to make the qualified expenditure. In addition, section 110(a) provides that an amount may be excluded only to the extent that such amount does not exceed the amount expended by the lessee for the construction or improvement of qualified long-term real property.

The IRS and Treasury Department believe that the absence of an extension of the statute of limitations and use of the term "expended" in the past tense indicate that the amount must be expended by the end of the taxable year it is received. Ac-

cordingly, the final regulations retain the expenditure time limitation. However, in recognition that a lessee may not be able to expend the amount in the same taxable year the lessee receives the construction allowance from the lessor, the final regulations also retain the 8 1/2 month rule provided in the proposed regulations. This 8 1/2 month rule, which grants the lessee an additional 8 1/2 months after the close of the taxable year in which the construction allowance was received to expend the amount, is consistent with the time period, including extensions, that a corporate taxpayer has to file its return for the taxable year in which the construction allowance is received.

Commentators requested that to the extent the final regulations retain the expenditure requirement, the requirement should be modified to include construction allowances used to reimburse lessee expenditures made in a prior year. In response to these comments, the final regulations clarify that, provided the lessee has not depreciated the expenditures, reimbursements received in a taxable year after the year in which the expenditures are made by the lessee are timely for purposes of the expenditure requirement.

Purpose Requirement

Consistent with section 110(a), the proposed regulations provided that a qualified lessee construction allowance must be under a short-term lease of retail space and for the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at the retail space. The proposed regulations required that the lease agreement for the retail space expressly provide 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. The purpose requirement was intended to further Congressional intent of ensuring consistency in the treatment of the construction allowance by both the lessor and the lessee.

Commentators suggested deleting the requirement in the proposed regulations that the lease agreement "expressly provides" that a construction allowance be for the purpose of constructing or improving qualified long-term real property. Other commentators suggested changing this language to "substantially provides" or using a standard that would lead a reasonable person to conclude that the purpose of the construction allowance amount is for the construction or improvement of qualified long-term real property. The final regulations do not adopt these suggestions. The IRS and the Treasury Department believe that this express language is consistent with the requirements of section 110(a) and is necessary to help ensure that the lessor and the lessee take consistent tax positions.

In addition, commentators noted that lease agreements do not necessarily address construction allowances. The construction allowance provisions may be contained in another document executed contemporaneously with the lease agreement or executed during the lease term. For example, the lessor may provide a construction allowance during the lease term for the remodeling of the retail space by the lessee. In response to these comments, the final regulations clarify that an ancillary agreement executed contemporaneously with the payment of a construction allowance, whether executed with the lease or during the term of the lease, is considered a provision of the lease agreement for this purpose.

Definition of Retail Space

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. The proposed regulations specifically requested comments on whether the definition of "retail space" needs to be clarified.

In response to comments, the final regulations clarify that offices for hair stylists, tailors, shoe repairmen, doctors, lawyers, accountants, insurance agents, financial advisors, stock brokers, securities dealers (including dealers who sell securities out of inventory), and bankers are included in the definition of retail space. The final regulations also clarify that a taxpayer is selling to the general public if the products or services for sale are made available to everyone even though only certain customers or clients are targeted.

A commentator suggested that retail space should include back-office support functions that are contiguous to the retail sales area and not be limited only to areas where customers purchase products and services. Section 110(c)(3) and the proposed regulations only require that the property be used "in the trade or business" of selling tangible personal property or services to the general public. In response to these comments, the final regulations state that the term "retail space" includes not only the space where the retail sales are made, but also space where activities supporting the retail activity are performed (such as an administrative office, a storage area, and an employee lounge).

Definition of Lease Term

Consistent with section 110(c)(2), the proposed regulations defined a short-term lease as 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)). Section 168(i)(3) provides rules on determining when renewal options will be considered part of the lease term. Section 168(i)(3)(B) provides that, in the case of nonresidential real property or residential rental property, any option to renew at fair market value, determined at the time of renewal, is not taken into account for purposes of determining the lease term.

A commentator suggested that the final regulations stipulate that certain common renewal options will be considered to be at fair market value. For example, the commentator suggested that if a lease sets rent at a certain percentage of sales for the original lease term and uses that same percentage of sales for renewal options, the renewals should be considered to be at fair market value. As the comment relates to the determination of lease term under section 168 and would affect other provisions in addition to section 110 that reference section 168(i)(3), such as sections 142 and 280F, the comment is beyond the scope of this regulation. Accordingly, the final regulations do not adopt the suggested comment.

Information Requirement

The proposed regulations required qualified lessee construction allowance information to be furnished by the lessor and the lessee to the IRS, and described the time and manner for providing that information to the IRS. The proposed regulations also provided that a lessor or a

lessee that fails to furnish the required information may be subject to a penalty under section 6721.

A commentator suggested that the required information to be furnished should be the information that is current at the time the lease is executed. According to the commentator, it would not be unusual for a lease to be executed years prior to the payment and receipt of the construction allowance. One of the parties to the lease may have been acquired by another taxpayer or its name and address may have changed.

The final regulations do not adopt the suggestion. The purpose of the information reporting by the lessor and the lessee is to ensure consistent treatment of the construction allowance as nonresidential property owned by the lessor. Accordingly, it is imperative that the identity of the persons paying and receiving the construction allowance amount and relevant information provided be correct.

A commentator suggested that the information requirement should absolve the party filing the information statement from any penalty under section 6721 if the party relied upon incorrect information received from the other party or if the information cannot be obtained from the other party after reasonable efforts. Section 6724(a) provides that no penalty shall be imposed under section 6721 with respect to any failure if it is shown that such failure is due to reasonable cause and not willful neglect. Thus, no penalty under section 6721 will apply to a lessor (or a lessee) if the failure to furnish qualified lessee construction allowance information resulted from the lessee (or the lessor) providing incorrect information to the other party to the lease upon which the lessor (or the lessee) relied in good faith.

Another commentator suggested that the information to be furnished by a lessor is duplicative because the lessee is required to furnish the same information to the IRS. According to the commentator, the lessee should bear the entire burden of filing the required information because the lessee is the primary beneficiary of section 110. The final regulations do not adopt the commentator's suggestion. The information provided by the lessor is helpful in corroborating the information provided by the lessee and ensures that the lessor treats the amount as nonresidential real property on its return. Moreover, the reporting requirement in section 110(d) specifically provides that both the lessor and the lessee should furnish information.

Effective Date

The proposed regulations proposed an effective date applicable to leases entered into on or after the date final regulations are published in the **Federal Register**. A commentator suggested delaying the effective date of the final regulations to allow businesses a short period to conform their business practices to the final regulations. The final regulations adopt this suggestion by making the regulations effective 30 days after the date the final regulations are published in the **Federal Register**.

Although the final regulations do not provide for an election to apply the regulations retroactively, taxpayers who comply with the rules set forth in the regulations for leases entered into after August 5, 1997, and prior to the effective date of the regulations (other than the reporting requirement) will be treated as meeting the requirements of section 110.

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. 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, 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 Paul F. Handleman, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

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 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. The term *retail space* includes not only the space where the retail sales are made, but also space where activities supporting the retail activity are performed (such as an administrative office, a storage area, and employee lounge). Examples of services typically sold to the general public include services provided by hair stylists, tailors, shoe repairmen, doctors, lawyers, accountants, insurance agents, stock brokers, securities dealers (including dealers who sell securities out of inventory), financial advisors and bankers. For purposes of this paragraph (b)(2)(iii), a taxpayer is selling to the general public if the products or services for sale are made available to the general public, even if the product or service is targeted to certain customers or clients.

(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 the retail space. An ancillary agreement between the lessor and the lessee providing for a construction allowance, executed contemporaneously with the lease or during the term of the lease, is considered a provision of the lease agreement for purposes of the preceding sentence, provided the agreement is executed before payment of the construction allowance.

(4) *Expenditure requirement*—(i) *In general.* Expenditures referred to in paragraph (b)(1)(iii) of this section may 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—

(A) The amount is expended by the lessee within 8 1/2 months after the close of the taxable year in which the amount was received; or

(B) The amount is a reimbursement from the lessor for amounts expended by the lessee in a prior year and for which the lessee has not claimed any depreciation deductions.

(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 October 5, 2000.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b) is amended by adding an entry for 1.110–1 to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 29, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 1, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 5, 2000, 65 F.R. 53584)

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.110–1	1545-1661
* * * * *	

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

T.D. 8898

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

Continuity of Interest

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the continuity of interest requirement for corporate reorganizations. The final regulations affect corporations and their shareholders. The final regulations provide that distributions and redemptions by a target corporation prior to a potential reorganization are taken into account for continuity of interest purposes to the extent that the consideration received by the target shareholder in the redemption or distribution is treated as other property or money under section 356 of the Internal Revenue Code, or to the extent that the consideration would be treated as other property or money if the target shareholder also had received stock of the issuing corporation in exchange for stock owned by the shareholder in the target corporation.

DATES: *Effective Dates*: These regulations are effective August 30, 2000.

Applicability Dates: For dates of applicability of these regulations, see the "Effective Dates" portion of the Supplementary Information of the preamble.

FOR FURTHER INFORMATION CONTACT: Marie Byrne, (202) 622-7750 (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 1545-1691.

The collection of information in these regulations is in §1.368–1(e)(7). The information is a private letter ruling request to apply the final regulations to a transaction in which a taxpayer has entered into a binding agreement on or after January 28, 1998 (the effective date of §1.368–1T), and before the effective date of the final regulations. This information will be used to ensure that all parties to the transaction take consistent positions for Federal tax purposes. The collection of information is elective. If §1.368–1T would apply to a transaction, but the taxpayer would prefer to apply the final regulations, the taxpayer may elect to submit the information. The likely respondents are businesses or other for-profit institutions.

Comments concerning the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of 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. Any such comments should be submitted not later than October 30, 2000.

Comments are specifically requested concerning:

(a) Whether the collection of information is necessary for the proper performance of the functioning of the Internal Revenue Service, including whether the information will have practical utility;

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

(c) How the quality, utility, and clarity of the information requested may be enhanced;

(d) 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

(e) Estimates of capital or start-up costs, and costs of operation, mainte-

nance, and purchase of services to provide information.

Estimated total annual reporting burden: 1,500 hours

The annual burden per respondent varies from 50 to 200 hours, depending on individual circumstances, with an estimated average of 150 hours.

Estimated number of respondents: 10

Estimated 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 it displays a valid control number assigned by the OMB.

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 January 28, 1998, the Treasury Department and IRS published final regulations on the continuity of interest (COI) requirement for potential corporate reorganizations, which permitted former target corporation (T) shareholders to sell stock in the issuing corporation (P) without causing the potential reorganization to fail to satisfy the COI requirement (T.D. 8760, 1998–1 C.B. 803 [63 F.R. 4174]). Additionally, the IRS and Treasury Department published temporary (T.D. 8761, 1998–1 C.B. 812) and proposed regulations (REG–120882–97, 1998–1 C.B. 824) (the Temporary Regulations) in the **Federal Register** at 63 F.R. 4183 and 63 F.R. 4204, respectively, relating to redemptions of, and extraordinary distributions on, T stock prior to certain otherwise qualifying reorganizations.

The Treasury Department and IRS received written comments in response to the proposed regulations. A public hearing on the proposed regulations was held on May 26, 1998. After consideration of all comments, §1.368–1T, published at 63 F.R. 4183, is removed. Section 1.368–1(e) is amended by this Treasury decision.

Explanation of Provisions

The Internal Revenue Code provides general nonrecognition treatment for reorganization transactions specifically described in section 368. In addition to complying with the statutory requirements and certain other requirements, a transaction generally must satisfy the COI requirement. The purpose of the COI requirement is to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. COI requires that in substance a substantial part of the value of the proprietary interests in T be preserved in the reorganization. These final regulations address the effect on COI of prereorganization redemptions and distributions.

The Temporary Regulations

The Temporary Regulations provide that a proprietary interest in T is not preserved if, prior to and in connection with a potential reorganization, it is redeemed, or to the extent that, prior to and in connection with a potential reorganization, an extraordinary distribution is made with respect to it.

Several commentators argued that the Temporary Regulations are overly broad. Some suggested that the scope of the COI requirement should closely parallel the law regarding the "solely for voting stock" requirement for reorganizations under §368(a)(1)(B) and (C), because both the solely for voting stock requirement and the COI requirement arose out of similar concerns, i.e., to prevent transactions that resemble sales from qualifying for nonrecognition treatment available to corporate reorganizations. These commentators maintain that, similar to the solely for voting stock rule, prereorganization redemptions and extraordinary distributions by T should not be taken into account for COI purposes unless P directly or indirectly furnishes the consideration for the redemption or distribution. A rule that goes beyond this, they argue, converts the COI requirement into an asset continuity test, and thus overlaps with the continuity of business enterprise requirement (COBE) and the "substantially all the assets" requirement for certain reorganizations.

In addition, one commentator maintained that the Temporary Regulations provide inconsistent results by treating extraordinary distributions taxed as dividends under section 301 as the equivalent of sales proceeds for purposes of COI.

Other commentators expressed concern that certain types of taxpayers, such as S corporations, are inappropriately adversely affected by the approach of the Temporary Regulations. The commentators noted that when an S corporation merges into a C corporation, it is common for the S corporation, in advance of the reorganization, to make distributions in the amount of its accumulated adjustments account (AAA). If large enough, such distributions may cause the potential reorganization to fail to qualify for tax-free treatment because the COI requirement is not satisfied under the Temporary Regulations. These commentators believe that this application of the COI rules in the Temporary Regulations to S corporation reorganizations is inconsistent with section 1371, which generally provides that subchapter C applies to an S corporation, except to the extent inconsistent with subchapter S, because the practice of making prereorganization AAA distributions makes it more difficult for S corporations than for C corporations to qualify for reorganization treatment. Similar concerns arise when a controlled foreign corporation (CFC) distributes income from its previously taxed income account with respect to its subpart F income (see section 959). Another commentator suggested that distributions made by a C corporation immediately prior to a merger with a Regulated Investment Company (RIC) or Real Estate Investment Trust (REIT) should not be treated as extraordinary distributions. Under §§1.852–12 (for RICs) and 1.857–11 (for REITs), a C corporation that merges into a RIC or REIT must distribute all non-RIC or non-REIT earnings and profits before the end of the RIC's or REIT's first taxable year. Consequently, a C corporation typically will distribute such earnings and profits prior to a merger with a RIC or REIT.

After considering these comments, the purpose of the COI requirement, and the other existing protections that prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations, the Treasury Department and IRS have concluded that the approach of the final regulations best reflects the purpose of the COI requirement. The regulations provide that a proprietary interest in T (other than one held by P) is not preserved

to the extent that consideration received prior to a potential reorganization, either in a redemption of T stock or in a distribution with respect to T stock, is treated as other property or money received in the exchange for purposes of section 356 or would be so treated if the T shareholder also had received stock of P in exchange for stock owned by the shareholder in T. In determining whether consideration is treated as other property or money under section 356 received in an exchange for a proprietary interest in T, taxpayers should consider all facts, circumstances, and relevant legal authorities.

The regulations posit for COI purposes that each T shareholder receives some P stock in exchange for T stock. Section 356 generally does not apply to a T shareholder who does not receive any P stock in exchange for T stock in a reorganization. See Rev. Rul. 74–515 (1974–2 C.B. 118). Solely for purposes of determining whether the COI requirement is satisfied, however, the regulations deem each T shareholder to have received some P stock in exchange for T stock (without ascribing any value to that stock). The regulations thus use the same criterion for determining whether COI is satisfied, regardless of whether a T shareholder receives any P stock. These final regulations do not offer safe harbors or special rules for the transactions about which commentators expressed concern. Unlike the temporary regulations, however, the final regulations do not automatically take all prereorganization redemptions and extraordinary distributions in connection with the reorganization into account for COI purposes.

Stock Repurchase Programs

Example 8 of §1.368–1(e)(6) illustrates the effect on COI of a general stock repurchase program. In the example, P repurchases a small percentage of its stock after a reorganization, as part of a preexisting stock repurchase program. COI is satisfied because the redemption of a small percentage of P stock was not in connection with the merger. In response to comments received, the IRS and Treasury Department issued further guidance on the effect of a stock repurchase program on COI in Rev. Rul. 99–58 (1999–52 I.R.B. 701). Because *Example 8* suggests a more restrictive approach to COI than was intended in this context, *Example 8* is removed by this Treasury decision.

Effect on Other Authorities

These COI regulations apply solely for purposes of determining whether the COI requirement is satisfied. No inference should be drawn from any provision of this regulation as to whether other reorganization requirements are satisfied, or as to the characterization of a related transaction.

Effect on Other Documents

The following publications do not apply to the extent they are inconsistent with these regulations:

Rev. Proc. 77–37 (1977–2 C.B. 568).

Rev. Proc. 86–42 (1986–2 C.B. 722).

Effective Dates

These regulations apply to transactions occurring after August 30, 2000, unless the transaction occurs pursuant to a written agreement that is (subject to customary conditions) binding on that date and at all times thereafter. Taxpayers who entered into a binding agreement on or after January 28, 1998 (the date that the temporary and proposed regulations were filed with the **Federal Register**), and before August 30, 2000, may request a private letter ruling permitting them to apply the final regulations to their transaction. A private letter ruling will not be issued unless the taxpayer establishes to the satisfaction of the IRS that there is not a significant risk of different parties to the transaction taking inconsistent positions, for U.S. tax purposes, with respect to the applicability of the final regulations to the transaction.

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 final 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 on the fact that while the burden of making this collection of information may be significant when applicable, taxpayers will have to make this collection of information only if they are corporations or shareholders of corporations who are parties to a purported reorganization in which COI would not be preserved under the Temporary regulations. The IRS estimates that the number of taxpayers who will need to make this collection of information will be 10 or fewer. 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, these final 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 Marie Byrne of the Office of the Associate 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 parts 1 and 602 are 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 1.368–1 is amended by:

1. Revising paragraph (e)(1)(ii).
2. Removing paragraph (e)(2)(ii).
3. Removing the paragraph designation (e)(2)(i).
4. Removing *Example 8* of paragraph (e)(6).
5. Redesignating *Example 9* of paragraph (e)(6) as *Example 8*.
6. Adding new *Example 9* to paragraph (e)(6).
7. Adding three sentences to the end of paragraph (e)(7).

The additions and revision read as follows:

§1.368–1 Purpose and scope of exception of reorganization exchanges.

*****

(e) *** (1) ***

(ii) For purposes of paragraph (e)(1)(i) of this section, a proprietary interest in the target corporation (other than one held by the acquiring corporation) is not preserved to the extent that consideration received prior to a potential reorganization, either in a redemption of the target corporation stock or in a distribution with respect to the target corporation stock, is treated as other property or money received in the exchange for purposes of section 356, or would be so treated if the target shareholder also had received stock of the issuing corporation in exchange for stock owned by the shareholder in the target corporation.

*****

(6) ***

Example 9. Preacquisition redemption by target corporation. T has two shareholders, A and B. P expresses an interest in acquiring the stock of T. A does not wish to own P stock. T redeems A's shares in T in exchange for cash. No funds have been or will be provided by P for this purpose. P subsequently acquires all the outstanding stock of T from B solely in exchange for voting stock of P. The cash received by A in the prereorganization redemption is not treated as other property or money under section 356, and would not be so treated even if A had received some stock of P in exchange for his T stock. The prereorganization redemption by T does not affect continuity of interest, because B's proprietary interest in T is unaffected, and the value of the proprietary interest in T is preserved.

(7)*** Paragraph (e)(1)(ii) of this section, however, applies to transactions occurring after August 30, 2000, unless the transaction occurs pursuant to a written agreement that is (subject to customary conditions) binding on that date and at all times thereafter. Taxpayers who entered into a binding agreement on or after January 28, 1998, and before August 30, 2000, may request a private letter ruling permitting them to apply the final regulation to their transaction. A private letter ruling will not be issued unless the taxpayer establishes to the satisfaction of the IRS that there is not a significant risk of different parties to the transaction taking inconsistent positions, for Federal tax purposes, with respect to the applicability of the final regulations to the transaction.

§1.368–1T [Removed]

Par. 3. Section 1.368–1T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. Section §602.101, paragraph (b) is amended by adding an entry 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.
* * * * *	
1.368–1	1545-1691
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 23, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 30, 2000, 8:45 a.m., and published in the issue of the Federal Register for August 31, 2000, 65 F.R. 52909)

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)–4: Section 411(d)(6) protected benefits.

T.D. 8900

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Special Rules Regarding Optional Forms of Benefit Under Qualified Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that permit qualified defined contribution plans to be amended to eliminate some alternative forms in which an account balance can be paid under certain circumstances, and permit certain transfers between defined contribution plans that were not permitted under prior final regulations. These regulations affect qualified retirement plan sponsors, administrators, and participants.

DATES: These regulations are effective September 6, 2000.

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, 202-622-6090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 1 under section 411(d)(6) of the Internal Revenue Code of 1986 (Code).

Section 411(d)(6) generally provides that a plan will not be treated as satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by a plan amendment. Section 411(d)(6)(B), which was added by the Retirement Equity Act of 1984 (REA), Public Law 98-397 (98 Stat. 1426), provides that a plan amendment that eliminates an optional form of benefit is treated as reducing accrued benefits to the extent that the amendment applies to benefits accrued as of the later of the adoption date or the effective date of the amendment. However, section 411(d)(6)(B) authorizes the Secretary of the Treasury to provide exceptions to this requirement. This authority does not extend to a plan amendment that would have the effect of elimi-

nating or reducing an early retirement benefit or a retirement-type subsidy. Section 204(g)(2) of the Employee Retirement Income Security Act of 1974 (ERISA), Public Law 93-406, (88 Stat. 829) provides a parallel rule to section 411(d)(6)(B) of the Code that applies under Title I of ERISA, and authorizes the Secretary of the Treasury to provide exceptions to this parallel ERISA requirement. Thus, Treasury regulations issued under section 411(d)(6)(B) of the Code apply as well for purposes of section 204(g)(2) of ERISA.

Final regulations regarding section 411(d)(6)(B) (the 1988 regulations) were published in the **Federal Register** on July 8, 1988. The 1988 regulations, and subsequent amendments to the regulations, define the optional forms of benefit that are protected under section 411(d)(6)(B) and provide for certain exceptions to the general rule of section 411(d)(6)(B). In general, these regulatory exceptions to the application of section 411(d)(6)(B) to optional forms of benefit have been developed to address certain specific practical problems. For example, §1.411(d)–4, Q&A-3(b) of the 1988 regulations permits a plan-to-plan transfer of a participant's entire nonforfeitable benefit to be made at the election of the participant, without a requirement that the transferee plan preserve all section 411(d)(6) protected benefits, but only if the participant is eligible to receive an immediate distribution and certain other conditions are satisfied. In addition, some regulatory exceptions to the application of section 411(d)(6)(B) to optional forms of benefit address plan amendments that are related to statutory changes. See Q&A-2(b) and Q&A-10 of §1.411(d)–4.

The IRS and Treasury recognize that the accumulation of a variety of payment choices in a plan may increase the cost and complexity of plan operations. For example, an employer that initially adopted a plan for which the plan document was prepared by a prototype sponsor may now be using a different prototype plan that offers a different array of distribution forms. The requirement to preserve virtually all preexisting optional forms for benefits accrued up to the date of change in the prototype plan may present significant practical problems in certain cases. Similar issues arise where employers merge with or acquire other businesses. These employers often face issues of whether to maintain separate plans, terminate one or more of the plans, or merge the plans. If the employer chooses to merge the plans, the resulting plan may accumulate a wide variety of optional forms, some of which may differ in insignificant ways or may entail special administrative costs. Because the elective transfer rule of §1.411(d)–4, Q&A-3(b) of the 1988 regulations has applied only to situations in which a participant's benefits have become distributable, its applicability has been limited.

In recent years, it has become easier for individuals to replicate the various payment choices available from qualified plans through other means. The Unemployment Compensation Amendments of 1992, Public Law 102-318 (106 Stat. 290), substantially expanded participants' ability to transfer distributions from qualified plans to individual retirement arrangements (IRAs) on a tax-deferred basis. Individuals who receive single-sum distributions from qualified plans frequently roll those distributions over directly to IRAs, under which distributions can be made in a wide variety of payment forms. There are also indications that the vast majority of participants in defined contribution plans who are given a choice of distribution forms that includes a single-sum distribution elect the single-sum distribution.

The IRS and Treasury issued Notice 98–29 (1998–1 C.B. 1163) to request public comment on several ways of providing regulatory relief from the requirements of section 411(d)(6)(B) for defined contribution plans in view of these considerations. Most of the public comments received in response to Notice 98–29 indicated that, particularly for defined contribution plans, the section 411(d)(6)(B) requirement that a plan continue to offer all existing payment options often imposes significant administrative burdens that are disproportionate to any corresponding benefit to participants. After considering the comments received in response to Notice 98–29, the IRS and Treasury issued proposed regulations (REG–109101–98, 2000–16 I.R.B. 903), which were published in the **Federal Register** (65 F.R. 16546) on March 29, 2000, to propose relief from the requirements of section 411(d)(6)(B) in a wide range of circumstances.

Seventeen written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. Nearly all of the written comments expressed support for the provisions of the proposed regulation that would provide relief from the requirements of section 411(d)(6)(B) and requested clarifications or extensions of that relief in various ways. After consideration of all of the written comments, the IRS and the Treasury Department are adopting the proposed regulations as revised by this Treasury Decision for the reasons summarized below.

These final regulations under section 411(d)(6)(B) do not affect other requirements of the Code. For example, a money purchase pension plan (or a plan otherwise described in section 401(a)(11)(B)) generally must satisfy certain requirements relating to qualified joint and survivor annuities and qualified preretirement survivor annuities, and those requirements are not affected by these final regulations. Similarly, these final regulations do not affect the requirements of section 401(a)(31) relating to direct rollovers.

Explanation of Provisions

A. *Permitted Amendments to Alternative Forms of Payment Under a Defined Contribution Plan*

In order to simplify plan administration, these final regulations adopt a modified version of the rule set forth in the proposed regulations that significantly expands the permitted changes that may be made to alternative forms of payment under a defined contribution plan. Under the rule in the proposed regulations, a defined contribution plan would not violate the requirements of section 411(d)(6) merely because the plan was amended to eliminate or restrict the ability of a participant to receive payment of the participant's accrued benefit under a particular optional form of benefit if, after the plan amendment became effective with respect to the participant, the distribution choices available to the participant included both payment of the accrued benefit in a single-sum distribution form and payment of the accrued benefit in an extended pay-

ment form (such as, for example, an annuity distribution), each of which was otherwise identical to the eliminated or restricted optional form of benefit. In the preamble to the proposed regulations, the IRS and the Treasury Department requested comments on whether an extended payment form should be required to be preserved as part of such a plan amendment, or should be required to be preserved in particular circumstances.

In general, comments stated that the rule set forth in the proposed regulations would simplify plan administration. However, most commentators also indicated that requiring the retention of an extended payment form would perpetuate administrative burdens that would not be justified by any comparative advantage to plan participants. These commentators pointed out various administrative burdens associated with retaining an extended payment form, such as maintaining a system to administer the extended payment form for the few (if any) participants who choose that payment form, including descriptions of the extended payment form in participant materials, explaining the extended payment form in response to participant inquiries, dealing with participant requests to accelerate distributions under the extended payment form, complying with the minimum required distribution rules of section 401(a)(9), and handling the problems that result from an increased incidence of missing participants. These commentators also pointed out the special burdens that maintenance of an extended payment option imposes in mergers and acquisitions. These commentators took the position that, in light of a participant's ability to roll over distributions to one or more IRAs, which commonly offer a far wider array of alternative payment forms, and in light of the ability of many participants to choose to retain their full vested account balance in the qualified plan, there is little or no advantage to the participant in rules requiring the plan sponsor to retain an option to receive extended payments from a qualified defined contribution plan.

After considering these comments regarding the desirability of requiring the retention of an extended payment form, and in light of the ability of participants to replicate any extended payment form that a defined contribution plan may offer by rolling over a single-sum distribution to an IRA, the IRS and the Treasury Department have determined that any advantages of requiring the retention of an extended payment form are outweighed by the countervailing considerations. Accordingly, these final regulations generally provide that a defined contribution plan does not violate the requirements of section 411(d)(6) merely because the plan is amended to eliminate or restrict the ability of a participant to receive payment of accrued benefits under a particular optional form of benefit if, after the plan amendment is effective with respect to the participant, the alternative forms of payment available to the participant include payment in a single-sum distribution form that is otherwise identical to the optional form of benefit that is being eliminated or restricted. The final regulations adopt the rules set forth in the proposed regulations for determining whether a single-sum distribution is otherwise identical to an optional form of benefit that is being eliminated or restricted.

However, the final regulations include a provision that protects participants taking distributions shortly after the plan is amended, who may have planned on the availability of the payment form that is being eliminated or restricted. Under this provision, a plan amendment that eliminates or restricts the ability of a participant to receive a particular optional form of benefit cannot apply to any distribution that has an annuity starting date earlier than the 90th day[1] after the date the participant receiving the distribution has been furnished a summary that reflects the amendment and that satisfies the requirements of the Labor Department regulations at 29 CFR 2520.104b–3 relating to a summary of material modifications for pension plans (or, if earlier, the first day of the second plan year following the plan year in which the amendment is adopted).

As noted above, the final regulations do not affect the survivor annuity requirements of sections 401(a)(11) and 417 or the direct rollover requirements of section 401(a)(31).

[1] This 90-day requirement is parallel to the 90-day election period applicable to any plan that is subject to the joint and survivor annuity requirements of section 417.

One commentator expressed concern that permitting plan amendments that eliminate alternative forms of payment would have the effect of permitting the elimination of subsidized early retirement benefits (i.e., distribution forms available upon early retirement that have a higher actuarial value than the normal retirement benefit that has been accrued at the time the distribution begins). These regulations, however, permit plan amendments eliminating alternative forms of payment only in certain circumstances involving defined contribution plans. Under a defined contribution plan, a participant is entitled to a distribution, in whatever form may be provided under the plan, only to the extent of the participant's individual account, plus earnings thereon. Accordingly, no alternative form of payment can be subsidized relative to any other payment form available under a defined contribution plan. Thus, these regulations do not have the effect of permitting the elimination of any early retirement subsidy or any other subsidized benefit forms.

B. *Voluntary Direct Transfers Between Plans*

Under certain circumstances, the 1988 regulations permitted elimination of optional forms of benefit in connection with transfers of benefits from one plan to another with a participant's consent. See §1.411(d)–4, Q&A-3(b) (as contained in 26 CFR part 1 revised April 1, 2000). The proposed regulations contained a number of changes to the 1988 regulations that would significantly liberalize the application of these elective transfer provisions. These final regulations generally finalize the provisions of the proposed regulations relating to elective transfers, with certain modifications that are described below.

The 1988 regulations permitted an elective transfer from one qualified plan to another only if the participant's benefit under the transferring plan was immediately distributable (a distributable event transfer). This condition precluded use of the elective transfer provision in the 1988 regulations in connection with merger and acquisition transactions involving plans with a cash or deferred arrangement under section 401(k) in cases in which benefits under the cash or deferred arrangement were not distributable because section

401(k)(10) was not applicable. In response to Notice 98–29, many commentators stated that permitting elective transfers from the former employer's section 401(k) plan to the new employer's section 401(k) plan under these circumstances would allow employers to permit employees to keep their previously earned retirement benefits in a qualified plan together with their newly earned retirement benefits, particularly in cases where the new employer chooses not to maintain the former employer's plan.

Section 1.411(d)–4, Q&A-3(c) of these final regulations retains and modifies the previously applicable section 411(d)(6) relief for distributable event transfers, and §1.411(d)–4, Q&A-3(b) of these final regulations adds new section 411(d)(6) relief for transfers in connection with certain corporate mergers and acquisitions or changes in the participant's employment status (transaction or employment change transfers). As a result, relief from section 411(d)(6) applies in each of the following cases:

- *Direct rollover.* Existing rules provide that if a direct rollover is made from one qualified retirement plan to another, as described in section 401(a)(31), the receiving plan is not required by section 411(d)(6) to offer the same optional forms of benefit as the sending plan offered. See §1.401(a)(31)–1, Q&A-14.
- *Distributable event transfer.* As discussed further below, in any case in which a participant is entitled to a distribution from either a defined benefit plan or a defined contribution plan but the participant is not eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that can be entirely rolled over, these final regulations provide section 411(d)(6) relief for a voluntary transfer. Thus, these regulations modify the distributable event transfer provisions of the 1988 regulations.
- *Transaction or employment change transfer.* As discussed further below, even if a participant is not entitled to a distribution to which the preceding rules would apply, these final regulations, like the proposed regulations, allow a voluntary transfer from a defined contribution plan to another defined contribution plan of the same type if the transfer occurs in connection with a corporate merger or acquisition or a change in the participant's employment status. See §1.411(d)–4, Q&A-3(b).

Under certain circumstances, it may be possible to accomplish a voluntary transfer of a participant's benefit from one defined contribution plan to another that could be structured as either a distributable event transfer or a transaction or employment change transfer. In such a situation, the plans would be required to comply with the requirements applicable to either one of those sets of rules with respect to the transfer.

1. *Expansion of Section 411(d)(6) Relief for Distributable Event Transfers*

Under section 401(a)(31), which was enacted after the issuance of the 1988 regulations, any eligible rollover distribution may be directly rolled over to an IRA or to another eligible retirement plan. The section 411(d)(6) requirements do not apply to amounts that have been distributed, including distributions that are directly rolled over to another plan under section 401(a)(31). Accordingly, for amounts that are distributable in an eligible rollover distribution, the elective transfer rules of the 1988 regulations have largely been duplicated by the enactment of section 401(a)(31) because the same section 411(d)(6) result generally is available through a direct rollover. These final regulations generally eliminate this duplication. Under these final regulations, for transfers occurring on or after January 1, 2002, the distributable event transfer rules are not available if the participant is eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of section 401(a)(31)(C). (Instead, the plan must offer a section 401(a)(31) direct rollover.) However, in other situations, including situations in which a single-sum distribution is not available or the participant's benefit includes an amount attributable to after-tax employee contributions, the distributable event transfer rules will be available.

Some commentators requested that plans have the ability to characterize a transfer that could be accomplished totally or in part as a direct rollover under section 401(a)(31) as a direct transfer to which section 411(d)(6) relief applies. They point out that this procedure is permitted under the 1988 regulations and that this procedure would simplify plan administration. These final regulations clarify that plans are not required to bifurcate a transaction into a partial section 401(a)(31) direct rollover and a partial elective transfer to which section 411(d)(6) relief applies, but that plans are permitted, as an alternative to bifurcation, to treat such a transaction entirely as an elective transfer to which section 411(d)(6) relief applies. However, as noted above, for transfers occurring on or after January 1, 2002, this section 411(d)(6) relief for distributable event transfers does not apply to an elective transfer that occurs at a time at which the participant is eligible to receive an immediate distribution of the participant's entire nonforfeitable account balance in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of section 401(a)(31)(C). Instead, a similar result could be achieved by means of a direct rollover to which section 401(a)(31) applies.

Under the proposed regulations, the section 411(d)(6) relief for transfers of immediately distributable amounts other than eligible rollover distributions would only have applied to transfers between plans of the same type (i.e., transfers from defined benefit plans to defined benefit plans and transfers from defined contribution plans to defined contribution plans), notwithstanding that the 1988 regulations granted section 411(d)(6) relief to transfers between plans of different types (i.e., transfers from defined benefit plans to defined contribution plans and vice versa). The preamble specifically requested comments on whether section 411(d)(6) relief was needed for distributable event transfers between different types of plans, given the availability of direct rollovers. Several commentators stated that this section 411(d)(6) relief provided under the 1988 regulations was still valuable and also requested clarification that the relief applied to transfers of amounts that were immediately distributable only in the form of periodic payments commencing

immediately. These final regulations adopt both of these recommendations.

2. *Section 411(d)(6) Relief for Transaction or Employment Change Transfers*

Section 1.411(d)–4, Q&A-3(b) of these final regulations retains and, in some respects, expands provisions of the proposed regulations that grant, subject to certain conditions, broad section 411(d)(6) relief for many types of elective transfers of a participant's entire benefit under a defined contribution plan, whether or not the benefit is immediately distributable (and whether or not the participant would be eligible for a distribution of the participant's entire benefit in a single-sum distribution that would be an eligible rollover distribution). In order to ensure that the participant's election occurs in connection with an independent event (and is not, in effect, a mere waiver), the transfer must be made either in connection with certain corporate transactions (such as a merger or acquisition) or in connection with a participant's change in employment status (for example, the participant's transfer to a different subsidiary or division of the employer, without regard to whether the transfer constitutes a separation from service) to an employment status with respect to which the participant is not entitled to additional allocations under the transferor plan, even if the event is not one that triggers the right to an immediate distribution. Such elective transfers can be made to a plan that is outside the employer's controlled group, to another plan of the same employer, or to a plan that is maintained by another member of the employer's controlled group.

A transaction or employment change transfer may involve benefits that are not fully vested under the transferor plan. However, where a participant's benefit that is not fully vested under the transferor plan is transferred pursuant to these rules, the vesting schedule amendment requirements of section 411(a)(10) must be satisfied.

A transaction or employment change transfer generally is only permitted between defined contribution plans of the same type (e.g., from a qualified cash or deferred arrangement under section 401(k) to another qualified cash or deferred arrangement). The restrictions on the types of plans between which transaction or employment change transfers are permitted facilitate administration of the qualified plan distribution rules by ensuring that amounts transferred to the receiving plan, in a transfer that is not itself a distribution, will be subject to similar legal restrictions with respect to in-service distributions. See Rev. Rul. 94–76 (1994–2 C.B. 46). In the case of transfers from plans that are subject to the survivor annuity requirements of sections 401(a)(11)(A) and 417, those survivor annuity requirements would in any event apply to the receiving plan with respect to the transferred amount as a result of the transferee plan rule of section 401(a)(11)(B)(iii)(III).

In response to comments, the final regulations clarify that the right to a transaction or employment change transfer is an other right or feature for purposes of section 401(a)(4) (unlike a distributable event transfer, which is treated as an optional form of benefit for purposes of section 401(a)(4)). In applying section 401(a)(4) to a transaction or employment change transfer right, the final regulations permit certain conditions to be disregarded. Thus, for example, section 401(a)(4) would be satisfied if, with respect to all participants: (1) the plan provides a transfer right in the event that an employee ceases to be covered by the plan because of any asset or stock disposition, merger or other similar business transaction involving a change of the employer; (2) the plan provides a transfer right in the event that an employee ceases to be covered by the plan because of an identified asset or stock disposition, merger or other similar business transaction that involves a change of the employer; or (3) the plan provides a transfer right in the event that an employee ceases to be covered by the plan because of a transfer of employment to a position covered by another plan within the employer's controlled group.

C. *Rules Regarding In-Kind Distributions*

The final regulations clarify and modify the rules regarding the application of the protections of section 411(d)(6)(B) to a right to receive benefit distributions in kind from defined contribution plans and defined benefit plans. Provisions for distribution in kind are sometimes found, for example, in plans invested in annuity contracts or in marketable mutual funds. The right to a particular form of investment is not a protected optional form of benefit. However, the investments made by a plan generally are subject to fiduciary requirements, including the prudence requirement of section 404(a)(1)(B) of ERISA. The 1988 regulations state that the right to a medium of distribution, such as cash or in-kind payments, is an optional form of benefit to which section 411(d)(6)(B) applies.

The proposed regulations provided that, if a defined benefit plan included an optional form of benefit under which benefits were distributed in the medium of an annuity contract, that optional form of benefit could be modified by substituting cash for the annuity contract. The proposed regulations separately provided a similar rule for defined contribution plans that provided an annuity optional form of benefit and for distribution of an annuity contract, and that substituted a non-annuity optional form of benefit for the annuity form. These final regulations combine and simplify these two rules. The final regulations clarify that a participant's right to receive a particular benefit in the form of cash payments from either a defined benefit plan or a defined contribution plan and a participant's right to receive that benefit in the form of the distribution of an annuity contract that provides for cash payments that are otherwise identical in all respects to those cash payments from the plan are not separate optional forms of benefit. Therefore, for example, if a plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract that provides for cash payments, that optional form of benefit may be modified by a plan amendment that substitutes cash payments from the plan for the distribution of the annuity contract, where those cash payments from the plan are identical to the cash payments payable from the annuity contract in all respects except for the source of the payments. Of course, a defined contribution plan that continues to offer a life annuity form of distribution must purchase an annuity contract from an insurance carrier in order to provide that optional form (and the

plan may either distribute that contract to the participant or hold the contract as a plan asset from which it makes the payments for the participant).

These final regulations permit a defined contribution plan to be amended to replace the ability to receive a distribution in the form of marketable securities (other than employer securities) with the ability to receive a distribution in the form of cash. Thus, the right to distributions from a defined contribution plan in the form of cash, employer securities or other property that is not marketable securities is generally protected. The protection for employer securities reflects the potential value of the special tax treatment provided to net unrealized appreciation (NUA) on employer securities under section 402(e)(4). The protection for assets that are not marketable securities reflects that possibility that a participant may assign a higher value to such assets than the plan without the participant having the ability to acquire the asset after receiving a cash distribution.

The proposed regulations would permit a defined contribution plan that gives a participant the right to an in-kind distribution (including employer securities and property that is not marketable securities) to be amended to limit the types of property in which distributions can be made to a participant to specific types of property allocated to the participant's account at the time of the amendment (and with respect to which the participant had the right to receive an in-kind distribution before the plan amendment). In addition, the proposed regulations would permit a defined contribution plan giving a participant the right to a distribution in a type of property to be amended to specify that the participant is permitted to receive a distribution in that type of property only to the extent that the plan assets allocated to the participant's account at the time of the distribution include that type of property.

These provisions of the proposed regulations were supported by commentators and have been adopted in these final regulations. In response to commentator suggestions, the examples from the proposed regulations have been modified in these regulations to clarify that a plan amendment that limits the right of a distribution in specified types of property to certain participants, as permitted by these regulations, need not itself contain a list of those participants. These provisions of the final regulations do not permit a plan to be amended in a way that affects protected features of optional forms of benefit other than the medium of distribution.

Effective Date and Applicability Date

These final regulations are effective September 6, 2000. These final regulations apply to plan amendments that are adopted and effective on or after September 6, 2000, except as provided in §1.411(d)–4, Q&A-2(e)(1)(ii) and Q&A-3(c)(1)(ii).

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 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 Linda S. F. Marshall of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

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

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

Par. 2. Section 1.411(d)–4 is amended as follows:

1. In Q&A-1, paragraph (b)(1), the last sentence is amended by removing the language "§1.401(a)(4)–4(d)" and adding "§1.401(a)(4)–4(e)(1)" in its place.

2. Q&A-2 is amended by:

a. In paragraph (a)(1), removing the language "in paragraph (b) of this Q&A-2" and adding the language "in this section" in its place.

b. Adding two sentences at the beginning of paragraph (a)(3)(ii)(A).

c. Revising the second sentence of paragraph (b)(2) introductory text.

d. Revising paragraph (b)(2)(iii).

e. Amending paragraph (b)(2)(viii) by removing the language " of the employer".

f. Adding paragraph (e).

3. Q&A-3 is amended by:

a. Revising paragraph (a)(3).

b. Adding paragraph (a)(4).

c. Revising paragraphs (b), (c), and (d).

The additions and revisions read as follows:

§1.411(d)–4 Section 411(d)(6) protected benefits.

* * * * *

A-2: * * *

(a) * * *

(3) * * *

(ii) *Annuity contracts*—(A) *General rule.* The right of a participant to receive a benefit in the form of cash payments from the plan and the right of a participant to receive that benefit in the form of the distribution of an annuity contract that provides for cash payments that are identical in all respects to the cash payments from the plan except with respect to the source of the payments are not separate optional forms of benefit. Therefore, for example, if a plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract that provides for cash payments, that optional form of benefit may be modified by a plan amendment that substitutes cash payments from the plan for the annuity contract, where those cash payments from the plan are identical to the cash payments payable from the annuity contract in all respects except with respect to the source of the payments. * * *

* * * * *

(b) * * *

(2) * * * The rules with respect to permissible eliminations and reductions provided in this paragraph (b)(2) generally are effective January 30, 1986; however, the rules of paragraphs (b)(2)(iii)(A) and

(B) and (b)(2)(viii) of this Q&A-2 are effective for plan amendments that are adopted and effective on or after September 6, 2000. * * *

* * * * *

(iii) *In-kind distributions*—(A) *In-kind distributions payable under defined contribution plans in the form of marketable securities other than employer securities.* If a defined contribution plan includes an optional form of benefit under which benefits are distributed in the form of marketable securities, other than securities of the employer, that optional form of benefit may be modified by a plan amendment that substitutes cash for the marketable securities as the medium of distribution. For purposes of this paragraph (b)(2)(iii)(A) and paragraph (b)(2)(iii)(B) of this Q&A-2, the term *marketable securities* means marketable securities as defined in section 731(c)(2), and the term *securities of the employer* means securities of the employer as defined in section 402(e)(4)(E)(ii).

(B) *Amendments to defined contribution plans to specify medium of distribution.* If a defined contribution plan includes an optional form of benefit under which benefits are distributable to a participant in a medium other than cash, the plan may be amended to limit the types of property in which distributions may be made to the participant to the types of property specified in the amendment. For this purpose, the types of property specified in the amendment must include all types of property (other than marketable securities that are not securities of the employer) that are allocated to the participant's account on the effective date of the amendment and in which the participant would be able to receive a distribution immediately before the effective date of the amendment if a distributable event occurred. In addition, a plan amendment may provide that the participant's right to receive a distribution in the form of specified types of property is limited to the property allocated to the participant's account at the time of distribution that consists of property of those specified types.

(C) *In-kind distributions after plan termination.* If a plan includes an optional form of benefit under which benefits are distributed in specified property, that optional form of benefit may be modified for distributions after plan termination by substituting cash for the specified property as the medium of distribution to the extent that, on plan termination, an employee has the opportunity to receive the optional form of benefit in the form of the specified property. This exception is not available, however, if the employer that maintains the terminating plan also maintains another plan that provides an optional form of benefit under which benefits are distributed in the specified property.

(D) *Examples.* The following examples illustrate the application of this paragraph (b)(2)(iii):

Example 1. (i) An employer maintains a profit-sharing plan under which participants may direct the investment of their accounts. One investment option available to participants is a fund invested in common stock of the employer. The plan provides that the participant has the right to a distribution in the form of cash upon termination of employment. In addition, the plan provides that, to the extent a participant's account is invested in the employer stock fund, the participant may receive an in-kind distribution of employer stock upon termination of employment. On October 18, 2000, the plan is amended, effective on January 1, 2001, to remove the fund invested in employer common stock as an investment option under the plan and to provide for the stock held in the fund to be sold. The amendment permits participants to elect how the sale proceeds are to be reallocated among the remaining investment options, and provides for amounts not so reallocated as of January 1, 2001, to be allocated to a specified investment option.

(ii) The plan does not fail to satisfy section 411(d)(6) solely on account of the plan amendment relating to the elimination of the employer stock investment option, which is not a section 411(d)(6) protected benefit. See paragraph (d)(7) of Q&A-1 of this section. Moreover, because the plan did not provide for distributions of employer securities except to the extent participants' accounts were invested in the employer stock fund, the plan is not required operationally to offer distributions of employer securities following the amendment. In addition, the plan would not fail to satisfy section 411(d)(6) on account of a further plan amendment, effective after the plan has ceased to provide for an employer stock fund investment option (and participants' accounts have ceased to be invested in employer securities), to eliminate the right to a distribution in the form of employer stock. See paragraph (b)(2)(iii)(B) of this Q&A-2.

Example 2. (i) An employer maintains a profit-sharing plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution either in cash or in kind. The plan's investments are limited to a fund invested in employer stock, a fund invested in XYZ mutual funds (which are marketable securities), and a fund invested in shares of PQR limited partnership (which are not marketable securities).

(ii) The following alternative plan amendments would not cause the plan to fail to satisfy section 411(d)(6):

(A) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership. See paragraph (b)(2)(iii)(A) of this Q&A-2.

(B) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that also provides that only participants with employer stock allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of employer stock, and that only participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of shares of PQR limited partnership. To comply with the plan amendment, the plan administrator retains a list of participants with employer stock allocated to their accounts as of the effective date of the amendment, and a list of participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment. See paragraphs (b)(2)(iii)(A) and (B) of this Q&A-2.

(C) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership to the extent that those assets are allocated to the participant's account at the time of the distribution. See paragraphs (b)(2)(iii)(A) and (B) of this Q&A-2.

(D) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that provides that only participants with employer stock allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of employer stock, and that only participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of shares of PQR limited partnership, and that further provides that the distribution of that stock or those shares is available only to the extent that those assets are allocated to those participants' accounts at the time of the distribution. To comply with the plan amendment, the plan administrator retains a list of participants with employer stock allocated to their accounts as of the effective date of the amendment, and a list of participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment. See paragraphs (b)(2)(iii)(A) and (B) of this Q&A-2.

Example 3. (i) An employer maintains a stock bonus plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution in employer stock. This is the only plan maintained by the employer under which distributions in employer stock are available. The employer decides to terminate the stock bonus plan.

(ii) If the plan makes available a single-sum distribution in employer stock on plan termination, the plan will not fail to satisfy section 411(d)(6) solely because the optional form of benefit providing a single-sum distribution in employer stock on termination of employment is modified to provide that such distribution is available only in cash. See paragraph (b)(2)(iii)(C) of this Q&A-2.

* * * * *

(e) *Permitted plan amendments affecting alternative forms of payment under defined contribution plans*—(1) *General rule.* A defined contribution plan does not violate the requirements of section 411(d)(6) merely because the plan is amended to eliminate or restrict the ability of a participant to receive payment of accrued benefits under a particular optional form of benefit if—

(i) After the plan amendment is effective with respect to the participant, the alternative forms of payment available to the participant include payment in a single-sum distribution form that is otherwise identical to the optional form of benefit that is being eliminated or restricted; and

(ii) The amendment does not apply to the participant with respect to any distribution with an annuity starting date that is earlier than the earlier of—

(A) The 90th day after the date the participant has been furnished a summary that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3 (relating to a summary of material modifications) for pension plans; or

(B) The first day of the second plan year following the plan year in which the amendment is adopted.

(2) *Otherwise identical single-sum distribution.* For purposes of this paragraph (e), a single-sum distribution form is otherwise identical to an optional form of benefit that is eliminated or restricted pursuant to paragraph (e)(1) of this Q&A-2 only if the single-sum distribution form is identical in all respects to the eliminated or restricted optional form of benefit (or would be identical except that it provides greater rights to the participant) except with respect to the timing of payments after commencement. For example, a single-sum distribution form is not otherwise identical to a specified installment form of benefit if the single-sum distribution form is not available for distribution on the date on which the installment form would have been available for commencement, is not available in the same medium of distribution as the installment form, or imposes any condition of eligibility that did not apply to the installment form. However, an otherwise identical distribution form need not retain rights or features of the optional form of benefit that is eliminated or restricted to the extent that those rights or features would not be protected from elimination or restriction under section 411(d)(6) or this section.

(3) *Examples.* The following examples illustrate the application of this paragraph (e):

Example 1. (i) P is a participant in Plan M, a qualified profit-sharing plan with a calendar plan year that is invested in mutual funds. The distribution forms available to P under Plan M include a distribution of P's vested account balance under Plan M in the form of distribution of various annuity contract forms (including a single life annuity and a joint and survivor annuity). The annuity payments under the annuity contract forms begin as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)). P has not previously elected payment of benefits in the form of a life annuity, and Plan M is not a direct or indirect transferee of any plan that is a defined benefit plan or a defined contribution plan that is subject to section 412. Plan M provides that distributions on the death of a participant are made in accordance with section 401(a)(11)(B)(iii)(I). On May 15, 2001, Plan M is amended so that, after the amendment is effective, P is no longer entitled to any distribution in the form of the distribution of an annuity contract. However, after the amendment is effective, P is entitled to receive a single-sum cash distribution of P's vested account balance under Plan M payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)). The amendment does not apply to P if P elects to have annuity payments begin before the earlier of January 1, 2003, or 90 days after the date on which the plan administrator of Plan M furnishes P with a summary that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3. On December 14, 2001, the plan administrator of Plan M furnishes P with a summary plan description that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3.

(ii) Plan M does not violate the requirements of section 411(d)(6) (or section 401(a)(11)) merely because, as of March 14, 2002, the plan amendment has eliminated P's option to receive a distribution in any of the various annuity contract forms previously available.

Example 2. (i) P is a participant in Plan M, a qualified profit-sharing plan to which section 401(a)(11)(A) does not apply. Upon termination of employment, P is entitled to receive cash distributions from Plan M, payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)), in the form of a single-sum distribution, or in substantially equal monthly installment payments over either 5, 10, 15, or 20 years. On May 15, 2001, Plan M is amended so that, after the amendment is effective, P is no longer entitled to receive a distribution in the form of substantially equal monthly installment payments over 5, 10, 15, or 20 years. However, after the amendment is effective, P continues to be entitled to receive cash distributions from Plan M, payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)), in the form of a single-sum distribution. The amendment does not apply to P if P elects to have annuity payments begin before January 1, 2002. On September 20, 2001, the plan administrator of Plan M furnishes P with a summary of material modifications that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3.

(ii) Plan M does not violate the requirements of section 411(d)(6) merely because, as of January 1, 2002, the plan amendment has eliminated P's option to receive a distribution in the form of substantially equal monthly installment payments over 5, 10, 15, or 20 years.

(4) *Effective date.* This paragraph (e) applies to plan amendments that are adopted on or after September 6, 2000.

* * * * *

A-3. (a) * * *

(3) *Waiver prohibition.* In general, except as provided in paragraph (b) of this Q&A-3, a participant may not elect to waive section 411(d)(6) protected benefits. Thus, for example, the elimination of the defined benefit feature of a participant's benefit under a defined benefit plan by reason of a transfer of such benefits to a defined contribution plan pursuant to a participant election, at a time when the benefit is not distributable to the participant, violates section 411(d)(6).

(4) *Direct rollovers.* A direct rollover described in Q&A-3 of §1.401(a)(31)–1 that is paid to a qualified plan is not a transfer of assets and liabilities that must satisfy the requirements of section 414(l), and is not a transfer of benefits for purposes of applying the requirements under section 411(d)(6) and paragraph (a)(1) of this Q&A-3. Therefore, for example, if such a direct rollover is made to another qualified plan, the receiving plan is not required to provide, with respect to amounts paid to it in a direct rollover, the same optional forms of benefit that were provided under the plan that made the direct rollover. See §1.401(a)(31)–1, Q&A-14.

(b) *Elective transfers of benefits between defined contribution plans*—(1) *General rule.* A transfer of a participant's entire benefit between qualified defined contribution plans (other than any direct rollover described in Q&A-3 of §1.401(a)(31)–1) that results in the elimination or reduction of section 411(d)(6)

protected benefits does not violate section 411(d)(6) if the following requirements are met—

(i) *Voluntary election.* The plan from which the benefits are transferred must provide that the transfer is conditioned upon a voluntary, fully-informed election by the participant to transfer the participant's entire benefit to the other qualified defined contribution plan. As an alternative to the transfer, the participant must be offered the opportunity to retain the participant's section 411(d)(6) protected benefits under the plan (or, if the plan is terminating, to receive any optional form of benefit for which the participant is eligible under the plan as required by section 411(d)(6)).

(ii) *Types of plans to which transfers may be made.* To the extent the benefits are transferred from a money purchase pension plan, the transferee plan must be a money purchase pension plan. To the extent the benefits being transferred are part of a qualified cash or deferred arrangement under section 401(k), the benefits must be transferred to a qualified cash or deferred arrangement under section 401(k). To the extent the benefits being transferred are part of an employee stock ownership plan as defined in section 4975(e)(7), the benefits must be transferred to another employee stock ownership plan. Benefits transferred from a profit-sharing plan other than from a qualified cash or deferred arrangement, or from a stock bonus plan other than an employee stock ownership plan, may be transferred to any type of defined contribution plan.

(iii) *Circumstances under which transfers may be made.* The transfer must be made either in connection with an asset or stock acquisition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (i.e., an acquisition or disposition within the meaning of §1.410(b)–2(f)) or in connection with the participant's change in employment status to an employment status with respect to which the participant is not entitled to additional allocations under the transferor plan.

(2) *Applicable qualification requirements.* A transfer described in this paragraph (b) is a transfer of assets or liabilities within the meaning of section 414(l)(1) and, thus, must satisfy the requirements of section 414(l). In addition, this paragraph (b) only provides relief under section 411(d)(6); a transfer described in this paragraph must satisfy all other applicable qualification requirements. Thus, for example, if the survivor annuity requirements of sections 401(a)(11) and 417 apply to the plan from which the benefits are transferred, as described in this paragraph (b), but do not otherwise apply to the receiving plan, the requirements of sections 401(a)(11) and 417 must be met with respect to the transferred benefits under the receiving plan. In addition, the vesting provisions under the receiving plan must satisfy the requirements of section 411(a)(10) with respect to the amounts transferred.

(3) *Status of elective transfer as other right or feature.* A right to a transfer of benefits from a plan pursuant to the elective transfer rules of this paragraph (b) is an other right or feature within the meaning of §1.401(a)(4)–4(e)(3), the availability of which is subject to the nondiscrimination requirements of section 401(a)(4) and §1.401(a)(4)–4. However, for purposes of applying the rules of §1.401(a)(4)–4, the following conditions are to be disregarded in determining the employees to whom the other right or feature is available—

(i) A condition restricting the availability of the transfer to benefits of participants who are transferred to a different employer in connection with a specified asset or stock disposition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (i.e., a disposition within the meaning of §1.410(b)–2(f)), or in connection with any such disposition, merger, or other similar transaction.

(ii) A condition restricting the availability of the transfer to benefits of participants who have a change in employment status to an employment status with respect to which the participant is not entitled to additional allocations under the transferor plan.

(c) *Elective transfers of certain distributable benefits between qualified plans—*(1) *In general.* A transfer of a participant's benefits between qualified plans that results in the elimination or reduction of section 411(d)(6) protected benefits does not violate section 411(d)(6) if—

(i) The transfer occurs at a time at which the participant's benefits are distributable (within the meaning of paragraph (c)(3) of this Q&A-3);

(ii) For a transfer that occurs on or after January 1, 2002, the transfer occurs at a time at which the participant is not eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of section 401(a)(31)(C);

(iii) The voluntary election requirements of paragraph (b)(1)(i) of this Q&A-3 are met;

(iv) The participant is fully vested in the transferred benefit in the transferee plan;

(v) In the case of a transfer from a defined contribution plan to a defined benefit plan, the defined benefit plan provides a minimum benefit, for each participant whose benefits are transferred, equal to the benefit, expressed as an annuity payable at normal retirement age, that is derived solely on the basis of the amount transferred with respect to such participant; and

(vi) The amount of the benefit transferred, together with the amount of any contemporaneous section 401(a)(31) direct rollover to the transferee plan, equals the entire nonforfeitable accrued benefit under the transferor plan of the participant whose benefit is being transferred, calculated to be at least the greater of the single-sum distribution provided for under the plan for which the participant is eligible (if any) or the present value of the participant's accrued benefit payable at normal retirement age (calculated by using interest and mortality assumptions that satisfy the requirements of section 417(e) and subject to the limitations imposed by section 415).

(2) *Treatment of transfer—*(i) *In general.* A transfer of benefits pursuant to this paragraph (c) generally is treated as a distribution for purposes of section 401(a). For example, the transfer is subject to the cash-out rules of section 411(a)(7), the early termination requirements of section 411(d)(2), and the survivor annuity requirements of sections 401(a)(11) and 417. A transfer pursuant to the elective transfer rules of this paragraph (c) is not treated as a distribution for purposes of the minimum distribution requirements of section 401(a)(9).

(ii) *Status of elective transfer as optional form of benefit.* A right to a transfer of benefits from a plan pursuant to the elective transfer rules of this paragraph (c) is an optional form of benefit under section 411(d)(6), the availability of which is subject to the nondiscrimination requirements of section 401(a)(4) and §1.401(a)(4)–4.

(3) *Distributable benefits.* For purposes of paragraph (c)(1)(i) of this Q&A-3, a participant's benefits are distributable on a particular date if, on that date, the participant is eligible, under the terms of the plan from which the benefits are transferred, to receive an immediate distribution of these benefits (e.g., in the form of an immediately commencing annuity) from that plan under provisions of the plan not inconsistent with section 401(a).

(d) *Effective date. This Q&A-3* is applicable for transfers made on or after September 6, 2000.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 28, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 31, 2000, 2:25 p.m., and published in the issue of the Federal Register for September 6, 2000, 65 F.R. 53901)

Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts

26 CFR 25.2702–3: Qualified interests.

T.D. 8899

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 25

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the definition of a qualified interest under section 2702 of the Internal Revenue Code. The final 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. These final regulations affect individuals who make a transfer in trust to a family member and retain an interest in the trust. These final regulations clarify that a trust that uses a note, other debt instrument, option, or similar financial arrangement to satisfy the annual payment obligation does not meet the requirements of section 2702(b).

DATES: *Effective Date*: These regulations are effective September 5, 2000.

FOR FURTHER INFORMATION CONTACT: James F. Hogan, (202)622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On June 22, 1999, the IRS published in the **Federal Register** (64 F.R. 33235) a notice of proposed rulemaking (REG–108287–98, 1999–28 I.R.B. 27) relating to the definition of a *qualified interest* under section 2702. The IRS received comments on the notice of proposed rulemaking; however, no request for a public hearing was received so no public hearing was held. This document adopts final regulations with respect to the notice of proposed rulemaking. A summary of the principal comments received is provided below.

In addition, the final regulations clarify the regulatory rule regarding the payment period of the annuity or unitrust amount and the proration of payments for periods of less than 12 months.

Comments on Notice of Proposed Rulemaking

Under the proposed regulations, the use of a note, other debt instrument, option, or similar financial arrangement does not constitute a payment of the annuity or unitrust amount to the grantor as required by section 2702. Further, the proposed regulations provide that 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.

Commentators suggested that the regulations should permit the use of short-term notes or notes that bear interest at the section 7520 rate. This suggestion was not adopted. A note issued by the trust, regardless of the term or the interest rate, effectively defers the required payment. Thus, the issuance of a note is not the current payment of the annuity or unitrust amount not less frequently than annually as required by the statute. Under these provisions, in order to satisfy the annuity or unitrust payment obligation under section 2702(b), the annuity or unitrust amount must be paid with either cash or other assets held by the trust.

Commentators also questioned whether the prohibition on the use of notes to make the annuity or unitrust payment applies if the trustee borrows the required funds from an unrelated party. The Treasury Department and the IRS acknowledge that a trustee may borrow from an unrelated party to make the payment. However, the step transaction doctrine will be applied where a series of transactions is used to achieve a result that is inconsistent with the regulations. For example, suppose that the trustee borrows cash from a bank to make the required annuity payment and then borrows cash from the grantor to repay the bank. Similarly, suppose the grantor requests that a bank make a loan to the trust, but as a prerequisite for making the loan, the bank requires the grantor to deposit with the bank an amount equal to the loan. There is no substantive difference between these series of transactions and the situation in which a trustee issues a note for the annuity amount directly to the grantor. The final regulations have added the words "directly or indirectly" to clarify this point.

In response to a comment, the final regulations clarify that a trust instrument provision expressly prohibiting the use of notes to satisfy the annual payments is not required for trusts established before September 20, 1999. However, as provided in the regulations, a retained interest in a trust established before September 20, 1999, will not be treated as a qualified interest if notes are used after September 20, 1999, to satisfy the payment obligation, or any notes is-

sued to satisfy the annual payment obligation on or prior to September 20, 1999, are not paid in full by December 31, 1999.

Proration of First Year's Payment

In response to comments, the regulations clarify the rules covering the period on which the annual payment must be based and the proration of the annuity or unitrust amount in the case of short periods. The final regulations make it clear that the annuity or unitrust amount need not be payable based on the taxable year of the trust. Rather, the annuity or unitrust amount may be payable annually or more frequently, (for example, monthly, quarterly, or semi-annually) based on the anniversary date of the creation of the trust. Thus, a trust providing for an annuity interest created on May 1st need not require that the trustee make payments based on the taxable year of the trust. Instead, the entire annual payment may be made by April 30th of each succeeding year of the trust term. If payment is based on the anniversary date of the trust, proration of the annuity or unitrust amount will be required only if the last period during which such amount is payable to the grantor is a short period. On the other hand, if payment is based on the taxable year of the trust, proration is required for each short taxable year of the trust during the grantor's term.

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 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 to these regulations, and 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 its impact on small business.

Drafting Information

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

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 25 is 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 revising the second and fourth sentences, and removing the last sentence.

2. Paragraph (b)(3) is revised.

3. Paragraph (b)(4) is redesignated as paragraph (b)(5).

4. A new paragraph (b)(4) is added.

5. Paragraph (c)(1)(i) is amended by revising the third and fifth sentences and removing the last sentence.

6. Paragraph (c)(3) is revised.

7. Paragraphs (c)(4) and (d)(5) are added.

The revisions and additions read as follows:

§25.2702–3 Qualified interests.

* * * * *

(b) * * *

(1) * * * (i) * * * The annuity amount must be payable to (or for the benefit of) the holder of the annuity interest at least annually. * * * Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the annuity amount does not constitute payment of the annuity amount.

* * * * *

(3) *Payment of annuity amount.* The annuity amount may be payable based on either the anniversary date of the creation of the trust or the taxable year of the trust. In either situation, the annuity amount may be paid annually or more frequently, such as semi-annually, quarterly, or monthly. If the payment is made based on the anniversary date, proration of the annuity amount is required only if the last period during which the annuity is payable to the grantor is a period of less than 12 months. If the payment is made based on the taxable year, proration of the annuity amount is required for each short taxable year of the trust during the grantor's term. The prorated amount is the annual annuity amount multiplied by a fraction, the numerator of which is the number of days in the short period and the denominator of which is 365 (366 if February 29 is a day included in the numerator).

(4) *Payment of the annuity amount in certain circumstances.* An annuity amount payable based on the anniversary date of the creation of the trust must be paid by the anniversary date. An annuity amount payable based on the taxable year of the trust may be paid after the close of the taxable year, provided the payment is made no later than the date by which the trustee is required to file the Federal income tax return of the trust for the taxable year (without regard to extensions). If the trustee reports for the taxable year pursuant to §1.671–4(b) of this chapter, the annuity payment must be made no later than the date by which the trustee would have been required to file the Federal income tax return of the trust for the taxable year (without regard to extensions) had the trustee reported pursuant to §1.671–4(a) of this chapter.

* * * * *

(c) * * *

(1) * * * (i) * * * The unitrust amount must be payable to (or for the benefit of) the holder of the unitrust interest at least annually. * * * Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the unitrust amount does not constitute payment of the unitrust amount.

* * * * *

(3) *Payment of unitrust amount.* The unitrust amount may be payable based on either the anniversary date of the creation of the trust or the taxable year of the trust. In either situation, the unitrust amount may be paid annually or more frequently, such as semi-annually, quarterly, or monthly. If the payment is made based on the anniversary date, proration of the unitrust amount is required only if the last period during which the annuity is payable to the grantor is a period of less than 12 months. If the payment is made

based on the taxable year, proration of the unitrust amount is required for each short taxable year of the trust during the grantor's term. The prorated amount is the annual unitrust amount multiplied by a fraction, the numerator of which is the number of days in the short period and the denominator of which is 365 (366 if February 29 is a day included in the numerator).

(4) *Payment of the unitrust amount in certain circumstances.* A unitrust amount payable based on the anniversary date of the creation of the trust must be paid by the anniversary date. A unitrust amount payable based on the taxable year of the trust may be paid after the close of the taxable year, provided the payment is made no later than the date by which the trustee is required to file the Federal income tax return of the trust for the taxable year (without regard to extensions). If the trustee reports for the taxable year pursuant to §1.671–4(b) of this chapter, the unitrust payment must be made no later than the date by which the trustee would have been required to file the Federal income tax return of the trust for the taxable year (without regard to extensions) had the trustee reported pursuant to §1.671–4(a) of this chapter.

(d) * * *

(5) *Use of debt obligations to satisfy the annuity or unitrust payment obligation*—(i) *In general.* In the case of a trust created on or after September 20, 1999, 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 issued after September 20, 1999, to satisfy the annuity or unitrust payment obligation; and

(B) Any notes or any other debt instruments that were 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 Internal Revenue Code, or the fair market value of the option.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 10, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 1, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 5, 2000, 65 F.R. 53587)

Part III. Administrative, Procedural, and Miscellaneous

2000 Marginal Production Rates

Notice 2000–50

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 1999 calendar year is $15.56.

Table 1 contains the applicable percentages for marginal production for taxable years beginning in calendar years 1991 through 2000.

Notice 2000–50 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
2000	19 percent

The principal author of this notice is Brenda M. Stewart of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Stewart at (202) 622-3120 (not a toll-free call).

2000 Section 43 Inflation Adjustment

Notice 2000–51

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 1999 calendar year ($15.56) does not exceed $28 multiplied by the inflation adjustment factor for the 2000 calendar year, the enhanced oil recovery credit for qualified costs paid or incurred in 2000 is determined without regard to the phaseout for crude oil price increases.

Table 1 contains the GNP implicit price deflator used for the 2000 calendar year, as well as the previously published GNP implicit price deflators used for the 1991 through 1999 calendar years.

Notice 2000–51 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)
1999	104.59 (used for 2000)***

* 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 defltor. The 1990 GNP price deflator used to compute the 1998 § 43 inflation adjustment factor is 93.63.

*** Beginning in 1999, the GNP implicit price deflator was rebased relative to 1996. The 1990 GNP implicit price deflator used to compute the 2000 § 43 inflation adjustment factor is 86.53.

Table 2 contains the inflation adjustment factor and the phase-out amount for taxable years beginning in the 2000 calendar year as well as the previously published inflation adjustment factors and phase-out amounts for the 1991 through 1999 calendar years.

Notice 2000–51 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
2000	1.2087	0

DRAFTING INFORMATION

The principal author of this notice is Brenda M. Stewart of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Stewart at (202) 622-3120 (not a toll-free call).

Renewable Electricity Production Credit, Publication of Inflation Adjustment Factor and Reference Prices for Calendar Year 2000

Notice 2000–52

This notice publishes the inflation adjustment factor and reference prices for calendar year 2000 for the renewable electricity production credit under § 45(a) of the Internal Revenue Code. The 2000 inflation adjustment factor and reference prices are used in determining the availability of the credit. The 2000 inflation adjustment factor and reference prices apply to calendar year 2000 sales of kilowatt-hours of electricity produced in the United States or a possession thereof from qualified energy resources.

BACKGROUND

Section 45(a) provides that the renewable electricity production credit for any tax year is an amount equal to the product of 1.5 cents multiplied by the kilowatt-hours of specified electricity produced by the taxpayer and sold to an unrelated person during the tax year. This electricity must be produced from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service.

Section 45(b)(1) provides that the amount of the credit determined under § 45(a) is reduced by an amount that bears the same ratio to the amount of the credit as (A) the amount by which the reference price for the calendar year in which the sale occurs exceeds 8 cents bears to (B) 3 cents. Under § 45(b)(2), the 1.5 cents in § 45(a) and the 8 cents in § 45(b)(1) are each adjusted by multiplying the amount by the inflation adjustment factor for the calendar year in which the sale occurs.

Section 45(c)(1) defines qualified energy resources as wind, closed-loop biomass, and poultry waste. Section 45(c)(3) defines a qualified facility as any facility owned by the taxpayer that originally is placed in service after December 31, 1993 (December 31, 1992, in the case of a facility using closed-loop biomass to produce electricity and December 31, 1999, in the case of a facility using poultry waste to produce electricity), and before January 1, 2002. See § 45(d)(7) for rules relating to the inapplicability of the credit to electricity sold to utilities under certain contracts.

Section 45(d)(2)(A) requires the Secretary to determine and publish in the Federal Register each calendar year the inflation adjustment factor and the reference prices for the calendar year. The inflation adjustment factor and the reference prices for the 2000 calendar year were published in the Federal Register on August 29, 2000, (168 Fed. Reg. 52474).

Section 45(d)(2)(B) defines the inflation adjustment factor for a calendar year as the fraction the numerator of which is the GDP implicit price deflator for the preceding calendar year and the denominator of which is the GDP implicit price deflator for the calendar year 1992. The term "GDP implicit price deflator" means the most recent revision of the implicit price deflator for the gross domestic product as computed and published by the Department of Commerce before March 15 of the calendar year.

Section 45(d)(2)(C) provides that the reference price is the Secretary's determination of the annual average contract price per kilowatt hour of electricity generated from the same qualified energy resource and sold in the previous year in the United States. Only contracts entered into after December 31, 1989, are taken into account.

INFLATION ADJUSTMENT FACTOR AND REFERENCE PRICES

The inflation adjustment factor for calendar year 2000 is 1.1382. The reference prices for calendar year 2000 are 4.95 cents per kilowatt-hour for facilities producing electricity from wind energy resources and 0 cents per kilowatt-hour for facilities producing electricity from closed-loop biomass and poultry waste energy resources.

PHASE-OUT CALCULATION

Because the 2000 reference prices for electricity produced from wind, closed-loop biomass, and poultry waste energy resources do not exceed 8 cents per kilowatt hour multiplied by the inflation adjustment factor, the phaseout of the credit provided in § 45(b)(1) does not apply to electricity produced from wind, closed-loop biomass, or poultry waste energy resources sold during calendar year 2000.

CREDIT AMOUNT

As required by § 45(b)(2), the 1.5¢ amount in § 45(a)(1) is adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1¢, such amount is rounded to the nearest multiple of 0.1¢. Under the calculation required by § 45(b)(2), the renewable electricity production credit for calendar year 2000 is 1.7¢ per kilowatt hour on the sale of electricity produced from wind energy, closed-loop bionass, and poultry waste resources.

DRAFTING INFORMATION CONTACT

The principal author of this notice is David A. Selig of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Mr. Selig at (202) 622-3040 (not a toll-free call).

SRLY Election

Notice 2000–53

This notice announces that the Treasury Department and the Internal Revenue Service intend to issue regulations permitting certain taxpayers to elect not to apply certain provisions of Treas. Reg. §§ 1.1502–15, – 21, and – 22 issued on June 25, 1999, and published in the Federal Register on July 2, 1999 (64 F.R. 36091). The notice also provides taxpayers a mechanism for making the election before the regulations are issued.

Treasury Regulations §§ 1.1502–15, –21, and –22 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. In §§ 1.1502–15(g), –21(g), and –22(g), the "overlap rule" eliminates the application of the SRLY rules in certain circumstances in which the rules of §§ 382 or 383 of the Internal Revenue Code also apply. The overlap rule, and consequently the elimination of the SRLY rules, is effective for tax years for which the due date of the return is after June 25, 1999. The elimination of SRLY could increase the amount of net operating loss carryovers that a consolidated group could absorb.

Treasury and the Service have been made aware that the application of the overlap rule has resulted in adverse tax consequences with respect to certain acquisitions of corporations from consolidated groups that occurred during a taxable year of the consolidated group to which the June 1999 regulations applied but prior to the actual issuance of those regulations (the "interim period"). Treasury and the Service believe that certain of these adverse tax consequences are inappropriate.

Accordingly, this notice announces that Treasury and the Service intend to issue regulations that provide an election to allow a corporation that ceased to be a member of a consolidated group as a result of a qualified stock purchase (as defined in § 338(d)(3)) in the interim period

(the "departing member") to avoid the application of the overlap rule of §§ 1.1502–15(g), –21(g), and –22(g) while it was in the former group. The election will be available to a departing member of a consolidated group that would otherwise be affected by the application of the overlap rule and that ceased to be a member of the consolidated group before June 26, 1999, or pursuant to a binding contract that was in effect before June 26, 1999.

The election will allow a departing member to determine the amount of its net operating loss and capital loss carryovers (including the amount of net operating loss carryovers treated as arising under § 1.1502–15(a)) to taxable years beginning after it ceases to be a member of the group by treating §§ 1.1502–15(g), –21(g), and –22 (g) as not applying with respect to that corporation (or to a subgroup in which it was included) while it was a member of the group. The election will be made solely by the departing member (or, under § 1.1502–77, its new common parent if it joins another consolidated group). The election will not require any action by the departing member's former consolidated group and will have no effect on the consolidated return filed by that group for the taxable year for which the due date of the return was after June 25, 1999, or any subsequent taxable year.

To make the election under this notice, a corporation must write "Election Pursuant to Notice 2000–53" across the top of page 1 of its original or amended tax return for the first taxable year (whether separate or consolidated) after it ceases to be a member of the group and file the return in accordance with the election as if §§ 1.1502–15(g), –21(g), and –22(g) did not apply while it was a member of the former group.

Treasury and the Service intend to amend the regulations under § 1502 to incorporate the guidance set forth in this notice. Until the regulations are amended, taxpayers may rely on the guidance set forth in this notice.

For further information regarding this notice contact David Kessler or Christopher M. Bass of the Office of Associate Chief Counsel (Corporate) at (202) 622-7770 (not a toll-free call).

Part IV. Items of General Interest

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Stoppenhagen, Larry	Ft. Wayne, IN	CPA	April 14, 2000 to April 13, 2001
Chon, James	N. Hollywood, CA	CPA	May 22, 2000 to May 21, 2003
Bleyer, Stephen A.	Bala Cynwyd, PA	CPA	June 26, 2000 to December 25, 2000
Knutson, Owen	Ouray, CO	CPA	July 3, 2000 to January 2, 2003
Silverman, Richard E.	Fayetteville, NY	CPA	August 1, 2000 to March 31, 2004
Holt, Jeffrey	Little Rock, AR	Enrolled Agent	October 1, 2000 to March 31, 2003
Barbagallo, Joseph	Newton, PA	CPA	October 15, 2000 to October 14, 2004

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Luebben, William	Hot Springs, AR	CPA	February 11, 2000

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

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 October 1, 2000, will be 9 percent for overpayments (8 percent in the case of a corporation), 9 percent for underpayments, and 11 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 is 6.5 percent.

Rev. Rul. 2000–42

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, 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)(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 2000 is 6 percent. Accordingly, an overpayment rate of 9 percent (8 percent in the case of a corporation) and an underpayment rate of 9 percent are established for the calendar quarter beginning October 1, 2000. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning October 1, 2000, is 6.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning October 1, 2000, is 11 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 6.5 percent, 8 percent, 9 percent, and 11 percent are published in Tables 66, 69, 71, and 75 of Rev. Proc. 95–17, 1995–1 C.B. 556, 620, 623, 625, and 629.

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 (Administrative Provisions and Judicial Practice). For further information regarding this revenue ruling, contact Mr. Bailey at (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.			1995–1 C.B.	
	RATE	TABLE	PG	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
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

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
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
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec 31, 2000	9%	71	625

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
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625

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
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 1, 2000	11%	75	629

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
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 2000–42

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 2000 is 5.72 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	2000	5.96	5.36 to 6.26	5.36 to 6.56

Drafting Information

The principal author of this notice is Todd Newman of the 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 2000–79

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:

Against All Odds, Inc., Livingston, NJ
Agape Multi-Purpose Ministry, Inc., Compton, CA
American Advocate, Inc., Baltimore, MD
American Family Thrift Stores, Brighton, MA
Arkansas Housing Partnership, Inc., Little Rock, AR
Ayehu Brehan Foundation, Inc., Ft. Washington, MD
Caretuck Farms Foundation, Inc., Lake Toxaway, NC
Children's Pennsylvania Adoption Network, Erie, PA
Christian Sports Camp, Inc., Doyle, TN
Christmas in April Carroll County, Inc., Westminster, MD
Cirik Foundation, Bonifacius, MN
Committee Hermandad Pro-Aguilares, Murietta, CA
Community Brainstorming Foundation of Milwaukee, Inc., Milwaukee, WI
Community Communications Center, Inc., New Haven, CT
Cyberlife Eternal, Inc., Fremont, CA
Dansville Ambulance Company, Inc., Dansville, NY
East Little Rock Community Development Corporation, Little Rock, AR
Eastern Maine Conservation Initiative, Portland, ME
Edward I. Rich Family Organization, Inc., Salt Lake City, UT
ESB Foundation, Tacoma, WA
FRP Community Housing Corporation, Philadelphia, PA
Good Samaritan Ministries International, Inc., Hillside, IL
Hamilton Amateur Figure Skating Association, Inc., Trenton, NJ
Health Development International, Santee, CA
Hispanic American Medical Scholarship Fund, Houston, TX
Idaho Association For Bilingual Education, Rupert, ID
IDEC or` Intake-Discharge Evaluation Center, Houston, TX
Institute for Better Education Through Resource Technology, Northridge, CA
Institute of American Studies, Inc., Sarasota, FL
International Cultural League, Rowland Heights, CA
Madison Youth Theatre, Madison, CT
MBARI Institute for Contemporary African Art, Inc., Washington, DC
New Vision Services, Inc., Neenah, WI
North Louisiana Child Development Agency, Inc., Jonesboro, LA
Oakland Technical High School Library Fund, Inc., Oakland, CA
Odyssey for Peace, Bexley, OH
Palm Beach Seaport Aquarium, Tequest, FL
Pinnacle Foundation, Inc., Milburn, NJ
PSI Chapter Diamond Association Charitable Foundation, Inc., Wheeling, WV
Ruby Diamond Breast Cancer Foundation, University Heights, OH
San Antonio Business Development Corporation, San Antonio, TX
SHARE Supportive Housing and Resources for the Elderly, Las Vegas, NV
Soccer Association of Warren County, Warren, PA
South Plainfield Vision 2001 Education Foundation, Inc., South Plainfield, NJ
Springfield Parents Recreation Association, Inc., Springfield, NJ
St. Joseph County Courthouse Restoration Corporation, South Bend, IN
Sustainable Communities, Inc., Santa Fe, NM
Terreverte Foundation, Cliffside Park, NJ
Theodora B. Brown Scholarship Fund, Inc., Red Bank, NJ
Topeka Shawnee County Child & Adolescent Assessment Center, Inc., Topeka, KS
Total Truth Ministries, Inc., Ottawa, IL
Trinity Housing Services, Inc., Paoli, PA
United States of America Foundation, San Diego, CA
United States Water Fitness Association, Inc., Boynton Beach, FL
Villa Encantada, Inc., Albuquerque, NM
Warthog Productions, Inc., Boston, MA
Wasco County Historical Museum, The Dalles, OR
Welcome Grove Development Center, Inc., Atlanta, GA
Winokur Family Foundation Wynnewood, PA
Young People Working for Christ, Wichita, KS

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 6071.—Time for Filing Returns and Other Documents

26 CFR 31.6071(b): Electronically filed information returns.

T.D.8895

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 31, and 301

Extension of Due Date for Electronically Filed Information Returns; Limitation of Failure to Pay Penalty for Individuals During Period of Installment Agreement

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations implementing section 6071(b) relating to the extension of the due date for certain electronically filed information returns. The final regulations also provide rules under section 6651(h) relating to a penalty reduction for certain individuals who have agreed with the IRS to make installment payments in satisfaction of their tax liability. The regulations relating to extension of filing dates affect payors required to file information returns after December 31, 1999. The regulations relating to penalty reduction affect individual taxpayers with installment agreements in effect during months beginning after December 31, 1999.

DATES: *Effective Date*: These regulations are effective August 18, 2000.

Applicability Date: The provisions of these regulations under section 6071(b) apply for returns required to be filed after December 31, 1999. The provisions of these regulations under section 6651(h) apply for determining the addition to tax for months beginning after December 31, 1999.

FOR FURTHER INFORMATION CONTACT: Marilyn E. Brookens, (202) 622-4920 (for information relating to the extension of due dates under section 6071(b)); or Robert B. Taylor, (202) 622-4940 (for information relating to the reduction in the penalty under section 6651(h)) (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains amendments to the Income Tax Regulations, Employment Tax Regulations, and Procedure and Administration Regulations (26 CFR Parts 1, 31, and 301), and implements sections 6071(b) and 6651(h), which were added to the Internal Revenue Code (Code) by the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685, 724 (1998 Act)). Section 6071(b) was added to the Code by section 2002 of the 1998 Act and extends the due date for information returns required by chapter 61, subchapter A, part III, subparts B and C (sections 6041 through 6053) that are filed electronically. The information returns affected include the Form W-2 series, Form W-2G, the Form 1098 series, the Form 1099 series, and Form 8027. Under section 6071(b) such information returns are due on or before March 31 of the year following the calendar year to which the returns relate. Section 6071(b) applies to information returns required to be filed with the IRS or the Social Security Administration after December 31, 1999.

Section 6651(h) was added to the Code by section 3303 of the 1998 Act and provides that, for individuals, the failure to pay penalty is reduced from 0.5 percent per month to 0.25 percent per month during the period an installment agreement under section 6159 is in effect with regard to a timely filed return. Section 6651(h) applies to any Federal tax liability of an individual (including a liability under subtitle C) and is effective for determining the addition to tax for months beginning after December 31, 1999.

On January 27, 2000, a notice of proposed rulemaking (REG-105279-99, 2000-8 I.R.B. 707) under sections 6071(b) and 6651(h) was published in the **Federal Register** (65 F.R. 4396). 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 sections 6071(b) and 6651(h) 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 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, 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 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 the regulations relating to the extension of due dates under section 6071(b) is Marilyn E. Brookens, Office of Associate Chief Counsel (Income Tax & Accounting). The principal author of the regulations relating to the reduction in the penalty under section 6651(h) is Robert B. Taylor, Office of Assistant Chief Counsel (Administrative Provisions and Judicial Practice). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 31, and 301 are 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 §1.6041-2, paragraph (a)(3)(ii) is revised to read as follows:

§1.6041-2 Return of information as to payments to employees.

(a) * * *

(3) * * *

(ii) *Exception.* In a case where an employer is not required to file Forms W-3 and W-2 under §31.6011(a)–4 or §31.6011(a)–5 of this chapter, returns on Forms W-3 and W-2 required under this paragraph (a) for any calendar year shall be filed on or before February 28 (March 31 if filed electronically) of the following year.

* * * * *

Par. 3. In §1.6041–6, the first sentence is revised to read as follows:

§1.6041–6 Returns made on Forms 1096 and 1099 under section 6041; contents and time and place for filing.

Returns made under section 6041 on Forms 1096 and 1099 for any calendar year shall be filed on or before February 28 (March 31 if filed electronically) of the following year with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for such forms. * * *

Par. 4. In §1.6042–2, the first sentence of paragraph (c) is revised to read as follows:

§1.6042–2 Returns of information as to dividends paid in calendar years after 1962.

* * * * *

(c) *Time and place for filing.* The returns required under this section for any calendar year shall be filed after September 30 of such year, but not before the payer's final payment for the year, and on or before February 28 (March 31 if filed electronically) of the following year with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for Form 1096. * * *

* * * * *

Par. 5. In §1.6043–2, paragraph (a) is revised to read as follows:

§1.6043–2 Return of information respecting distributions in liquidation.

(a) Unless the distribution is one in respect of which information is required to be filed pursuant to §1.332–6(b), 1.368–3(a), or 1.1081–11, every corporation making any distribution of $600 or more during a calendar year to any shareholder in liquidation of the whole or any part of its capital stock shall file a return of information on Forms 1096 and 1099, giving all the information required by such form and by the regulations in this part. A separate Form 1099 must be prepared for each shareholder to whom such distribution was made, showing the name and address of such shareholder, the number and class of shares owned by him in liquidation of which such distribution was made, and the total amount distributed to him on each class of stock. If the amount distributed to such shareholder on any class of stock consisted in whole or in part of property other than money, the return on such form shall in addition show the amount of money distributed, if any, and shall list separately each class of property other than money distributed, giving a description of the property in each such class and a statement of its fair market value at the time of the distribution. Such forms, accompanied by transmittal Form 1096 showing the number of Forms 1099 filed therewith, shall be filed on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which such distribution was made with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for Form 1096.

* * * * *

Par. 6. In §1.6044–2, the first sentence of paragraph (d) is revised to read as follows:

§1.6044–2 Returns of information as to payments of patronage dividends with respect to patronage occurring in taxable years beginning after 1962.

* * * * *

(d) *Time and place for filing.* The return required under this section on Forms 1096 and 1099 for any calendar year shall be filed after September 30 of such year, but not before the payer's final payment for the year, and on or before February 28 (March 31 if filed electronically) of the following year, with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for such forms. * * *

* * * * *

Par. 7. Section §1.6045–1 is amended by adding paragraph (r) to read as follows:

§1.6045–1 Returns of information of brokers and barter exchanges.

* * * * *

(r) *Electronic filing.* Notwithstanding the time prescribed for filing in paragraph (j) of this section, Forms 1096 and 1099 required under this section for reporting periods ending during a calendar year shall, if filed electronically, be filed after the last calendar day of the reporting period elected by the broker or barter exchange and on or before March 31 of the following calendar year.

Par. 8. In §1.6045–2, paragraph (g)(3) is revised to read as follows:

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

* * * * *

(g) * * *

(3) *Time and place of filing.* The returns required under this paragraph (g) for any calendar year shall be filed after September 30 of such year, but not before the final substitute payment for the year is received by the broker, and on or before February 28 (March 31 if filed electronically) of the following year with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for Form 1096.

* * * * *

Par. 9. In §1.6045–4, the first sentence of paragraph (j) is revised to read as follows:

§1.6045–4 Information reporting on real estate transactions with dates of closing on or after January 1, 1991.

* * * * *

(j) *Time and place for filing.* A reporting person shall file the information returns required by this section with respect to a real estate transaction after December 31 of the calendar year that includes the date of closing (as determined under paragraph (h)(2)(ii) of this section) and on or before February 28 (March 31 if filed electronically) of the following calendar year. * * *

* * * * *

Par. 10. In §1.6047–1, the first sentence of paragraph (a)(6) is revised to read as follows:

§1.6047–1 Information to be furnished with regard to employee retirement plan covering an owner-employee.

(a) * * *

(6) *Time and place for filing.* The return required under this section for any calendar year shall be filed after the close of that year and on or before February 28 (March 31 if filed electronically) of the following year with any of the Internal Revenue Service Centers, the addresses of which are listed in the instructions for Form 1096. * * *

* * * * *

Par. 11. Section 1.6049–4 is amended by:

1. Revising the first sentence of paragraph (g)(1).

2. Revising the first sentence of paragraph (g)(2).

The revisions read as follows:

§1.6049–4 Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.

* * * * *

(g) * * * (1) *Annual return.* Except as provided in paragraph (g)(2) of this section, the returns required under this section for any calendar year for the payment of interest shall be filed after September 30 of such year, but not before the payor's final payment to the payee for the year, and on or before February 28 (March 31 if filed electronically) of the following year. * * *

(2) *Transactional return.* In the case of a return under paragraph (e) of this section, relating to returns on a transactional basis, such return shall be filed at any time but in no event later than February 28 (March 31 if filed electronically) of the year following the calendar year in which the interest was paid. * * *

* * * * *

Par. 12. In §1.6049–7, the first sentence of paragraph (b)(2)(iv) is revised to read as follows:

§1.6049–7 Returns of information with respect to REMIC regular interests and collateralized debt obligations.

* * * * *

(b) * * *

(2) * * *

(iv) *Time and place for filing a return with respect to amounts includible as interest.* The returns required under this paragraph (b)(2) for any calendar year must be filed after September 30 of that year, but not before the payor's final payment to the payee for the year, and on or before February 28 (March 31 if filed electronically) of the following year. * * *

* * * * *

Par. 13. In §1.6050A–1, paragraph (b) is revised to read as follows:

§1.6050A–1 Reporting requirements of certain fishing boat operators.

* * * * *

(b) *Time and place for filing.* Returns required to be made under this section on Form 1099-MISC shall be filed with the Internal Revenue Service Center, designated in the instructions for Form 1099-MISC, on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the relevant services were performed.

* * * * *

Par. 14. In §1.6050D–1, paragraph (b) is revised to read as follows:

§1.6050D–1 Information returns relating to energy grants and financing.

* * * * *

(b) *Time and place for filing.* Returns required to be made under this section shall be filed with the Internal Revenue Service Center designated in the instructions for Form 6497 or 1099-G on or before the last day of February (March 31 if filed electronically) of the year following the calendar year for which the return is made.

Par. 15. In §1.6050E–1, the first sentence of paragraph (h) is revised to read as follows:

§1.6050E–1 Reporting of State and local income tax refunds.

* * * * *

(h) *Time and place for filing.* The returns required under this section for any calendar year shall be filed after September 30 of that calendar year, but not before the refund officer's final payment (or allowance of credit or offset) for the year, and on or before February 28 (March 31 if filed electronically) of the following year. * * *

* * * * *

Par. 16. In §1.6050H–2, the first and second sentences of paragraph (a)(4) are revised to read as follows:

§1.6050H–2 Time, form, and manner of reporting interest received on qualified mortgage.

(a) * * *

(4) *Time and place for filing return.* An interest recipient must file a return required by this paragraph (a) on or before February 28 (March 31 if filed electronically) of the year following the calendar year for which it receives the mortgage interest. If no interest is required to be reported for the calendar year, but a reimbursement of interest on a qualified mortgage is required to be reported for the calendar year, then a return required by this paragraph (a) must be filed on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the reimbursement was made. * * *

* * * * *

Par. 17. In §1.6050J–1T, A-33 is revised to read as follows:

§1.6050J–1T Questions and answers concerning information returns relating to foreclosures and abandonments of security (temporary).

* * * * *

A-33: The return or returns must be filed on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the acquisition of an interest in the property occurs or in which the lender knows or has reason to know of the abandonment of the property.

* * * * *

Par. 18. In §1.6050P–1, paragraph (a)(4)(i) is revised to read as follows:

§1.6050P–1 Information reporting for discharges of indebtedness by certain financial entities.

(a) * * *

(4) * * * (i) *In general.* Except as provided in paragraph (a)(4)(ii) of this section, returns required by this section must be filed with the Internal Revenue Service office designated in the instructions for Form 1099-C on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which the identifiable event occurs.

* * * * *

Par. 19. In §1.6052–1, paragraph (b)(1)(ii) is revised to read as follows:

§1.6052–1 Information returns regarding payment of wages in the form of group-term life insurance.

* * * * *

(b) * * * (1) * * *

(ii) *Exception.* In a case where an employer is not required to file Forms W-3 and W-2 under §31.6011(a)–4 or §31.6011(a)–5 of this chapter, returns on Forms W-3 and W-2 required under paragraph (a) of this section for any calendar year shall be filed on or before February 28 (March 31 if filed electronically) of the following year.

* * * * *

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

Par. 20. The authority citation for part 31 continues to read in part as follows:

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

Par. 21. In §31.3402(q)–1, the first sentence of paragraph (f)(1) is revised to read as follows:

§31.3402(q)–1 Extension of withholding to certain gambling winnings.

* * * * *

(f)(1) *In general.* Every person making payment of winnings for which a statement is required under paragraph (e) of this section shall file a return on Form W-2G with the Internal Revenue Service Center serving the district in which is located the principal place of business of the person making the return on or before February 28 (March 31 if filed electronically) of the calendar year following the calendar year in which the payment of winnings is made. * * *

* * * * *

Par. 22. In §31.6053–3, the first sentence of paragraph (a)(4) is revised to read as follows:

§31.6053–3 Reporting by certain large food or beverage establishments with respect to tips.

(a) * * *

(4) *Time and place for filing.* The information return required by this paragraph (a) shall be filed on or before the last day of February (March 31 if filed electronically) of the year following the calendar year for which the return is made with the Internal Revenue Service Center specified by the Form 8027 or its instructions. * * *

* * * * *

Par. 23. In §31.6071(a)–1, paragraph (a)(3)(i) is revised to read as follows:

§31.6071(a)–1 Time for filing returns and other documents.

(a) * * *

(3) * * * (i) *General rule.* Each information return in respect of wages as defined in the Federal Insurance Contributions Act or of income tax withheld from wages which is required to be made under §31.6051–2 shall be filed on or before the last day of February (March 31 if filed electronically) of the year following the calendar year for which it is made, except that, if a tax return under §31.6011(a)–5(a) is filed as a final return for a period ending prior to December 31, the information statement shall be filed on or before the last day of the second calendar month following the period for which the tax return is filed.

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 24. The authority citation for part 301 continues to read in part as follows:

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

Par. 25. Section 301.6651–1 is amended by:

1. Revising the last sentence in paragraph (a)(2).

2. Revising the second sentence in paragraph (a)(3).

3. Adding paragraph (a)(4).

The revisions and additions read as follows:

§301.6651–1 Failure to file tax return or to pay tax.

(a) * * *

(2) * * * Except as provided in paragraph (a)(4) of this section, the amount to be added to the tax is 0.5 percent of the amount of tax shown on the return if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate.

(3) * * * Except as provided in paragraph (a)(4) of this section, the amount to be added to the tax is 0.5 percent of the amount stated in the notice and demand if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate. * * *

(4) *Reduction of failure to pay penalty during the period an installment agreement is in effect*—(i) *In general.* In the case of a return filed by an individual on or before the due date for the return (including extensions)—

(A) The amount added to tax for a month or fraction thereof is determined by using 0.25 percent instead of 0.5 percent under paragraph (a)(2) of this section if at any time during the month an installment agreement under section 6159 is in effect for the payment of such tax; and

(B) The amount added to tax for a month or fraction thereof is determined by using 0.25 percent instead of 0.5 percent under paragraph (a)(3) of this section if at any time during the month an installment agreement under section 6159 is in effect for the payment of such tax.

(ii) *Effective date.* This paragraph (a)(4) applies for purposes of determining additions to tax for months beginning after December 31, 1999.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 1, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 17, 2000, 8:45 a.m., and published in the issue of the Federal Register for August 18, 2000, 65 F.R. 50405)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 1.1031(a)–1: Property held for productive use in trade or business or for investment; 1.1031(k)–1: Treatment of deferred exchanges.

Rev. Proc. 2000–37

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor under which the Internal Revenue Service will not challenge (a) the qualification of property as either "replacement property" or "relinquished property" (as defined in § 1.1031(k)–1(a) of the Income Tax Regulations) for purposes of § 1031 of the Internal Revenue Code and the regulations thereunder or (b) the treatment of the "exchange accommodation titleholder" as the beneficial owner of such property for federal income tax purposes, if the property is held in a "qualified exchange accommodation arrangement" (QEAA), as defined in section 4.02 of this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 1031(a)(1) provides that no gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of like kind that is to be held either for productive use in a trade or business or for investment.

.02 Section 1031(a)(3) provides that property received by the taxpayer is not treated as like-kind property if it: (a) is not identified as property to be received in the exchange on or before the day that is 45 days after the date on which the taxpayer transfers the relinquished property; or (b) is received after the earlier of the date that is 180 days after the date on which the taxpayer transfers the relinquished property, or the due date (determined with regard to extension) for the transferor's federal income tax return for the year in which the transfer of the relinquished property occurs.

.03 Determining the owner of property for federal income tax purposes requires an analysis of all of the facts and circumstances. As a general rule, the party that bears the economic burdens and benefits of ownership will be considered the owner of property for federal income tax purposes. *See* Rev. Rul. 82–144, 1982–2 C.B. 34.

.04 On April 25, 1991, the Treasury Department and the Service promulgated final regulations under § 1.1031(k)–1 providing rules for deferred like-kind exchanges under § 1031(a)(3). The preamble to the final regulations states that the deferred exchange rules under § 1031(a)(3) do not apply to reverse-*Starker* exchanges (*i.e.*, exchanges where the replacement property is acquired before the relinquished property is transferred) and consequently that the final regulations do not apply to such exchanges. T.D. 8346, 1991–1 C.B. 150, 151; *see Starker v. United States*, 602 F.2d 1341 (9th Cir. 1979). However, the preamble indicates that Treasury and the Service will continue to study the applicability of the general rule of § 1031(a)(1) to these transactions. T.D. 8346, 1991–1 C.B. 150, 151.

.05 Since the promulgation of the final regulations under § 1.1031(k)–1, taxpayers have engaged in a wide variety of transactions, including so-called "parking" transactions, to facilitate reverse like-kind exchanges. Parking transactions typically are designed to "park" the desired replacement property with an accommodation party until such time as the taxpayer arranges for the transfer of the relinquished property to the ultimate transferee in a simultaneous or deferred exchange. Once such a transfer is arranged, the taxpayer transfers the relinquished property to the accommodation party in exchange for the replacement property, and the accommodation party then transfers the relinquished property to the ultimate transferee. In other situations, an accommodation party may acquire the desired replacement property on behalf of the taxpayer and immediately exchange such property with the taxpayer for the relinquished property, thereafter holding the relinquished property until the taxpayer arranges for a transfer of such property to the ultimate transferee. In the parking arrangements, taxpayers attempt to arrange the transaction so that the accommodation party has enough of the benefits and burdens relating to the property so that the accommodation party will be treated as the owner for federal income tax purposes.

.06 Treasury and the Service have determined that it is in the best interest of sound tax administration to provide taxpayers with a workable means of qualifying their transactions under § 1031 in situations where the taxpayer has a genuine intent to accomplish a like-kind exchange at the time that it arranges for the acquisition of the replacement property and actually accomplishes the exchange within a short time thereafter. Accordingly, this revenue procedure provides a safe harbor that allows a taxpayer to treat the accommodation party as the owner of the property for federal income tax purposes, thereby enabling the taxpayer to accomplish a qualifying like-kind exchange.

SECTION 3. SCOPE

.01 *Exclusivity.* This revenue procedure provides a safe harbor for the qualification under § 1031 of certain arrangements between taxpayers and exchange accommodation titleholders and provides for the treatment of the exchange accommodation titleholder as the beneficial owner of the property for federal income tax purposes. These provisions apply only in the limited context described in this revenue procedure. The principles set forth in this revenue procedure have no application to any federal income tax determinations other than determinations that involve arrangements qualifying for the safe harbor.

.02 *No inference.* No inference is intended with respect to the federal income tax treatment of arrangements similar to those described in this revenue procedure that were entered into prior to the effective date of this revenue procedure. Further, the Service recognizes that "parking" transactions can be accomplished outside of the safe harbor provided in this revenue procedure. Accordingly, no inference is intended with respect to the federal income tax treatment of "parking" transactions that do not satisfy the terms of the safe harbor provided in this revenue procedure, whether entered into prior to or after the effective date of this revenue procedure.

.03 *Other issues.* Services for the taxpayer in connection with a person's role as the exchange accommodation titleholder in a QEAA shall not be taken into account in determining whether that person or a related person is a disqualified

person (as defined in § 1.1031(k)–1(k)). Even though property will not fail to be treated as being held in a QEAA as a result of one or more arrangements described in section 4.03 of this revenue procedure, the Service still may recast an amount paid pursuant to such an arrangement as a fee paid to the exchange accommodation titleholder for acting as an exchange accommodation titleholder to the extent necessary to reflect the true economic substance of the arrangement. Other federal income tax issues implicated, but not addressed, in this revenue procedure include the treatment, for federal income tax purposes, of payments described in section 4.03(7) and whether an exchange accommodation titleholder may be precluded from claiming depreciation deductions (*e.g.*, as a dealer) with respect to the relinquished property or the replacement property.

.04 *Effect of Noncompliance.* If the requirements of this revenue procedure are not satisfied (for example, the property subject to a QEAA is not transferred within the time period provided), then this revenue procedure does not apply. Accordingly, the determination of whether the taxpayer or the exchange accommodation titleholder is the owner of the property for federal income tax purposes, and the proper treatment of any transactions entered into by or between the parties, will be made without regard to the provisions of this revenue procedure.

SECTION 4. QUALIFIED EXCHANGE ACCOMMODATION ARRANGEMENTS

.01 *Generally.* The Service will not challenge the qualification of property as either "replacement property" or "relinquished property" (as defined in § 1.1031(k)–1(a)) for purposes of § 1031 and the regulations thereunder, or the treatment of the exchange accommodation titleholder as the beneficial owner of such property for federal income tax purposes, if the property is held in a QEAA.

.02 *Qualified Exchange Accommodation Arrangements.* For purposes of this revenue procedure, property is held in a QEAA if all of the following requirements are met:

(1) Qualified indicia of ownership of the property is held by a person (the "exchange accommodation titleholder") who is not the taxpayer or a disqualified person and either such person is subject to federal income tax or, if such person is treated as a partnership or S corporation for federal income tax purposes, more than 90 percent of its interests or stock are owned by partners or shareholders who are subject to federal income tax. Such qualified indicia of ownership must be held by the exchange accommodation titleholder at all times from the date of acquisition by the exchange accommodation titleholder until the property is transferred as described in section 4.02(5) of this revenue procedure. For this purpose, "qualified indicia of ownership" means legal title to the property, other indicia of ownership of the property that are treated as beneficial ownership of the property under applicable principles of commercial law (*e.g.*, a contract for deed), or interests in an entity that is disregarded as an entity separate from its owner for federal income tax purposes (*e.g.*, a single member limited liability company) and that holds either legal title to the property or such other indicia of ownership;

(2) At the time the qualified indicia of ownership of the property is transferred to the exchange accommodation titleholder, it is the taxpayer's bona fide intent that the property held by the exchange accommodation titleholder represent either replacement property or relinquished property in an exchange that is intended to qualify for nonrecognition of gain (in whole or in part) or loss under § 1031;

(3) No later than five business days after the transfer of qualified indicia of ownership of the property to the exchange accommodation titleholder, the taxpayer and the exchange accommodation titleholder enter into a written agreement (the "qualified exchange accommodation agreement") that provides that the exchange accommodation titleholder is holding the property for the benefit of the taxpayer in order to facilitate an exchange under § 1031 and this revenue procedure and that the taxpayer and the exchange accommodation titleholder agree to report the acquisition, holding, and disposition of the property as provided in this revenue procedure. The agreement must specify that the exchange accommodation titleholder will be treated as the beneficial owner of the property for all federal income tax purposes. Both parties must report the federal income tax attributes of the property on their federal income tax returns in a manner consistent with this agreement;

(4) No later than 45 days after the transfer of qualified indicia of ownership of the replacement property to the exchange accommodation titleholder, the relinquished property is properly identified. Identification must be made in a manner consistent with the principles described in § 1.1031(k)–1(c). For purposes of this section, the taxpayer may properly identify alternative and multiple properties, as described in § 1.1031(k)–1(c)(4);

(5) No later than 180 days after the transfer of qualified indicia of ownership of the property to the exchange accommodation titleholder, (a) the property is transferred (either directly or indirectly through a qualified intermediary (as defined in § 1.1031(k)–1(g)(4))) to the taxpayer as replacement property; or (b) the property is transferred to a person who is not the taxpayer or a disqualified person as relinquished property; and

(6) The combined time period that the relinquished property and the replacement property are held in a QEAA does not exceed 180 days.

.03 *Permissible Agreements.* Property will not fail to be treated as being held in a QEAA as a result of any one or more of the following legal or contractual arrangements, regardless of whether such arrangements contain terms that typically would result from arm's length bargaining between unrelated parties with respect to such arrangements:

(1) An exchange accommodation titleholder that satisfies the requirements of the qualified intermediary safe harbor set forth in §1.1031(k)–1(g)(4) may enter into an exchange agreement with the taxpayer to serve as the qualified intermediary in a simultaneous or deferred exchange of the property under § 1031;

(2) The taxpayer or a disqualified person guarantees some or all of the obligations of the exchange accommodation titleholder, including secured or unsecured debt incurred to acquire the property, or indemnifies the exchange accommodation titleholder against costs and expenses;

(3) The taxpayer or a disqualified person loans or advances funds to the exchange accommodation titleholder or guarantees a loan or advance to the exchange accommodation titleholder;

(4) The property is leased by the exchange accommodation titleholder to the taxpayer or a disqualified person;

(5) The taxpayer or a disqualified person manages the property, supervises improvement of the property, acts as a contractor, or otherwise provides services to the exchange accommodation titleholder with respect to the property;

(6) The taxpayer and the exchange accommodation titleholder enter into agreements or arrangements relating to the purchase or sale of the property, including puts and calls at fixed or formula prices, effective for a period not in excess of 185 days from the date the property is acquired by the exchange accommodation titleholder; and

(7) The taxpayer and the exchange accommodation titleholder enter into agreements or arrangements providing that any variation in the value of a relinquished property from the estimated value on the date of the exchange accommodation titleholder's receipt of the property be taken into account upon the exchange accommodation titleholder's disposition of the relinquished property through the taxpayer's advance of funds to, or receipt of funds from, the exchange accommodation titleholder.

.04 *Permissible Treatment.* Property will not fail to be treated as being held in a QEAA merely because the accounting, regulatory, or state, local, or foreign tax treatment of the arrangement between the taxpayer and the exchange accommodation titleholder is different from the treatment required by section 4.02(3) of this revenue procedure.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for QEAAs entered into with respect to an exchange accommodation titleholder that acquires qualified indicia of ownership of property on or after September 15, 2000.

SECTION 6. 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 1545-1701. 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 are contained in section 4.02 of this revenue procedure, which requires taxpayers and exchange accommodation titleholders to enter into a written agreement that the exchange accommodation titleholder will be treated as the beneficial owner of the property for all federal income tax purposes. This information is required to ensure that both parties to a QEAA treat the transaction consistently for federal tax purposes. The likely respondents are businesses and other for-profit institutions, and individuals.

The estimated average annual burden to prepare the agreement and certification is two hours. The estimated number of respondents is 1,600, and the estimated total annual reporting burden is 3,200 hours.

The estimated annual frequency of responses is on occasion.

Books and 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 J. Peter Baumgarten of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Baumgarten at (202) 622-4950 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 446, 481; 1.446-1, 1.481-1.)

Rev. Proc. 2000-38

SECTION 1. PURPOSE

This revenue procedure provides three permissible methods of accounting for distributor commissions (as defined in § 2 below). A taxpayer may change to or adopt any of the three methods. This revenue procedure provides procedures for a taxpayer to obtain consent from the Commissioner of Internal Revenue to change to any of the three methods of accounting for distributor commissions, including rules relating to the limitations, terms, and conditions the Commissioner deems necessary to make the change.

SECTION 2. DEFINITIONS

Under Rule 12b-1 (17 C.F.R. § 270. 12b-1), an open-end regulated investment company ("mutual fund") may adopt, for one or more classes of its shares, a plan that permits it to use fund assets to pay a fee to cover distribution costs of fund shares ("distribution fee"). For purposes of this revenue procedure, the term "distributor commissions" means commissions paid or incurred by a distributor of a mutual fund on the sale of mutual fund shares for which the distributor is to receive a distribution fee from the mutual fund and, in some cases, a contingent deferred sales charge from the investor in future taxable year(s) (typically referred to in the mutual fund industry as "B shares"). Distributor commissions do not include commissions paid or incurred on the sale of mutual fund shares for which the distributor is to receive a distribution fee and, in some cases, a contingent deferred sales charge in future taxable years and will make commission payments to the selling broker in an amount equal to the amount it receives each year that the shares remain outstanding (typically referred to in the mutual fund industry as "C shares").

SECTION 3. BACKGROUND

.01 Mutual funds generally distribute new shares to the public through a distributor. If an investor purchases mutual fund shares through a broker, either the investor or the distributor pays the brokerage commissions. If the distributor pays the brokerage commissions (i.e., distributor commissions), the distributor typically recovers this cost by collecting from the mutual fund a distribution fee in accordance with Rule 12b-1 and, in some cases, by receiving a sales charge from the investor if the shares are redeemed within a specified period of time.

.02 Under § 446, the Commissioner has broad authority to determine whether a method of accounting clearly reflects income. Under § 446(b), if a taxpayer's method of accounting does not clearly reflect income, the computation of taxable income must be made under a method

that, in the opinion of the Secretary, does clearly reflect income. *See Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), 1979–1 C.B. 167; *Commissioner v. Hansen*, 360 U.S. 446 (1959), 1959–2 C.B. 460; § 1.446–1(c)(2)(ii) of the Income Tax Regulations.

.03 To minimize disputes regarding the accounting for distributor commissions and to provide appropriate methods for matching those commissions with the related distribution fees and sales charges so as to clearly reflect income, the Internal Revenue Service will permit a taxpayer that complies with the requirements of this revenue procedure to account for distributor commissions using any of the three permissible methods of accounting described in § 5 of this revenue procedure. A taxpayer may use any of these three methods to account for the distributor commissions related to each class of shares within each mutual fund for which it acts as a distributor.

.04 A change in a taxpayer's treatment of distributor commissions to any of the three permissible methods described in § 5 of this revenue procedure is a change in method of accounting to which §§ 446 and 481 apply. Sections 446(e) and 1.446–1(e) provide 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)(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.

SECTION 4. SCOPE

This revenue procedure applies to a taxpayer that chooses to account for distributor commissions under any of the three permissible methods of accounting for distributor commissions provided in § 5 of this revenue procedure. This revenue procedure does not apply to amortizable section 197 intangibles.

SECTION 5. PERMISSIBLE METHODS OF ACCOUNTING

.01 DISTRIBUTION FEE PERIOD METHOD.

(1) *Description of Method.* The treatment of distributor commissions in accordance with the distribution fee period method is a permissible method of accounting. Under the distribution fee period method, a taxpayer must capitalize distributor commissions paid or incurred during the taxable year on the sale of shares in a mutual fund and amortize those amounts ratably over a specific recovery period determined by the number of years for which the 12b–1 plan provides the taxpayer is to receive a distribution fee from the mutual fund as a result of the sale of those shares (distribution fee period). Amortization for a short taxable year is based on the number of months in the short taxable year (taking into account the half-year convention if § 5.01(2)(b) applies).

(2) *Pooling Allowed.*

(a) For purposes of accounting for distributor commissions under the distribution fee period method, a taxpayer may establish one or more pools of commissions. A pool may be established with respect to distributor commissions related to a class of shares of a mutual fund sold in a single taxable year. A pool of distributor commissions may contain commissions related to a class of mutual fund shares sold in a single taxable year from one or more mutual funds, provided the distributor commissions for each class of mutual fund shares is accounted for under the distribution fee method. However, a pool may only include distributor commissions related to a class of mutual fund shares sold in a single taxable year with the same distribution fee period and the same compensation structure.

(b) A taxpayer that establishes annual pools for purposes of using the distribution fee period method must compute the amount of the amortization deduction using a half-year convention.

(c) Distribution fees have the same compensation structure if they are calculated on the basis of the same percentage of the mutual fund's average net assets.

(3) *Termination of Right to Distribution Fees.*

(a) Basis recovery allowed. A taxpayer that uses the distribution fee period method described in this § 5.01 may account for the termination of its right to receive a distribution fee for a particular share in a mutual fund by claiming in the year of termination a loss or, for a sale of the distributor's right to all, or an undivided interest in a part, of its future distribution fees for the share, an offset against sales proceeds. A taxpayer that uses pools in connection with the distribution fee period method described in this § 5.01 determines its unrecovered basis in its right to receive distribution fees for particular shares in a prior year pool that are terminated by multiplying its unrecovered basis in the applicable pool of distributor commissions as of the beginning of the year by a fraction, the numerator of which is the number of terminated shares for which commissions were in the pool as of the beginning of the year and the denominator of which is the number of shares for which commissions were in the pool as of the beginning of the year. To determine the unrecovered basis for its right to receive distribution fees for a particular share in a current year pool that is terminated in the initial year (i.e., the year the share giving rise to the right to receive distribution fees is sold), the taxpayer must multiply the unrecovered basis in the applicable pool as of the end of the year by a fraction, the numerator of which is the number of shares terminated during the year for which commissions in the pool were paid or incurred during the year and the denominator of which is the number of shares sold during the year for which commissions in that pool were paid or incurred during the year. The unrecovered basis in the applicable pool of distributor commissions must be reduced by the basis allocable to the terminated shares, as determined in the preceding two sentences, before calculating the amortization deduction for the year. If a taxpayer does not have sufficient information to relate a termination event to a specific pool, the taxpayer must treat the termination event as relating to the earliest remaining pool in accordance with the principles of § 1.1012–1(c)(1).

(b) Termination events. For purposes of § 5.01(3)(a) of this revenue procedure, a taxpayer's right to a distribution fee for a particular share terminates when the taxpayer is no longer entitled to receive a distribution fee related to that share in subsequent years. Termination may occur as a result of (i) a sale of the distributor's right to all future distribution fees for the share, (ii) the redemption of the share by the shareholder, or (iii) the conversion of the share into another class of shares for

which the taxpayer is not entitled to receive a distribution fee. If a taxpayer sells an undivided interest in its right to all present and future distribution fees associated with a share or a portion of a pool, termination occurs in proportion to the interest sold.

.02 5-YEAR METHOD.

(1) *Description of Method.* The treatment of distributor commissions in accordance with the 5-year method is a permissible method of accounting. Under the 5-year method, a taxpayer must capitalize distributor commissions paid or incurred during the taxable year and amortize those amounts ratably over a 5-year period. Amortization for a short taxable year is based on the number of months in the short taxable year (taking into account the half-year convention).

(2) *Pooling Required.*

(a) For purposes of accounting for distributor commissions under the 5-year method, a taxpayer must establish one or more pools of commissions. All commissions related to a class of shares of a mutual fund sold in a single taxable year must be in the same pool. A pool of distributor commissions may contain commissions related to classes of mutual fund shares from one or more mutual funds, provided the distributor commissions for each of the classes of mutual fund shares are accounted for using the 5-year method.

(b) A taxpayer that uses the 5-year method must compute the amount of the amortization deduction using a half-year convention.

(3) *Termination of Right to Distribution Fees.* A taxpayer that uses the 5-year method described in this § 5.02 may not claim a loss or an offset against sales proceeds for the unamortized portion of a distributor commission as a result of a termination event for a particular share, as described in § 5.01(3)(b) of this revenue procedure. However, if the taxpayer experiences a termination event with respect to the distribution fees related to all the shares in a pool, the taxpayer may claim a loss or an offset against sales proceeds for the unamortized portion of the distributor commissions in that pool. In addition, if a taxpayer sells an undivided interest in its right to all present and future distribution fees for all the shares in a pool, the taxpayer experiences a termination event with respect to the pool, but only in proportion to the interest sold, and may claim the corresponding loss or offset against sales proceeds.

.03 USEFUL LIFE METHOD

(1) *Description of Method.* The treatment of distributor commissions in accordance with the useful life method is a permissible method of accounting. Under the useful life method, a taxpayer must capitalize distributor commissions paid or incurred during the taxable year and recover those amounts over their estimated useful life. *See* § 1.167(a)–1(b).

(2) *Determination of Useful Life.* The recovery method and useful life of distributor commissions must be established by taking into account all the facts and circumstances including, for example, (i) the period during which the taxpayer is to receive distribution fees from a mutual fund under the 12b–1 plan with respect to particular shares, and (ii) the experience of the taxpayer regarding how long a typical share burdened with a given distribution fee remains outstanding after purchase. *See* § 1.167(a)–1(b).

(3) *Pooling Allowed.* For purposes of accounting for distributor commissions under the useful life method, a taxpayer may establish one or more pools of commissions. A taxpayer that establishes annual pools under the useful life method must compute the amount of the amortization deduction using a half-year convention.

(4) *Retirement of Right to Distribution Fees.* The determination of whether or not a taxpayer using the useful life method may claim a loss is governed by §1.167(a)–8. For example, if the useful life of the distributor commissions under the useful life method does not reflect any retirements, including a termination of a right to a distribution fee, the taxpayer may claim a loss for the unamortized portion of a distributor commission as a result of a retirement. If the useful life of the distributor commissions under the useful life method is an average useful life that reflects retirements, the taxpayer may not claim a loss for the unamortized portion of a distributor commission as a result of a retirement, regardless of whether the distributor commission is accounted for as a single asset or in a pool, unless distributor commissions related to all the shares in the pool are retired.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

.01 *Change to the Distribution Fee Period Method*, the 5-year Method, or the Useful Life Method. A taxpayer that wants to change its method of accounting for distributor commissions for the taxable year that includes January 1, 2001, to any of the three methods described in this revenue procedure must follow the automatic change in method of accounting provisions in Rev. Proc. 99–49, 1999–52 I.R.B. 725, (or its successor) with the following modifications:

(1) A taxpayer that files a copy of the Form 3115, Application for Change in Accounting Method, to change its method of accounting for distributor commissions with the national office of the Internal Revenue Service on or before April 2, 2001, is not subject to the scope limitations in § 4.02 of Rev. Proc. 99–49, unless the taxpayer's method of accounting for distributor commissions is an issue under consideration before a federal court within the meaning of § 3.09(3) of Rev. Proc. 99–49. If the taxpayer is under examination, before an appeals office, or before a federal court at the time that a copy of the Form 3115 is filed with the national office, the taxpayer must provide a duplicate copy of the Form 3115 to the examining agent, appeals officer, or counsel for the government, as appropriate, at the time the copy of the Form 3115 is filed. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent, appeals officer, or counsel for the government, as appropriate. If the taxpayer's method of accounting for distributor commissions is an issue pending within the meaning of § 6.01(6) of this revenue procedure at the time that a Form 3115 is filed with the national office, the taxpayer also must provide to the examining agent or appeals officer, as appropriate, an executed closing agreement substantially in the form set forth in APPENDIX A of this revenue procedure.

(2) The change must be made using a cut-off method and applies only to distributor commissions paid or incurred on or after January 1, 2001. Because no items are duplicated or omitted from income when a cut-off method is used, a § 481(a)

adjustment described in § 5.03 of Rev. Proc. 99–49 is not necessary. See § 2.06 of Rev. Proc. 99–49.

(3) The year of change is the taxable year that includes January 1, 2001.

(4) Section 6.02(2)(a) of Rev. Proc. 99–49 is modified to allow the required copy of the Form 3115 to be filed with the national office before the first day of the year of change if the taxpayer properly files a Form 3115 under this revenue procedure.

(5) In order to assist the Internal Revenue Service in processing changes in method of accounting under this revenue procedure, and to ensure proper handling, § 6.02(3)(a) of Rev. Proc. 99–49 is modified to require that a Form 3115 filed under this revenue procedure include the statement: "Automatic Change Filed Under [*insert section number*] of Rev. Proc. 2000–38." This statement must be legibly printed or typed at the top of any Form 3115 filed under this revenue procedure.

(6) For purposes of this revenue procedure, the taxpayer's method of accounting for distributor commissions is an issue pending if the Service has given the taxpayer written notification indicating an adjustment is being made or will be proposed with respect to the taxpayer's method of accounting for distributor commissions. This will normally occur after the Service has gathered information sufficient to determine that a proposed adjustment is appropriate and justified, although the exact amount of the adjustment may not yet be determined.

.02 *Audit Protection.* If a taxpayer complies with the requirements of this revenue procedure for changing its method of accounting for distributor commissions to any of the three methods of accounting described in this revenue procedure, the treatment of distributor commissions will not be raised as an issue in any taxable year before the year of change and, if the treatment of distributor commissions has already been raised as an issue in a taxable year before the year of change, the treatment of distributor commissions will not be further pursued.

.03 *Changes Not Made under this Revenue Procedure.* A taxpayer that wants to change from a method of currently deducting distributor commissions to a method of capitalizing and amortizing distributor commissions under any of the three methods described in this revenue procedure for any taxable year other than the taxable year that includes January 1, 2001, must follow the automatic change in method of accounting provisions in Rev. Proc. 99–49. However, this change must be made on a cut-off basis as described in § 2.06 of Rev. Proc. 99–49. A change from one method of amortizing described in this revenue procedure to another method of amortizing described in this revenue procedure, and a change from pooling to single asset, or vice versa, under the distribution fee period method or the useful life method, must be made in accordance with the automatic change in method of accounting provisions in § 2.02 of the APPENDIX of Rev. Proc. 99–49. A change in the useful life of distributor commissions under the distribution fee period method or the useful life method is not a change in method of accounting. *See* § 1.446–1(e)(2)(ii)(*b*).

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective October 2, 2000.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–49 is modified and amplified to include this accounting method change in the APPENDIX.

DRAFTING INFORMATION

The principal author of this revenue procedure is John Moriarty of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information about this revenue procedure, contact John Moriarty at (202) 622–4950 (not a toll-free call).

APPENDIX A

Department of the Treasury–Internal Revenue Service

Closing Agreement on Final Determination Covering Specific Matters

Under § 7121 of the Internal Revenue Code of 1986,

[Taxpayer's name, address, telephone number, and identifying number]

("the taxpayer") and the Commissioner of Internal Revenue make the following closing agreement:

WHEREAS, the taxpayer is a distributor of open-end regulated investment companies ("mutual funds").

WHEREAS, the taxpayer is an accrual basis taxpayer.

WHEREAS, the taxpayer incurs commissions on the sale of shares in the mutual funds for which the taxpayer is to receive a distribution fee under Rule 12b–1 (17 C.F.R. § 270.12b–1). For purposes of this closing agreement, the term "distributor commissions" has the meaning ascribed to it in Rev. Proc. 2000–38.

WHEREAS, the taxpayer seeks to account for distributor commissions under one of the methods described in Rev. Proc. 2000–38 and has filed a Form 3115 requesting permission to change its method of accounting for distributor commissions in accordance with Rev. Proc. 2000–38 and the Commissioner is relying on that Form 3115 in proceeding with this closing agreement.

NOW IT IS HEREBY DETERMINED AND AGREED for federal income tax purposes:

1. That the taxpayer changes its present method of accounting for distributor commissions for purposes of filing federal tax returns to the [Insert name of method] method described in Rev. Proc. 2000–38 effective for the taxable year which includes January 1, 2001 ("year of change"). The Commissioner consents to that change in method of accounting.

2. That the execution of this agreement does not signify the Commissioner's agreement with the useful life or recovery method selected by the taxpayer. In accordance with § 601.204(c) of the Statement of Procedural Rules, in examining returns involving the adoption of either the useful life method or the distribution fee period method the Commissioner will ascertain whether the representations on which the change in method of accounting is based, including representations related to the useful life of the distributor commissions, reflect an accurate statement of the material facts.

3. That the taxpayer's change in accounting method for distributor commissions must be made using a cut-off method without an adjustment under § 481(a).

4. That the Commissioner accepts the taxpayer's reported method of accounting for distributor commissions for all taxable years prior to the year of change.

5. That this agreement does not preclude the taxpayer from requesting, nor the Service from requiring, a change in the taxpayer's method of accounting for distributor commissions for years after the year of change.

This agreement is final and conclusive except:

(1) The matter it relates to may be reopened in the event of fraud, malfeasance or misrepresentation of a material fact;

(2) It is subject to the Internal Revenue Code Sections that expressly provide that effect be given to their provisions (including any stated exception for I.R.C. § 7122) notwithstanding any law or rule of law; and

(3) If it relates to a tax period ending after the date of this agreement, it is subject to any law enacted after the agreement date, that applies to the tax period.

By Signing, the parties certify that they have read and agreed to the terms of this document.

Taxpayer (other than individual):_____

By:_____ Date:_____

Title:_____

Commissioner of Internal Revenue

By:_____ Date:_____

Title:_____

Instructions

This agreement must be signed and filed in triplicate. (All copies must have original signatures.) The original and copies of the agreement must be identical. The name of the taxpayer must be stated accurately. The agreement may relate to one or more years.

If an attorney or agent signs the agreement for the taxpayer, the power of attorney (or a copy) authorizing that person to sign must be attached to the agreement. If the agreement is made for a year when a joint income tax return was filed by a husband and wife, it should be signed by or for both spouses. One spouse may sign as agent for the other if the document (or a copy) specifically authorizing that spouse to sign is attached to the agreement.

If the fiduciary signs the agreement for a decedent or an estate, an attested copy of the letters testamentary or the court order authorizing the fiduciary to sign, and a certificate of recent date that the authority remains in full force and effect must be attached to the agreement. If a trustee signs, a certified copy of the trust instrument or a certified copy of extracts from that instrument must be attached showing:

(1) the date of the instrument;

(2) that it is or is not of record in any court;

(3) the names of the beneficiaries;

(4) the appointment of the trustee, the authority granted, and other information necessary to show that the authority extends to Federal tax matters; and

(5) that the trust has not been terminated, and that the trustee appointed is still acting. If a fiduciary is a party, Form 56, Notice Concerning Fiduciary Relationship, is ordinarily required.

If the taxpayer is a corporation, the agreement must be dated and signed with the name of the corporation, the signature and title of an authorized officer or officers, or the signature of an authorized attorney or agent. It is not necessary that a copy of an enabling corporate resolution be attached.

Use additional pages if necessary, and identify them as part of this agreement.

Please see Revenue Procedure 68–16, C. B. 1968 1, page 770, for a detailed description of practices and procedures applicable to most closing agreements.

I have examined the specific matters involved and recommend the acceptance of the proposed agreement

_____ _____

(Receiving Officer) (Date)

_____

(Title)

I have examined the specific matters involved and recommend the acceptance of the proposed agreement

_____ _____

(Reveiwing Officer) (Date)

_____

(Title)

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Guidance Under Subpart F Relating to Partnerships

REG-112502-00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: A notice of proposed rulemaking and notice of proposed rulemaking by cross-reference to temporary regulations published in the **Federal Register** on March 26, 1998, providing guidance under subpart F relating to partnerships and branches, were withdrawn by a notice of proposed rulemaking published in the **Federal Register** on July 13, 1999. 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 5, 2000, must be received by November 14, 2000.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-112502-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG-112502-00), 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/comments.html. The public hearing will be held in room 4718, 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, Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On March 26, 1998 (63 F.R. 14613), the IRS issued proposed regulations (REG-104537-97,1998-1 C.B. 892) which contained two sets of provisions, one relating to the treatment under subpart F of a controlled foreign corporation's (CFC's) distributive share of partnership income (including a clarification of the manufacturing exception under the foreign base company sales income rules) and the other relating to hybrid branch transactions. The provisions relating to hybrid branch transactions were also issued as temporary regulations (T.D. 8767, 1998-1 C.B. 875). Congress and taxpayers raised concerns about the proposed and temporary regulations relating to hybrid branch transactions. To respond to these concerns, on July 6, 1998, Treasury and the IRS issued Notice 98-35 (1998-2 C.B. 34), which announced that they would withdraw the proposed regulations and remove the temporary regulations. Notice 98-35 also announced that Treasury and the IRS would issue two new separate sets of proposed regulations. One proposed regulation would contain hybrid branch rules. The other proposed regulation would contain rules pertaining to the treatment under subpart F of a CFC's distributive share of partnership income. On July 13, 1999, in furtherance of Notice 98-35, Treasury and the IRS published REG-113909-98 (1999-30 I.R.B. 125 [64 F.R. 37727]), which withdrew the proposed regulations and issued new proposed regulations containing the hybrid branch provisions with new dates of applicability to give Congress and the Treasury more time to evaluate the issues raised by these provisions. On the same date, T.D. 8827 (1999-30 I.R.B. 120 [64 F.R. 37677]) removed the temporary regulations relating to hybrid branch transactions. Treasury and the IRS are now proposing the regulations relating to the subpart F treatment of a CFC's distributive share of partnership income.

This document substantially restates the former proposed regulations relating to the treatment of a CFC's distributive share of partnership income under subpart F. These new proposed regulations, however, do not contain the provisions of the former proposed regulations that clarified the manufacturing exception under subpart F. Regulations clarifying the manufacturing exception will be proposed at a later date.

Explanation of Provisions

These proposed regulations clarify the appropriate treatment under subpart F of certain partnership items that had been the subject of *Brown Group, Inc. v. Commissioner*, 77 F.3d 217 (8th Cir. 1996), vacating and remanding 104 T.C. 105 (1995). In *Brown Group*, a Cayman Islands partnership with a Cayman Islands CFC partner earned commission income from purchasing footwear in Brazil on behalf of the CFC's U.S. parent. This commission income would have been subpart F income, specifically foreign base company sales income under section 954(d), to the CFC if it had earned this commission income directly and under the same circumstances in which the partnership earned this income. The Tax Court applied an aggregate theory of partnerships and held that the CFC's distributive share of this commission income was foreign base company sales income. The Eighth Circuit, vacating and remanding the Tax Court's decision, applied an entity theory of partnerships and held that the CFC's distributive share of this commission income was not foreign base company sales income.

In response to the Eighth Circuit's opinion, the IRS announced that it intended to issue regulations under subpart F to clarify its position that whether a CFC partner's distributive share of partnership income is subpart F income generally is determined at the CFC partner level. See Notice 96-39 (1996-2 C.B. 209).

The proposed regulations would provide guidance for the treatment under subpart F of a CFC partner's distributive share of subpart F income. The regulations would provide general rules to determine whether a CFC partner's distributive share of partnership income falls within, not only foreign base company sales income, the category of income at

issue in *Brown Group*, but any category of subpart F income. These regulations also would provide guidance about the treatment of a CFC partner's distributive share of foreign personal holding company income, foreign base company sales income, foreign base company services income, and earnings invested in United States property under certain specific provisions of subpart F.

The proposed regulations are based on the authority of subchapter K and subpart F and the policies underlying those provisions. The legislative history of subchapter K provides that a partnership distributive share should be characterized by using the approach that best serves the Internal Revenue Code or regulations section at issue.

To allow a CFC to avoid subpart F treatment for items of income through the simple expedient of receiving them as distributive shares of partnership income, rather than directly, is contrary to the intent of subpart F. Subpart F was intended to limit deferral of U.S. income tax on passive income received by CFCs, as well as on certain other kinds of easily transferable income.

Under these proposed regulations, gross income would be characterized at the partnership level, as, for example, sales income. If any part of the partnership's gross income would be subpart F income if received directly by partners that are CFCs, it must be separately taken into account by each partner, under section 702. Thus, to the extent the separately stated income is subpart F income at the CFC partner level, it will be taken into account in determining the CFC's total subpart F income for the taxable year and U.S. shareholders of the CFC will currently include their pro rata share of this income in gross income to the extent provided under the rules of subpart F.

The regulations under section 702 would be clarified to expressly provide that an item must be separately taken into account when, if separately taken into account by any partner, the item would result in an income tax liability for that partner, or any other person, different from that which would result if the partner did not take the item into account separately. This clarification incorporates into the regulations Rev. Rul. 86–138 (1986–2 C.B. 84), which holds that a subsidiary partnership in a multi-tiered arrangement must separately state items which, if separately taken into account by any partner of any partnership in the multi-tiered arrangement, would affect the income tax liability of that partner.

The regulations under section 952 also would be clarified to expressly include within the definition of subpart F income a CFC's distributive share of any item of gross income of a partnership to the extent the income would have been subpart F income if received by the CFC partner directly. Comments are requested as to whether this rule should apply for ownership interests that fall below certain thresholds.

The proposed regulations would provide further that, generally, in determining whether a distributive share of partnership income is subpart F income, whether an entity is a related person and whether an activity takes place in or outside the CFC's country of incorporation is determined with respect to the CFC partner and not the partnership. Applying these rules to the *Brown Group* facts, the income would be characterized at the partnership level as commission income from the purchase of shoes in Brazil on behalf of the U.S. parent for sale in the U.S. Each partner would be required to separately take into account its distributive share of this commission income. It would then be determined at the CFC partner level that the shoes were manufactured and sold for use outside of the CFC's country of incorporation (Cayman Islands), and that the U.S. parent was a related person with respect to the CFC. Thus, the CFC's distributive share of commission income would be foreign base company sales income.

The proposed regulations also would address whether a CFC's distributive share of partnership income can qualify for the exceptions from foreign personal holding company income treatment that are based on the activities performed by the CFC in connection with the property through which it earns the income. The proposed regulations would provide that an exception requiring activity would generally apply if the exception would have applied to the income if the CFC itself had directly earned the income taking into account only the property and activities of the partnership. This requirement is not met if the partnership can qualify for the exception only by taking into account the separate activities of its partners. Thus, for example, if the partnership earns rental income from leasing real property that it owns and with respect to which it performs active and substantial management functions, the CFC partner's distributive share of the rental income can be excluded from subpart F income under the active rents exception of section 954(c)(2)(A) if the rental income is earned from a person that is not a related person with respect to the CFC partner. However, if the partnership owns the real property but the CFC contracts to perform the management functions, the rental income is not excludible under this exception.

These proposed regulations would clarify how the manufacturing exception of §1.954–3(a)(4) applies in the context of the distributive share rules. The proposed regulations would provide that the manufacturing activities of a partnership may be taken into account under the distributive share rules when the partnership sells the property that it manufactures. As previously noted, the general rules would provide that income that could be foreign base company sales income at the CFC partner level is separately stated and that determinations as to relatedness and the relevant country are made at the partner level. Consistent with the general rules outlined above, these regulations would allow a CFC's distributive share of sales income to be excluded, under the manufacturing exception of §1.954–3(a)(4), when the partnership manufactures the property that it sells (without regard to the activities of the CFC partner or any other person).

The general rule, described above, would determine whether a CFC partner's distributive share of partnership income is foreign base company services income when the income is earned from performing services for or on behalf of a person that is a related person with respect to the CFC partner. These proposed regulations also would describe how the substantial assistance rule of §1.954–4(b)(1)(iv) applies when the CFC earns services income through a partnership. When the partnership is performing services for a person unrelated to the CFC partner but the CFC partner, or a related person, provides sub-

stantial assistance to the partnership contributing to the performance of those services, the CFC partner and the partnership would be regarded as separate entities and the substantial assistance provided to the partnership by the CFC partner, or a related person, would cause the CFC's partner's distributive share of the services income to be treated as foreign base company services income. Treasury and the IRS are considering applying similar principles to branches of CFCs. Comments are requested on this issue.

Finally, consistent with Rev. Rul. 90–112 (1990–2 C.B. 186), the regulations would provide that, for purposes of section 956, a CFC partner's investment in U.S. property includes the U.S. property held by a partnership to the extent of the CFC's interest in the partnership. Comments are requested as to whether, for purposes of section 956, a CFC partner's interest in a partnership should be based on the CFC's capital interest in the partnership, the CFC's interest in partnership profits, or another standard, such as the facts and circumstances relating to the CFC's interest in the partnership.

Treasury is currently conducting a study to review the provisions of subpart F. The study may examine the foreign base company rules, contract manufacturing, and the use of hybrid partnerships under subpart F. Although comments will be sought separately on the study, comments received on these regulations will be reviewed in connection with the study.

Proposed Effective Date

These regulations are proposed to apply for taxable years of a controlled foreign corporation beginning on or after the date the final regulations are published in the **Federal Register**. For prior periods, the IRS will rely on principles and authorities under subpart F and subchapter K to apply an aggregate approach, (including §1.701–2(e) and (f) of the regulations for periods for which it is applicable).

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 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 timely submitted to the IRS. All comments will be available for public inspection and copying. The IRS and Treasury specifically request comments on the clarity of these proposed regulations and how they may be made easier to understand.

A public hearing has been scheduled for December 5, 2000, at 10 a.m., in room 4718, 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 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 Valerie Mark of the Office of the Associate Chief Counsel (International), 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 26 CFR part 1 continues to read in part as follows:

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

Par. 2 Section §1.702–1 is amended as follows:

1. Paragraph (a)(8)(ii) is revised.

2. Paragraph (c)(1)(iii) is amended by removing the word "and".

3. Paragraph (c)(1)(iv) is amended by removing the period at the end and adding "; and" in its place.

4. Paragraph (c)(1)(v) is added.

The addition and revision read as follows:

§1.702–1 Income and credits of partner.

(a) * * *

(8) * * *

(ii) Each partner must also take into account separately the partner's distributive share of any partnership item which, if separately taken into account by any partner, would result in an income tax liability for that partner, or for any other person, different from that which would result if that partner did not take the item into account separately. Thus, if any partner is a controlled foreign corporation, as defined in section 957, items of income that would be gross subpart F income if separately taken into account by the controlled foreign corporation must be separately stated for all partners. Under section 911(a), if any partner is a bona fide resident of a foreign country who may exclude from gross income the part of the partner's distributive share which qualifies as earned income, as defined in section 911(b), the earned income of the partnership for all partners must be separately stated. Similarly, all relevant items of in-

come or deduction of the partnership must be separately stated for all partners in determining the applicability of section 183 (relating to activities not engaged in for profit) and the recomputation of tax thereunder for any partner. This paragraph (a)(8)(ii) applies to taxable years beginning on or after the date final regulations are published in the Federal Register.

* * * * *

(c) * * *

(1) * * *

(v) In determining whether the *de minimis* or full inclusion rules of section 954(b)(3) apply.

* * * * *

Par. 3. In §1.952–1, paragraph (g) is added to read as follows:

§1.952–1 Subpart F income defined.

* * * * *

(g) *Treatment of distributive share of partnership income*— (1) *In general.* A controlled foreign corporation's distributive share of any item of income of a partnership is income that falls within a category of subpart F income described in section 952(a) to the extent the item of income would have been income in such category if received by the controlled foreign corporation directly. For specific rules regarding the treatment of a distributive share of partnership income under certain provisions of subpart F, see §§1.954–1(g), 1.954–2(a)(5), 1.954–3(a)(6), and 1.954–4(b)(2)(iii).

(2) *Example.* The application of this paragraph (g) may be illustrated by the following example:

Example. CFC, a controlled foreign corporation, is an 80-percent partner in PRS, a foreign partnership. PRS earns $100 of interest income that is not export financing interest, as defined in section 954(c)(2)(B), from a person unrelated to CFC. This interest income would have been foreign personal holding company income to CFC, under section 954(c), if it had received this income directly. Accordingly, CFC's distributive share of this interest income, $80, is foreign personal holding company income.

(3) *Effective date.* This paragraph (g) applies to taxable years of a controlled foreign corporation beginning on or after the date final regulations are published in the Federal Register.

Par. 4. In §1.954–1, paragraph (g) is added to read as follows:

§1.954–1 Foreign base company income.

* * * * *

(g) *Distributive share of partnership income*—(1) *Application of related person and country of organization tests.* Unless otherwise provided, to determine the extent to which a controlled foreign corporation's distributive share of any item of gross income of a partnership would have been subpart F income if received by it directly, under §1.952–1(g), if a provision of subpart F requires a determination of whether an entity is a related person, within the meaning of section 954(d)(3), or whether an activity occurred within or outside the country under the laws of which the controlled foreign corporation is created or organized, this determination shall be made by reference to such controlled foreign corporation and not by reference to the partnership.

(2) *Examples.* The application of paragraph (g)(1) of this section is illustrated by the following examples:

Example 1. CFC, a controlled foreign corporation organized in Country A, is an 80-percent partner in Partnership, a partnership organized in Country A. All of the stock of CFC is owned by USP, a U.S. corporation. Partnership earns commission income from purchasing Product O on behalf of USP, from unrelated manufacturers in Country B, for sale in the United States. To determine whether CFC's distributive share of Partnership's commission income is foreign base company sales income under section 954(d), CFC is treated as if it purchased Product O on behalf of USP. Under section 954(d)(3), USP is a related person with respect to CFC. Thus, with respect to CFC, the sales income is deemed to be derived from the purchase of personal property on behalf of a related person. Because the property purchased is both manufactured and sold for use outside of Country A, CFC's country of organization, CFC's distributive share of the sales income is foreign base company sales income.

Example 2. (i) CFC1, a controlled foreign corporation organized in Country A, is an 80-percent partner in Partnership, a partnership organized in Country B. CFC2, a controlled foreign corporation organized in Country B, owns the remaining 20 percent interest in Partnership. CFC1 and CFC2 are owned by a common U.S. parent, USP. CFC2 manufactures Product A in Country B. Partnership earns sales income from purchasing Product A from CFC2 and selling it to third parties located in Country B that are not related persons with respect to CFC1 or CFC2. To determine whether CFC1's distributive share of Partnership's sales income is foreign base company sales income under section 954(d), CFC1 is treated as if it purchased Product A from CFC2 and sold it to third parties in Country B. Under section 954(d)(3), CFC2 is a related person with respect to CFC1. Thus, with respect to CFC1, the sales income is deemed to be derived from the purchase of personal property from a related person. Because the property purchased is both manufactured and sold for use outside of Country A, CFC1's country of organization, CFC1's distributive share of the sales income is foreign base company sales income.

(ii) To determine whether CFC2's distributive share of Partnership's sales income is foreign base company sales income, CFC2 is treated as if it directly sold Product A to third parties within Country B. Because Product A is both manufactured and sold for use within CFC2's country of organization, CFC2's distributive share of Partnership's sales income is not foreign base company sales income.

(3) *Effective date.* This paragraph (g) applies to taxable years of a controlled foreign corporation beginning on or after the date final regulations are published in the Federal Register.

Par. 5. In §1.954–2, paragraph (a)(5) is 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) [Reserved]

(ii) *Certain other exceptions applicable to foreign personal holding company income.* To determine the extent to which a controlled foreign corporation's distributive share of an item of income of a partnership is foreign personal holding company income, the exceptions contained in section 954(c) that are based on whether the controlled foreign corporation is engaged in the active conduct of a trade or business, including section 954(c)(2), (h) and (i), and paragraphs (b)(2) and (6), (e)(1)(ii) and (3)(ii), (iii) and (iv), (f)(1)(ii), (g)(2)(ii), and (h)(3)(ii) of this section, shall apply only if 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 taking into account only the activities of, and property owned by, the partnership and not the separate activities or property of the controlled foreign corporation or any other person.

(iii) [Reserved]

(iv) *Effective date.* This paragraph (a)(5) applies to taxable years of a controlled foreign corporation beginning on or after the date final regulations are published in the Federal Register.

* * * * *

Par. 6. In §1.954–3, paragraph (a)(6) is added to read as follows:§1.954–3 Foreign base company sales income.

(a) * * *

(6) *Special rule applicable to distributive share of partnership income*—(i) *In general.* To determine the extent to which a controlled foreign corporation's distribu-

tive share of any item of gross income of a partnership would have been foreign base company sales income if received by it directly, under §1.952–1(g), the property sold will be considered to be manufactured, produced or constructed by the controlled foreign corporation, within the meaning of paragraph (a)(4) of this section, only if the manufacturing exception of paragraph (a)(4) of this section would have applied to exclude the income from foreign base company sales income if the controlled foreign corporation had earned the income directly, determined by taking into account only the activities of, and property owned by, the partnership and not the separate activities or property of the controlled foreign corporation or any other person.

(ii) Example. The application of paragraph (a)(6)(i) of this section is illustrated by the following example:

Example. CFC, a controlled foreign corporation organized under the laws of Country A, is an 80-percent partner in Partnership X, a partnership organized under the laws of Country B. Partnership X performs activities in Country B that would constitute the manufacture of Product O, within the meaning of paragraph (a)(4) of this section, if performed directly by CFC. Partnership X, through its sales offices in Country B, then sells Product O to Corp D, a corporation that is a related person with respect to CFC, within the meaning of section 954(d)(3),for use within Country B. CFC's distributive share of Partnership X's sales income is not foreign base company sales income because the manufacturing exception of paragraph (a)(4) of this section would have applied to exclude the income from foreign base company sales income if CFC had earned the income directly. (The branch rule of paragraph (b) of this section does not apply to these facts).

(iii) *Effective date.* This paragraph (a)(6) applies to taxable years of a controlled foreign corporation beginning on or after the date final regulations are published in the **Federal Register**.

* * * * *

Par. 7. In §1.954–4, paragraph (b)(2)(iii) is added to read as follows:

§1.954–4 Foreign base company services income.

* * * * *

(b) * * *

(2) * * *

(iii) *Special rule applicable to distributive share of partnership income.* A controlled foreign corporation's distributive share of a partnership's services income will be deemed to be derived from services performed for or on behalf of a related person, within the meaning of section 954(e)(1)(A), if the partnership is a related person with respect to the controlled foreign corporation, under section 954(d)(3), and, in connection with the services performed by the partnership, the controlled foreign corporation, or a person that is a related person with respect to the controlled foreign corporation, provided assistance that would have constituted substantial assistance contributing to the performance of such services, under paragraph (b)(2)(ii) of this section, if furnished to the controlled foreign corporation by a related person. This paragraph (b)(2)(iii) applies to taxable years of a controlled foreign corporation beginning on or after the date final regulations are published in the **Federal Register**.

* * * * *

Par. 8. In §1.956–2, paragraph (a)(3) is added to read as follows:

§1.956–2 Definition of United States property.

(a) * * *

(3) *Property owned through partnership.* For purposes of section 956, if a controlled foreign corporation is a partner in a partnership that owns property that would be United States property, within the meaning of paragraph (a)(1) of this section, if owned directly by the controlled foreign corporation, the controlled foreign corporation will be treated as holding an interest in the property equal to its interest in the partnership and such interest will be treated as an interest in United States property. This paragraph (a)(3) applies to taxable years of a controlled foreign corporation beginning 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 19, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 20, 2000, 65 F.R. 56836)

TOLL-FREE NUMBER FOR THE APPEALS OFFICER (CUSTOMER SERVICE/OUTREACH) PROGRAM

Announcement 2000–80

This document informs the public of the new Appeals Officer (Customer Service/Outreach) program. Appeals now has a toll-free number for contacting an Appeals Officer (Customer Service/Outreach) who will provide assistance with an Appeals tax matter. Previously, Announcement 99–98, 1999–42 I.R.B. 520, listed telephone numbers which were not toll-free.

The toll-free number for contacting an Appeals Officer (Customer Service/Outreach) is **1-877-457-5055.** The new toll-free system will automatically send the call to the nearest Appeals Officer (Customer Service/Outreach). This new service emphasizes 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.

Appeals presently has an Appeals Officer (Customer Service/Outreach) in each of the thirty-three Appeals Offices nationwide. A list of the office locations appears at the end of this announcement.

The duties of the Appeals Officer (Customer Service/Outreach) 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 Service representatives 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.

The Appeals Officers (Customer Service/Outreach) endorse the Commissioner's concept for modernizing the Internal Revenue Service to focus on:

1) Service to Each Taxpayer
2) Service to All Taxpayers
3) Productivity Through a Quality Work Environment

Please call **1-877-457-5055** whenever you need assistance with an Appeals tax matter.

Appeals on the World-Wide Web

For further information on the Appeals organization, visit the recently updated Appeals section of the IRS Web Site at **www.irs.gov/prod/ind_info/appeals**. Included are links to information on:

- ***Appeals Redesign and Program Development*** - An introduction to the Appeals organization;
- ***Appeals Expectations-Yours and Ours*** - A review of mutual commitments for the Appeals Process;
- ***Alternative Dispute Resolution Programs*** - Are you having trouble resolving your Appeals case?;
- ***Appeal Rights*** - IRS publications providing detailed information on what can be appealed;
- ***Appeals Officer (Customer Service/Outreach) Program*** - How to contact nationwide Appeals Officers (Customer Service/Outreach) and their role in the Appeals process;
- ***Other Appeals Programs*** - Collection Appeals, Innocent Spouse, Bankruptcy, Offer-In-Compromise, and Industry Specialization; and
- ***Other Sites*** - Various sites and publications including the new IRS organization, tax law questions, U.S. Tax Court Site, where to get assistance.

Drafting Information

The principal author of this announcement is Thomas C. Louthan, Director, Strategic Planning and Communications (Appeals). For further information regarding this announcement contact Mr. Louthan at (202) 694-1842 or Darlene M. Marshall at (202) 694-1875 (not toll-free calls).

Appeals Officer (Customer Service/Outreach) Program
[Office Location]

Toll-Free Number: 1-877-457-5055

Phoenix, AZ
Laguna Niguel, CA
Los Angeles, CA
San Francisco, CA
San Jose, CA
Denver, CO
East Hartford, CT
Ft. Lauderdale, FL
Jacksonville, FL
Atlanta, GA
Chicago, IL
Indianapolis, IN
New Orleans, LA
Boston, MA
Baltimore, MD
Detroit, MI
St. Paul, MN
St. Louis, MO
Greensboro, NC
Newark, NJ
Buffalo, NY
Hempstead, NY
New York, NY
Cleveland, OH
Oklahoma City, OK
Philadelphia, PA
Nashville, TN
Austin, TX
Dallas, TX
Houston, TX
Richmond, VA
Seattle, WA
Milwaukee, WI

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

Section 1.—Tax Imposed

26 CFR 1.1(h)–1: Capital gains look-through rule for sales or exchanges of interests in a partnership, S corporation, or trust.

T.D. 8902

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

Capital Gains, Partnership, Subchapter S, and Trust Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to sales or exchanges of interests in partnerships, S corporations, and trusts. The 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 regulations affect partnerships, partners, S corporations, S corporation shareholders, trusts, and trust beneficiaries.

DATES: *Effective Date*: These regulations are effective September 21, 2000.

FOR FURTHER INFORMATION CONTACT: Jeanne M. Sullivan or David J. Sotos (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have 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 1545-1654. Responses to these collections of information are required to verify compliance with section 1(h) and to determine that the tax on capital gains has been computed correctly.

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/recordkeeper is 10 minutes.

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

Section 311 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788, 831) (the 1997 Act), as modified by sections 5001 and 6005(d) of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685, 787, 800) (the 1998 Act), reduced the maximum statutory tax rates for long-term capital gains of individuals in general and provided regulatory authority to apply the rules to sales and exchanges of interests in pass-thru entities and to sales and exchanges by pass-thru entities. On August 9, 1999, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–106527–98, 1999–34 I.R.B. 304 [64 F.R. 43117]) relating to the taxation of capital gains in the case of sales or exchanges of interests in partnerships, S corporations, and trusts. The regulations interpreted rules added by the 1997 Act and amended by the 1998 Act, and provided guidance relating to the division of the holding period of a partnership interest. The IRS received no requests to speak at a public hearing that was scheduled for November 18, 1999, and canceled the hearing. Written comments were received in response to the notice of proposed rulemaking. After consideration of the comments, the proposed regulations under sections 1(h), 741, and 1223 are adopted, as revised by this Treasury decision. The comments received and revisions made are discussed below.

Explanation of Revisions and Summary of Comments

1. *Look-Through Capital Gain*

a. In General

Section 1(h) provides maximum capital gains rates 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. Twenty-eight percent rate gain includes 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 and certain other types of gain.

Capital gain attributable to the sale or exchange of an interest in a pass-thru entity held for more than one year generally is in the 20-percent rate gain category. However, the proposed regulations provide that, when a taxpayer sells or exchanges an interest in a partnership, S corporation, or trust that holds collectibles, rules similar to the rules under section 751(a) apply to determine the capital gain that is attributable to certain unrealized gain in the collectibles. Furthermore, under the proposed regulations, rules similar to the rules under section 751(a) also apply to determine the capital gain attributable to certain unrealized gain in section 1250 property held by a partnership when a taxpayer sells or exchanges an interest in a partnership that holds such property.

b. Net Collectibles Loss

Twenty-eight percent rate gain is the excess (if any) of (i) the sum of collectibles gain and section 1202 gain, over

(ii) the sum of collectibles loss, the net short-term loss, and the amount of long-term capital loss carried under section 1212(b)(1)(B) to the taxable year. One commentator suggested that, when an interest in a partnership, S corporation, or trust is transferred, net collectibles loss as well as net collectibles gain in property held by such an entity should be taken into account in determining a taxpayer's overall collectibles gain or collectibles loss. The Treasury Department (Treasury) and the IRS believe that the proposed regulations are consistent with the rule in section 1(h)(6)(B), which, in providing look-through treatment with respect to collectibles, refers only to "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 . . ." Accordingly, the comment is not adopted in the final regulations.

c. Limitations with Respect to Section 1231 Property

Section 1(h)(7)(B) limits the amount of unrecaptured section 1250 gain recognized as a consequence of sales, exchanges, and conversions described in section 1231(a)(3)(A) to the taxpayer's net section 1231 gain (as defined in section 1231(c)(3)) for the taxable year. The proposed regulations provide that, upon a partner's transfer of a partnership interest, the partner's allocable share of section 1250 capital gain (as defined in §1.1(h)-1(b)(3)) is not treated as section 1231 gain for purposes of applying the limitation in section 1(h)(7)(B). There has been some confusion regarding whether the section 1(h)(7)(B) limitation applies to all unrecaptured section 1250 gain, including section 1250 capital gain recognized on the transfer of a partnership interest.

Because the transfer of an interest in a partnership is not described in section 1231(a)(3)(A), the limitation provided in section 1(h)(7)(B) is not applicable with respect to such transfers. Accordingly, under the final regulations (and consistent with the proposed regulations), where a partner sells an interest in a partnership, the partner must take into account the entire allocable share of section 1250 capital gain in determining the unrecaptured section 1250 gain under section 1(h)(7)(A), without regard to the limitation set forth in section 1(h)(7)(B).

d. Redemption of a Partnership Interest

Some practitioners have expressed concern that the look-through capital gains provisions of the proposed regulations apply to the redemption of a partnership interest. To apply the regulations in the context of redemptions, it would be necessary to import the concepts utilized in section 751(b). Treasury and the IRS believe that this would not be advisable. Accordingly, these regulations do not apply to any transaction that is treated as a redemption of a partnership interest for Federal income tax purposes.

e. Allocating Section 704(c) Gain and Loss

Certain commentators requested that the final regulations provide guidance with respect to the proportionate part of the section 704(c) built-in gain or loss that is transferred to the purchaser when a section 704(c) partner sells a portion of a partnership interest. This issue is relevant because, in determining a taxpayer's share of collectibles gain or section 1250 capital gain on the sale of a partnership interest, it is necessary to calculate how much of such gain would be allocated with respect to the partnership interest sold if the underlying collectibles or section 1250 property held by the partnership were sold for their fair market value. In making this determination where a partner sells only a portion of its interest in a partnership, it is necessary to determine how much section 704(c) gain relating to collectibles or section 1250 property is allocable to the portion of the partnership interest that is sold. Although relevant, Treasury and the IRS believe that this issue is beyond the scope of these regulations. Accordingly, this comment is not addressed in these regulations.

f. Look-Through Capital Gain Where the Pass-Thru Entity Has a Short-Term Holding Period in Collectibles

The final regulations modify the proposed regulations to provide that a pass-thru entity's holding period in the collectibles is not relevant in determining whether long-term capital gain recognized on the sale of an interest in the entity is collectibles gain (taxable at a 28-percent rate). Consistent with the purpose of the look-through provisions contained in section 1(h), these regulations characterize a transferor's long-term capital gain recognized on the sale of the interest in a pass-thru entity by reference to the entity's underlying assets that give rise to such gain. Where a transferor recognizes long-term capital gain on the sale of an interest in a partnership, S corporation, or trust, it would be anomalous to provide the transferor with a better tax result if the entity has a short-term holding period in collectibles than if the entity has a long-term holding period in such property. This rule is not relevant with respect to section 1250 property. Because all depreciation with respect to section 1250 property held for one year or less is treated as additional depreciation under section 1250(b)(1), such amounts will be treated as unrealized receivables under section 751(c) and thus will give rise to ordinary income under section 751(a) upon a disposition of the partnership interest.

2. *Determination of Holding Period in a Partnership*

a. In General

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. Under the proposed regulations, the holding period of a portion of a partnership interest generally is 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.

Under the proposed regulations, a selling partner generally cannot identify and use the actual holding period for a portion of the partner's interest. However, the proposed regulations provide that a selling partner is permitted to identify the portion of a partnership interest sold with its holding period 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.

b. Contributions of Cash by Existing Partners

The proposed regulations include an example of a pro rata contribution of cash by partners that results in a divided holding period in those partners' interests in the partnership. Commentators suggested that it is inappropriate to provide for a divided holding period where an existing partner contributes cash to the partnership, particularly where the contribution is pro rata by all of the partners. According to these commentators, such an approach may unfairly convert portions of long-term appreciation of partnership assets into a short-term capital gain on the sale of a long held partnership interest. (This conversion occurs regardless of whether the partner sells all or a portion of a partnership interest.)

The conversion of long-term appreciation in partnership assets into short-term capital gain upon the sale of a partnership interest as a result of cash contributions to the partnership is largely the product of partners having unitary bases in their partnership interests. See Rev. Rul. 84-53 (1984-1 C.B. 159) (a partner has a single basis in a partnership interest). Under this rule, gain attributable to previously contributed or acquired assets may be allocated to the short-term portion of a partnership interest even though the value of the short-term portion is no greater than the amount of cash contributed to the partnership. If basis from contributed cash or property could be traced to a segregated interest in the partnership, this conversion of long-term capital appreciation into short-term capital gain would not occur. Larger problems would arise, however, in the context of partnership taxation if a partner were allowed to have a divided basis in a partnership interest.

An aggregate approach to determining the holding period of an interest in a partnership would make it more likely that a contribution of cash would not give rise to a short-term holding period. Under an aggregate approach, one could trace contributed funds into the partnership and determine whether a new holding period was created by reference to whether the funds were used for capital expenditures (in which circumstance, a short-term holding period generally would be appropriate) or for operating expenditures of the partnership (in which circumstance, no new holding period should be created). On the other hand, to the extent that a partnership interest is a capital asset that is distinct from the partnership's assets (an entity approach), its holding period and basis should be determined independently and should not be affected by the partnership's use of the contributed funds. In choosing the entity approach in the proposed regulations, Treasury and the IRS concluded that tracing funds to their ultimate use in the partnership is not an administrable means of determining whether a contribution to a partnership creates a new holding period.

Furthermore, the proposed regulations are consistent with general rules relating to the holding period of capital and section 1231 assets. Where a capital asset (including a capital asset held for one year or less) or property described in section 1231 is contributed to a partnership, section 1223(1) requires the tacking of the holding period in the partnership interest, whether the partners make pro rata contributions of property or instead make non-pro rata contributions that increase the proportionate interests of one or more partners.

In addition, the proposed regulations avoid inappropriate results that may occur if cash contributions are ignored after the formation of a partnership. If cash contributions were ignored, it would be possible for partners to form shelf partnerships with nominal cash contributions in order to start their holding period in the interests, where the majority of cash would not be contributed (and significant operating assets of the partnership would not be acquired) until some time in the future. This clearly would not be a proper result.

Based upon the foregoing, Treasury and the IRS continue to believe that the approach taken in the proposed regulations is appropriate. However, in response to comments, Treasury and the IRS have provided one exception, and explicitly grant authority for another, where the contribution of cash will not create a new holding period in a partnership interest.

If a partner makes cash contributions and receives cash distributions from a partnership during the one-year period before sale of all or a portion of the interest in the partnership, Treasury and the IRS believe it is appropriate that the net cash contribution to the partnership determine the portion of the interest that is held for one year or less. Therefore, the final regulations provide that, if a partner makes one or more cash contributions and receives one or more cash distributions with respect to the partnership during the one-year period ending on the date of the sale or exchange of all or a portion of the partner's interest in the partnership, in applying the rules for determining the partner's holding period in its partnership interest with respect to cash contributions, the partner may reduce the cash contributions made during the year by cash distributions received on a last-in-first-out basis, treating all cash distributions as if they were received by the partner immediately before the sale or exchange. This rule also applies in determining the holding period of a partnership interest where gain or loss is recognized under section 731(a) upon a distribution by the partnership.

In addition, the final regulations include authority for the Secretary to provide, in published guidance, additional exceptions to the general holding period rules with respect to other cash contributions, including *de minimis* cash contributions, to a partnership. Treasury and the IRS request comments as to the appropriate level for a *de minimis* exception.

c. Treatment of Deemed Cash Contributions under Section 752(a)

Section 752(a) provides that an increase in a partner's share of partnership liabilities, or an increase in a partner's individual liabilities by reason of the partner's assumption of partnership liabilities, shall be treated as a contribution of money by the partner to the partnership. Some practitioners have questioned whether a partner's deemed contribution of cash under section 752(a) will give rise to a new holding period in that partner's interest in the partnership. A deemed contribution of cash resulting from a shift among partners in their share of liabilities or as a result of a partnership incurring new debt does not expand the net asset base of the partners represented by their

interests in the partnership. Accordingly, it is inappropriate to create a new holding period as a result of such deemed contributions. However, to the extent that a partner actually assumes a debt of the partnership, thus causing an increase in the net asset base of the partnership, the creation of a new holding period with respect to a portion of the partner's interest is appropriate.

In addressing a similar issue, the capital account rules regarding the treatment of liabilities under §1.704–1(b)(2)(iv)(c) attempt to measure the increase or decrease in a partner's economic interest in the partnership resulting from the assumption of liabilities by either the partner or the partnership. Those rules provide:

> (1) money contributed by a partner to a partnership includes the amount of any partnership liabilities that are assumed by such partner (other than [certain] liabilities . . . that are assumed by a distributee partner [in connection with a distribution of property by the partnership]) but does not include increases in such partner's share of partnership liabilities (see section 752(a)), and (2) money distributed to a partner by a partnership includes the amount of such partner's individual liabilities that are assumed by the partnership (other than [certain] liabilities . . . that are assumed by the partnership [in connection with a contribution of property to the partnership]) but does not include decreases in such partner's share of partnership liabilities (see section 752(b)). . .

This rule is incorporated in the final regulations. The final regulations provide that deemed contributions and distributions of cash under sections 752(a) and (b) will be disregarded in determining a partner's holding period in its partnership interest to the same extent that such amounts are disregarded under §1.704–1(b)(2)(iv)(c). (Deemed distributions under section 752(b) are relevant as a result of the cash netting rule added in these final regulations.)

d. Contribution of Section 751 Assets

Commentators noted that, if a partner has a short-term holding period in a partnership interest on account of the contribution of assets described in section 751(c) or (d) (section 751 assets), the rules of section 751(a) in conjunction with the proposed regulations cause the section 751 assets to be counted twice if a partnership interest is sold within 12 months of the contribution, once in applying section 751(a) to treat part of the amount received as ordinary income, and again in determining the selling partner's short-term capital gain. In response to these comments, the final regulations provide that, if a partner recognizes ordinary income or loss on account of section 751 assets, either under section 751(a) as a result of the sale of all or part of the partnership interest or as a result of the sale by the partnership of the section 751 assets, the section 751 assets shall be disregarded in determining the division of the holding period of an interest in a partnership upon a sale of such partnership interest during the one-year period following the contribution. This rule does not apply if, in the absence of the rule, a partner would not be treated as having held any portion of the interest for more than one year. Accordingly, if a partner's only contributions to a partnership are contributions of section 751 assets or section 751 assets and cash within the prior one-year period, the adjustment will not be available, and the partner appropriately will be treated as having a short-term holding period with respect to the entire interest.

A similar rule disregarding the contribution of section 751 assets does not apply in determining the holding period of a partnership interest with respect to gain or loss recognized under section 731 upon a distribution by a partnership. Properly coordinating the holding period rules with gain or loss determinations under section 751(b) would be inordinately complex. In addition, where, within a one-year period, a partner contributes section 751 assets to a partnership and receives a cash distribution large enough to require the recognition of gain, it is likely that the contribution and distribution will constitute a disguised sale of the section 751 assets to the partnership under section 707(a)(2)(B), thus rendering the holding period rules irrelevant since the sale of an asset to a partnership does not affect the holding period of an interest in the partnership.

e. Treatment of Recapture and Other Unrealized Receivables

An example in the proposed regulations treats the portion of a contributed asset that would be recaptured as ordinary income under section 1245 upon disposition as non-section 1231 property for purposes of the tacked holding period rule in section 1223(1). Some commentators have raised questions regarding the position taken in this example. For purposes of these regulations, Treasury and the IRS believe that it is appropriate to characterize all properties and potential gain treated as unrealized receivables under section 751(c) and the regulations thereunder as separate assets that are not capital assets or property described in section 1231. Accordingly, while the example in the proposed regulations has been eliminated, a specific rule has been added in the final regulations to provide for such a result. This rule is consistent with the rule added in the final regulations regarding the holding period exception for contributed section 751 assets. As discussed above, that rule will disregard the contribution of section 751 assets (including properties and potential gain treated as unrealized receivables under section 751(c)) in computing the holding period of a partnership interest where the interest is sold within one year after contribution. Accordingly, while section 1245 recapture (and similar items treated as unrealized receivables) will be treated as a separate asset that is not a capital or section 1231 asset, the asset will not give rise to a short-term holding period where a partnership interest is sold. This rule also is similar to the rule contained in § 1.755–1(a), which provides that properties and potential gain treated as unrealized receivables under section 751(c) are considered separate ordinary income assets for purposes of allocating basis adjustments under section 755.

f. Identification of Publicly Traded Partnership Units

The proposed regulations provide that 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. Commentators suggested that it may be appropriate to provide that a partner must be consistent in electing, for holding period purposes, to identify units of a publicly traded partnership that are sold or exchanged in order to avoid distortion in the total long-term and short-term capital

gain recognized. This suggestion is adopted in the final regulations.

g. Conversion from General Partnership to Limited Partnership

A commentator requested clarification that a partner's holding period in its partnership interest carries over when a partnership converts from a general partnership to a limited partnership, as described in Rev. Rul. 84-52 (1984–1 C.B. 157). The ruling concludes that, pursuant to section 1223(1), there will be no change to the holding period of any partner's interest in the partnership as a result of such a conversion. The final regulations do not change the result set forth in Rev. Rul. 84-52.

h. Other Miscellaneous Issues

The proposed regulations contain an example which, consistent with Rev. Rul. 84–53, states that a partner has a single basis in its partnership interest. Certain commentators suggested that the principle that a partner has a single basis in its partnership interest should be set forth in regulations, rather than simply relying on Rev. Rul. 84–53. The rules set forth in these regulations address only holding period and character issues. In illustrating the operation of certain of these rules, the example accurately reflects current law. Treasury and the IRS believe that the inclusion of a separate rule providing that a partner has a single basis in its partnership interest is unnecessary and is beyond the scope of these regulations.

Finally, it was suggested that the final regulations cross-reference section 83(f), which provides that in determining the holding period of property to which section 83(a) applies, only the holding period during which rights are transferable or are not subject to a substantial risk of forfeiture shall be included. Treasury and the IRS currently are studying the extent to which section 83(a) applies to the issuance of certain partnership interests (i.e., a profits interest in a partnership) in exchange for services. Section 83(f) is relevant to the extent that section 83(a) applies with respect to a partnership interest. However, in order to avoid any implication that section 83(a) applies to all partnership interests issued in exchange for services, a cross reference to section 83(f) has not been 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. It is hereby certified that the collection of information in these regulations will not have a significant impact on a substantial number of small businesses. This certification is based upon the fact that the economic burden imposed on taxpayers by the collection of information and recordkeeping requirements of these regulations is insignificant. For example, the estimated average annual burden per respondent is 10 minutes. Therefore, a Regulatory Flexibility Analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). 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 Jeanne M. Sullivan and David J. Sotos of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from Treasury and the IRS participated in their development.

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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 adding an entry in numerical order to read in part as follows:

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

Section 1.1(h)–1 is also issued under 26 U.S.C. 1(h); * * *

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., under 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., under 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*—(i) *Definition.* For purposes of this section, *collectibles gain* shall be treated as gain 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.

(ii) *Share of collectibles gain allocable to an interest in a partnership, S corporation, or a 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 gain (but not net 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 for cash equal to the fair market value of the assets 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 (b)(2) applies only to transfers by non-grantor transferors (as defined in paragraph (a) of this section). This paragraph (b)(2) does not apply to a transaction that is treated, for Federal income tax purposes, as a redemption of an interest in a partnership, S corporation, or trust.

(3) *Section 1250 capital gain*—(i) *Definition.* For purposes of this section, *section 1250 capital gain* means the 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 for cash equal to the fair market value of the assets 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 capital 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. This paragraph (b)(3) does not apply to a transaction that is treated, for Federal income tax purposes, as a redemption of a partnership interest.

(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 look-through capital gain determined under paragraph (b) of this section.

(d) *Special rule for tiered entities.* In determining whether a partnership, S corporation, or trust has gain from collectibles, such partnership, S corporation, or trust shall be treated as owning its proportionate share of the collectibles of any partnership, S corporation, or trust in which it owns an interest either directly or indirectly through a chain of such entities. In determining whether a partnership has section 1250 capital gain, such partnership shall be treated as owning its proportionate share of the section 1250 property of any partnership in which it owns an interest, either directly or indirectly through a chain of partnerships.

(e) *Notification requirements.* Reporting 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 cause holders of such interests to recognize collectibles gain and in the case of sales or exchanges of interests in a partnership that cause holders of such interests to recognize 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 *B*'s basis for the partnership interest is $10,000 ($9,000 plus $1,000, B's share of partnership liabilities). 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 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 for cash equal to the fair market value of the assets 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 for cash equal to the fair market value of the assets immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $1,000 of 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 gain from the collectibles, are divided equally between *A* and *B*. Under these facts, *B*'s amount realized is $17,000, consisting of the cash received, $16,000, plus $1,000, *B*'s share of the partnership liabilities assumed by *T*. See section 752. *B* will recognize $7,000 of ordinary income with respect to the unrealized receivables (determined under §1.751–1(a)(2)). Accordingly, *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 for cash equal to the fair market value of the assets immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $2,000 of 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* will recognize a $2,000 residual 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. (The total adjusted basis and fair market value of the partnership's capital assets are the same as in *Example 1*.) If *PRS* were to sell all of its collectibles in a fully taxable transaction for cash equal to the fair market value of the assets immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $1,000 of loss from the sale of the collectibles. 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 A's *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 for cash equal to the fair market value of the assets immediately before the transfer to *T*, *A* would be allocated $100 of 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*.

Example 5. Sale or exchange of partnership interest where part of the interest has a short-term holding period. (i) *A*, *B*, and *C* form an equal partnership (*PRS*). In connection with the formation, *A* contributes $5,000 in cash and a capital asset with a fair market value of $5,000 and a basis of $2,000; *B* contributes $7,000 in cash and a collectible with a fair market value of $3,000 and a basis of $3,000; and *C* contributes $10,000 in cash. 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 *A*'s interest in *PRS* to *T* for $14,000 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	$ 22,000	$22,000
Unrealized Receivables	0	6,000
Capital Asset	2,000	5,000
Collectible	3,000	9,000
Capital Assets	5,000	14,000
Total	$ 27,000	$42,000

(ii) Although at the time of the transfer *A* has not held *A*'s interest in *PRS* for more than one year, 50 percent of the fair market value of *A*'s interest in *PRS* was received in exchange for a capital asset with a long-term holding period. Therefore, 50 percent of *A*'s interest in *PRS* has a long-term holding period. See §1.1223–3(b)(1).

(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 $2,000 of ordinary income. Accordingly, *A* will recognize $2,000 ordinary income and $5,000 ($7,000 - $2,000) of capital gain on account of the transfer to *T* of *A*'s interest in *PRS*. Fifty percent ($2,500) of that gain is long-term capital gain and 50 percent ($2,500) is short-term capital gain. See §1.1223–3(c)(1).

(iv) If the collectible were sold or exchanged in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated $2,000 of gain attributable to the collectible. The gain attributable to the collectible that is allocable to the portion of the transferred interest in *PRS* with a long-term holding period is $1,000 (50 percent of $2,000). Accordingly, *A* will recognize $1,000 of collectibles gain on account of the transfer of *A*'s interest in *PRS*.

(v) The difference between the amount of pre-look-through long-term capital gain or loss ($2,500) and the look-through capital gain ($1,000) is the amount of residual long-term capital gain or loss that *A* will recognize on account of the transfer of *A*'s interest in *PRS*. Under these facts, *A* will recognize a residual long-term capital gain of $1,500 and a short-term capital gain of $2,500.

(g) *Effective date.* This section applies to transfers of interests in partnerships, S corporations, and trusts that occur on or after September 21, 2000.

Par. 3. 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. This paragraph (e) applies to transfers of interests in partnerships that occur on or after September 21, 2000.

(f) For rules relating to dividing the holding period of an interest in a partnership, see §1.1223–3. This paragraph (f) applies to transfers of partnership interests and distributions of property from a partnership that occur on or after September 21, 2000.

Par. 4. Section 1.1223–3 is added under the undesignated center heading "General Rules for Determining Capital Gains and Losses" to read as follows:

§1.1223–3 Rules relating to the holding periods of partnership interests.

(a) *In general.* A partner shall not have a divided holding period in an interest in a partnership unless—

(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 (e.g., section 1223).

(b) *Accounting for holding periods of an interest in a partnership*—(1) *General rule.* The portion of a partnership interest to which a holding period relates shall be determined by reference to a fraction, the numerator of which is the fair market value of the portion of the partnership interest received in the transaction to which the holding period relates, and the denominator of which is the fair market value of the entire partnership interest (determined immediately after the transaction).

(2) *Special rule.* For purposes of applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged (or with respect to which gain or loss is recognized upon a distribution under section 731), if a partner makes one or more contributions of cash to the partnership and receives one or more distributions of cash from the partnership during the one-year period ending on the date of the sale or exchange (or distribution with respect to which gain or loss is recognized under section 731), the partner may reduce the cash contributions made during the year by cash distributions received on a last-in-first-out basis, treating all cash distributions as if they were received immediately before the sale or exchange (or at the time of the distribution with respect to which gain or loss is recognized under section 731).

(3) *Deemed contributions and distributions.* For purposes of paragraphs (b)(1) and (2) of this section, deemed contributions of cash under section 752(a) and deemed distributions of cash under section 752(b) shall be disregarded to the same extent that such amounts are disregarded under §1.704–1(b)(2)(iv)(c).

(4) *Adjustment with respect to contributed section 751 assets.* For purposes of applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged, if a partner receives a portion of the partnership interest in exchange for property described in section 751(c) or (d) (section 751 assets) within the one-year period ending on the date of the sale or exchange of all or a portion of the partner's interest in the partnership, and the partner recognizes ordinary income or loss on account of such a section 751 asset in a fully taxable transaction (either as a result of the sale of all or part of the partner's interest in the partnership or the sale by the partnership of the section 751 asset), the contribution of the section 751 asset during the one-year period shall be disregarded. However, if, in the absence of this paragraph, a partner would not be treated as having held any portion of the interest for more than one year (e.g., because the partner's only contributions to the partnership are contributions of section 751 assets or section 751 assets and cash within the prior one-year period), this adjustment is not available.

(5) *Exception.* The Commissioner may prescribe by guidance published in the Internal Revenue Bulletin (see §601.-601(d)(2) of this chapter) a rule disregarding certain cash contributions (including contributions of a *de minimis* amount of cash) in applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged.

(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) *Certain*

publicly traded partnerships. A selling partner in a publicly traded partnership (as defined under section 7704(b)) may use the actual holding period of the portion of a partnership interest transferred if—

(A) The ownership interest is divided into identifiable units with ascertainable holding periods;

(B) The selling partner can identify the portion of the partnership interest transferred; and

(C) The selling partner elects to use the identification method for all sales or exchanges of interests in the partnership after September 21, 2000. The selling partner makes the election referred to in this paragraph (c)(2)(i)(C) by using the actual holding period of the portion of the partner's interest in the partnership first transferred after September 21, 2000, in reporting the transaction for federal income tax purposes.

(ii) *Other partnerships.* 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.* Except as provided in paragraph (b)(2) of this section, 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) *Section 751(c) assets.* For purposes of this section, properties and potential gain treated as unrealized receivables under section 751(c) shall be treated as separate assets that are not capital assets as defined in section 1221 or property described in section 1231.

(f) 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 percent 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 $17,000. Assuming *PRS* holds no inventory or unrealized receivables (as defined under section 751(c)) and no collectibles or section 1250 property, *A* will realize $5,000 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 section 751 asset and a capital asset. A contributes inventory with a basis of $2,000 and a fair market value of $6,000 and a capital asset which *A* has held for more than one year with a basis of $4,000 and a fair market value of $6,000, and *B* contributes cash of $12,000 to form a partnership (*AB*). As a result of the contribution, one-half of *A*'s interest in *AB* is treated as having been held for more than one year under section 1223(1). Six months later, *A* transfers one-half of *A*'s interest in *AB* to *C* for $6,000, realizing a gain of $3,000. If *AB* 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 $4,000 of ordinary income on account of the inventory. Accordingly, *A* will recognize $2,000 of ordinary income and $1,000 of capital gain ($3,000 - $2,000) on account of the transfer to *C*. Because *A* recognizes ordinary income on account of the inventory that was contributed to *AB* within the one year period ending on the date of the sale, the inventory will be disregarded in determining the holding period of *A*'s interest in *AB*. All of the capital gain will be long-term.

Example 3. Netting of cash contributions and distributions. (i) On January 1, 2000, *A* holds a 50 percent interest in the capital and profits of a partnership (*PS*). The value of *A*'s *PS* interest is $900, and *A*'s holding period in the entire interest is long-term. On January 2, 2000, when the value of *A*'s *PS* interest is still $900, *A* contributes $100 to *PS*. On June 1, 2000, *A* receives a distribution of $40 cash from the partnership. On September 1, 2000, when the value of *A*'s interest in *PS* is $1,350, *A* contributes an additional $230 cash to *PS*, and on October 1, 2000, *A* receives another $40 cash distribution from *PS*. *A* sells *A*'s entire partnership interest on November 1, 2000, for $1,600. *A*'s adjusted basis in the *PS* interest at the time of the sale is $1,000.

(ii) For purposes of netting cash contributions and distributions in determining the holding period of *A*'s interest in *PS*, *A* is treated as having received a distribution of $80 on November 1, 2000. Applying that distribution on a last-in-first-out basis to reduce prior contributions during the year, the contribution made on September 1, 2000, is reduced to $150 ($230 - $80). The holding period then is determined as follows: Immediately after the contribution of $100 on January 2, 2000, *A*'s holding period in *A*'s *PS* interest is 90 percent long-term ($900/($900 + $100)) and 10 percent short-term ($100/($900 + $100)). The contribution of $150 on September 1, 2000, causes 10 percent of *A*'s partnership interest ($150/($1,350 + $150)) to have a short-term holding period. Accordingly, immediately after the contribution on September 1, 2000, *A*'s holding period in *A*'s *PS* interest is 81 percent long-term (.90 x .90) and 19 percent short-term ((.10 x .90) + .10). Accordingly, $486 ($600 x .81) of the gain from *A*'s sale of the *PS* interest is long-term capital gain, and $114 ($600 x .19) is short-term capital gain.

Example 4. 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 percent interest in *PRS* is $100. *A, B, C,* and *D* each contribute an additional $100 to partnership capital, thereby increasing the fair market value of each partner's interest to $200. 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 50 percent ($100/$200) of each partner's interest in *PRS*.

Example 5. Sale or exchange of a portion of an interest in a partnership. (i) *A, B,* and *C* form an equal partnership (*PRS*). In connection with the formation, *A* contributes $5,000 in cash and a capital asset (capital asset 1) with a fair market value of $5,000 and a basis of $2,000; *B* contributes $7,000 in cash and a capital asset (capital asset 2) with a fair market value of $3,000 and a basis of $3,000; and *C* contributes $10,000 in cash. 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 $7,000 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	$ 22,000	$22,000
Unrealized Receivables	0	6,000
Capital Asset 1	2,000	5,000
Capital Asset 2	3,000	9,000
Capital Assets	5,000	14,000
Total	$ 27,000	$42,000

(ii) Although at the time of the transfer *A* has not held *A*'s interest in *PRS* for more than one year, 50 percent of the fair market value of *A*'s interest in *PRS* was received in exchange for a capital asset with a long-term holding period. Therefore, 50 percent 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 $2,000 of ordinary income. One-half of that amount ($1,000) is attributable to the portion of *A*'s interest in *PRS* transferred to *T*. Accordingly, *A* will recognize $1,000 ordinary income and $2,500 ($3,500 - $1,000) of capital gain on account of the transfer to *T* of one-half of *A*'s interest in *PRS*. Fifty percent ($1,250) of that gain is long-term capital gain and 50 percent ($1,250) is short-term capital gain.

Example 6. Sale of units of interests in a 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 on January 1, 1999. On August 1, 2000, *A* purchases five additional units for $10,000. At the time of purchase, 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 and elects to use the identification method for all subsequent sales or exchanges of interests in the partnership by using the actual holding period in reporting the transaction on *A*'s federal income tax return, 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*). More than one year later, *A* receives a distribution worth $22,000 from *PRS*, which reduces *A*'s interest in *PRS* to 36 percent. After the distribution, *B* owns 64 percent 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—(i) On January 1, 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*). On September 30, 2000, when *A*'s interest in *ABC* is worth $12,000 (and the basis of *A*'s partnership interest is still $10), *A* contributes $12,000 cash in exchange for an additional interest in *ABC*. *A* is allocated a loss equal to $10,000 by *ABC* for the taxable year ending December 31, 2000, thereby reducing the basis of *A*'s partnership interest to $2,010. On February 1, 2001, *ABC* makes a cash distribution to *A* of $10,000. *ABC* holds no inventory or unrealized receivables. (Assume that *A* is allocated no gain or loss for the taxable year ending December 31, 2001, so that the basis of *A*'s partnership interest does not increase or decrease as a result of such allocations.)

(ii) The netting rule contained in paragraph (b)(2) of this section provides that, in determining the holding period of *A*'s interest in *ABC*, the cash contribution made on September 30, 2000, must be reduced by the distribution made on February 1, 2001. Accordingly, for purposes of determining the holding period of *A*'s interest in *ABC*, *A* is treated as having made a cash contribution of $2,000 ($12,000 - $10,000) to *ABC* on September 30, 2000. *A*'s holding period in one-seventh of *A*'s interest in *ABC* ($2,000 cash contributed over the $14,000 value of the entire interest (determined as if only $2,000 were contributed rather than $12,000)) begins on the day after the cash contribution. *A* recognizes $7,990 of capital gain as a result of the distribution. See section 731(a)(1). One-seventh of the capital gain recognized as a result of the distribution is short-term capital gain, and six-sevenths 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.

(g) *Effective date.* This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after September 21, 2000.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. In § 602.101, paragraph (b) is amended by 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.
1.1(h)–1(e)	1545-1654
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 29, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 20, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 21, 2000, 65 F.R. 57092)

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 2000. See Rev. Rul. 2000–45, page 337.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62–2: Reimbursements and other expense allowance arrangements.

Rules are set forth under which a reimbursement or other expense allowance arrangement for the cost of lodging, meal, and incidental expenses or meal and incidental expenses incurred by an employee while traveling away from home will satisfy the requirement of § 62 (c) of the Code as to substantiation of the amount of the expenses. See Rev. Proc. 2000–39, page 340.

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 lodging, meal, and incidental expenses or meal and incidental expenses incurred while traveling away from home. See Rev. Proc. 2000–39, page 340.

Section 170.—Charitable, Etc., Contributions and Gifts

(Also § 1366.)

Charitable contributions; S corporations; section 170(a)(2). This ruling provides that an accrual-basis S corporation may not elect under section 170(a)(2) to treat a charitable contribution as paid in the year authorized by the S corporation's board of directors if the contribution is paid by the S corporation after the close of the tax year.

Rev. Rul. 2000–43

ISSUE

May an accrual-basis subchapter S corporation elect under § 170(a)(2) of the Internal Revenue Code to treat a charitable contribution as paid in the year authorized by the S corporation's Board of Directors if the contribution is paid by the S corporation after the close of the taxable year and before the 15th day of the third month following the close of the taxable year?

FACTS

Taxpayer is the sole shareholder of an accrual-basis subchapter S corporation. The S corporation reports on a calendar year period. On December 31, 1999, the S corporation's Board of Directors authorized a charitable contribution to Charity, a qualified donee under § 170(c)(2) and an organization described under § 501(c)(3). The S corporation paid the charitable contribution to Charity on March 1, 2000.

LAW AND ANALYSIS

Section 170(a)(1) allows as a deduction any charitable contribution (as defined in § 170(c)) the payment of which is made within the taxable year. Under § 170(b)(1), the percentage limitation on charitable contributions for an individual is 50 percent, 30 percent, or 20 percent of the taxpayer's contribution base (generally adjusted gross income) for the taxable year, depending generally on the type of property contributed and the type of qualified donee. Under § 170(b)(2), the percentage limitation on charitable contributions by a corporation is 10 percent of the taxpayer's taxable income with certain adjustments.

Under § 170(a)(2), a corporation reporting its taxable income on the accrual basis may elect to deduct a charitable contribution in the year in which the board of directors authorizes the contribution, if the payment is made by the 15th day of the third month following the close of the taxable year. The election may be made only at the time of the filing of the return for the taxable year and is made by reporting the contribution on the return. See § 1.170A–11(b)(2) of the Income Tax Regulations.

The legislative history to § 170(a)(2) provides that the exception for accrual basis corporations was desirable because corporations intending to make the maximum charitable contribution allowable as a deduction had experienced difficulty in determining before the end of the taxable year what constituted 5 percent of their net income (the § 170(b) gross income limitation for corporations at the time of enactment). S. Rep. No. 831, 81st Cong., 1st Sess. at 1949–2 C.B. 289, 290–1.

Section 1363(b) states that the taxable income of an S corporation is computed in the same manner as in the case of an individual with certain exceptions, among which is an exception that the deductions referred to in § 703(a)(2) are not allowed to the corporation. Section 703(a)(2)(C) specifically refers to the deduction for charitable contributions provided in § 170.

Section 1366(a)(1)(A) provides that in determining the tax of a shareholder, each shareholder takes into account the shareholder's pro rata share of the corporation's items of income (including tax-exempt income), loss, deduction or credit, the separate treatment of which could affect any shareholder's tax liability. Section 1366(a)(1) provides further that the items referred to in § 1366(a)(1)(A) include amounts described in § 702(a)(4). Section 702(a)(4) refers to charitable contributions (as defined in § 170(c)).

Section 1.1366–1(a)(2)(iii) provides that the separately stated items of a subchapter S corporation include charitable contributions, grouped by the percentage limitations of § 170(b), paid by the corporation within the taxable year of the corporation.

The legislative history of § 1366 states that the corporate limitation on charitable contributions will no longer apply. Instead, charitable contributions by S corporations will pass through to the shareholders and be subject to the individual limitations on deductibility. See H.R. Rep. No. 826, 97th Cong., 2d Sess. 14 (1982); S. Rep. No. 640, 97th Cong., 2d Sess. 16 (1982).

Under § 1363(b), a subchapter S corporation computes its taxable income in the same manner as an individual. The election in § 170(a)(2) is not available to an individual. An individual taxpayer may deduct a

charitable contribution only in the year in which payment is actually made to the charitable organization. Furthermore, the rationale behind § 170(a)(2), a corporation's difficulty in determining its charitable contribution limit under § 170(b)(2), does not apply to subchapter S corporations because a subchapter S corporation is not subject to the same § 170(b)(2) limit.

Accordingly, under the facts described above, the S corporation must report the charitable contribution on its tax return for the year in which it actually paid the charitable contribution, the taxable year ending December 31, 2000.

HOLDING

An accrual-basis subchapter S corporation may not elect under § 170(a)(2) to treat a charitable contribution as paid in the year authorized by the S corporation's Board of Directors if the contribution is paid by the S corporation after the close of the taxable year.

DRAFTING INFORMATION

The principal author of this revenue ruling is Martin Schäffer of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Martin Schäffer at (202) 622-3080 (not a toll-free call).

Section 267.—Losses, Expenses, and Interest With Respect to Transactions Between Related Taxpayers

26 CFR 1.267 (a)–1: Deductions disallowed.

When a payor provides a per diem allowance to an employee who is a related party, the rules set forth for the deemed substantiation to the payor of the amount of the employee's ordinary and necessary business expenses for lodging, meal, and incidental expenses incurred while traveling away from home do not apply. See Rev. Proc. 2000–39, page 340.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

26 CFR 1.274–5: Substantiation requirements.

Rules are set forth for an optional method for substantiating the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or meal and incidental expenses incurred while traveling away from home when a payor provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Rules are also set forth for an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expense paid or incurred while traveling away from home. See Rev. Proc. 2000–39, page 340.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

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

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

LIFO; price indexes; department stores. The August 2000 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, 2000.

Rev. Rul. 2000–46

The following Department Store Inventory Price Indexes for August 2000 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, 2000.

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. 1999	Aug. 2000	Percent Change from Aug. 1999 to Aug. 2000[1]
1. Piece Goods	546.1	509.2	-6.8
2. Domestics and Draperies	630.1	617.9	-1.9
3. Women's and Children's Shoes	635.3	618.3	-2.7
4. Men's Shoes	882.3	913.2	3.5
5. Infants' Wear	623.9	619.8	-0.7
6. Women's Underwear	550.7	570.2	3.5
7. Women's Hosiery	322.1	334.7	3.9
8. Women's and Girls' Accessories	528.1	532.0	0.7
9. Women's Outerwear and Girls' Wear	377.6	370.5	-1.9
10. Men's Clothing	609.9	605.4	-0.7
11. Men's Furnishings	610.6	612.9	0.4
12. Boys' Clothing and Furnishings	473.3	473.0	-0.1
13. Jewelry	962.0	936.5	-2.7
14. Notions	793.9	785.9	-1.0
15. Toilet Articles and Drugs	971.6	971.0	-0.1
16. Furniture and Bedding	679.3	687.9	1.3
17. Floor Coverings	602.1	603.2	0.2
18. Housewares	788.2	778.5	-1.2
19. Major Appliances	234.8	230.9	-1.7
20. Radio and Television	65.7	58.8	-10.5
21. Recreation and Education[2]	97.0	92.2	-4.9
22. Home Improvements[2]	127.6	129.2	1.3
23. Auto Accessories[2]	106.8	106.2	-0.6
Groups 1 - 15: Soft Goods	589.9	585.3	-0.8
Groups 16 - 20: Durable Goods	447.4	437.2	-2.3
Groups 21 - 23: Misc. Goods[2]	102.9	99.8	-3.0
Store Total[3]	536.9	529.7	-1.3

[1] Absence of a minus sign before the percentage change in this column signifies a 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 Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (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 October 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

Section 707.—Transactions Between Partner and Partnership

26 CFR 1.707–3: Disguised sales of property to partnership; general rules.

(Also §§ 381, 707, 721, 731, 752; 1.707–3, 1.707–4, 1.707–5.)

This ruling provides that a corporation that acquires assets of another corporation in a transaction described in § 381(a) of the Code succeeds to the status of the other corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability under the regulations regarding the disguised sale provisions of § 707(a)(2)(B)

Rev. Rul. 2000–44

ISSUE

Does a corporation that acquires assets of another corporation in a transaction described in § 381(a) of the Internal Revenue Code succeed to the status of the other corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability under the regulations regarding the disguised sale provisions of § 707(a)(2)(B)?

FACTS

Corporation *P* owns all of the stock of corporation *S*. *S* has only one asset, rental property, that is encumbered by a nonrecourse liability of $40*x* originally incurred by *S* on January 1, 1995. *S* incurred $5*x* in capital expenditures with respect to the rental property on December 1, 1998.

On January 1, 1999, *S* distributes the rental property, subject to the $40*x* liability, to *P* in a transaction that qualifies as a complete liquidation of *S* within the meaning of § 332.

On January 1, 2000, *P* contributes the rental property, subject to the $40*x* liability, to a partnership (*PRS*) in exchange for an interest in *PRS*. In connection with the transaction, *PRS* reimburses *P* $5*x* for the capital expenditures incurred by *S* with respect to the contributed property. At the time that *P* transfers the rental property to *PRS*, the rental property has a fair market value of $100*x* and an adjusted basis of $70*x*.

LAW

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 731(a)(1) provides that in the case of a distribution by a partnership to a partner, gain shall not be recognized to the partner, except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Section 752(b) provides that any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of the individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

Section 707(a)(2)(B) provides that if (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to the partner (or another partner), and (iii) the transfers when viewed together are properly characterized as a sale or exchange of property, then the transfers shall be treated either as a transaction between the partnership and a partner not acting in the partner's capacity as a partner or as a transaction between two or more partners acting other than in their capacity as partners.

Section 1.707–3(a) of the Income Tax Regulations provides that, except as otherwise provided in § 1.707–3, if a transfer of property by a partner to a partnership and one or more transfers of money or other consideration by the partnership to the partner constitute a sale based on all the facts and circumstances, the transfers are treated as a sale of property to the partnership.

Section 1.707–3(c)(1) provides that if within a 2-year period a partner transfers property to a partnership and the partnership transfers money or other consideration to the partner (without regard to the order of the transfers), the transfers are presumed to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

Section 1.707-4(d) provides that, in general, notwithstanding the presumption relating to transfers made within 2 years of each other, a transfer of money or other consideration by the partnership to a partner is not treated as part of a sale of property by the partner to the partnership under § 1.707-3(a) to the extent that the transfer to the partner by the partnership is made to reimburse the partner for, and does not exceed the amount of, capital expenditures that (1) are incurred during the 2-year period preceding the transfer by the partner to the partnership; and (2) are incurred by the partner with respect to (i) partnership organization and syndication costs described in § 709; or (ii) property contributed to the partnership by the partner, but only to the extent the reimbursed capital expenditures do not exceed 20 percent of the fair market value of the property at the time of the contribution (preformation expenditures).

Section 1.707-5(a)(1) provides that for purposes of the disguised sale rules, if a partnership assumes or takes property subject to a qualified liability, as defined in

§ 1.707-5(a)(6), the partnership is treated as transferring consideration to the partner only to the extent that the transfer of property to the partnership is otherwise treated as part of a sale. By contrast, if the partnership assumes or takes property subject to a liability of the partner other than a qualified liability, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of that liability immediately after the partnership assumes or takes subject to the liability as provided in § 1.707-5(a)(2), (3), and (4).

Under § 1.707-5(a)(6), a qualified liability is (1) a liability that was incurred by the partner more than 2 years prior to the earlier of the date the partner agrees in writing to transfer the property or the

date the partner transfers the property to the partnership and that has encumbered the transferred property throughout that 2-year period; (2) a liability that was incurred within the 2-year period that has encumbered the transferred property since it was incurred, so long as the liability was not incurred in anticipation of the transfer of the property to a partnership; (3) a liability that is allocable under the rules of § 1.163–8T of the temporary Income Tax Regulations to capital expenditures with respect to the property; or (4) a liability that was incurred in the ordinary course of the trade or business in which property transferred to the partnership was used or held but only if all the assets related to that trade or business are transferred other than assets that are not material to a continuation of the trade or business. Certain additional limitations apply with respect to recourse liabilities. See § 1.707–5(a)(6)(ii).

Under § 1.707–4(e), the Commissioner may provide by guidance published in the Internal Revenue Bulletin situations in addition to those specifically addressed in the regulations where payments or transfers to a partner will not be treated as part of a disguised sale.

Section 381(a) references certain transactions that involve one corporation acquiring assets of another corporation in a tax-free transfer (that is, liquidations under § 332, reorganizations under § 368(a)(1)(A), (C), and (F), and certain nondivisive reorganizations under § 368(a)(1)(D) and (G)).

ANALYSIS

The rules regarding preformation expenses and qualified liabilities contained in the disguised sale regulations recognize that certain expenditures will be made, and certain liabilities will be incurred, under circumstances that do not violate the disguised sale rules. Where a corporation incurs preformation expenses or undertakes a borrowing, and another corporation acquires assets of the corporation in a § 381 transaction, the transfer does not alter the circumstances under which the expenditures or indebtedness were originally incurred or otherwise raise concerns that would justify not treating the transferee corporation as having incurred the expenditures or undertaken the liabilities at the time they were incurred or undertaken by the predecessor corporation.

Transactions enumerated in § 381(a) involve situations where the transferor corporation is absorbed by the transferee corporation in a tax-free transaction. Given the purposes for the rules relating to preformation expenses and qualified liabilities, it is appropriate that, in transactions described in § 381(a), the transferee corporation will succeed to the status of the distributor or transferor corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability.

Accordingly, under the facts presented, *P* will succeed to the status of *S* for purposes of determining whether the $5*x* cash reimbursement from *PRS* qualifies for the exception for reimbursements of preformation expenditures under § 1.707–4(d). *S* incurred $5*x* in capital expenditures with respect to the rental property on December 1, 1998, which is within the 2-year period preceding the transfer of the property to *PRS*. The reimbursed capital expenditures do not exceed 20 percent of the fair market value of the contributed property. Thus, the $5*x* cash reimbursement from *PRS* to *P* for the capital expenditures incurred by *S* with respect to the rental property falls within the exception for reimbursement of preformation expenditures and will not give rise to a disguised sale between *P* and *PRS* under § 707(a)(2)(B) and the regulations.

P also will succeed to the status of *S* for purposes of determining whether the $40*x* liability is a qualified liability within the meaning of § 1.707–5(a)(6). The $40*x* liability encumbering the property was incurred by *S* on January 1, 1995, which is more than 2 years prior to the date the rental property was contributed to *PRS*. Accordingly, the $40*x* liability is a qualified liability within the meaning of § 1.707-5(a)(6). As a result, the fact that *P* transfers the rental property to *PRS* subject to the liability will not give rise to a disguised sale between *P* and *PRS* under § 707(a)(2)(B) and the regulations.

HOLDING

A corporation that acquires assets of another corporation in a transaction described in § 381(a) will succeed to status of the other corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability under the regulations regarding the disguised sale provisions of § 707(a)(2)(B).

DRAFTING INFORMATION

The principal author of this revenue ruling is Shannon Cohen of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Shannon Cohen at (202) 622-3050 (not a toll-free call).

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 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

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 October 2000.

Rev. Rul. 2000–45

This revenue ruling provides various prescribed rates for federal income tax purposes for October 2000 (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 ad-

justed 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. 2000–45 TABLE 1

Applicable Federal Rates (AFR) for October 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	6.30%	6.20%	6.15%	6.12%
110% AFR	6.94%	6.82%	6.76%	6.73%
120% AFR	7.58%	7.44%	7.37%	7.33%
130% AFR	8.22%	8.06%	7.98%	7.93%
Mid-Term				
AFR	6.09%	6.00%	5.96%	5.93%
110% AFR	6.71%	6.60%	6.55%	6.51%
120% AFR	7.33%	7.20%	7.14%	7.09%
130% AFR	7.95%	7.80%	7.73%	7.68%
150% AFR	9.20%	9.00%	8.90%	8.84%
175% AFR	10.78%	10.50%	10.37%	10.28%
Long-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%

REV. RUL. 2000–45 TABLE 2

Adjusted AFR for October 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.30%	4.25%	4.23%	4.21%
Mid-term adjusted AFR	4.52%	4.47%	4.45%	4.43%
Long-term adjusted AFR	5.33%	5.26%	5.23%	5.20%

REV. RUL. 2000–45 TABLE 3

Rates Under Section 382 for October 2000

Adjusted federal long-term rate for the current month	5.33%
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.)	5.53%

REV. RUL. 2000–45 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for October 2000

Appropriate percentage for the 70% present value low-income housing credit	8.41%
Appropriate percentage for the 30% present value low-income housing credit	3.60%

REV. RUL. 2000–45 TABLE 5

Rate Under Section 7520 for October 2000

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 Discounts on Tax-1 Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 1366.—Pass-Thru of Items to Shareholders

26 CFR 1.1366–1: Shareholder's share of items of an S corporation.

May an accrual-basis subchapter S corporation elect under § 170(a)(2) of the Internal Revenue Code to treat a charitable contribution as paid in the year authorized by the S corporation's Board of Directors if the contribution is paid by the S corporation after the close of the taxable year and before the 15th day of the third month following the close of the taxable year? See Rev. Rul. 2000–43, page 333.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

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 2000. See Rev. Rul. 2000–45, page 337.

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, sections 62, 162, 267, 274; 1.62-2, 1.162-17, 1.267(a)-1, 1.274-5.)

Rev. Proc. 2000-39

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2000-9, 2000-2 I.R.B. 280, by providing rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home will be deemed substantiated under § 1.274-5 of the Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. This revenue procedure also provides an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. Use of a method 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. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meal and incidental expenses.

SECTION 2. 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 expenses paid or incurred while traveling away from home in pursuit of a trade or business. However, under § 262, no portion of such travel expenses that is attributable to personal, living, or family expenses is deductible.

.02 Section 274(n) generally limits the amount allowable as a deduction under § 162 for any expense for food, beverages, or entertainment to 50 percent of the amount of the expense that otherwise would be allowable as a deduction. In the case of any expenses for food or beverages consumed while away from home (within the meaning of § 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, § 274(n)(3) gradually increases the deductible percentage to 80 percent for taxable years beginning in 2008. For taxable years beginning in 2000 or 2001, the deductible percentage for these expenses is 60 percent.

.03 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 for any traveling expense (including meals and lodging while away from home) 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.

.04 Section 1.274-5(g) of the regulations, in part, grants the Commissioner the authority to prescribe rules relating to reimbursement arrangements or *per diem* allowances for ordinary and necessary expenses paid or incurred while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such arrangements or allowances, if in accordance with reasonable business practice, will be regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel expenses for purposes of § 1.274-5(c), and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of such travel expenses for purposes of § 1.274-5(f).

.05 For purposes of determining adjusted gross income, § 62(a)(2)(A) allows an employee a deduction for 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.

.06 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.

.07 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 1.62-2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274-5(g) or 1.274-5(j)(1) 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 *per diem* 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 days 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 days of travel not substantiated.

.08 Section 1.62-2(h)(2)(i)(B) provides that if a payor pays a per diem allowance

that meets the requirements of § 1.62-2(c)(1), the portion, if any, of the allowance that relates to days 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 § 1.274-5(g) or § 1.274-5(j)(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 portion.

.09 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 *per diem* allowances.

.10 Section 1.274-5(j)(1) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals paid or incurred while traveling away from home in lieu of substantiating the actual cost of meals.

.11 Section 5.04 of this revenue procedure contains revisions to the list of high-cost localities and to the high-low rates for purposes of section 5.

.12 Section 6.07 of this revenue procedure contains a revision to the related party rules.

.13 Sections 3.02, 4.04(5), and 5.06 provide transition rules for the last 3 months of calendar year 2000 due to changes in the effective date of the CONUS rates published by GSA.

SECTION 3. DEFINITIONS

.01 *Per diem allowance.* The term "*per diem* 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 ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses or for meal and incidental expenses for travel away from home 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 or below the applicable federal per diem rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.02 *Federal per diem rate and federal M&IE rate.*

(1) *General rule.* The federal *per diem* rate is equal to the sum of the applicable federal lodging expense rate and the applicable federal meal and incidental expense (M&IE) rate for the day and locality of travel.

(a) *CONUS rates.* The rates for localities in the continental United States ("CONUS") are set forth in Appendix A to 41 C.F.R. ch. 301. However, in applying section 4.01, 4.02, or 4.03 of this revenue procedure, taxpayers may continue to use the CONUS rates in effect for the first 9 months of 2000 for expenses of all CONUS travel while away from home that are paid or incurred during calendar year 2000 in lieu of the updated GSA rates. A taxpayer must consistently use either these rates or the updated rates for the period of October 1, 2000, through December 31, 2000.

(b) *OCONUS rates.* The rates for localities outside the continental United States ("OCONUS") are established by the Secretary of Defense (rates for non-foreign localities, including Alaska, Hawaii, Puerto Rico, the Northern Mariana Islands, and the possessions of the United States) and by the Secretary of State (rates for foreign localities), and are published in the Per Diem Supplement to the Standardized Regulations (Government Civilians, Foreign Areas) (updated on a monthly basis).

(c) *Internet access to the rates.* The CONUS and OCONUS rates may be found on the Internet at www.policyworks.gov/perdiem.

(2) *Locality of travel.* The term "locality of travel" means the locality where an employee traveling away from home in connection with the performance of services as an employee of the employer stops for sleep or rest.

(3) *Incidental expenses.* The term "incidental expenses" includes, but is not limited to, expenses for laundry, cleaning and pressing of clothing, and fees and tips for services, such as for porters and baggage carriers. The term "incidental expenses" does not include taxicab fares, lodging taxes, or the costs of telegrams or telephone calls.

.03 *Flat rate or stated schedule.*

(1) *In general.* Except as provided in section 3.03(2) of this revenue procedure, an 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 3.01 of this revenue procedure. Such allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, an hourly payment to cover meal and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule. Likewise, a payment based on the number of miles traveled (*e.g.*, cents per mile) to cover meal and incidental expenses paid to an over-the-road truck driver who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

(2) *Limitation.* For purposes of this revenue procedure, an allowance that is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced) does not meet the business connection requirement of § 1.62-2(d), is not a *per diem* allowance, and is not paid at a flat rate or stated schedule, unless, as of December 12, 1989, (a) the allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the allowance, or (b) an allowance computed on that basis was commonly used in the industry in which the employee is employed. See § 1.62-2(d)(3)(ii).

SECTION 4. PER DIEM SUBSTANTIATION METHOD

.01 *Per diem allowance.* If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal,

and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for such day or the amount computed at the federal *per diem* rate (see section 3.02 of this revenue procedure) for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.02 *Meals only per diem allowance.* If a payor pays a *per diem* allowance only for meal and incidental expenses in lieu of reimbursing actual expenses for meal and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for such day or the amount computed at the federal M&IE rate (see section 3.02 of this revenue procedure) for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure). A *per diem* allowance is treated as paid only for meal and incidental expenses if (1) the payor pays the employee for actual expenses for lodging based on receipts submitted to the payor, (2) the payor provides the lodging in kind, (3) the payor pays the actual expenses for lodging directly to the provider of the lodging, (4) the payor does not have a reasonable belief that lodging expenses were or will be incurred by the employee, or (5) the allowance is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced).

.03 *Optional method for meals only deduction.* In lieu of using actual expenses, employees and self-employed individuals, in computing the amount allowable as a deduction for ordinary and necessary meal and incidental expenses paid or incurred for travel away from home, may use an amount computed at the federal M&IE rate (see section 3.02 of this revenue procedure) for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee or self-employed individual is away from home. Such amount will be deemed substantiated for purposes of paragraphs (b)(2) (travel away from home) and (c) of § 1.274-5, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel expenses in accordance with those regulations.

.04 *Special rules for transportation industry.*

(1) *In general.* This section 4.04 applies to (a) a payor that pays a *per diem* allowance only for meal and incidental expenses for travel away from home as described in section 4.02 of this revenue procedure to an employee in the transportation industry, or (b) an employee or self-employed individual in the transportation industry who computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 of this revenue procedure.

(2) *Rates.* A taxpayer described in section 4.04(1) of this revenue procedure may treat $38 as the federal M&IE rate for any locality of travel in CONUS, and/or $42 as the federal M&IE rate for any locality of travel OCONUS. A payor that uses either (or both) of these special rates with respect to an employee must use the special rate(s) for all amounts subject to section 4.02 of this revenue procedure paid to that employee for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. Similarly, an employee or self-employed individual that uses either (or both) of these special rates must use the special rate(s) for all amounts computed pursuant to section 4.03 of this revenue procedure for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. See section 4.04(5) of this revenue procedure for transition rules.

(3) *Periodic rule.* A payor described in section 4.04(1) of this revenue procedure may compute the amount of the employee's expenses that is deemed substantiated under section 4.02 of this revenue procedure periodically (not less frequently than monthly), rather than daily, by comparing the total *per diem* allowance paid for the period to the sum of the amounts computed at the federal M&IE rate(s) for the localities of travel for the days (or partial days, see section 6.04 of this revenue procedure) the employee is away from home during the period. For example, assume an employee in the transportation industry travels away from home within CONUS on 17 days (including partial days, see section 6.04 of this revenue procedure) during a calendar month and receives a *per diem* allowance only for meal and incidental expenses from a payor that uses the special rule under section 4.04(2) of this revenue procedure. The amount deemed substantiated under section 4.02 of this revenue procedure is equal to the lesser of the total *per diem* allowance paid for the month or $646 (17 days at $38 per day).

(4) *Transportation industry defined.* For purposes of this section 4.04 of this revenue procedure, an employee or self-employed individual is "in the transportation industry" only if the employee's or individual's work (a) is of the type that directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and (b) regularly requires travel away from home which, during any single trip away from home, usually involves travel to localities with differing federal M&IE rates. For purposes of the preceding sentence, a payor must determine that an employee or a group of employees is "in the transportation industry" by using a method that is consistently applied and in accordance with reasonable business practice.

(5) *Transition rules.* Under the calendar-year convention provided in section 4.04(2), a taxpayer who used the federal M&IE rates during the first 9 months of calendar year 2000 to substantiate the amount of an individual's travel expenses under sections 4.02 or 4.03 of Rev. Proc. 2000-9 may not use, for that individual, the special transportation industry rates provided in this section 4.04 until January 1, 2001. Similarly, a taxpayer who used the special transportation industry rates during the first 9 months of calendar year 2000 to substantiate the amount of an individual's travel expenses may not use, for that individual, the federal M&IE rates until January 1, 2001.

SECTION 5. HIGH-LOW SUBSTANTIATION METHOD

.01 *General rule.* If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses incurred or to be incurred

by an employee for travel away from home and the payor uses the high-low substantiation method described in this section 5 for travel within CONUS, the amount of the expenses that is deemed substantiated for each calendar day is equal only substantiation method provided in section 4.02 or 4.03 of this revenue procedure.

.02 *Specific high-low rates.* Except as provided in section 5.06 of this revenue procedure, the *per diem* rate set forth in this section 5.02 is $201 for travel to any "high-cost locality" specified in section 5.03 of this revenue procedure, or $124 for travel to any other locality within CONUS. Whichever *per diem* rate applies, it is applied as if it were the federal *per diem* rate for the locality of travel. For purposes of applying the high-low substantiation method and the § 274(n) limitation on meal expenses (see section 6.05 of this revenue procedure), the federal M&IE rate shall be treated as $42 for a high-cost locality and $34 for any other locality within CONUS.

.03 *High-cost localities.* The following localities have a federal *per diem* rate of $163 or more, and are high-cost localities for all of the calendar year or the portion of the calendar year specified in parenthesis under the key city name, except as provided in section 5.06 of this revenue procedure:

Key city	*County or other defined location*
California	
Palm Springs (January 1-May 31)	Riverside
San Francisco	San Francisco
Sunnyvale/Palo Alto/San Jose	Santa Clara
Tahoe City	Placer
Colorado	
Aspen (January 1-April 30)	Pitkin
Silverthorne/Keystone	Summit
Telluride (January 1-March 31)	San Miguel
Vail (July 1-March 31)	Eagle
District of Columbia	
Washington, D.C.	Washington, D.C.; the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, in Virginia; and the counties of Montgomery and Prince George's in Maryland
Florida	
Key West (January 1-April 30)	Monroe
Idaho	
Sun Valley	City limits of Sun Valley
Illinois	
Chicago	Cook and Lake
Louisiana	
New Orleans/St. Bernard (January 1-May 31)	Orleans, St. Bernard, Plaquemine, and Jefferson Parishes
Maryland	
(For the counties of Montgomery and Prince George's, see District of Columbia)	
Ocean City (June 15-October 31)	Worcester
Massachusetts	
Boston	Suffolk
Cambridge	Middlesex County (except Lowell)
Martha's Vineyard (June 1-October 15)	Dukes

Michigan	
Mackinac Island	Mackinac
Traverse City	Grand Traverse
(June 1-September 30)	
Montana	
Big Sky	Gallatin (except West Yellowstone Park)
(November 1-April 30)	
New Jersey	
Cape May	Cape May (except Ocean City)
(June 1-November 30)	
Ocean City	City limits of Ocean City
(June 15-September 15)	
Piscataway/Belle Mead	Somerset and Middlesex
Princeton/Trenton	Mercer County
New York	
The Bronx/Brooklyn/Queens	The boroughs of The Bronx, Brooklyn, and Queens
Manhattan	Manhattan
Nassau County/Great Neck	Nassau County
Suffolk County	Suffolk County
White Plains	City limits of White Plains
Pennsylvania	
Hershey	City limits of Hershey
(June 1-September 15)	
Philadelphia	Philadelphia
Utah	
Park City	Summit
(December 15-March 31)	
Virginia	
(For the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, see District of Columbia)	
Wintergreen	Nelson

.04 *Changes in high-cost localities.* The list of high-cost localities in section 5.03 of this revenue procedure differs from the list of high-cost localities in section 5.03 of Rev. Proc. 2000-9.

(1) The following localities (listed by key cities) have been added to the list of high-cost localities: Palm Springs, California; New Orleans/St. Bernard, Louisiana; Traverse City, Michigan; Trenton, New Jersey; and Wintergreen, Virginia.

(2) The portion of the year for which the following are high-cost localities (listed by key cities) has been changed: Aspen, Colorado; Telluride, Colorado; Vail, Colorado; Key West, Florida; Sun Valley, Idaho; Ocean City, Maryland; Martha's Vineyard, Massachusetts; Big Sky, Montana; Cape May, New Jersey; and Park City, Utah.

(3) The following localities (generally listed by key cities) have been removed from the list of high-cost localities: Charlevoix, Michigan, and Union County, New Jersey.

.05 *Specific limitation.*

(1) Except as provided in section 5.05(2) of this revenue procedure, a payor that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid to that employee for travel away from home within CONUS during the calendar year. See section 5.06 of this revenue procedure for transition rules.

(2) With respect to an employee described in section 5.05(1) of this revenue procedure, the payor may reimburse actual expenses or use the meals only *per diem* method described in section 4.02 of this revenue procedure for any travel away from home, and may use the *per diem* substantiation method described in section 4.01 of this revenue procedure for any OCONUS travel away from home.

.06 *Transition rules.* A payor who used the substantiation method of section 4.01 of Rev. Proc. 2000-9 for an employee during the first 9 months of calendar year 2000 may not use the High-Low Substantiation Method in section 5 of this revenue procedure for that employee until January 1, 2001. A payor who used the High-Low Substantiation Method of section 5 of Rev. Proc. 2000-9 for an employee during the first 9 months of calendar year 2000 must continue to use the High-Low Substantiation Method for the remainder of calendar year 2000 for that employee. A payor described in the previous sentence may use the rates and high-cost localities published in section 5 of Rev. Proc. 2000-9, in lieu of the updated rates and high-cost localities provided in section 5 of this

revenue procedure, for travel on or after October 1, 2000, and before January 1, 2001, if those rates and localities are used consistently during this period for all employees reimbursed under this method.

SECTION 6. LIMITATIONS AND SPECIAL RULES

.01 *In general.* The federal *per diem* rate and the federal M&IE rate described in section 3.02 of this revenue procedure for the locality of travel will be applied in the same manner as applied under the Federal Travel Regulations, 41 C.F.R. Part 301-11 (2000), except as provided in sections 6.02 through 6.04 of this revenue procedure.

.02 *Federal per diem rate.* A receipt for lodging expenses is not required in determining the amount of expenses deemed substantiated under section 4.01 or 5.01 of this revenue procedure. See section 7.01 of this revenue procedure for the requirement that the employee substantiate the time, place, and business purpose of the expense.

.03 *Federal per diem or M&IE rate.* A payor is not required to reduce the federal *per diem* rate or the federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that meal and incidental expenses were or will be incurred by the employee.

.04 *Proration of the federal per diem or M&IE rate.* Pursuant to the Federal Travel Regulations, in determining the federal *per diem* rate or the federal M&IE rate for the locality of travel, the full applicable federal M&IE rate is available for a full day of travel from 12:01 a.m. to 12:00 midnight. For purposes of determining the amount deemed substantiated under section 4 or 5 of this revenue procedure with respect to partial days of travel away from home, either of the following methods may be used to prorate the federal M&IE rate to determine the federal *per diem* rate or the federal M&IE rate for the partial days of travel:

(1) Such rate may be prorated using the method prescribed by the Federal Travel Regulations. Currently the Federal Travel Regulations allow three-fourths of the applicable federal M&IE rate for each partial day during which the employee or self-employed individual is traveling away from home in connection with the performance of services as an employee or self-employed individual; or

(2) Such rate may be prorated using any method that is consistently applied and in accordance with reasonable business practice. For example, if an employee travels away from home from 9 a.m. one day to 5 p.m. the next day, a method of proration that results in an amount equal to 2 times the federal M&IE rate will be treated as being in accordance with reasonable business practice (even though only 1 1/2 times the federal M&IE rate would be allowed under the Federal Travel Regulations).

.05 *Application of the appropriate § 274(n) limitation on meal expenses.* All or part of the amount of an expense deemed substantiated under this revenue procedure is subject to the appropriate limitation under § 274(n) (see section 2.02 of this revenue procedure) on the deductibility of food and beverage expenses.

(1) When an amount for meal and incidental expenses is computed pursuant to section 4.03 of this revenue procedure, the taxpayer must treat such amount as an expense for food and beverages.

(2) When a *per diem* allowance is paid only for meal and incidental expenses, the payor must treat an amount equal to the lesser of the allowance or the federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure) as an expense for food and beverages.

(3) When a *per diem* allowance is paid for lodging, meal, and incidental expenses, the payor must treat an amount equal to the federal M&IE rate for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee is away from home as an expense for food and beverages. For purposes of the preceding sentence, when a *per diem* allowance for lodging, meal, and incidental expenses is paid at a rate that is less than the federal *per diem* rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure), the payor may treat an amount equal to 40 percent of such allowance as the federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.06 *No double reimbursement or deduction.* If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses or for meal and incidental expenses in accordance with section 4 or 5 of this revenue procedure, any additional payment with respect to such expenses is treated as paid under a nonaccountable plan, is included in the employee's gross income, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. Similarly, if an employee or self-employed individual computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 or 4.04 of this revenue procedure, no other deduction is allowed to the employee or self-employed individual with respect to such expenses. For example, assume an employee receives a *per diem* allowance from a payor for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home. During that trip, the employee pays for dinner for the employee and two business associates. The payor reimburses as a business entertainment meal expense the meal expense for the employee and the two business associates. Because the payor also pays a *per diem* allowance to cover the cost of the employee's meals, the amount paid by the payor for the employee's portion of the business entertainment meal expense 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.

.07 *Related parties.* Sections 4.01 and 5 of this revenue procedure will not apply in any case in which a payor and an employee are related within the meaning of § 267(b), but for this purpose the percentage of ownership interest referred to in § 267(b)(2) shall be 10 percent.

SECTION 7. APPLICATION

.01 If the amount of travel expenses is deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place, and business purpose of the

travel expenses in accordance with paragraphs (b)(2) (travel away from home) and (c) (other than subparagraph (2)(iii)(A) thereof) of § 1.274-5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274-5(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274-5(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.

.02 An arrangement providing *per diem* allowances will be treated as satisfying the requirement of § 1.62-2(f)(2) with respect to returning amounts in excess of expenses 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 days of travel not substantiated, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance *per diem* allowance for meal and incidental expenses of $200, based on an anticipated 5 days of business travel at $40 per day to a locality for which the federal M&IE rate is $34, and the employee substantiates 3 full days of business travel. 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)) the portion of the allowance that is attributable to the 2 unsubstantiated days of travel ($80), even though the employee is not required to return the portion of the allowance ($18) that exceeds the amount of the employee's expenses deemed substantiated under section 4.02 of this revenue procedure ($102) for the 3 substantiated days of travel. However, the $18 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 7.04 of this revenue procedure.

.03 An employee is not required to include in gross income the portion of a *per diem* allowance received from a payor that is less than or equal to the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the per diem allowance in accordance with section 7.01 of this revenue procedure. See § 1.274-5(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).

.04 An employee is required to include in gross income only the portion of the per diem allowance received from a payor that exceeds the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the per diem allowance in accordance with section 7.01 of this revenue procedure. See § 1.274-5(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).

.05 If the amount of the expenses that is deemed substantiated under the rules provided in section 4.01, 4.02, or 5 of this revenue procedure is less than the amount of the employee's business expenses for travel away from home, the employee may claim an itemized deduction for the amount by which the business travel expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business travel expenses, includes on Form 2106, Employee Business Expenses, the deemed substantiated portion of the *per diem* allowance received from the payor, and includes in gross income the portion (if any) of the *per diem* allowance received from the payor that exceeds the amount deemed substantiated. See § 1.274-5(f)(2)(iii). However, for purposes of claiming this itemized deduction with respect to meal and incidental expenses, 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 amount computed under section 4.03 of this revenue procedure minus the amount deemed substantiated under sections 4.02 and 7.01 of this revenue procedure. The itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.06 An employee who does not receive a *per diem* allowance for meal and incidental expenses may deduct an amount computed pursuant to section 4.03 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.07 A self-employed individual may deduct an amount computed pursuant to section 4.03 of this revenue procedure in determining adjusted gross income under § 62(a)(1). This deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n).

.08 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 8. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a *per diem* allowance, if any, that relates to the days of business travel substantiated and that exceeds the amount deemed substantiated for those days under section 4.01, 4.02, or 5 of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62-2(h)(2)(i)(B).

.02 In the case of a *per diem* allowance paid as a reimbursement, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes in the pay-

roll period in which the payor reimburses the expenses for the days of travel substantiated. See § 1.62-2(h)(2)(i)(B)(*2*).

.03 In the case of a *per diem* allowance paid as an advance, the excess described in section 8.01 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 days of travel with respect to which the advance was paid are substantiated. See § 1.622(h)(2)(i)(B)(*3*). If some or all of the days of travel 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 days within a reasonable period of time, the portion of the allowance that relates to those days is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.622(h)(2)-(i)(A).

.04 In the case of a *per diem* allowance only for meal and incidental expenses for travel away from home paid to an employee in the transportation industry by a payor that uses the rule in section 4.04(3) of this revenue procedure, the excess of the *per diem* allowance paid for the period over the amount deemed substantiated for the period under section 4.02 of this revenue procedure (after applying section 4.04(3) 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 excess is computed. See § 1.62-2(h)(2)(i)(B)(*4*).

.05 For example, assume that an employer pays an employee a *per diem* allowance to cover business expenses for meals and lodging for travel away from home at a rate of 120 percent of the federal *per diem* rate for the localities to which the employee travels. The employer does not require the employee to return the 20 percent by which the reimbursement for those expenses exceeds the federal *per diem* rate. The employee substantiates 6 days of travel away from home: 2 days in a locality in which the federal *per diem* rate is $100 and 4 days in a locality in which the federal *per diem* rate is $125. The employer reimburses the employee $840 for the 6 days of travel away from home (2 x (120% x $100) + 4 x (120% x $125)), and does not require the employee to return the excess payment of $140 (2 days x $20 ($120-$100) + 4 days x $25 ($150-$125)). For the payroll period in which the employer reimburses the expenses, the employer must withhold and pay employment taxes on $140. See section 8.02 of this revenue procedure.

SECTION 9. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2000-9 is hereby superseded (except to the extent specified in sections 4.04(5) and 5.06 of this revenue procedure) for *per diem* allowances that are paid both (1) to an employee on or after October 1, 2000, and (2) with respect to lodging, meal, and incidental expenses or with respect to meal and incidental expenses paid or incurred for travel while away from home on or after October 1, 2000. Rev. Proc. 2000-9 is also hereby superseded (except to the extent specified in section 4.04(5) of this revenue procedure) for purposes of computing the amount allowable as a deduction for meal and incidental expenses paid or incurred by an employee or self-employed individual for travel while away from home on or after October 1, 2000.

.02 Notice 2000-48, 2000-37 I.R.B. 265, is hereby superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Associate 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).

Part IV. Items of General Interest

TeleFile Voice Signature Test; Correction

Announcement 2000–81

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Correction to removal of temporary regulations.

SUMMARY: This document contains corrections to a removal of temporary regulations that provides that an individual Federal income tax return completed as part of the Telefile Voice Signature test will be treated as a return that is signed, authenticated, verified and filed by the taxpayer. This document was published in the Federal Register on July 18, 2000 (65 F.R. 44437).

DATES: This correction is effective July 18, 2000.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Need for Correction

As published, the removal of temporary regulations (TD 8892, 2000–32 I.R.B.158) contains errors that may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the removal of temporary regulations (TD 8892), which is the subject of FR Doc. 00-18116, is corrected as follows:

1. On page 44438, column 1, in amendatory instruction **Par. 6.**, line 1, the language, "**Par. 6.** Section 602.101(c) is amended" is corrected to read "**Par. 6.** Section 602.101(b) is amended".

§602.101 [Corrected]

2. On page 44438, column 1, the paragraph designation §602.101 (c) is correctly designated §602.101 (b).

Cynthia Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization and Strategic Planning).

(Filed by the Office of the Federal Register on September 18, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 19, 2000, 65 F.R. 56484)

New Form 8869, Qualified Subchapter S Subsidiary Election

Announcement 2000-83

New Form 8869 is now available. A parent S corporation uses Form 8869 to elect to treat one or more of its eligible subsidiaries as a qualified subchapter S subsidiary (QSub).

The new form replaces the temporary procedures for filing a QSub election under Notice 97-4, 1997-1 C.B. 351. As a result, Form 966, Corporate Dissolution or Liquidation, may no longer be used to make a QSub election.

You can obtain Form 8869 by telephone or by using IRS electronic information services.

Request by	Number or address
Telephone	**1-800-TAX-FORM**
	(1-800-829-3676)
Personal computer:	
IRS Internet Web Site	**www.irs.gov**
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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 2000. 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 2000.

Rev. Rul. 2000–48

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 2000.

Table 1
Rev. Rul. 2000–48
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
Jul '00	39.75	54.78	67.30	77.84	79.31	82.61	86.02	89.38	92.82	96.56	100.53
Aug '00	39.75	54.78	67.30	77.84	79.09	82.39	85.78	89.14	92.57	96.29	100.25
Sep '00	39.75	54.78	67.30	77.84	78.89	82.17	85.55	88.89	92.32	96.04	99.99

Table 1 (cont'd)
Rev. Rul. 2000–48
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	1998	1999	2000
Jul '00	104.92	109.29	112.52
Aug '00	104.64	109.02	112.52
Sep '00	104.37	108.77	112.52

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul. 98–3, 1998–1 C.B. 248, for dispositions occurring during the calendar years 1996 and 1997;
Rev. Rul. 98–13, 1998–1 C.B. 686, for dispositions occurring during the period January through March 1998; Rev. Rul. 98–31, 1998–1 C.B. 1269, for dispositions occurring during the period April through June 1998; Rev. Rul. 98–45, 1998–2 C.B. 364, 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. 99–54, 1999–51 I.R.B. 675, for dispositions occurring during the calendar year 1999; Rev. Rul. 2000–22, 2000–16 I.R.B. 880, for dispositions occurring during the period January through March 2000; and Rev. Rul. 2000–31, 2000–26 I.R.B. 1269, for dispositions occurring during the period April through June 2000.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office

of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran at (202) 622-3040 (not a toll-free call).

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351–2: Receipt of property.

T.D. 8904

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Treatment of Nonqualified Preferred Stock and Other Preferred Stock in Certain Exchanges and Distributions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to nonqualified preferred stock. The regulations address the effective date of the definition of nonqualified preferred stock and the treatment of nonqualified preferred stock and similar preferred stock received by shareholders in certain corporate reorganizations and distributions. The regulations are necessary to reflect changes to the law concerning these types of preferred stock that were made by the Taxpayer Relief Act of 1997.

EFFECTIVE DATE: These regulations are effective October 2, 2000.

FOR FURTHER INFORMATION CONTACT: Richard E. Coss, (202) 622-7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On January 26, 2000, the IRS and Treasury published in the **Federal Register** a notice of proposed rulemaking (REG–105089–99, 2000–6 I.R.B. 580 [65 F.R. 4203]) relating to nonqualified preferred stock (as defined in section 351(g)(2) of the Internal Revenue Code) (NQPS). The proposed regulations address the effective date of the definition of NQPS, and provide rules exempting from treatment as NQPS certain preferred stock received by shareholders in corporate reorganizations and distributions subject to sections 354, 355, and 356.

No comments responding to the notice of proposed rulemaking were submitted, and no public hearing was requested or held. However, one commentator suggested that the rule in the proposed regulations interpreting section 351(g)(2)-(C)(i)(II) (relating to preferred stock transferred in connection with the performance of services) should be expanded to include transactions subject to section 351.

The IRS and Treasury agree with this suggestion. Accordingly, these final regulations extend the exemption from treatment as NQPS in §1.356–7(c) to preferred stock received by shareholders in certain stock exchanges under section 351. The proposed regulations are adopted as revised 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 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, 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 Richard E. Coss of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury 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 the following entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.351–2 also issued under 26 U.S.C. 351(g)(4).
Section 1.354–1 also issued under 26 U.S.C. 351(g)(4).
Section 1.355–1 also issued under 26 U.S.C. 351(g)(4).
Section 1.356–7 also issued under 26 U.S.C. 351(g)(4). * * *
Section 1.1036–1 also issued under 26 U.S.C. 351(g)(4). * * *

Par. 2. Section 1.351–2 is amended by adding paragraph (e) to read as follows:

§1.351–2 Receipt of property.

* * * * *

(e) See §1.356–7(a) for the applicability of the definition of nonqualified preferred stock in section 351(g)(2) for stock issued prior to June 9, 1997, and for stock issued in transactions occurring after June 8, 1997, that are described in section 1014(f)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 921). See §1.356–7(c) for the treatment of preferred stock received in certain exchanges for common or preferred stock described in section 351(g)(2)(C)(i)(II).

Par. 3. Section 1.354–1 is amended by adding paragraph (f) to read as follows:

§1.354–1 Exchanges of stock and securities in certain reorganizations.

* * * * *

(f) See §1.356–7(a) and (b) for the treatment of nonqualified preferred stock (as defined in section 351(g)(2)) received in certain exchanges for nonqualified preferred stock or preferred stock. See §1.356–7(c) for the treatment of preferred stock received in certain exchanges for common or preferred stock described in section 351(g)(2)(C)(i)(II).

Par. 4. Section 1.355–1 is amended by adding paragraph (d) to read as follows:

§1.355–1 Distribution of stock and securities of a controlled corporation.

* * * * *

(d) *Nonqualified preferred stock.* See §1.356–7(a) and (b) for the treatment of nonqualified preferred stock (as defined in section 351(g)(2)) received in certain exchanges for (or in certain distributions with respect to) nonqualified preferred stock or preferred stock. See §1.356–7(c) for the treatment of the receipt of preferred stock in certain exchanges for (or in certain distributions with respect to) common or preferred stock described in section 351(g)(2)(C)(i)(II).

Par. 5. Section 1.356–7 is added to read as follows:

§1.356–7 Rules for treatment of nonqualified preferred stock and other preferred stock received in certain transactions.

(a) *Stock issued prior to effective date.* Stock described in section 351(g)(2) is nonqualified preferred stock (NQPS) regardless of the date on which the stock is issued. However, sections 351(g), 354(a)(2)(C), 355(a)(3)(D), 356(e), and 1036(b) do not apply to any transaction occurring prior to June 9, 1997, or to any transaction occurring after June 8, 1997, that is described in section 1014(f)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 921). For purposes of this section, preferred stock that is not NQPS is referred to as Qualified Preferred Stock (QPS).

(b) *Receipt of preferred stock in exchange for (or distribution on) substantially identical preferred stock*—(1) *General rule.* For purposes of sections 354(a)(2)(C)(i), 355(a)(3)(D), and 356(e)(2), preferred stock is QPS, even though it is described in section 351(g)(2), if it is received in exchange for (or in a distribution with respect to) preferred stock (the original preferred stock) that is QPS, provided —

(i) The original preferred stock is QPS solely because, on its issue date, either a right or obligation described in clause (i), (ii), or (iii) of section 351(g)(2)(A) was not exercisable until after a 20-year period beginning on the issue date, or the right or obligation was exercisable within the 20-year period beginning on the issue date but was subject to a contingency which made remote the likelihood of the redemption or purchase, or the issuer's (or a related party's) right to redeem or purchase the stock was not more likely than not to be exercised within a 20-year period beginning on the issue date, or because of any combination of these reasons; and

(ii) The stock received is substantially identical to the original preferred stock.

(2) *Substantially identical.* The stock received is substantially identical to the original preferred stock if—

(i) The stock received does not contain any term or terms that, in relation to any term or terms of the original preferred stock, either decrease the period in which a right or obligation described in clause (i), (ii), or (iii) of section 351(g)(2)(A) can be exercised, or increase the likelihood that such a right or obligation will be exercised, or accelerate the timing of the returns from the stock instrument, including the timing of actual or deemed dividends or other distributions received on the stock; and

(ii) As a result of the exchange or distribution, exercise of the right or obligation does not become more likely than not to occur within a 20-year period beginning on the issue date of the original preferred stock.

(3) *Treatment of stock received.* The stock received will continue to be treated as QPS in subsequent transactions involving such stock, and the principles of this paragraph (b) apply to such transactions as though the stock received is the original preferred stock issued on the same date as the original preferred stock.

(c) *Stock transferred for services.* For purposes of sections 351(g)(1), 354(a)-(2)(C)(i), 355(a)(3)(D), and 356(e)(2), preferred stock containing a right or obligation described in clause (i), (ii) or (iii) of section 351(g)(2)(A) that is exercisable only upon the holder's separation from service from the issuer or a related person (as described in section 351(g)(3)(B)) will be treated as transferred in connection with the performance of services (and representing reasonable compensation) within the meaning of section 351(g)(2)(C)(i)(II), if such preferred stock is received in exchange for (or in a distribution with respect to) existing stock containing a similar right or obligation (exercisable only upon separation from service) and the existing stock was transferred in connection with the performance of services for the issuer or a related person (and represented reasonable compensation when transferred). In applying the rules relating to NQPS, the preferred stock received will continue to be treated as transferred in connection with the performance of services (and representing reasonable compensation) in subsequent transactions involving such stock, and the principles of this paragraph (c) apply to such transactions.

(d) *Rights to acquire stock.* For purposes of §1.356–6, the principles of paragraphs (a), (b), and (c) of this section apply.

(e) *Examples.* In the examples in this paragraph (e), T and P are corporations, A is a shareholder of T, and A surrenders and receives (in addition to the stock exchanged in the examples) common stock in the reorganizations described. The following examples illustrate paragraphs (a), (b), and (c) of this section:

Example 1. In 1995, A transfers property to T and receives T preferred stock that is described in section 351(g)(2) in a transaction under section 351. In 2002, pursuant to a reorganization under section 368(a)(1)(B), A surrenders the T preferred stock in exchange for P NQPS. Under paragraph (a) of this section, the T preferred stock issued to A in 1995 is NQPS. However, because section 351(g) does not apply to transactions occurring before June 9, 1997, the T NQPS was not "other property" within the meaning of section 351(b) when issued in 1995. Under sections 354(a)(2)(C) and 356(e)(2), the P NQPS received by A in 2002 is not "other property" within the meaning of section 356(a)(1)(B) because it is received in exchange for NQPS.

Example 2. T issues QPS to A on January 1, 2000 that is not NQPS solely because the holder cannot require T to redeem the stock until January 1, 2022. In 2007, pursuant to a reorganization under section 368(a)(1)(A) in which T merges into P, A surrenders the T preferred stock in exchange for P preferred stock with terms that are identical to the terms of the T preferred stock, including the term that the holder cannot require the redemption of the stock until January 1, 2022. Because the P stock and the T stock have identical terms, and because the redemption did not become more likely than not to occur within the 20-year period that begins on January 1, 2000 (which is the issue date of the T preferred stock) as a result of the exchange, under paragraph (b) of this section, the P preferred stock received by A is treated as QPS. Thus, the P preferred stock received is not "other property" within the meaning of section 356(a)(1)(B).

Example 3. The facts are the same as in *Example 2*, except that, in addition, in 2010, pursuant to a recapitalization of P under section 368(a)(1)(E), A exchanges the P preferred stock above for P NQPS that permits the holder to require P to redeem the stock in 2020. Under paragraph (b) of this section, the P preferred stock surrendered by A is treated as QPS. Be-

cause the P preferred stock received by A in the recapitalization is not substantially identical to the P preferred stock surrendered, the P preferred stock received by A is not treated as QPS. Thus, the P preferred stock received is "other property" within the meaning of section 356(a)(1)(B).

Example 4. T issues preferred stock to A on January 1, 2000 that permits the holder to require T to redeem the stock on January 1, 2018, or at any time thereafter, but which is not NQPS solely because, as of the issue date, the holder's right to redeem is subject to a contingency that makes remote the likelihood of redemption on or before January 1, 2020. In 2007, pursuant to a reorganization under section 368(a)(1)(A) in which T merges into P, A surrenders the T preferred stock in exchange for P preferred stock with terms that are identical to the terms of the T preferred stock. Immediately before the exchange, the contingency to which the holder's right to cause redemption of the T stock is subject makes remote the likelihood of redemption before January 1, 2020, but the P stock, although subject to the same contingency, is more likely than not to be redeemed before January 1, 2020. Because, as a result of the exchange of T stock for P stock, the exercise of the redemption right became more likely than not to occur within the 20-year period beginning on the issue date of the T preferred stock, the P preferred stock received by A is not substantially identical to the T stock surrendered, and is not treated as QPS. Thus, the P preferred stock received is "other property" within the meaning of section 356(a)(1)(B).

Example 5. The facts are the same as in *Example 4*, except that, immediately before the merger of T into P in 2007, the contingency to which the holder's right to cause redemption of the T stock is subject makes it more likely than not that the T stock will be redeemed before January 1, 2020. Because exercise of the redemption right did not become more likely than not to occur within the 20-year period beginning on the issue date of the T preferred stock as a result of the exchange, the P preferred stock received by A is substantially identical to the T stock surrendered, and is treated as QPS. Thus, the P preferred stock received is not "other property" within the meaning of section 356(a)(1)(B).

Example 6. A is an employee of T. In connection with A's performance of services for T, T transfers to A in 2000 an amount of T common stock that represents reasonable compensation. The T common stock contains a term granting A the right to require T to redeem the common stock, but only upon A's separation from service from T. In 2005, pursuant to a reorganization under section 368(a)(1)(A) in which T merges into P, A receives, in exchange for A's T common stock, P preferred stock granting a similar redemption right upon A's separation from P's service. Under paragraph (c) of this section, the P preferred stock received by A is treated as transferred in connection with the performance of services (and representing reasonable compensation) within the meaning of section 351(g)(2)(C)(i)(II). Thus, the P preferred stock received by A is QPS.

(f) *Effective dates.* This section applies to transactions occurring on or after October 2, 2000.

Par. 6. Section 1.1036–1 is amended by adding paragraph (d) to read as follows:

§1.1036–1 Stock for stock of the same corporation.

* * * * *

(d) *Nonqualified preferred stock.* See §1.356–7(a) for the applicability of the definition of nonqualified preferred stock in section 351(g)(2) for stock issued prior to June 9, 1997, and for stock issued in transactions occurring after June 8, 1997, that are described in section 1014(f)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788, 921).

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved September 25, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 29, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 2, 2000, 65 F.R. 58650)

Section 412.—Minimum Funding Standards

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, 2000. See Rev. Proc. 2000–40, page 357.

A procedure describes a method whereby a plan administrator or plan sponsor may obtain approval for a change in funding method. See Rev. Proc. 2000–41, page 371.

Section 1397.—Other Definitions and Special Rules

26 CFR 1.1397E–1: Qualified zone academy bonds.

T.D. 8903

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: Final regulations.

SUMMARY: This document contains final regulations relating to the Federal income tax treatment of qualified zone academy bonds. These regulations provide guidance to State and local governments that issue qualified zone academy bonds and to banks, insurance companies, and other taxpayers that hold those bonds. These regulations make final certain temporary regulations.

DATES: *Effective Date*: These regulations are effective September 26, 2000.

Applicability Date: For dates of applicability, see §1.1397E–1(k).

FOR FURTHER INFORMATION CONTACT: Timothy L. Jones or Allan B. Seller at 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 (Code) by redesignating section 1397E as section 1397F and adding a new section 1397E. Section 1397E authorizes a type of debt instrument known as a qualified zone academy bond.

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 enhance 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.

Temporary regulations (REG–119-449–97, 1998–1 C.B. 667) interpreting section 1397E were published on January 7, 1998 (63 F.R. 671), and amended on

July 1, 1999 (64 F.R. 35573). The temporary regulations generally treat the allowance of the credit as if it were a payment of interest on the bond.

Code section 1397E(e), as amended by section 509 of the Ticket to Work and Work Incentives Improvement Act of 1999, Public Law 106–170 (113 Stat. 1860), imposes a national limitation on the amount of qualified zone academy bonds that can be issued. For each applicable year, the IRS publishes a revenue procedure allocating the national limitation among the States and the possessions.

Bonds Issued by a State or Local Government

Section 1397E(d)(1)(B) requires that a qualified zone academy bond be issued by a State or local government within the jurisdiction of which a qualified zone academy (as defined in section 1397E(d)(4)) is located. Commentators requested clarification that, for these purposes, a State or local government means a State or political subdivision as defined for purposes of section 103(c). Commentators also requested that the final regulations include a provision for the issuance of qualified zone academy bonds on behalf of a State or local government in a manner similar to the issuance of obligations on behalf of a State or political subdivision under section 103.

The final regulations provide that, for purposes of section 1397E(d)(1)(B), the term *State or local government* means a State or political subdivision as defined for purposes of section 103(c). The final regulations also specify that a qualified zone academy bond may be issued on behalf of a State or local government under rules similar to those for determining whether a bond issued on behalf of a State or political subdivision constitutes an obligation of that State or political subdivision for purposes of section 103.

Private Business Contribution Requirement

Section 1397E(d)(1)(C)(ii) requires the issuer of a qualified zone academy bond to certify that it has written assurances that the private business contribution requirement of section 1397E(d)(2) will be met with respect to the qualified zone academy. For these purposes, the private business contribution requirement is met if the eligible local education agency (as defined in section 1397E(d)(4)(B)) has written commitments from private entities to make qualified contributions having a present value as of the issue date of 10 percent or more of the proceeds of the issue.

The Code does not define *private entities* for these purposes. Section 1397E(d)(2)(B) defines *qualified contribution* as any contribution (of a type and quality acceptable to the eligible local education agency) of (i) equipment for use in the qualified zone academy, (ii) technical assistance in developing curriculum or in training teachers in order to promote appropriate market driven technology in the classroom, (iii) services of employees as volunteer mentors, (iv) internships, field trips, or other educational opportunities outside the academy for students, or (v) any other property or service specified by the eligible local education agency.

Commentators requested clarification of the meaning of *private entities* for these purposes. For example, commentators asked whether the term may include an organization described in section 501(c)(3) or a private individual.

The final regulations provide that, for purposes of section 1397E(d)(2)(A), the term *private entities* includes any person (as defined in section 7701(a)) other than the United States, a State or local government, or any agency or instrumentality thereof or related party with respect thereto.

Commentators also sought clarification regarding the meaning of *qualified contribution* under section 1397E(d)(2)(B). The final regulations provide that cash received with respect to a qualified zone academy from a private entity constitutes a qualified contribution if it is to be used to purchase any property or service described in section 1397E(d)(2)(B)(i), (ii), (iii), (iv) or (v). The final regulations also indicate that services of employees of the eligible local education agency do not constitute qualified contributions.

Issuer Certifications

Section 1397E(d)(1)(C) requires the issuer to certify (1) that it has written assurances that the private business contribution requirement will be met, and (2) that it has the written approval of the eligible local education agency for the bond issuance. The Treasury and the IRS intend that these certifications will be respected and may be relied on by taxpayers if the certifications are reasonably made.

95 Percent Test

Section 1397E(d)(1)(A) requires that 95 percent or more of the proceeds of an issue of qualified zone academy bonds be used for a qualified purpose described in section 1397E(d)(5) with respect to a qualified zone academy. The Treasury and the IRS intend that the qualified purposes set forth in section 1397E(d)(5) are to be broadly interpreted. The Treasury and the IRS also intend that issuers may apply principles similar to the requirements of §1.142–2 (without regard to the requirement therein that the period between the issue date and the first call date not exceed 10 1/2 years) to cure an unexpected failure to spend 95 percent or more of the proceeds of an issue for a qualified purpose. Further, the Treasury and the IRS intend that taxpayers may rely on an issuer's determination that a public school (or academic program within a public school) is a qualified zone academy for purposes of section 1397E(d)(4) if the determination has a reasonable basis.

Effective Dates

The final regulations apply to bonds sold on or after September 26, 2000. In addition, the final regulations permit elective, retroactive application to bonds sold before September 26, 2000, of either of the following sections of the regulations: §1.1397E–1(c) (private business contribution requirement) and §1.1397E–1(i) (State or local government).

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 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, the notice of pro-

posed rulemaking preceding these regulations was sent to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

* * * * *

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 entry for Section 1.1397E–1T and adding a new entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * * Section 1.1397E–1 also issued under 26 U.S.C. 1397E(b) and (d).

§1.1397E–1T [Redesignated as §1.1397E–1]

Par. 2. Section 1.1397E–1T is redesignated as '1.1397E–1.

Par. 3. Newly designated '1.1397E–1 is amended as follows:

1. The section heading is revised.

2. Revising paragraphs (c), (f)(2), (i) and (j).

3. Adding a new paragraph (k).

The revisions and addition read as follows:

§1.1397E–1 Qualified zone academy bonds.

* * * * *

(c) *Private business contribution requirement*—(1) *Reasonable discount rate.* To determine the present value (as of the issue date) of qualified contributions from private entities under section 1397E(d)(2), the issuer must use a reasonable discount rate. The credit rate determined under paragraph (b) of this section is a reasonable discount rate.

(2) *Definition of private entities.* For purposes of section 1397E(d)(2)(A), the term *private entities* includes any person (as defined in section 7701(a)) other than the United States, a State or local government, or any agency or instrumentality thereof or related party with respect thereto. To determine whether a person is related to the United States or a State or local government under this paragraph (c)(2), rules similar to those for determining whether a person is a related party under §1.150–1(b) shall apply (treating the United States as a governmental unit for purposes of §1.150–1(b)).

(3) *Qualified contribution.* For purposes of section 1397E(d)(2)(A), the term *qualified contribution* means any contribution (of a type and quality acceptable to the eligible local education agency) of any property or service described in section 1397E(d)(2)(B)(i), (ii), (iii), (iv) or (v). In addition, cash received with respect to a qualified zone academy from a private entity (other than cash received indirectly from a person that is not a private entity as part of a plan to avoid the requirements of section 1397E) constitutes a qualified contribution if it is to be used to purchase any property or service described in section 1397E(d)(2)(B)(i), (ii), (iii), (iv) or (v). Services of employees of the eligible local education agency do not constitute qualified contributions.

* * * * *

(f) * * *

(2) *Adjustment if the holder cannot use the credit to offset a tax liability.* If a holder holds a qualified zone academy bond on the credit allowance date but cannot use all or a portion of the credit to reduce its income tax liability (for example, because the holder is not an eligible taxpayer or because the limitation in section 1397E(c) applies), the holder is allowed a deduction for the taxable year that includes the credit allowance date (or, at the option of the holder, the next succeeding taxable year). The amount of the deduction is equal to the amount of the unused credit deemed paid on the credit allowance date.

* * * * *

(i) *State or local government*—(1) *In general.* For purposes of section 1397E(d)(1)(B), the term *State or local government* means a State or political subdivision as defined for purposes of section 103(c).

(2) *On behalf of issuer.* A qualified zone academy bond may be issued on behalf of a State or local government under rules similar to those for determining whether a bond issued on behalf of a State or political subdivision constitutes an obligation of that State or political subdivision for purposes of section 103.

(j) *Cross-references.* See section 171 and the regulations thereunder for rules relating to amortizable bond premium. See §1.61–7(d) for the seller's treatment of a bond sold between interest payment dates (credit allowance dates) and §1.61–7(c) for the buyer's treatment of a bond purchased between interest payment dates (credit allowance dates).

(k) *Effective dates.* Except as provided in this paragraph (k), this section applies to bonds sold on or after September 26, 2000. Each of paragraphs (c) and (i) of this section may be applied by issuers to bonds that are sold before September 26, 2000.

Bob Wenzel,
Deputy Commissioner of Internal Revenue.

Approved September 19, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 25, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2000, 65 F.R. 57732)

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(a) 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, 2000, shall be at the rate of 26 1/2 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, 2000, 38.3 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 61.7 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 August 30, 2000.
By Authority of the Board.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on September 11, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 12, 2000, 65 F.R. 55066)

Part III. Administrative, Procedural, and Miscellaneous

Tax on Certain Imported Substances; Notice of Determinations

Notice 2000–54

This notice announces determinations, under Notice 89–61 (1989–1 C.B. 717), that the list of taxable substances in § 4672(a)(3) will be modified to include nine polyether polyol substances. This modification is effective October 1, 1992.

Background

Under § 4672(a), an importer or exporter of any substance may request that the Secretary determine whether that substance should be listed as a taxable substance. The Secretary shall add the substance to the list of taxable substances in § 4672(a)(3) if the Secretary determines that taxable chemicals constitute more than 50 percent of the weight, or more than 50 percent of the value, of the materials used to produce the substance. This determination is to be made on the basis of the predominant method of production. Notice 89–61 sets forth the rules relating to the determination process.

Determinations

On July 14, 2000, the Secretary determined that nine polyether polyol substances should be added to the list of taxable substances in § 4672(a)(3), effective October 1, 1992.

The rate of tax prescribed for poly(propylene)glycol, under § 4671(b)(3), is $7.74 per ton. This is based upon a conversion factor for propylene of 0.781, a conversion factor for chlorine of 1.31, and a conversion factor for sodium hydroxide of 1.43.

The rate of tax prescribed for poly(propylene/ethylene)glycol, under § 4671(b)(3), is $7.16 per ton. This is based upon a conversion factor for propylene of 0.663, a conversion factor for chlorine of 1.11, a conversion factor for sodium hydroxide of 1.21, and a conversion factor for ethylene of 0.123.

The rate of tax prescribed for poly(propyleneoxy)glycerol, under § 4671(b)(3), is $6.38 per ton. This is based upon a conversion factor for propylene of 0.645, a conversion factor for chlorine of 1.08, and a conversion factor for sodium hydroxide of 1.18.

The rate of tax prescribed for poly(ethyleneoxy)glycerol, under § 4671(b)(3), is $3.31 per ton. This is based upon a conversion factor for ethylene of 0.681.

The rate of tax prescribed for poly(propyleneoxy/ethyleneoxy)glycerol, under § 4671(b)(3), is $7.20 per ton. This is based upon a conversion factor for propylene of 0.71, a conversion factor for chlorine of 1.05, a conversion factor for sodium hydroxide of 1.05, and a conversion factor for ethylene of 0.126.

The rate of tax prescribed for poly(propyleneoxy)sucrose, under § 4671(b)(3), is $4.18 per ton. This is based upon a conversion factor for propylene of 0.423, a conversion factor for chlorine of 0.707, and a conversion factor for sodium hydroxide of 0.773.

The rate of tax prescribed for poly(propyleneoxy/ethyleneoxy)sucrose, under § 4671(b)(3), is $6.11 per ton. This is based upon a conversion factor for propylene of 0.549, a conversion factor for chlorine of 0.918, a conversion factor for sodium hydroxide of 1.0, and a conversion factor for ethylene of 0.14.

The rate of tax prescribed for poly(propyleneoxy/ethyleneoxy)diamine, under § 4671(b)(3), is $4.92 per ton. This is based upon a conversion factor for propylene of 0.498, a conversion factor for chlorine of 0.833, and a conversion factor for sodium hydroxide of 0.91.

The rate of tax prescribed for poly(propyleneoxy/ethyleneoxy)benzenediamine, under § 4671(b)(3), is $5.25 per ton. This is based upon a conversion factor for propylene of 0.491, a conversion factor for chlorine of 0.821, a conversion factor for sodium hydroxide of 0.897, and a conversion factor for ethylene of 0.081.

The petitioner is Dow Chemical Company, a manufacturer and exporter of these substances. No material comments were received on this petition. The following information is the basis for the determinations.

The nine polyether polyol substances are liquids. They are produced predominantly by the base-catalyzed reaction of cyclic ethers, usually ethylene oxide and propylene oxide, with active hydrogen-containing compounds (initiators) such as water, glycols, polyols, and amines. The reaction is carried out by a discontinuous batch process at elevated temperatures and pressures and under an inert atmosphere. The particular substance produced depends upon the oxides, initiators, reaction conditions, and catalysts used. The stoichiometric amounts of oxide reacted on the initiator determine the chain lengths and thus the molecular weights. The HTS number for these substances is 3907.20.00.

Poly(propylene)glycol

CAS number: 025322–69–4

Poly(propylene)glycol is derived from the taxable chemicals propylene, chlorine, and sodium hydroxide.

The stoichiometric material consumption formula for this substance is: n+1(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) + H_2O (water) → $C_3H_8O_2(C_3H_6O)_n$ (poly(propylene)glycol) + n+1(2 NaCl (sodium chloride) + H_2O (water))

Poly (propylene)glycol has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 90 percent by weight of the materials used in its production.

Poly(propylene/ethylene)glycol

CAS number: 053637–25–5

Poly(propylene/ethylene)glycol is derived from the taxable chemicals propylene, chlorine, sodium hydroxide, and ethylene.

The stoichiometric material consumption formula for this substance is: n+1(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) + H_2O (water) + m/2(2 C_2H_4 (ethylene) + O_2 (oxygen)) → $C_3H_8O_2(C_3H_6O)_n(C_2H_4O)_m$ (poly(propylene/ethylene)glycol) + n+1(2 NaCl (sodium chloride) + H_2O (water))

Poly(propylene/ethylene)glycol has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 90 percent by weight of the materials used in its production.

Poly(propyleneoxy)glycerol

CAS number: 025791–96–2

Poly(propyleneoxy)glycerol is derived from the taxable chemicals propylene, chlorine, and sodium hydroxide.

The stoichiometric material consumption formula for this substance is:$C_3H_8O_3$ (glycerine) + n(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) → $C_3H_8O_3(C_3H_6O)_n$ (poly(propyleneoxy)glycerol) + n(2 NaCl (sodium chloride) + H_2O (water))

Poly(propyleneoxy)glycerol has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 85 percent by weight of the materials used in its production.

Poly(ethyleneoxy)glycerol

CAS number: 031694–55–0

Poly(ethyleneoxy)glycerol is derived from the taxable chemical ethylene.

The stoichiometric material consumption formula for this substance is: $C_3H_8O_3$ (glycerine) + m/2(2 C_2H_4 (ethylene) + O_2 (oxygen)) → $C_3H_8O_3(C_2H_4O)_m$ (poly(ethyleneoxy)glycerol)

Poly(ethyleneoxy)glycerol has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute more than 50 percent by weight of the materials used in its production.

Poly(propyleneoxy/ethyleneoxy)glycerol

CAS number: 009082–00–2

Poly(propyleneoxy/ethyleneoxy)glycerol is derived from the taxable chemicals propylene, chlorine, sodium hydroxide, and ethylene.

The stoichiometric material consumption formula for this substance is: $C_3H_8O_3$ (glycerine) + n(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) + m/2(2 C_2H_4 (ethylene) + O_2 (oxygen)) → $C_3H_8O_3(C_3H_6O)_n(C_2H_4O)_m$ (poly(propyleneoxy/ethyleneoxy)glycerol) + n(2 NaCl (sodium chloride) + H_2O (water))

Poly(propyleneoxy/ethyleneoxy)glycerol has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 85 percent by weight of the materials used in its production.

Poly(propyleneoxy)sucrose

CAS number: 009049–71–2

Poly(propyleneoxy)sucrose is derived from the taxable chemicals propylene, chlorine, and sodium hydroxide.

The stoichiometric material consumption formula for this substance is: $C_{12}H_{22}O_{11}$(sucrose) + n(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) → $C_{12}H_{22}O_{11}(C_3H_6O)_n$ (poly(propyleneoxy)sucrose) + n(2 NaCl (sodium chloride) + H_2O (water))

Poly(propyleneoxy)sucrose has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 65 percent by weight of the materials used in its production.

Poly(propyleneoxy/ethyleneoxy)sucrose

CAS number: 026301–10–0

Poly(propyleneoxy/ethyleneoxy) sucrose is derived from the taxable chemicals propylene, chlorine, sodium hydroxide, and ethylene.

The stoichiometric material consumption formula for this substance is: $C_{12}H_{22}O_{11}$ (sucrose) + n(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) + m/2(2 C_2H_4 (ethylene) + O_2 (oxygen)) → $C_{12}H_{22}O_{11}(C_3H_6O)_n(C_2H_4O)_m$ (poly(propyleneoxy/ethyleneoxy)sucrose) + n(2 NaCl (sodium chloride) + H_2O (water))

Poly(propyleneoxy/ethyleneoxy) sucrose has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 75 percent by weight of the materials used in its production.

Poly(propyleneoxy/ethyleneoxy)diamine

CAS number: 031568–06–6

Poly(propyleneoxy/ethyleneoxy)diamine is derived from the taxable chemicals propylene, chlorine, and sodium hydroxide.

The stoichiometric material consumption formula for this substance is: $C_4H_{12}N_2O$ (aminoethylethanolamine) + n(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) → $C_4H_{12}N_2O(C_3H_6O)_n$ (poly(propyleneoxy/ethyleneoxy)diamine) + n(2 NaCl (sodium chloride) + H_2O (water))

Poly(propyleneoxy/ethyleneoxy) diamine has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 60 percent by weight of the materials used in its production.

Poly(propyleneoxy/ethyleneoxy)benzenediamine

CAS number: 067800–94–6

Poly(propyleneoxy/ethyleneoxy)benzenediamine is derived from the taxable chemicals propylene, chlorine, sodium hydroxide, and ethylene.

The stoichiometric material consumption formula for this substance is: $C_7H_{10}N_2$ (ortho–toluenediamine) + n(C_3H_6 (propylene) + Cl_2 (chlorine) + 2 NaOH (sodium hydroxide)) + m/2(2 C_2H_4 (ethylene) + O_2 (oxygen)) → $C_7H_{10}N_2(C_3H_6O)_n(C_2H_4O)_m$ (poly(propyleneoxy/ethyleneoxy)benzenediamine) + n(2 NaCl (sodium chloride) + H_2O (water))

Poly(propyleneoxy/ethyleneoxy)benzenediamine has been determined to be a taxable substance because a review of its stoichiometric material consumption formula shows that, based on the predominant method of production, taxable chemicals constitute at least 60 percent by weight of the materials used in its production.

The principal author of this notice is Ruth Hoffman, Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ruth Hoffman at (202) 622-3130 (not a toll-free number).

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26 CFR 601.201: Rulings and determination letters.
(Also, Part I, § 412.)

Rev. Proc. 2000–40

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DRAFTING INFORMATION

SECTION 1. PURPOSE AND SCOPE

.01 This revenue procedure provides approval to change the funding method used to determine the minimum funding standard for defined benefit plans as further described below. The approval under this revenue procedure is granted in accordance with § 412(c)(5) of the Internal Revenue Code and section 302(c)(5) of the Employee Retirement Income Security Act of 1974 (ERISA). Section 3 provides approval to change the funding method of the plan to one of seventeen methods, including a change in the asset valuation method to one of six asset valuation methods, a change in the valuation date to the first day of the plan year, and a change in the method for valuing ancillary benefits to the method used to value retirement benefits. Section 4 provides approvals for certain changes that become necessary or expedient under special circumstances.

.02 Any changes in funding method under this revenue procedure must satisfy the rules of Section 5 concerning the continued maintenance of certain amortization bases, the creation of an amortization base resulting from the change in method (method change base), and the amortization period for the method change base. Taxpayers, plan administrators, and enrolled actuaries are cautioned to consider the overall restrictions for use of this procedure (see section 6.01), the additional restrictions for approval of any of the changes listed in section 3 (see section 6.02), and specific restrictions described under each of the approvals. Approval for changes not provided by this revenue procedure may be requested from the Internal Revenue Service.

.03 The funding method changes approved in this revenue procedure also apply for purposes of § 404. However, calculations under the funding method for purposes of § 404 may require certain modifications to elements in the calculations. For example, for purposes of § 412, the value of assets used in the determination of the normal cost under an aggregate funding method is adjusted for any credit balance or funding deficiency in the funding standard account. The value of assets is not adjusted in that manner for purposes of § 404 but is, instead, adjusted for any undeducted contributions (see § 1.404(a)–14(d)(2) of the Income Tax Regulations).

.04 The application of a funding method must conform to all of the re-

quirements of the regulations under § 412. Thus, for example, in a method which allocates liabilities among different elements of past and future service, the allocation of liabilities must be reasonable as required under § 1.412(c)(3)–1(c)(5).

SECTION 2. BACKGROUND

.01 Section 412(c)(5)(A), as amended, and section 302(c)(5)(A) of 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)(1)–1 provides that the term "funding method", when used in § 412 of the Code, has the same meaning as the term "actuarial cost method" in section 3(31) of ERISA. Section 1.412(c)(1)–1 of the regulations further provides that the funding method of a plan includes not only the overall funding method used by the plan but also each specific method of computation used in applying the overall method. Therefore, for example, the funding method of a plan includes the date on which assets and liabilities are valued (the valuation date). The funding method also includes the definition of compensation which is used to determine the normal cost or accrued liability. Furthermore, a change in a particular aspect of a funding method does not change any other aspects of that method. For example, a change in funding method from the unit credit to the level dollar individual entry age normal method does not change the current valuation date or asset valuation method used for the plan.

.03 Section 1.412(c)(2)–1 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.

.04 Rev. Proc. 95–51, 1995–2 C.B. 431, as modified by Rev. Proc. 98–10, 1998–1 C.B. 279, and by Rev. Proc. 99–45, 1999–49 I.R.B. 603, granted approval for certain changes in funding method. Rev. Proc. 2000–41, 2000–42 I.R.B. 371, provides the procedure by which a plan administrator or plan sponsor may obtain approval of the Secretary of the Treasury for a change in funding method.

SECTION 3. APPROVAL FOR SPECIFIED CHANGES

Subject to the applicability restrictions of section 6 and to the individual conditions under each method below, approval is granted for a change to one of the following funding methods. The development of the normal cost is described for each of the funding methods provided in subsections .01, through .09. For funding methods that directly calculate an accrued liability, within the meaning of Rev. Rul. 81–13, 1981–1 C.B. 229, the development of the accrued liability is also described.

.01 Approval 1. Approval is granted for a change in funding method to the unit credit funding method described below.

(1) This approval does not apply if the plan is a cash balance plan. For this purpose, a cash balance plan is a defined benefit plan that defines any portion of an employee's benefits by reference to the employee's hypothetical account, where such hypothetical account is determined by reference to hypothetical allocations and hypothetical earnings that are designed to mimic the actual allocations of contributions and earnings to an employee's account that would occur under a defined contribution plan.

(2) Under this method, the normal cost is the sum of the individual normal costs for all active participants. An individual normal cost is the sum of the normal costs for the various benefits valued using the method. The normal cost for each benefit is the present value of the portion of the projected benefit at each expected separation date that is allocated to the current plan year as set forth in paragraphs (5) and (6) below. For purposes of this approval, separation date includes any date of benefit commencement, if earlier.

(3) The accrued liability under the method is the sum of the individual accrued liabilities for each participant. An individual's accrued liability is the sum of the accrued liabilities for the various benefits valued using the method. The accrued liability for each benefit is the present value of the portion of the projected benefit at each expected separation date that is allocated to prior plan years as set forth in paragraphs (4), (5), and (6) below.

(4) For a participant other than an active participant, or for a beneficiary, the projected benefit is the accrued retirement benefit, or other plan benefit, under the terms of the plan and the projected benefit is allocated to prior plan years.

(5) For an active participant, when valuing all benefits other than ancillary benefits that are not directly related to the accrued retirement benefit, the projected benefit related to a particular separation date is the benefit determined for the participant under the plan's benefit formula(s) calculated using the projected compensation and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date. The projected benefit at each expected separation date is allocated to the years of credited service as follows.

(a) The portion of the projected benefit allocated to the current plan year is determined as

(i) the benefit that would be determined for the participant under the plan's benefit formula(s) calculated using the projected compensation, if applicable, and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date, except taking into account only credited service through the end of the current plan year, minus

(ii) the benefit that would be determined for the participant under the plan's benefit formula(s) calculated using the projected compensation, if applicable, and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date, except taking into account only credited service through the beginning of the current plan year.

(b) The portion of the projected benefit allocated to prior plan years is the benefit determined for the participant under the plan's benefit formulas calculated using the projected compensation, if applicable, and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date, except taking into account only credited service through the beginning of the current plan year (i.e., the amount in subparagraph (a)(ii) above).

(c) Notwithstanding that the alloca-

tions in subparagraphs (a) and (b) only take into account credited service as of the beginning and end of the plan year, if a participant is expected to satisfy an eligibility requirement for a particular benefit that is being valued (e.g., subsidized early retirement benefit) as of an expected separation date, the amounts in subparagraphs (a) and (b), and in paragraph (6) below, must be determined as if the employee has satisfied the eligibility requirement.

(d) The portion of the projected benefit allocated to prior plan years may not be less than the participant's actual accrued benefit as of the beginning of the current plan year. In addition, the benefit determined as of the end of the current plan year in subparagraph (a)(i) above may not be less than the participant's estimated accrued benefit as of the end of the current plan year.

(6) For active participants, when valuing ancillary benefits that are not directly related to the accrued retirement benefit, the projected benefit related to a particular separation date is the benefit determined for the participant under the plan's benefit formula(s) calculated using the projected compensation and the projection, under respective assumptions, of any other components that would be used in the calculation of the benefit on the expected separation date. The portion of the projected benefit allocated to the current plan year is the projected benefit at the expected separation date divided by the number of years of service the participant will have at such date. The portion of such projected benefit allocated to prior years of service is the projected benefit multiplied by a fraction, the numerator of which is the number of years of service at the beginning of the plan year, and the denominator of which is the number of years of service the participant will have at the expected separation date.

(7) The unfunded liability equals the total accrued liability less the actuarial value of plan assets. All present values are determined as of the valuation date.

(8) The following examples illustrate the application of the method.

(a) Example 1. The retirement benefit under the terms of a plan is equal to 1.3% of high 1-year compensation per year of service, but not less than the top-heavy minimum of 2% of high 5-year average compensation for each year the plan is top-heavy (not exceeding 20%), as required under § 416(c). Compensation under the plan is limited to $100,000. The plan has been top-heavy only for the last 7 years. Employee E has 10 years of service at the beginning of the current plan year. E's compensation for that year is $30,000. The compensation is assumed to increase at the rate of 5% compounded yearly. The particular benefit being valued is the early retirement benefit anticipated to commence at the expected separation date 7 years in the future (i.e., after completion of 17 years of service). At this separation date, the employee will be eligible for early retirement, and will have projected compensation of $40,202, and projected high 5-year average compensation of $36,552. The allocated benefits determined for Employee E at the beginning and end of the plan year, and on the separation date, are shown in the table below.

	Determined As of the		
Allocated Benefit Determined Under Plan	Beginning of Plan Year	End of Plan Year	Separation Date
(1) 1.3% Benefit Formula	$5,226[1]	$5,749[1]	$8,885[3]
(2) Top-Heavy Formula	$5,117[2]	$5,848[2]	$7,310[3]
(3) Allocated Benefit (greater of (1) and (2))	$5,226	$5,848	$8,885

FOOTNOTES

[1]$5,226 = $40,202 x 1.3% x 10; $5,749 = $40,202 x 1.3% x 11
[2]$5,117 = $36,552 x 2.0% x 7; $5,848 = $36,552 x 2.0% x 8
[3]$8,885 = $40,202 x 1.3% x 17; $7,310 = $36,552 x 2.0% x 10

The benefit allocated to the current year is $622 ($5,848- $5,226), and the benefit allocated to prior years is $5,226. In this case, the projected benefit at the separation date is based on the 1.3% benefit formula, and the current year's benefit allocation of the projected benefit results in an amount which is based on the 1.3% benefit formula at the beginning of the year and on the top-heavy formula at the end of the year.

(b) Example 2: Plan B is an accumulation plan within the meaning of § 1.401(a)(4)–12. The benefit formula under Plan B for each plan year is 1% of compensation for such year. The sum of the amounts for each of the years constitutes an employee's benefit. The accrued benefit at any date under Plan B is the benefit payable at normal retirement age for the years of service to date. Employee F has 3 years of service at the beginning of the year. The benefit being valued is the normal retirement benefit payable at the normal retirement date (the date Employee F reaches normal retirement age). At normal retirement age, Employee F will have 20 years of service. Compensation is assumed to increase at a rate of 5% per year. Employee F's compensation was $28,665, $27,170, and $26,000 for the prior year, the second prior year, and the third prior year, respectively. For valuation purposes, Employee F's compensation for the current year is assumed to be $30,098. During the preceding plan year, Plan B was amended effective on the first day of the current plan year to provide that with respect to all prior plan years, the normal retirement benefit is updated to the greater of the benefit actually accumulated as of the beginning of the current plan year or 1% of the preceding year's compensation multiplied by the number of years of service prior to the beginning of the current plan year.

The benefit determined for Employee F, taking into account only credited service through the beginning of the current plan year under the plan's benefit formula is $860 (the greater of (a) $818 ((1% x $26,000) + (1% x $27,170) + (1% x $28,665)), or (b) $860 (1% x $28,665 x 3)). Taking the amendment into account, the projected benefit payable at normal retirement age is $8,637 ($860 + (1% x $30,098 x 25.84), where 25.84 is the accumulation of $1 payable at the end of the year for 17 years determined at 5% interest). For purposes of allocating the projected benefit, changes in compensation assumed for later plan years are not taken into account in accordance with the plan's benefit formula. The benefit allocated to the current plan year is $301 ((860 + (1% x $30,098)) - 860).

.02 Approval 2. Approval is granted for a change in funding method to the

level percent of compensation aggregate funding method described below.

(1) This approval applies only to plans which provide for compensation-related benefits.

(2) Under this method, the normal cost is calculated in the aggregate as the normal cost accrual rate multiplied by the total compensation of all active participants.

(a) The normal cost accrual rate is

(i) the total present value of future benefits of all participants and beneficiaries less adjusted assets, divided by

(ii) the total, for all active participants, of the present value of the compensation expected to be paid to each participant for each year of the participant's anticipated future service, determined as of the participant's attained age.

(b) For this purpose, the adjusted assets are equal to

(i) the actuarial value of the assets, plus

(ii) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)-(2)(D), use of the shortfall method under § 1.412(c)(1)–2, and the transition under § 1.412(c)(3)–2(d), minus

(iii) the credit balance (or plus the funding deficiency), if any, in the funding standard account.

.03 Approval 3. Approval is granted for a change in funding method to the level dollar aggregate funding method described below.

(1) Under this method, the normal cost is calculated in the aggregate as the normal cost per active participant multiplied by the number of active participants.

(a) The normal cost per active participant is

(i) the total present value of future benefits of all participants and beneficiaries, less adjusted assets, divided by

(ii) the total, for all active participants, of the present value of an annuity of $1 per year for every year of a participant's anticipated future service, determined as of the participant's attained age.

(b) For this purpose, the adjusted assets are equal to

(i) the actuarial value of the assets, plus

(ii) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)-(2)(D), use of the shortfall method under § 1.412(c)(1)–2 of the regulations, and the transition under § 1.412(c)(3)–2(d), minus

(iii) the credit balance (or plus the funding deficiency), if any, in the funding standard account.

.04 Approval 4. Approval is granted for a change in funding method to the level percent of compensation individual aggregate funding method described below.

(1) This approval applies only for plans which provide for compensation-related benefits.

(2) This approval does not apply if the actuarial value of assets is less than the present value of benefits for inactive participants and beneficiaries, or if the amount in paragraph (3)(b)(i) is less than zero.

(3) Under this method, the normal cost is the sum of the individual normal costs for each active participant.

(a) The normal cost for an active participant is

(i) the present value of future benefits for the participant, less allocated adjusted assets, divided by

(ii) the ratio of (A) the present value of the compensation expected to be paid to the participant for each year of the participant's anticipated future service, determined as of the participant's attained age, to (B) the participant's current compensation.

(b) For this purpose, allocated adjusted assets are calculated as follows:

(i) First, the adjusted value of the assets is equal to:

(A) the actuarial value of the assets, plus

(B) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412 (b)(2)(D), use of the shortfall method under § 1.412(c)(1)–2, and the transition under § 1.412(c)(3)–2(d), minus

(C) the credit balance (or plus the funding deficiency), if any, in the funding standard account, minus

(D) any liabilities retained by the plan for any inactive participant or beneficiary.

(ii) In the first year the method is used, the allocated adjusted value of the assets for an active participant is calculated by allocating the adjusted value of the assets in proportion to the present value of accrued benefits, or in proportion to the accrued liability determined under one of the immediate gain funding methods described in subsection .01 or .08.

(iii) For years subsequent to the first year in which the method is used, the adjusted value of the assets is allocated to an active participant in the proportion that

(A) the sum of the allocated adjusted assets and calculated normal cost as of the valuation date for the prior year for that active participant bears to

(B) the total of the amounts in (A) for all active participants.

.05 Approval 5. Approval is granted for a change in funding method to the level dollar individual aggregate funding method described below.

(1) This approval does not apply if the actuarial value of assets is less than the present value of benefits of inactive participants and beneficiaries, or if the amount in paragraph (2)(b)(i) is less than zero.

(2) Under this method, the normal cost is the sum of the individual normal costs for each active participant.

(a) The normal cost for an active participant is

(i) the present value of future benefits for the participant less allocated adjusted assets, divided by

(ii) the present value of an annuity of $1 per year for every year of the participant's anticipated future service, determined as of the participant's attained age.

(b) For this purpose, allocated adjusted assets are calculated as follows:

(i) First, the adjusted value of the assets is equal to:

(A) the actuarial value of the assets, plus

(B) the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)(2)(D), use of the shortfall method under § 1.412(c)(1)-2, and the transition under § 1.412(c)(3)-2(d), minus

(C) the credit balance (or plus the fund-

ing deficiency), if any, in the funding standard account, minus

(D) any liabilities retained by the plan for any inactive participant or beneficiary.

(ii) In the first year the method is used, allocated adjusted assets for an active participant is calculated by allocating the adjusted value of the assets in proportion to the present value of accrued benefits, or in proportion to the accrued liability determined under one of the immediate gain funding methods described in subsection .01 or .09.

(iii) For years subsequent to the first year in which the method is used, the adjusted value of the assets is allocated to an active participant in the proportion that

(A) the sum of the allocated adjusted assets and calculated normal cost as of the valuation date for the prior year for that active participant bears to

(B) the total of the amounts in (A) for all active participants.

.06 Approval 6. Approval is granted for a change in funding method to the level percent of compensation frozen initial liability funding method described below.

(1) This approval applies only for plans which provide for compensation-related benefits.

(2) Under this method, the normal cost is calculated in the aggregate, for every year the method is used including the first, as the normal cost accrual rate multiplied by the total compensation of all active participants.

(a) The normal cost accrual rate is

(i) the total present value of future benefits of all participants and beneficiaries less the sum of the actuarial value of assets and the unfunded liability, divided by

(ii) the total, for all active participants, of the present value of the compensation expected to be paid to each participant for each year of the participant's anticipated future service, determined as of the participant's attained age.

(b) As of the date of change, the unfunded liability is set equal to the unfunded accrued liability determined under the level percentage of compensation individual entry age normal funding method described in subsection .08.

(c) For years subsequent to the plan year of the change in method, the unfunded liability equals

(i) the unfunded liability for the prior plan year, plus the normal cost for the prior plan year (the result adjusted with appropriate interest to the valuation date), minus the actual contribution(s) for the prior plan year (adjusted with appropriate interest to the valuation date), and

(ii) the unfunded liability is further increased (or decreased) by the amount of any base established on the valuation date which results from a plan amendment or a change in assumptions. Such bases are amortized over the period(s) described in § 412(b)(2)(B) or § 412(b)(3)(B), as applicable.

.07 Approval 7. Approval is granted for a change in funding method to the level dollar frozen initial liability funding method described below.

(1) Under this method, the normal cost is calculated in the aggregate, for every year the method is used including the first, as the normal cost per active participant multiplied by the number of active participants.

(a) The normal cost per active participant is

(i) the total present value of future benefits of all participants and beneficiaries less the sum of the actuarial value of assets and the unfunded liability, divided by

(ii) the total, for all active participants, of the present value of an annuity of $1 per year for every year of a participant's anticipated future service, determined as of the participant's attained age.

(b) As of the date of change, the unfunded liability is set equal to the unfunded accrued liability determined under the level dollar individual entry age normal funding method described in subsection .09.

(c) For years subsequent to the plan year of the change in method, the unfunded liability equals

(i) the unfunded liability for the prior plan year, plus the normal cost for the prior plan year (the result adjusted with appropriate interest to the valuation date), minus the actual contribution(s) for the prior plan year (adjusted with appropriate interest to the valuation date), and

(ii) the unfunded liability is further increased (or decreased) by the amount of any base established on the valuation date which results from a plan amendment or a change in assumptions. Such bases are amortized over the period(s) described in § 412(b)(2)(B) or § 412(b)(3)(B), as applicable.

.08 Approval 8. Approval is granted for a change in funding method to the level percent of compensation individual entry age normal funding method described below.

(1) This approval does not apply if the alternative minimum funding standard account is used at any time within the 5-year period commencing with the first day of the plan year for which the change is made.

(2) This approval applies only for plans which provide for compensation-related benefits.

(3) Under this method, the normal cost is the sum of the individual normal costs for all active participants. For an active participant, the normal cost is the participant's normal cost accrual rate, multiplied by the participant's current compensation.

(a) The normal cost accrual rate equals

(i) the present value of future benefits for the participant, determined as of the participant's entry age, divided by

(ii) the present value of the compensation expected to be paid to the participant for each year of the participant's anticipated future service, determined as of the participant's entry age.

(b) In calculating the present value of future compensation, the salary scale must be applied both retrospectively and prospectively to estimate compensation in years prior to and subsequent to the valuation year based on the compensation used for the valuation.

(c) The accrued liability is the sum of the individual accrued liabilities for all participants and beneficiaries. A participant's accrued liability equals the present value, at the participant's attained age, of future benefits less, the present value at the participant's attained age of the individual normal costs payable in the future. A beneficiary's accrued liability equals the present value, at the beneficiary's attained age, of future benefits. The unfunded accrued liability equals the total accrued liability less the actuarial value of assets.

(d) Under this method, the entry age used for each active participant is the participant's age at the time he or she would have commenced participation if the plan had always been in existence under current terms, or the age as of which he or she first earns service credits for purposes of benefit accrual under the current terms

of the plan. Alternatively, the entry age may be determined as the age at the valuation date next following the time described in the preceding sentence.

.09 Approval 9. Approval is granted for a change in funding method to the level dollar individual entry age normal funding method described below.

(1) This approval does not apply if the alternative minimum funding standard account is used at any time within the 5-year period commencing with the first day of the plan year for which the change is made.

(2) Under this method, the normal cost is the sum of the individual normal costs for all active participants.

(a) For an active participant, the individual normal cost equals

(i) the present value of future benefits for the participant, determined as of the participant's entry age, divided by

(ii) the present value of an annuity of $1 per year for every year of the participant's anticipated future service, determined as of the participant's entry age.

(b) The accrued liability is the sum of the individual accrued liabilities for all participants and beneficiaries. A participant's accrued liability equals the present value, at the participant's attained age, of future benefits, less the present value at the participant's attained age of the individual normal costs payable in the future. A beneficiary's accrued liability equals the present value, at the beneficiary's attained age, of future benefits. The unfunded accrued liability equals the total accrued liability less the actuarial value of the plan assets.

(c) Under this method, entry age used for each active participant is the participant's age at the time he or she would have commenced participation if the plan had always been in existence under current terms, or the age as of which he or she first earns service credits for purposes of benefit accrual under the current terms of the plan. Alternatively, the entry age may be determined as the age at the valuation date next following the time described in the preceding sentence.

.10 Approval 10. Approval is granted for a change in asset valuation method to fair market value as defined in § 1.412(c)(2)–1(c).

.11 Approval 11. Approval is granted for a change in asset valuation method to the average value as defined in § 1.412(c)(2)–1(b)(7) (which does not have a phase-in), or to any alternative formulation that is algebraically equivalent to this average value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)–1(c).

For example, under § 1.412(c)-(2)–1(b)(7), if the averaging period is five years, the average value is based on the fair market value of assets in the current year and the adjusted values of assets for the prior four years as provided in § 1.412(c)(2)–1(b)(8). An alternative formulation which is algebraically equivalent to this method is one in which the average value of assets is equal to the fair market value on the valuation date, minus decreasing fractions (4/5, 3/5, 2/5 and 1/5, in this example) of the appreciation and depreciation of the assets in each of the four preceding years. The stated averaging period may not exceed five (5) plan years.

.12 Approval 12. Approval is granted for a change in asset valuation method to the average value (as defined in § 1.412(c)(2)–1(b)(7)), modified to use the phase-in described below, or to any alternative formulation that is algebraically equivalent to this average value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)–1(c).

In the first year this method is used, the average value is calculated as in Approval 11, except that the adjusted values for all but the most recent prior year are replaced by the adjusted value for the most recent prior year. In the second year, the average is calculated as in Approval 11, except that the values for all but the most recent two prior years are replaced by the adjusted value for the second most recent prior year. This process is continued until values for all prior years in the averaging period are phased in. The stated averaging period may not exceed five (5) plan years.

.13 Approval 13. Approval is granted for a change in the valuation date to the day that is the first day of the plan year.

.14 Approval 14. Approval is granted to change the funding method used for valuing ancillary benefits to the funding method used to value retirement benefits, if the prior method for valuing ancillary benefits had been the one-year term method. For this purpose, ancillary benefits are defined in § 1.412(c)(3)–1(f)(2) and include pre-retirement death and disability benefits.

.15 Approval 15. Approval is granted for a change in asset valuation method to the smoothed market value (without phase-in) described below, or to any alternative formulation that is algebraically equivalent to this smoothed value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c-(2)–1(c).

Under this method, the actuarial value of assets is equal to the market value of assets less a decreasing fraction (i.e., (n-1)/n, (n-2)/n, etc., where n equals the number of years in the smoothing period) of the gain or loss for each of the preceding n-1 years. The stated smoothing period may not exceed five (5) plan years.

Under this method, a gain or loss for a year is determined by calculating the difference between the expected value of the assets for the year and the market value of the assets at the valuation date. The expected value of the assets for the year is the market value of the assets at the valuation date for the prior year brought forward with interest at the valuation interest rate to the valuation date for the current year plus contributions minus disbursements (i.e., benefits and expenses), all adjusted with interest at the valuation rate to the valuation date for the current year. If the expected value is less than the market value, the difference is a gain. Conversely, if the expected value is greater than the market value, the difference is a loss.

For example, if the smoothing period is five years, the actuarial value of the assets will be the market value of the plan's assets, with gains subtracted or losses added at the rates described as follows:

(i) 4/5 of the prior year's gain or loss

(ii) 3/5 of the second preceding year's gain or loss

(iii) 2/5 of the third preceding year's gain or loss

(iv) 1/5 of the fourth preceding year's gain or loss

.16 Approval 16. Approval is granted for a change in asset valuation method to

the smoothed market value (with phase-in) described below, or to any alternative formulation that is algebraically equivalent to this smoothed value. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412(c)(2)–1(c).

In the first year this method is used the actuarial value of assets is equal to the market value as of the valuation date. In each subsequent year, the smoothed value is calculated in the same manner as in Approval 15, except that the only gains or losses recognized are those occurring in the year of the change and in later years. The stated smoothing period may not exceed five (5) plan years.

.17 Approval 17. Approval is granted for a change in asset valuation method to the average value (as defined in § 1.412-(c)(2)–1(b)(7)), modified to use the alternative phase-in as described below, or to any alternative formulation that is algebraically equivalent to this average. The asset value determined under the method will be adjusted to be no greater than 120% and no less than 80% of the fair market value defined in § 1.412-(c)(2)–1(c).

In the first year this method is used, the actuarial value of assets is equal to the market value. In the second year, the average value is calculated in the same manner as in Approval 11, except that the averaging period is two years. In the third year, the average value is calculated in the same manner as in Approval 11, except that the averaging period is three years. This process continues until the stated averaging period (not to exceed five years) is reached.

SECTION 4. SPECIAL APPROVALS

.01 Approvals to Remedy Unreasonable Allocation of Costs.

(1) If a plan uses an individual aggregate funding method and an individual normal cost becomes negative for a participant, approval is granted to re-allocate excess assets to other participants in proportion to the present value of accrued benefits, or in proportion to the accrued liability determined under the immediate gain funding method described in section 3.01, section 3.08 (only if the normal cost for a participant is determined as a level percent of compensation under the plan's method), section 3.09 (only if the normal cost for a participant is determined as a level dollar amount under the plan's method) or in proportion to the allocated adjusted assets prior to the reallocation. For this purpose, excess assets are defined as the excess, if any, of the assets currently allocated to the participant over the present value of the participant's future benefits.

(2) If a plan uses a spread gain funding method which establishes an initial unfunded liability using an immediate gain funding method (e.g., frozen initial liability or attained age normal), and the normal cost and/or unfunded liability become(s) negative, then, in the case where the normal cost under the plan's method is determined as a level percentage of compensation, approval is granted to reestablish the unfunded liability under the funding method described in section 3.01 if the unfunded liability was originally established under the unit credit method, or under the funding method described in section 3.08 if the unfunded liability was originally established under the entry age normal method. See Rev. Rul. 81–213, 1981–2 C.B. 101, regarding whether a funding method is a spread gain funding method or an immediate gain funding method. In the case where the normal cost under the plan's method is determined as a level dollar amount, approval is granted to reestablish the unfunded liability under the funding method described in section 3.01 if the unfunded liability was originally established under the unit credit method, or under the funding method described in section 3.09 if the unfunded liability was originally established under the entry age normal method. If the reestablished unfunded liability is less than zero, approval is granted to change to the aggregate funding method described in section 3.02 (if the normal cost under the plan's method is determined as a level percent of compensation), or section 3.03 (if the normal cost under the plan's method is determined as a level dollar amount).

(3) If a plan that uses a spread gain funding method which establishes an initial unfunded liability using an immediate gain funding method (e.g., frozen initial liability or attained age normal), becomes fully funded within the meaning of § 412-(c)(6) (without taking into account § 412-(c)(7)(A)(i)(I)), approval is granted to change to the aggregate funding method described in section 3.02 (if the normal cost under the plan's method is determined as a level percent of compensation), or section 3.03 (if the normal cost under the plan's method is determined as a level dollar amount).

(4) If a plan uses an individual aggregate funding method and the actuarial value of plan assets is less than the present value of benefits for inactive participants and beneficiaries, or if the actuarial value of the assets, plus the sum of the outstanding balances of the amortization bases established on account of funding waivers under § 412(b)(2)(C), switchback to the regular funding standard under § 412(b)(2)(D), use of the shortfall method under § 1.412-(c)(1)–2, and the transition under § 1.412(c)(3)–2(d), minus the credit balance (or plus the funding deficiency), if any, in the funding standard account, minus any liabilities retained by the plan for any inactive participant or beneficiary is less than zero, approval is granted to change to the aggregate funding method described in section 3.02 (if the normal cost under the plan's method is determined as a level percent of compensation), or section 3.03 (if the normal cost under the plan's method is determined as a level dollar amount).

(5) If a plan provides that no participant may accrue a benefit as of a date that is no later than the first day of the plan year, approval is granted to change to the unit credit method described in section 3.01.

.02 Approval for Change in Funding Method for Fully Funded Terminated Plans.

(1) For a plan year during which a plan is terminated, the funding method may be changed to a method described in paragraph (2) provided that the conditions set forth in paragraph (3) are satisfied. As part of the change in method, the valuation date may be changed to the date of termination or the first day of the plan year, and the asset valuation method may be changed to value plan assets at fair market value.

(2) A method is described in this subsection if the normal cost for the plan year is the present value of the benefits accruing in the plan year, and the accrued liability is the present value of the benefits accrued as of the first day of the plan year.

(3) The conditions in this subsection are satisfied if:

(a) As of the date of termination, the fair market value of the assets of the plan (exclusive of contributions receivable) is not less than the present value of all benefit liabilities (whether or not vested), and

(b) if applicable, a timely notice of intention to terminate was filed with the Pension Benefit Guaranty Corporation (PBGC).

.03 Approval for Takeover Plans.

(1) Approval is granted by this paragraph for a change in funding method where all the conditions set forth in paragraphs (2) through (4) are satisfied.

(2) There has been both a change in the enrolled actuary for the plan and a change in the business organization providing actuarial services to the plan.

(3) The method used by the new actuary is substantially the same as the method used by the prior actuary, and is consistent with the information contained in the prior actuarial valuation reports or prior Schedules B of Form 5500. Also, the method used by the new actuary must be applied to the prior year (using the assumptions of the prior actuary) and the absolute value of each resulting difference in normal cost, accrued liability (if directly computed under the method) and actuarial value of assets, that is attributable to the change in cost method, does not exceed five percent (5%) of the respective amounts calculated by the prior actuary for that year.

(4) The change in costs due to the change in method is treated in the same manner as an experience gain or loss, unless the actuarial assumptions are being changed, in which case the change in method is treated as part of the change in assumptions.

.04 Approval for Change in Valuation Software

(1) Approval is granted for a change in method that results from a change in valuation software where all the conditions set forth in paragraphs (2) through (8) are satisfied. Note that certain changes in valuation software may not constitute changes in funding method. For example, the update of the valuation software to incorporate the actual social security taxable wage base for the current year is not a change in funding method. Also, if all of the results of each specific computation are the same after the change in valuation software, there is no change in funding method.

(2) There has been a modification to the computations in the valuation software or a different valuation software system has been used. Examples of modifications to the computations in the valuation software include a change from commutation functions to direct calculation of actuarial values, changes in the rounding conventions or changes to correct errors or inefficiencies in the computations. Examples of using a different valuation software system include a change in the spreadsheet software (e.g., Lotus 1-2-3 to Excel) or a change in the actuarial software vendor.

(3) The underlying method is unchanged and is consistent with the information contained in the prior actuarial valuation reports and prior Schedules B of Form 5500.

(4) The modification to the computations in the valuation software or the use of a different valuation software system is designed to produce results that are no less accurate than the results produced prior to the modification or change.

(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 account determined using the old software (all other factors being held constant) by more than two percent (2%).

(6) A change in valuation software requiring approval was not made for the prior plan year.

(7) Section 4.04 (Approval for Takeover Plans) of this revenue procedure is not applicable to the change.

(8) The effect of the change in method is treated in the same manner as an experience gain or loss, unless the actuarial assumptions are being changed, in which case the effect of the change in method is treated as part of the effect of the change in assumptions.

.05 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 8 1/2 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 deficiencies with respect to the smaller plan are disregarded for purposes of applying § 412 and § 4971 with respect to the larger plan.

.06 Approval for Certain Mergers With Same Plan Year And Merger Date of First or Last Day of Plan Year

(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)–1(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 changes (i.e., changes in funding method, actuarial assumptions, or plan benefits). 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 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.

.07 Approval for Certain Mergers With Transition Period No More Than 12 Months

(1) Approval is granted for a change in method that results from a merger of one plan with another plan where all the conditions set forth in paragraphs (2) through (7) are satisfied, and the procedures set forth in paragraphs (8) through (15) are followed.

(2) The merger is not a *de minimis* merger within the meaning of § 1.414-(l)–1(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) Each of the plans, prior to the merger, had a valuation date that was the first day of the plan year.

(5) The plans do not have the same plan year, or, if both plans have the same plan

year, the date of the merger is not the first day or the last day of the plan year.

(6) The period from the first day of the plan year of the plan that is not the ongoing plan to the end of the plan year of the ongoing plan (as defined in section 4.06(9) above) in which the merger takes place (the "transition period") does not exceed 12 months.

(7) The ongoing plan does not have a funding deficiency for the prior plan year, and the plan that is not the ongoing plan does not have a funding deficiency for the short plan year described in (8) below.

(8) For the period from the beginning of the plan year of the plan that is not the ongoing plan to the date of the merger (the "short plan year"), the charges and credits to the funding standard account for such plan are determined without regard to the merger. For the short plan year, the charges and credits to the funding standard account for that plan are ratably adjusted using the principles of Rev. Rul. 79–237 in the same manner as if the date of the merger was the date of plan termination of that plan, and a Schedule B of Form 5500 is filed for the short plan year. Any contributions made for that plan after the date of the merger, but not later than 8 1/2 months after the date of the merger, are credited to the funding standard account of that plan for the short plan year.

(9) Charges and credits attributable to the plan that is not the ongoing plan for the period, if any, from the date of the merger to the end of the plan year of the ongoing plan (the "interim period") are determined without regard to the merger as set forth in this paragraph. Accordingly, the charges and credits are determined based upon the funding method, actuarial assumptions, and valuation results used for purposes of paragraph (8) above, and are ratably adjusted to reflect the length of the interim period. Such charges and credits should include interest to reflect the period from the valuation date (of the plan that is not the ongoing plan) to the date of the merger, as well as interest for the interim period. The credit balance, if any, at the end of the short plan year described in paragraph (8) above is carried forward to the beginning of the interim period.

(10) Unless the date of the merger is the first day of the plan year of the ongoing plan, the funding standard account for the ongoing plan for the plan year in which the merger occurs is determined in steps. In the first step the funding standard account for the ongoing plan is determined without regard to the merger. In the second step, charges and credits attributable to the plan that is not the ongoing plan are determined for the interim period as described in paragraph (9) above. In the third step the charges and credits from the first two steps are combined in a manner similar to the treatment for separate plans under § 413(c)(4)(A) except that the credit balance or funding deficiency for each plan at the end of the year are combined to determine an overall credit balance or funding deficiency. Schedule B of Form 5500 is filed for the ongoing plan for the plan year in which the merger occurred with the combined entries to the funding standard account as described above. The other entries on the Schedule B (e.g. lines dealing with accrued liability) should be those for the ongoing plan without regard to the merger.

(11) For the plan year of the ongoing plan following the plan year in which the merger occurs the funding method for the ongoing plan is determined in accordance with the rules set forth in paragraphs (11), (12), and (13). 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. 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. The funding method used for the plan which is not the ongoing plan is disregarded.

(12) An experience gain or loss is determined separately for each of the two plans, for the period prior to the valuation date for the plan year following the plan year in which the merger occurred, without regard to the merger and any associated changes (i.e., changes in funding method, actuarial assumptions, or plan benefits). 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.

(13) All amortization bases that were maintained for the two plans continue to be maintained for the ongoing plan to the extent they would be maintained under the funding method used for the ongoing plan. 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 (12)). In the case of 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 for whether a funding method directly calculates an accrued liability.

(14) The deductible limit under § 404 for the plan that is not the ongoing plan for the short plan year is determined, without regard to the merger, following the procedures set forth in section 5 of Rev. Proc. 87–27. The deductible limit under § 404 for the plan that is the ongoing plan is determined for the plan year in which the merger occurs as the sum of the limit determined for the plan without regard to the merger plus the limit determined with respect to the plan that is not the ongoing plan for the interim period described in paragraph (9) above.

(15) If the date of the merger is the first day of the plan year of the ongoing plan, the minimum funding standard and the deductible limit under § 404 are determined under this paragraph (15). The minimum funding standard and deductible limit under § 404 are determined for the short plan year as described in paragraphs (8) and (14) above as if the merger occurred on the last day of the preceding plan year of the ongoing plan.

However, as there is no interim period, the calculations described in paragraphs (9) and (10) are not made. Instead, the minimum funding standard and deductible limit under § 404 for the plan year of the merger will fully reflect the merger in the manner described in paragraphs (11), (12), and (13).

(16) The following example illustrates the application of this subsection.

(a) Plan A has a plan year that begins on October 1 and ends on the following September 30. The valuation date for Plan A is October 1, the first day of the plan year.

(b) Plan B has a plan year that begins on July 1 and ends on the following June 30. The valuation date for Plan B is July 1, the first day of the plan year.

(c) Plan A is merged into Plan B on April 1, 2001.

(d) An actuarial valuation was made with respect to Plan A as of October 1, 2000, for the plan year commencing October 1, 2000, using the entry age normal method as described in section 3.09 with the actuarial value of the assets determined using the smoothing method described in section 3.15. The valuation interest rate for Plan A is 6 percent. The relevant valuation results are as follows: the normal cost equals $5,000; the unfunded accrued liability equals $50,000; the credit balance from the prior year equals $10,000; the amortization charges equals $6,938; and the outstanding balance of amortization bases equal $60,000. Plan A has no unfunded current liability. No contribution was made to Plan A for the short plan year from October 1, 2000, through April 1, 2001.

(e) An actuarial valuation was made with respect to Plan B as of July 1, 2000, for the plan year commencing July 1, 2000, using the entry age normal method as described in section 3.08 with the actuarial value of the assets determined as the fair market value of the assets. The valuation interest rate for Plan B is 8 percent. The relevant valuation results are as follows: the normal cost equals $8,000; the unfunded accrued liability equals $101,000; the credit balance from the prior year equals $19,000; the amortization charges equal $11,428; and the outstanding balance of amortization bases equals $120,000. Plan B has no unfunded current liability.

(f) For Plan A, the period from October 1, 2000, to April 1, 2001, is treated as a short plan year for purposes of § 412. The charges and credits to the funding standard are determined based upon the October 1, 2000, actuarial valuation without regard to the merger and are ratably adjusted to reflect the short plan year from October 1, 2000, to April 1, 2001. A Schedule B of Form 5500 is filed for the short plan year with the relevant entries for the funding standard account reported as follows: the normal cost is $2,500 (1/2 times $5,000), the amortization charge is $3,469 (1/2 times $6,938), and the interest on the normal cost and amortization charge is $176 (for the period from October 1, 2000, through April 1, 2001). Thus, the total charges are $6,145. The credits to the funding standard account that are reported on the Schedule B are $10,295 representing the prior year credit balance of $10,000 plus $295 interest for the short plan year. As a result, a credit balance of $4,150 ($10,295 less $6,145) is reported on the Schedule B as of April 1, 2001.

(g) For Plan B, the minimum funding standard for the plan year beginning July 1, 2000, is determined in steps as described in paragraph (10) above.

First, the minimum funding standard is determined for Plan B without regard to the merger using the July 1, 2000, actuarial valuation. Thus, the normal cost would be $8,000, the amortization charge would be $11,428, and interest on these amounts (using the 8 percent interest rate) would be $1,554, and the total charges would be $20,982. The credits (without regard to employer contributions) would be the credit balance of $19,000 plus interest (at 8 percent) of $1,520 for total credits of $20,520. Accordingly, Plan B would have a funding deficiency of $462 ($20,982 minus $20,520) if there were no employer contributions and the merger was disregarded.

Second, charges and credits attributable to Plan A are determined for the interim period (from April 1, 2001 (the date of the merger) to June 30, 2001 (the end of the plan year of the ongoing plan in which the merger occurs)). The charges consist of a normal cost of $1,287 (3/12 of $5,000 adjusted for one half years interest at 6 percent), an amortization charge of $1,786 (3/12 of $6,938 adjusted for one half years interest at 6 percent), plus interest of $45 (for the interim period at 6 percent) for total charges of $3,118. The credits (without regard to employer contributions) consist of the credit balance of $4,150 (from the Schedule B for the short plan year from October 1, 2000, to April 1, 2001) plus interest (at 6 percent for the interim period) of $61 for total credits of $4,211. Accordingly, for the interim period from April 1, 2001, to June 30, 2001, the charges and credits attributable to Plan A would result in a credit balance of $1,093 (the excess of $4,211 over $3,118) if there were no employer contribution and the merger was disregarded.

Third, the charges and credits for the first two steps are combined except that the credit balance or funding deficiency that were separately determined at the end of the year are combined to determine an overall credit balance or funding deficiency. Thus, the charges reported on the 2000 Schedule B for Plan B would consist of a normal cost of $9,287 ($8,000 plus $1,287), an amortization charge of $13,214 ($11,428 plus $1,786), interest charge of $1,599, and total charges of $24,100 ($20,982 plus $3,118). The credits reported on the 2000 Schedule B for Plan B would consist of a prior year credit balance of $23,150 ($19,000 plus $4,150), interest credits of $1,581 ($1,520 plus $61), and total credits of $24,731 ($20,520 plus $4,211). The credit balance reported on the 2000 Schedule B as of June 30, 2001, would be $631 ($1,093 minus $462).

(h) With the July 1, 2001, actuarial valuation for Plan B, the funding method for the plan as merged is the entry age normal method with the actuarial value of the assets determined using a method described in section 3. An amortization base is established pursuant to section 5 to reflect the change in funding method.

.08 Approval for Other Mergers With Transition Period More Than 12 Months

(1) Approval is granted for a change in method that is otherwise described in section 4.07 (except that the transition period described in section 4.07(6) exceeds 12 months) if the procedures set forth in paragraphs (2) through (6) are followed. If, however, the date of the merger is the first day of the plan year of the ongoing plan, the merger is treated as occurring on the day before the first day of the plan year of the ongoing plan. In such a case, the length of the transition period would be less than 12 months, and the rules of section 4.07 apply.

(2) For the period from the beginning of the plan year of the plan that is not the ongoing plan to the date of the merger (the "short plan year"), the charges and credits to the funding standard account for that plan are determined without regard to the merger. For the short plan year, the charges and credits to the funding standard account for that plan are ratably adjusted using the principles of Rev. Rul. 79–237 in the same manner as if the date of the merger was the date of plan termination of that plan, a Schedule B of Form 5500 is filed for that plan for the short plan year. Any contributions made for that plan after the date of the merger, but not later than 8 1/2 months after the date of the merger, are credited to the funding standard account of that plan for the short plan year.

(3) Charges and credits attributable to the plan that is not the ongoing plan for the period from the date of the merger to the end of the plan year of the plan that is the ongoing plan (the "interim period") are determined without regard to the merger as set forth in this paragraph (3). Accordingly, the charges and credits are determined based upon the funding method, actuarial assumptions, and valuation results used for purposes of paragraph (2) above.

(a) For the period from the date of the merger to the date that would have been the end of the plan year of the plan that is not the ongoing plan had there been no merger (the "first partial period"), the charges and credits to the funding standard account are determined by ratably adjusting the charges and credits determined under paragraph (2) above to reflect the length of the first partial period. Such charges and credits should include interest to reflect the period from the valuation date (of the plan that is not the on-

going plan) to the date of the merger, as well as interest for the interim period. The credit balance at the end of the short plan year described in paragraph (2) above is carried forward to the beginning of the first partial period.

(b) For the period from the date that would have been the end of the plan year of the plan that is not the ongoing plan had there been no merger to the end of the plan year of the ongoing plan in which the merger occurs (the "second partial period"), the charges and credits to the funding standard account are determined based upon the expected normal cost amortization charge, and amortization credit from the valuation used for purposes of paragraph (2) above, and are ratably adjusted to reflect the length of the second partial period. Such charges and credits should include interest for the second partial period. In addition, if the funding method used for the plan that is not the ongoing plan is a funding method that directly calculates an accrued liability within the meaning of Rev. Rul. 81–13, an amortization base is developed to reflect the gain or loss with respect to assets for the short plan year by comparing the expected and actual value of the assets. For this purpose, the expected value of the assets is computed as the market value of the assets determined for purposes of paragraph (2), plus contributions made for the short plan year described in paragraph (2), minus disbursements (i.e., benefit payments and expenses determined on either an actual or expected basis), with all items adjusted for expected interest at the valuation rate for the period to the date of the merger. The actual value of the assets is set to the market value of the assets of the plan that is not the ongoing plan (that become part of the assets of the ongoing plan) on the date of the merger. The amortization charge or credit (whichever is the case) is determined for such base and is ratably adjusted to reflect the length of the interim period.

(4) The funding standard account for the ongoing plan for the plan year in which the merger occurs is determined in steps. In the first step the funding standard account for the ongoing plan is determined without regard to the merger. In the second step, the funding standard account for the plan that is not the ongoing plan is determined for the interim period by adding together the charges and credits for the first and second partial periods described in paragraph (3) above. In the third step the charges and credits from the first two steps are combined in a manner similar to the treatment for separate plans under § 413(c)(4)(A) except that the credit balance or funding deficiency for each plan at the end of the year are combined to determine an overall credit balance or funding deficiency. Schedule B of Form 5500 is filed for the ongoing plan for the plan year in which the merger occurred with the combined entries to the funding standard account as described above. The other entries on the Schedule B (e.g., lines dealing with accrued liability) should be those for the ongoing plan without regard to the merger.

(5) For the plan year following the plan year in which the merger occurs the funding method for the ongoing plan is determined in accordance with the rules in paragraphs (11), (12), and (13) of section 4.07.

(6) The deductible limit under § 404 for the plan that is not the ongoing plan for the short plan year is determined, without regard to the merger, following the procedures set forth in section 5 of Rev. Proc. 87–27. The deductible limit under § 404 for the plan that is the ongoing plan is determined for the plan year in which the merger occurs as the sum of the limit determined for the plan without regard to the merger plus the limit determined with respect to the plan that is not the ongoing plan for the interim period.

(7) The following example illustrates the application of this subsection. The facts are the same as in the example in section 4.07(16) except that the plan year of Plan B is the calendar year and the valuation date is January 1, 2001. Additional facts are that the market value of the assets of Plan A as of the valuation date of October 1, 2000, is $800,000, the market value of the assets of Plan A at the date of the merger is $820,000, and there are no disbursements expected from Plan A during this period.

(a) For Plan A, for the period from October 1, 2000, through April 1, 2001, is treated as a short plan year. The funding standard account for this period is determined as shown in section 4.07(16)(f). Thus, there is a credit balance of $4,150 as of the end of the short period.

(b) For Plan B, the minimum funding standard for the plan year beginning January 1, 2001, is determined in steps as described in paragraph (4) above.

First, the minimum funding standard is determined is determined for Plan B without regard to the merger using the January 1, 2001, actuarial valuation. Thus, the normal cost would be $8,000, the amortization charge would be $11,428, the interest on these amounts (using the 8 percent interest rate) would be $1,554, and the total charges would be $20,982. The credits (without regard to employer contributions) would be the credit balance of $19,000 plus interest (at 8 percent) of $1,520 for total credits of $20,520. Accordingly, Plan B would have a funding deficiency of $462 ($20,982 minus $20,520) if there were no employer contributions and the merger was disregarded.

Second, charges and credits are determined for Plan A for the interim period (from April 1, 2001 (the date of the merger) to December 31, 2001 (the end of the plan year of the ongoing plan in which the merger occurs)) by adding together the charges and credits for the first and second partial periods. For the first partial period, the charges consist of a normal cost of $2,574 (6/12 of $5,000 adjusted for one half years interest at 6 percent), an amortization charges of $3,572 (6/12 of $6,938, with one half years interest at 6 percent) plus interest of $275 (for the period from April 1, 2001, to December 31, 2001). The credits consist of the credit balance of $4,150 (from the Schedule B for the short plan year from October 1, 2000, to April 1, 2001) plus interest (at 6 percent for the period from April 1, 2001, to December 31, 2001) of $185 for total credits of $4,336. For the second partial period, the charges consist of a normal cost of $1,250 (3/12 of $5,000), amortization charges of $2,348 (3/12 of $6,938 plus 9/12 of $818) plus interest of $71 (which includes interest on 9/12 of $818 for the period from April 1, 2001, to December 31, 2001). As part of this calculation, an amortization base of $3,650 is established to represent the asset loss from October 1, 2000, to April 1, 2001 (determined as expected assets of $823,650 less actual assets of $820,000). The amortization charge for this base is $818. There are no amortization credits for the second partial period.

Third, the charges and credits for the first two steps are combined except that the credit balance or funding deficiency for each plan at the end of the year are combined to produce an overall credit balance or funding deficiency. Thus, the charges reported on the 2001 Schedule B for Plan B would consist of a normal cost of $11,824 ($8,000 plus $2,574 plus $1,250), amortization charges of $17,347 ($11,428 plus $3,572 plus $2,347), interest of $1,900 ($1,554 plus $275 plus $71) for total charges of $31,071. The credits reported on the 2001 Schedule B (without regard to employer contributions) would be a prior year credit balance of $23,150 ($19,000 plus $4,150), interest credits of $1,705 ($1,520 plus $185), and total credits of $24,856 . The funding deficiency reported on the 2001 Schedule B as of December 31, 2001, would be $6,216 ($462 plus $5,753) if there were no employer contributions for the plan year.

SECTION 5. GENERAL RULES RELATING TO FUNDING METHODS

Approval for a change to any method in this revenue procedure does not apply un-

less the provisions of sections .01 through .03 are satisfied.

.01 Amortization Bases.

(1) Continued Maintenance of Waiver, Shortfall, Five-Year Alternative Switchback, and Transition Bases. In the case of a plan which, prior to a change in funding method, has a funding waiver base described in § 412(b)(2)(C), a base due to a switchback to the regular funding standard account described in § 412(b)(2)(D), a shortfall base described in § 1.412 (c)(1)–2(g), or a transition base described in § 1.412(c)(3)–2(d), the current funding method, regardless of any other characteristics, must maintain such base(s) as if the funding method had not changed and must charge, or credit, the funding standard account with the amortization charge(s), or credit(s), for such base(s) after the change in funding method.

(2) Creation of a Funding Method Change Base. Except in the case of a change to a funding method described in section 3.02, section 3.03, section 3.04, or section 3.05, all existing bases shall be maintained and an amortization base shall be established equal to the difference between the unfunded accrued liability under the new method and an amount equal to (A) the net sum of the outstanding balances of all amortization bases (including, when the preceding method was an immediate gain method, the gain or loss base for the immediately preceding period), treating credit bases as negative bases, less (B) the credit balance (or plus the funding deficiency), if any, in the funding standard account, less (C) the sum of (i) any existing accumulation of additional funding charges for prior plan years due to § 412(l), (ii) any existing accumulation of additional interest charges due to late or unpaid quarterly installments for prior plan years and (iii) any existing accumulation of additional interest charges due to the amortization of prior funding waivers (which sum can be found on the Schedule B, for example, in 1997 on Line 9q(4)), all adjusted for interest at the valuation rate to the valuation date in the plan year for which the change is made. If this difference is a positive or negative number, the resulting base will be a charge base or a credit base, respectively. In the case of a change to a funding method described in section 3.02, section 3.03, section 3.04, or section 3.05, (a) the bases described in paragraph (1) must be maintained, and (b) all amortization bases other than those described in paragraph (1) shall be considered fully amortized.

(3) Amortization Period. For any charge or credit base established pursuant to the requirements of paragraph (2), the amortization period is 10 years.

(4) No base is established due solely to a change in valuation date.

.02 Although compensation must be limited in accordance with § 401(a)(17) in determining benefits to be valued, it may or may not be so limited in determining the present value of future compensation expected to be paid to the participant for each year of the participant's anticipated future service. However, the alternative used is part of the method and any change in such practice is a change in funding method.

.03 Whenever, under the funding method, the normal cost is calculated as a level percentage of compensation, then an individual's compensation is included in the amount of current year's compensation to which the normal cost percentage is applied if and only if the compensation for that individual is included in the present value of future compensation over which normal costs are spread. Similarly, whenever the normal cost is calculated as a level dollar amount, then an individual is included in the determination of the number of individuals by which the normal cost per participant is multiplied if and only if that individual is included for purposes of determining the present value of an annuity of $1 for years of anticipated service over which normal costs are spread.

SECTION 6. RESTRICTIONS UNDER REVENUE PROCEDURE

.01 General Restrictions.

(1) This revenue procedure does not apply to a change in funding method for a plan year if either (a) a Schedule B of Form 5500 has been filed for such plan year using some other funding method or (b) the due date (including extensions) for such Schedule B has passed.

(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 section 4, other than the approval described in section 4.02 (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.

(3) This revenue procedure does not apply if, for the plan year of the change, a minimum funding waiver under § 412(d) has been requested for the plan or is being amortized, or if an extension of an amortization period under § 412(e) has been requested or is currently applicable for computing minimum funding requirements, for the plan.

(4) This revenue procedure does not apply if the plan is under an Employee Plans examination for any plan year, or if the plan sponsor, or a representative, has received verbal or written notification from the Tax Exempt and Government Entities Division of an impending Employee Plans examination, or of an impending referral from another part of the Service for an Employee Plans examination, or if the plan has been under such an examination and is in Appeals or in litigation for issues raised in an Employee Plans examination.

(5) Except as provided in section 4.02, this revenue procedure does not apply to a change which is made for a plan year in which the plan is terminated.

(6) Non-Applicability if Shortfall Method is Discontinued. If the current method makes use of the shortfall method, approval to change to another funding method under this revenue procedure will apply only if the new funding method continues to make use of the shortfall method. For example, approval is not granted to change from the entry age normal method (which uses the shortfall method) to the unit credit method under section 3.01 unless the unit credit method makes use of the shortfall method.

.02 Additional Restrictions For Approvals in Section 3.

(1) Non-Applicability for Reversion Cases. This revenue procedure does not apply to changes in funding method required by Treasury Release R-2697 dated May 24, 1984, concerning the reversion of assets from a terminated plan. Furthermore, approval under section 3 does not apply if, in the 15 years preceding the date of change, such plan was involved in a transaction described in such Treasury Release subsequent to May 24, 1984.

(2) Non-Applicability for Plans Using Universal Life Insurance Products. Approval to change to a method described in section 3 does not apply in the case of a plan for which some of the assets are provided through universal life insurance policies unless, under the funding method adopted, (a) all plan benefits including those provided by the universal life insurance policies are considered liabilities in calculating costs and are funded using the same method as used for retirement costs, and (b) the cash value as of the valuation date of such contracts is treated the same as all other assets of the plan in calculating costs. However, the requirements of (a) above will not fail to be satisfied merely because ancillary benefits, within the meaning of § 1.412(c)(3)–1(f)(2) of the regulations, are funded on a reasonable one-year term funding method.

(3) Four-Year Limitation on Changes. Approval to change to a method described in section 3 does not apply to any of the following changes:

(a) the asset valuation method is being changed and the asset valuation method was changed in any of the four (4) preceding plan years,

(b) the valuation date is being changed and the valuation date was changed in any of the four (4) preceding plan years, or

(c) The funding method is being changed in a way not described in (a) or (b), and a funding method change (other than a change for which approval is provided by section 4 of this revenue procedure, or a change described in (a) or (b)) was made in any of the four (4) preceding plan years.

(4) Non-Applicability when Liabilities are Adjusted for Assets. Approval to change to a method described in section 3 does not apply to a change in funding method under which the liabilities are adjusted to reflect the performance or expected performance of the assets.

(5) Non-Applicability if Benefit Accruals are Frozen Under the Plan. Approval to change to any method described in sections 3.02 through 3.09, does not apply if a plan provides that no participant may accrue a benefit as of a date that is no later than the first day of the plan year. In such a case, approval to change to the method described in section 3.01 applies only as described in section 4.01(5).

(6) Non-Applicability if Negative Normal Cost or Negative Unfunded Liability Results From the Change. 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.

(7) Non-Applicability if Change in Method is Being Made Pursuant to a Spin-off or Merger. 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 section 4.05, section 4.06, section 4.07, or section 4.08.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for plan years commencing on or after January 1, 2000.

SECTION 8. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 95–51, as clarified and modified by Rev. Proc. 98–10 and Rev. Proc. 99–45, is superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is James E. Holland, Jr. of the Tax Exempt and Government Entities 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 Friday. Mr. Holland's number is (202) 622-6730 (also not a toll free number).

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26 CFR 601.201: Rulings and determination letters.

(Also Part I, § 412.)

Rev. Proc. 2000–41

Section 1. Purpose

The purpose of this revenue procedure is to set forth the procedure by which a plan administrator or plan sponsor may obtain approval of the Secretary of the Treasury for a change in funding method as provided by § 412(c)(5)(A) of the Internal Revenue Code, as amended (the "Code"), and § 302(c)(5)(A) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

Section 2. Background

.01 Section 3(31) of ERISA lists some acceptable actuarial cost methods.

.02 Section 412(c)(5)(A) of the Code and § 302(c)(5)(A) of ERISA 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.

.03 Rev. Proc. 78–37, 1978–2 C.B. 540, provides the procedure by which a plan administrator or plan sponsor may obtain approval of the Secretary of the Treasury for a change in funding method.

.04 Rev. Proc. 2000–40, 2000–42 I.R.B. 357, provides approval to change the funding method used to determine the minimum funding requirement for defined benefit plans to any one of the methods described therein.

.05 Rev. Proc. 2000–4, 2000–1 I.R.B. 115, sets forth the current general procedures of the Service relating to the issuance of rulings, determination letters, and opinion letters on employee plans and exempt organization matters. These general procedures are updated annually. Sections 9.02(11) and (12) of Rev. Proc. 2000–4 set forth the requirements for designating an authorized representative.

.06 Rev. Proc. 2000–8, 2000–1 I.R.B. 230, sets forth the current procedures re-

lating to the payment of user fees for requests to the Service for rulings, opinion letters, determination letters, and similar requests. The user fee procedures are updated annually.

Section 3. Scope and Definition

.01 This revenue procedure applies to any defined benefit plan that is subject to § 412 of the Code or § 302 of ERISA.

.02 Any change in a plan's current method of computing the minimum funding requirement under § 412 of the Code or § 302 of ERISA is a change in funding method (see § 1.412(c)(1)–1(b) of the Income Tax Regulations). The following are examples of a change in funding method:

Example 1 – The minimum funding requirement is computed using the entry age normal method. Changing the method to the unit credit method is a change in funding method.

Example 2 – The minimum funding requirement is computed using the aggregate method under which the normal cost is level as a percentage of compensation. Changing the method to the aggregate method under which the normal cost is level as a dollar amount is a change in funding method.

Example 3 – The method of valuing liabilities is unchanged, but the method of valuing assets is changed from one method to another method. This is a change in funding method.

Example 4 – The valuation date for the plan is the date that is the first day of the plan year. Changing the valuation date to the date that is the last day of the plan year is a change in funding method.

Example 5 – The valuation date for the plan is the date that is the first day of the plan year. The plan year is changed, and the valuation date is changed to the date that is the first day of the new plan year. This is a change in funding method.

Example 6 – The plan's enrolled actuary uses Vendor A's software to determine the plan's minimum funding requirement. If the enrolled actuary changes to Vendor B's software and the results of each specific computation are not the same after the change in valuation software, this is a change in funding method.

Example 7 – The method for determining the cost of ancillary benefits is changed from one method to another method. This is a change in funding method.

.03 This revenue procedure applies to any change in funding method for any plan year after the first plan year in which a plan is subject to § 412 of the Code or § 302 of ERISA. A funding method adopted for a newly established plan is not a change in funding method. A plan established as a result of a spin-off within the meaning of § 1.414(l)–1(b)(4), other than a plan established as a result of a de minimis spin-off, is not a newly established plan for this purpose.

.04 Approval will be given to a change in funding method only if the proposed method is acceptable and the transition to the proposed method is acceptable. In addition, a change in funding method that has a significant effect on a plan's minimum funding requirement or full funding limitation in the year of change may be reviewed to assess the appropriateness of the change in light of that effect.

Section 4. Application

.01 A plan administrator, plan sponsor, or the authorized representative of either who desires to obtain approval for a change in funding method should make a written request (no form is prescribed for requesting approval) to:

Internal Revenue Service
Commissioner, TE/GE
Attention: T:EP:RA
P.O. Box 27063, McPherson Station
Washington, DC 20038

.02 (1) The request should be made no later than the close of the plan year for which the change is to be effective. However, requests made after the close of the plan year, but no later than 2 1/2 months after the close of the plan year, will generally be considered, at the discretion of the Service, if a statement is attached to the request detailing an adequate reason for the delay. Requests made after 2 1/2 months after the close of the plan year generally will not be considered. However, if a request for approval of a change in funding method involves a plan merger, the request should be made no later than 4 months before the filing deadline for Schedule B (Actuarial Information) of Form 5500 (of the merged plan) for the plan year in which the merger took place.

(2) If a change to an element of a funding method was recently approved and a subsequent modification of the same element is requested, the subsequent modification generally will not be considered. For example, if a plan was using a 5-year smoothing asset valuation method prior to 1999 and the plan sponsor received approval to set the actuarial value of assets at market value for 1999 (with a phase-in of gains and/or losses in subsequent years), a request in 2001 to set the actuarial value of assets to market value for 2001 (with a phase-in of gains and/or losses in subsequent years) will not be considered.

.03 The request must satisfy all the requirements of Rev. Proc. 2000–4. Attention is called to section 9 of Rev. Proc. 2000–4 concerning signatures, authorized representatives, a power of attorney and declaration of representative, and a penalties of perjury statement. However, a statement of proposed deletions pursuant to § 6110(c) of the Code is not required to be furnished. All signatures should be accompanied by the typed name and title (if applicable) of the signer.

.04 The following information shall accompany the request:

(1) The employer identification number, the plan name and number, and the name and address of the plan administrator or plan sponsor.

(2) A copy of the actuarial valuation report for the plan year preceding the year of change, and, if available, a draft of the actuarial valuation report for the year of change. For requests involving mergers, a copy of each of the valuation reports for all the merging plans for the plan year preceding the change and, if available, a draft of the actuarial valuation report for the year of change, should be included.

(3) A copy of the Schedule B (Actuarial Information) of Form 5500, including attachments thereto, that has been filed for the plan year preceding the year of change. For requests involving mergers, a copy of the most recent Schedule B that has been filed for a plan year preceding the year of change should be included for each of the merging plans.

(4) A statement of the plan year first affected by the proposed change.

(5) A description of the current funding method and the proposed funding method. The method can be described by reference to a method contained in Rev. Proc. 2000–40. For example, the level percent of compensation individual entry age normal method may be described by reference to section 3.08 of Rev. Proc. 2000–40. The method can also be described by indicating a

particular variation of a method described in Rev. Proc. 2000–40. The description of a method should be such that it would allow two independent actuaries to arrive at the same valuation results using the same method and assumptions for a given plan. If applicable, the description should indicate whether the method involves the use of a certain rule in the first year of the change and a different rule in subsequent years. For example, an asset valuation method change may restart at market value in the year of change, and may phase-in gains and losses in subsequent years. Additionally, if the method is an asset valuation method not described in Rev. Proc. 2000–40, a numerical illustration demonstrating the calculation of the actuarial value of assets under the current method and the proposed method should be included. If the change in funding method involves a plan merger, a description of the funding method that was used by each of the merging plans before the merger and the proposed funding method that is used by the merged plan should be included.

(6) A brief statement of the reason for the proposed change and a statement why automatic approval under Rev. Proc. 2000–40 cannot be used to make the change.

(7) A statement of whether a change in funding method was previously requested.

(8) A statement of other changes being made for the year of change, such as a change in plan year or change in actuarial assumptions.

(9) Technical Information

(A) A worksheet should be prepared by the enrolled actuary for the plan. The worksheet should contain the information described below determined as of the valuation date in the year of the change in funding method. The information below should be shown (1) prior to any change in plan provisions, assumptions, or funding methods that apply in the year of change, and (2) after the change in funding method and other changes that occur in the year of change:

(i) A list of the amortization bases maintained (including, for each base, the type of base, outstanding balance, amortization period, and amortization amount). Note that the bases maintained prior to and after implementing all current year changes will differ by the inclusion of the new base(s). The calculation of the new base(s) should also be shown.

If bases are combined and offset in the year of change, in addition to the resulting single base, show information on each of the bases involved.

(ii) The unfunded liability of the plan. For immediate gain methods, show the actuarial value of assets prior to any adjustments.

(iii) The basic funding formula (or equation of balance). If the equation of balance is not satisfied, explain the effect on the operation of the funding method in the year of change.

In the case of a plan change involving a merger, the above information should be provided for all merging plans as of the date of the merger. If the plan change involves a spin-off, the above information should be provided for the original plan immediately prior to the spin-off date and for the plans immediately after the spin-off date.

(B) The calculation of the § 412 full funding limitation for the plan year prior to the plan year of change, and for the plan year of change. In the case of a plan merger, the calculation of the § 412 full funding limitation should be given for all merging plans immediately prior to the merger and for the merged plan after the merger.

(10) A statement of whether a waiver of the minimum funding standard is currently in effect and whether a request for a waiver is currently pending or is expected to be submitted in the near future.

A checklist has been provided in Appendix A for the convenience of the taxpayer submitting the request. In certain cases some of the material described above may be inappropriate or burdensome to furnish. In such cases, the request for approval should include a statement indicating why such material is not being furnished.

.05 The Service may request additional information as needed.

.06 If a conference has been requested, a conference will be granted only in accordance with section 12 of Rev. Proc. 2000–4. Furthermore, if the Service proposes an adverse holding, the taxpayer will be offered a conference in accordance with section 12.02 of Rev. Proc. 2000–4.

.07 If the request for the change in funding method is approved, the instructions under line 5 of Schedule B (Actuarial Information) of Form 5500 should be followed in reporting the change. Currently, this requires entering the date of the ruling letter on line 5k of Schedule B.

Section 5. Class Rulings

.01 In a case where approval is desired for a change in funding method that is identical for a group of plans in excess of 40 receiving actuarial services from the same insurance company or consulting firm, a "class ruling" may be requested approving the change for all consenting taxpayers in the class. A class generally consists of the group of plans (1) receiving actuarial services from the same insurance company or consulting firm, or whose actuarial valuations are produced using the software of the same vendor, and (2) for which the element of the funding method that is proposed to be changed was the same. An element of a funding method is defined for purposes of this

revenue procedure as (1) an asset valuation method, (2) a valuation date, or (3) the funding method without regard to the asset valuation method or the valuation date.

.02 The class ruling may be requested by an enrolled actuary on behalf of an insurance company or consulting firm that provides actuarial services to the plans. An enrolled actuary on behalf of a software vendor may also request a class ruling; such ruling would apply to all plans whose actuarial valuations are produced using that vendor's software (both before and after the change in funding method).

.03 The enrolled actuary making the request should state the period for which the class ruling is proposed to be effective. The ruling will apply to plan years beginning within the stated period. The stated period cannot begin prior to 12 months before the month in which the request is made. Generally, the period cannot be longer than 36 months.

.04 In lieu of the plan-specific information otherwise required under section 4, the request for a class ruling shall contain the following information:

(1) The name and enrollment number of the actuary making the request.

(2) The name and address of the insurance company, consulting firm, or software vendor described in subsection 5.02.

(3) A statement indicating that the applicant believes that the class ruling will be applied to at least 40 plans and an estimate of the number of plans that is expected to change the funding method in accordance with the class ruling.

(4) The information described in subsections 4.04(5), 4.04(6), and 4.04(9), except that the numerical results requested in 4.04(9) should be a numerical illustrative example rather than actual numerical results.

.05 If the change in funding method is approved, a "class ruling letter" will be issued to the insurance company, consulting firm, or software vendor requesting the ruling. However, it is not incumbent upon the plan administrator or plan sponsor of any plan to agree to the change in funding method. If the change in funding method covered by the class ruling letter is desired, the instructions under line 5 of Schedule B (Actuarial Information) and line 7 of Schedule R (Retirement Plan Information) of Form 5500 should be followed in reporting the change. Currently, this requires entering the date of the class ruling letter on line 5k of Schedule B and reporting the plan sponsor's agreement to the change in funding method on line 7 of Schedule R.

.06 If a request for a class ruling is approved, at least 30 of the plans covered by the ruling must make the change in funding method in order for the ruling to become effective.

.07 The Service may, in its discretion, limit the period for which a class ruling will be effective, impose conditions on the use of the class ruling, or decline to issue a class ruling.

Section 6. Effect on other Documents

.01 Rev. Proc. 2000–4 is modified to the extent that this revenue procedure provides special procedures for issuing rulings with respect to a change in funding method.

.02 Rev. Proc. 78–37 is superseded.

Section 7. Effective Date

This revenue procedure is effective for requests for changes in funding method made on or after December 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 1545–1704.

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 revenue procedure is in sections 4 and 5. This information is required to evaluate and process the request for a change in funding method. The collection of information is required to obtain approval for a change in funding method. The likely respondents are businesses or other for-profit institutions, nonprofit institutions, and small businesses and organizations.

The estimated total annual reporting burden is 5,400 hours.

The estimated annual burden per respondent varies from 12 to 24 hours, depending on individual circumstances, with an estimated average burden of 18 hours. The estimated number of respondents and/or recordkeepers is 300.

The estimated annual frequency of responses is one.

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 John C. Heil of Employee Plans Actuarial Group 2, TE/GE Rulings and Agreements. For further information regarding this revenue procedure, please contact the Employee Plans Actuarial Group taxpayer assistance telephone service between the hour of 2:30 p.m. and 3:30 p.m., Eastern Time, Monday through Thursday at (202) 622-6076 (not a toll-free number). Mr. Heil's telephone number is (202) 622-7383 (prior to October 28, 2000), or (202) 283-9694 (after October 28, 2000), also not toll-free numbers.

Appendix A

CHANGE IN FUNDING METHOD REQUEST CHECKLIST
IS YOUR SUBMISSION COMPLETE?

Instructions

The Service will be able to respond more quickly to your change in funding method request if it is carefully prepared and complete. To ensure your request is in order, use this checklist. Answer each question in the checklist by inserting Y for yes, N for no, or N/A for not applicable, as appropriate, in the blank next to the item. ***Sign and date the checklist (as taxpayer or authorized representative) and place it on top of your request.***

You must submit a completed copy of this checklist with your request. If a completed checklist is not submitted with your request, substantive consideration of your submission will be deferred until a completed checklist is received. However, this checklist need not be submitted if the request involves a class ruling described in section 5 of this revenue procedure.

_____ 1. If you want to designate an authorized representative or a third party contact, have you included a properly executed Form 2848 (Power of Attorney and Declaration of Representative) or Third Party Contact Authorization Form?

_____ 2. Have you satisfied all the requirements of Rev. Proc. 2000–4 or its successors (especially concerning signatures and penalties of perjury statement)? (See sections 2.05 & 4.03)

_____ 3. Have you included the user fee required under Rev. Proc. 2000–8 or its successors? (See section 2.06)

_____ 4. Have you included the employer identification number, the plan name and number, and the name and address of the plan administrator or plan sponsor? (See section 4.04(1))

_____ 5. Have you included a copy of the actuarial valuation report for the plan year preceding the year of change, and, if available, a draft of the actuarial valuation report for the year of change? (See section 4.04(2))

_____ 6. Have you included a copy of the last Schedule B (Actuarial Information) of Form 5500, including attachments thereto (for requests involving mergers, a copy of the last Schedule B for each of the merging plans)? (See section 4.04(3))

_____ 7. Have you included a statement of the plan year first affected by the proposed change? (See section 4.04(4))

_____ 8. Have you included a complete description of the current and proposed funding methods, including asset valuation methods? (See section 4.04(5))

_____ 9. Have you included a brief statement of the reason for the proposed change and a statement why automatic approval under Rev. Proc. 2000–40 cannot be used to make the change? (See section 4.04(6))

_____ 10. Have you included a statement whether a change in funding method was previously requested? (See section 4.04(7))

_____ 11. Have you included a statement of other changes being made for the year of change, such as a change in plan year or change in actuarial assumptions? (See section 4.04(8))

_____ 12. Have you included a worksheet prepared by the enrolled actuary for the plan, showing a "before and after" list of the amortization bases, the unfunded liability of the plan, and the basic funding formula (or equation of balance) using the proposed method? Have you included the calculation of the full funding limitation for the plan year prior to the plan year of change and for the plan year of change? (See section 4.04(9))

_____ 13. Have you included a statement of whether a waiver of the minimum funding standard is currently in effect and whether a request for a waiver is currently pending or is expected to be submitted in the near future? (See section 4.04(10))

_____

Signature Date

_____

Title or Authority

_____

Typed or printed name of person signing checklist

Part IV. Items of General Interest

Withdrawal of Previous Proposed Regulations; Notice of Proposed Rulemaking and Notice of Public Hearing

Agent for Consolidated Group

REG–103805–99

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of previous proposed regulations; notice of proposed rulemaking; and notice of public hearing.

SUMMARY: This document contains proposed regulations regarding the agent for an affiliated group that files a consolidated return (consolidated group). The proposed regulations address certain issues raised by the current regulations concerning the agent for the group when the common parent ceases to be the common parent, as well as questions concerning the scope of the common parent's authority. These proposed regulations affect all consolidated groups. This document also provides notice of a public hearing on these proposed regulations. In addition, this document withdraws a portion of the proposed rulemaking (LR–97–79, 1984–2 C.B. 821) published in the **Federal Register**, July 31, 1984.

DATES: Written and electronic comments must be received by December 26, 2000. Outlines of topics to be discussed at the public hearing scheduled for 10 a.m. on January 22, 2001, must be received by December 26, 2000.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–103805–99), 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:M&SP:RU (REG–103805–99), 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. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Gerald B. Fleming or George R. Johnson, (202) 622-7930; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, Sonya Cruse, (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 27, 2000.

Comments are specifically requested concerning:

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

The accuracy of the estimated burden associated with the proposed collection of information;

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 the proposed regulations is in §1.1502–77(d). This information is required for the common parent to notify the IRS of the designation of a new agent for the consolidated group when the common parent's existence is about to terminate and for the designated corporation to confirm that it agrees to serve as the group's new agent and qualifies to be the group's agent. The collection of information is required to obtain a benefit, i.e., to designate a new agent for the consolidated group. The likely respondents are business or other for-profit institutions.

The regulations provide that a common parent or a previously designated agent of a consolidated group should notify the Commissioner in writing, in accordance with procedures prescribed by the Commissioner, that it anticipates going out of existence and that it designates another corporation to serve as the group's agent for specified prior consolidated return years. In addition, the notification should include a statement by the designated corporation agreeing to serve as the group's agent and, if the designated corporation was not itself a member of the group, a statement that it is or will be liable for the tax. An agent designated by the Commissioner is required to give notice to each corporation (or any successor) that was a member of the group during any part of the relevant consolidated return year. The burden for the collection of information in §1.1502–77(d) is as follows:

Estimated total annual reporting burden: 200 hours.

Estimated average annual burden per respondent: 2 hours.

Estimated number of respondents: 100.

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 mate-

rial 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 amendments to 26 CFR part 1 under section 1502 of the Internal Revenue Code of 1986 (Code). The proposed amendments clarify and supplement existing rules under §1.1502–77 concerning the agent for a consolidated group and the designation of a new agent to act for the group. The proposed amendments also clarify rules concerning the common parent as agent for a corporation whose income is improperly included in a consolidated return. In addition, the proposed amendments modify and clarify the rules concerning the proper party to apply for and receive a refund payment due to a tentative carryback adjustment under §1.1502–78. The proposed regulations also terminate §1.1502–77T for tax years beginning on or after the effective date of final regulations amending §1.1502–77.

Section 1.1502–77(a) currently provides that the common parent is the "sole agent" for the consolidated group with respect to nearly all procedural tax matters relating to the group's tax liability for a consolidated return year. Notwithstanding this general rule, §1.1502–77(a) provides that the IRS may, upon notifying the common parent, deal directly with any member of the group in respect of its liability, in which case that member shall have full authority to act for itself.

Because the common parent's authority to act as agent for the group terminates when the common parent corporation ceases to exist, §1.1502–77(d) provides for the designation of a new agent to act for the group. Section 1.1502–77(d) first grants the terminating common parent, prior to going out of existence, the authority to designate a remaining member to act as agent for the group (a designated agent) regarding the group's prior consolidated return years. If the common parent goes out of existence without designating a new agent, §1.1502–77(d) provides that the remaining members of the group may designate a new agent. A designation of a new agent under this provision, by either the common parent or the remaining members, is subject to the approval of the district director with which the group files its return. Section 1.1502–77(d) also grants the IRS the authority to deal separately with each remaining member of the group with respect to its liability in the event that neither the common parent nor the surviving members designate a new agent.

Decisions of the United States Tax Court have highlighted difficulties in applying these rules to situations where a group continues to exist following a transaction described in §1.1502–75(d) (a group structure change), in which a new common parent has replaced the former common parent (which may or may not have remained in existence or remained a member of the group). See *Interlake Corp. v. Commissioner*, 112 T.C. 103 (1999); *Union Oil Co. v. Commissioner*, 101 T.C. 130 (1993); *Southern Pacific Co. v. Commissioner*, 84 T.C. 395, 404 (1985).

On September 8, 1988, various final and temporary regulations under section 1502 were published in the **Federal Register** (T.D. 8226, 1988–2 C.B. 325 [53 F.R. 34729]). At the same time, a notice of proposed rulemaking (LR-66-88, 1988–2 C.B. 848) cross-referenced to the text of the temporary regulations was also published (53 F.R. 34779). Included in the temporary regulations was §1.1502–77T. In situations where the corporation that was the common parent of the group ceases to be the common parent, §1.1502–77T provides alternative agents to act for a consolidated group, but only for purposes of mailing notices of deficiency and waiving periods of limitations. Specifically, §1.1502–77T allows the following alternative agents to act on behalf of the group: (1) the common parent of the group for all or any part of the year to which the notice or waiver applies, (2) a successor to the former common parent in a transaction to which section 381(a) applies, (3) the agent designated by the group under §1.1502–77(d), or (4) if the group remains in existence under §1.1502–75(d)(2) or (3), the common parent of the group at the time the notice is mailed or the waiver given.

The IRS received no comments on §1.1502–77T and has not issued final regulations concerning alternative agents.

Reasons for Change

Given the common parent's role as the agent for the group, issues arise about who has authority to act on behalf of the group for consolidated return years where the common parent has ceased to exist (e.g., due to a merger or liquidation) or where, while continuing to exist, it has ceased to be the common parent of the group (e.g., as a result of being acquired by another corporation). Other issues arise concerning the proper agent, as well as the scope of that agency, where a consolidated return improperly includes the income of a corporation that should have filed separately or when the IRS issues a tentative refund in response to a claim filed by a former member of the group.

Although the current provisions of §§1.1502–77 and 1.1502–77T provide guidance in limited situations, numerous issues have arisen in situations outside the scope of these provisions. The alternative agent approach of §1.1502–77T addressed agency issues regarding notices of deficiency and waivers of periods of limitations. It was intended to offer flexibility in allowing both taxpayers and the IRS to choose from among several potential agents to act for the group and also to ensure that whichever corporation is selected would be a permissible agent to act for the group. However, an alternative agent provided by §1.1502–77T is the agent for the group only for purposes of mailing notices of deficiency or for executing consents to extend periods of limitations. Under §1.1502–77T, an alternative agent has no authority to act as the group's agent for other purposes (e.g., filing a refund claim, receiving refund payments or executing a closing agreement). As a result, under the current rules, absent a designation of one of the remaining members to act as agent under §1.1502–77(d), the IRS may have no option other than to deal separately with each remaining member for any purpose not covered by §1.1502–77T.

The IRS and Treasury initially considered the possibility of expanding the scope of the authority of alternative

agents under §1.1502–77T to include all matters under the common parent's scope of authority as set forth in §1.1502–77(a). However, it was ultimately concluded that the shortcomings of the alternative agent approach outweigh its benefits. In particular, that approach lacks certainty because the IRS could deal with any one of several alternative agents and more than one corporation could initiate actions on behalf of the group. Also, a corporation could serve as an alternative agent without having been related to members of the group during the consolidated return year at issue or without being liable for the consolidated tax for that year.

In lieu of expanding the alternative agent approach of §1.1502–77T, the IRS and Treasury propose to revise the rules of §1.1502–77 and to terminate the application of §1.1502–77T. Under the proposed regulations, as discussed in more detail below, the common parent remains the agent for the group's consolidated return year as long as it remains in existence, regardless of whether it continues to be a common parent or a member of the group, or whether the group continues under §1.1502–75(d).

The proposed regulations set forth procedures for a common parent to designate a new agent for the group when the common parent ceases to exist, and permit the IRS to designate a new agent if the common parent fails to do so. The proposed regulations do not contain a provision allowing the remaining members to designate a new agent if the common parent fails to make a designation before it ceases to exist. The proposed regulations provide that the common parent acts as the agent with regard to the liability of any corporation whose income is improperly included in the group's return but whose liability is subsequently computed on the basis of a separate return or as a member of another consolidated group.

Finally, the proposed regulations modify the rule in §1.1502–78(a) concerning an application under section 6411 for a tentative carryback adjustment with respect to a loss or business credit arising in a separate return limitation year. Under the proposed amendments, the application should be filed by the common parent for the carryback year instead of the corporation to which the loss or credit is attributable. In addition, the proposed amendments clarify that any refund under §1.1502–78(b) related to a tentative carryback adjustment must be paid to the corporation that was the common parent (or is the designated agent) for the carryback year. The proposed amendments also replace the word "investment" with "business" in the term *unused investment credit* in §1.1502–78(a) to conform to changes in section 6411.

Explanation of Provisions

In order to reduce uncertainty for both taxpayers and the IRS, the proposed amendments to §1.1502–77(a) provide that the common parent for a consolidated return year remains the agent for the group for that year as long as it continues to exist. This rule applies even if the common parent, for whatever reason, ceases to be the common parent. Thus, for example, if the common parent becomes a subsidiary member of the consolidated group, which continues under §1.1502–75(d), if the common parent becomes a stand-alone corporation, or even if the common parent becomes a subsidiary member of another group, it remains the agent of the group for those consolidated return years during which it was the group's common parent. Cf. *Interlake Corp. v. Commissioner*, 112 T.C. 103 (1999); *Union Oil Co. v. Commissioner*, 101 T.C. 130 (1993).

The proposed regulations provide a rule for situations where a corporation files a consolidated return as the common parent of an affiliated group but is subsequently determined not to be the actual common parent of that group. In such situations, the corporation that filed as the common parent is considered to be the agent for each member of the claimed group even though it was not actually the common parent. This situation may arise, for example, where the common parent fails to own stock satisfying the 80-percent voting and value requirement of section 1504(a)(2).

The proposed regulations clarify that the common parent's authority as agent for a taxable year extends to any successor of a member. For purposes of §1.1502–77 only, the term *successor* means a party that, pursuant to applicable law, has become primarily liable for the tax liabilities of the common parent or any subsidiary member. Such determination is made without regard to §1.1502–1(f)(4) (defining the term *successor* for purposes of the definition of a separate return limitation year). The proposed regulations also clarify that the common parent remains the sole agent with respect to the consolidated tax liability under §1.1502–6 of a subsidiary (or its successor) that is or becomes a disregarded entity for Federal tax purposes.

Where transferee liability exists under applicable law, the proposed regulations provide that, for purposes of assessing, paying or collecting transferee liability, actions of the common parent with respect to the group's tax liability will derivatively affect the liability of a transferee of a member, regardless of whether the transferor member remains in existence. This provision is essentially an application of general principles of transferee liability in the context of a consolidated group. Under case law, the actions of a transferor derivatively affect the liability of a transferee, even if the actions are taken after the transfer occurs. See, e.g., *United States v. Vassallo, Inc.*, 274 F.2d 791, 793–794 (3d Cir. 1960). As provided in the proposed regulations, the common parent's actions on behalf of the group are always binding on each member of the group. Therefore, any actions of a common parent with respect to the group's liability for a consolidated return year will derivatively affect the liability of a transferee of a transferor member that remains in existence, even if the action occurs after the transfer giving rise to the transferee liability.

The proposed regulations recognize the derivative effect of the common parent's actions on transferee liability and further provide that actions taken by or with respect to the common parent, as agent for the group, after a transferor member has ceased to exist, also derivatively affect the liability of a transferee of such member to the same extent as if the transferor member had remained in existence. For example, under this provision, a waiver extending the limitations period for assessment, executed by the common parent (as agent for the group) after a member ceases to exist, would have the derivative effect of extending the limitations period with re-

spect to a transferee of such member.

The proposed regulations revise the rules governing the designation of a new agent for the group when the common parent ceases to exist. They retain the current provision under §1.1502–77(d) for the common parent to notify the IRS and designate, subject to the approval of the IRS, another member to act as the group's agent for the consolidated return year.

As under the current rule, the proposed regulations provide that the common parent may designate one of the remaining members of the group as the new agent for the group. The proposed regulations provide that the member designated as the agent for a consolidated return year must have been a member of the group during the consolidated return year and must not subsequently have been disregarded as an entity separate from its owner or treated as a partnership for purposes of Federal taxes. However, the common parent may also designate a domestic corporation (that is not disregarded as an entity separate from its owner or classified as a partnership for Federal tax purposes) that is primarily liable as a successor of any corporation that was a member of the group during the consolidated return year. In addition, the common parent will be permitted to designate any domestic corporation (that is not disregarded as an entity separate from its owner or classified as a partnership for Federal tax purposes) that is to become primarily liable as the common parent's successor in connection with a transaction in which the common parent's existence terminates. If an agent previously designated under this provision ceases to exist, the proposed regulations provide for such terminating agent to designate a new agent in the same manner that is available to a common parent that is going out of existence.

For purposes of the designation provision, a corporation's existence is deemed to cease not only if the corporation ceases to exist under applicable law, but also if the corporation becomes a disregarded entity or reclassified as a partnership for Federal tax purposes. However, if treating a corporation as ceasing to exist when it becomes a disregarded entity or reclassified as a partnership would leave no other corporation eligible to serve as a designated agent for the group, its existence would not be deemed to terminate. As used in the proposed regulations, the term *disregarded entity* includes a qualified subchapter S subsidiary for which an election is made pursuant to section 1361(b)(3)(B), a qualified REIT subsidiary within the meaning of section 856(i)(2), or an entity that is disregarded as an entity separate from its owner under the "check-the-box" rules of §301.7701–3. If, as a result of becoming a disregarded entity or reclassified as a partnership, the group's agent ceases to exist for Federal tax purposes without designating a new agent and subsequently purports to act on behalf of the group, any actions taken by the purported agent will, to the extent determined appropriate by the Commissioner, have the same effect as if the agent's existence had not terminated.

In the event the common parent (or a previously designated agent) fails to designate a new agent before going out of existence, the proposed regulations authorize the IRS to designate a new agent for the group. The IRS may designate one of the remaining members of the group for the consolidated return year (that has not been disregarded as an entity separate from its owner or reclassified as a partnership for Federal tax purposes), or any domestic corporation (that is not disregarded as an entity separate from its owner or classified as a partnership for Federal tax purposes) that is primarily liable as a successor of such a member, to act as the group's agent. This provides the IRS with a readily available option in cases where it needs to address a consolidated group's tax liability and no new agent has otherwise been designated. Any corporation that the IRS designates as the agent for the consolidated return year generally will continue as the group's agent as long as it remains in existence. At the request of one or more members, however, the IRS may (but is not required to) replace a designated agent with another member (or successor of a member) for the consolidated return year.

The proposed regulations direct the IRS and the designated agent to provide notification of the designation to the other remaining members/successors. Any failure by the IRS and/or the designated agent to give notification to a member/successor does not invalidate the designation.

Under the current regulations, the remaining members for a consolidated return year may designate a new agent in the event the common parent does not designate a new agent that is approved by the IRS. In practice, taxpayers have seldom utilized this provision because it is unwieldy and largely impracticable except for groups comprising only a few members. Accordingly, in light of the infrequency with which taxpayers use this provision, and in the interest of providing simple and administrable procedures, the IRS and Treasury have concluded that there is no longer a need to provide for any designation by the remaining members.

As under the current regulations, the proposed regulations provide that a designation by the common parent or a designated agent cannot become effective until it is approved by the IRS. The proposed regulations clarify that the Commissioner's approval of a designation by a common parent (or designated agent) will not be effective before the corporation making the designation ceases to exist. In the absence of an effective approved designation, a notice of deficiency or any other communication mailed to the former common parent or former designated agent, even if no longer in existence, is treated as having been properly mailed to all members and successors.

The proposed regulations retain the provision in the current regulations authorizing the Commissioner, upon notifying the common parent, to deal separately with a member concerning that member's several liability for the consolidated tax. In such a case, the member would have full authority to act for itself.

The proposed regulations eliminate §1.1502–77T for consolidated return years beginning after the date that the final regulations under §1.1502–77 are published in the **Federal Register**.

The proposed regulations provide that the common parent is the sole agent for any corporation that is improperly included in the group's return and whose tax liability should have been computed on the basis of a separate return or as a member of another consolidated group. This provision is consistent with the current rule of §1.1502–77(c)(2), relating to the effect of waivers of periods of limitations on assessment that are executed by the common parent. The proposed regulations are also con-

sistent with rulings of the Tax Court in several cases. See *Intervest Enterprises, Inc. v. Commissioner*, 59 T.C. 91, 96–97 (1972); *Lone Star Life Insurance Company v. Commissioner*, T.C. Memo. 1997–465; *INI, Inc. v. Commissioner*, T.C. Memo. 1995–112, *aff'd per curiam*, 107 F.3d 27 (11th Cir. 1997). See also *Alumax Inc. v. Commissioner*, 109 T.C. 133, 196 (1997) (holding that the improper inclusion of a corporation in a consolidated return does not alter the agency relationship established under §1.1502–77(c)), *aff'd on other grounds*, 165 F.3d 822 (11th Cir. 1999).

The proposed regulations amend §1.1502–78(a) to provide that the common parent for the carryback year should file any application under section 6411 for a tentative carryback adjustment with respect to a loss or credit arising in a separate return limitation year that may be carried back to a consolidated return year. The current rule, which provides that the corporation to which such loss or credit is attributable should file such application, is inconsistent with the general rule of §1.1502–77 that the common parent is the sole agent for the group and with the rule of §1.1502–78(b) that payment of any resulting refund is made to the common parent.

In *Interlake Corp. v. Commissioner*, 112 T.C. 103, 112–113 (1999), the Tax Court found that §1.1502–78(b) is unclear as to whether the common parent in the carryback year or the common parent in the loss year should be the group's agent to receive a refund resulting from a tentative carryback adjustment. 112 T.C. at 112–113. The proposed regulations amend §1.1502–78(b) to provide expressly that the refund should be paid to the common parent or designated agent for the group's carryback year.

Finally, because the position of district director will be eliminated in the restructuring of the IRS, the proposed regulations substitute "the Commissioner" for various references to the district director in §1.1502–77. If the proposed rules are adopted, procedures for the designation of a new agent under the new IRS structure, by either a terminating common parent or the Commissioner, will be announced when final regulations are issued. It is anticipated that such procedures will be embodied in a revenue procedure that may also include provisions for one or more members of a group to request that the Commissioner designate an agent in situations where the common parent or previously designated agent failed to designate a new agent before it ceased to exist, whether or not the Commissioner has already designated an agent. Comments are invited concerning these procedures.

Proposed Effective Date

The amendments to §1.1502–77 are proposed to apply to consolidated return years beginning on or after the date final regulations are published in the **Federal Register**. The current rules of §§1.1502–77 and 1.1502–77T continue to apply with respect to consolidated return years beginning before the effective date of final regulations under §1.1502–77. Thus, the alternative agent approach of the temporary regulation would continue to apply for purposes of mailing notices of deficiency and executing waivers of periods of limitations on assessment with respect to consolidated return years beginning before the date final regulations are published in the **Federal Register**.

The amendments to §1.1502–78 are proposed to apply to taxable years to which a loss or credit may be carried back and for which the due date (without extensions) of the original return is 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 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 will primarily affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses, and, moreover, that any burden on taxpayers is minimal. 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, these regulations will be submitted to the Chief Counsel for Advocacy of 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 comments (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS.

The IRS and Treasury request comments on the clarity of the proposed rules and how they may be made easier to understand or to implement. In addition, comments are requested on the treatment in the proposed regulations of entities that become disregarded as entities separate from their owners or become partnerships for Federal tax purposes. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 22, 2001, beginning at 10 a.m. in room 4718, 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 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 (a signed original and eight (8) copies) by December 26, 2000.

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 Gerald B. Fleming, George R. Johnson and Steven J. Hankin, Office of the Assistant Chief Counsel (Field Service). 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 removing entries for sections 1.1502–77(e) and 1.1502–78(b) and adding entries in numerical order to read in part as follows:

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

Section 1.1502–77 also issued under 26 U.S.C. 1502 and 6402(j).

Section 1.1502–78 also issued under 26 U.S.C. 1502, 6402(j), and 6411(c). * * *

Section 1.1502–77A also issued under 26 U.S.C. 1502 and 6402(j). * * *

Par. 2. Immediately following §1.1502–41A, an undesignated center heading is added to read as follows:

REGULATIONS APPLICABLE TO TAXABLE YEARS BEGINNING BEFORE THE DATE FINAL REGULATIONS ARE PUBLISHED IN THE **FEDERAL REGISTER**

Par. 3. Immediately before §1.1502–79A, an undesignated center heading is added to read as follows:

REGULATIONS APPLICABLE TO TAXABLE YEARS BEFORE January 1, 1997

Par. 4. Section 1.1502–77 is redesignated as §1.1502–77A and transferred immediately after the undesignated center heading "REGULATIONS APPLICABLE TO TAXABLE YEARS BEGINNING BEFORE THE DATE FINAL REGULATIONS ARE PUBLISHED IN THE **FEDERAL REGISTER**"; the section heading of newly designated §1.1502–77A is revised; paragraph (e) is redesignated as paragraph (f); and paragraph (g) is added to read as follows:

*§1.1502–77A Common parent agent for subsidiaries applicable for consolidated return years beginning before the date final regulations are published in the **Federal Register**.*

* * * * *

(g) *Effective date.* This section applies to consolidated return years beginning before the date final regulations under §1.1502–77 are published in the **Federal Register**, except paragraph (e) of this section applies to statutory notices and waivers of the statute of limitations for taxable years for which the due date (without extensions) of the consolidated return is after September 7, 1988, and which begin before the date final regulations under §1.1502–77 are published in the **Federal Register**.

Par. 5. New §1.1502–77 is added to read as follows:

§1.1502–77 Agent for the group.

(a) *Scope of agency*—(1) *In general*—(i) *Common parent.* Except as provided in paragraphs (a)(3) and (6) of this section, the common parent for a consolidated return year, for all matters relating to the tax liability for the consolidated return year, shall be the sole agent for—

(A) Each subsidiary in the group; and

(B) Any successor of any member (including the common parent).

(ii) *Other agents.* For purposes of this section, any corporation described in paragraphs (a)(1)(ii)(A) and (B) of this section will act as the agent in place of the common parent to the same extent and subject to the same limitations as are applicable to the common parent, and any reference in this section to the common parent will include any such other agent—

(A) Any corporation designated as the agent pursuant to paragraph (d) of this section to replace the common parent or a previously designated agent; and

(B) Any corporation that files a consolidated return as the common parent for a group, notwithstanding that such corporation is subsequently determined not to have been the proper agent for the claimed group.

(iii) *Successor.* For purposes of this section only, the term *successor* means a party that is primarily liable, pursuant to applicable law (including, for example, by operation of a state or Federal merger statute), for the tax liability of the common parent or any subsidiary of the group. Such determination is made without regard to §1.1502–1(f)(4).

(iv) *Disregarded entity.* If a subsidiary of a group or its successor is or becomes a disregarded entity for Federal tax purposes, the common parent will continue to serve as the sole agent with respect to that subsidiary's tax liability under §1.1502–6 for consolidated return years during which it was a member of the group, even though the entity generally is not treated as a person separate from its owner for Federal tax purposes.

(v) *Transferee liability.* For purposes of assessing, paying and collecting transferee liability, any action taken by or directed to the common parent with respect to the group's tax liability will derivatively affect the liability of a transferee (or subsequent transferees) of a member, regardless of whether the member terminates its existence prior to such action.

(2) *Specific matters subject to agency.* As sole agent, the common parent is authorized to act in its own name for all matters relating to the tax liability for the consolidated return year. Except as provided in paragraphs (a)(3) and (6) of this section, no subsidiary or successor shall have authority to act for or to represent itself in any such matter. For example—

(i) Any election available to a subsidiary corporation in the computation of its separate taxable income must be made by the common parent, as must any change in an election previously made by or for a subsidiary corporation;

(ii) All correspondence will be carried on directly with the common parent;

(iii) The common parent shall file for all extensions of time, including extensions of time for payment of tax under section 6164;

(iv) The common parent in its own name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each member or any successor thereof;

(v) The common parent will file claims for refund, and any refund will be made directly to and in the name of the common

parent and will discharge any liability of the Government to any member or any successor thereof with respect to such refund;

(vi) Notices of claim disallowance will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each member or any successor thereof;

(vii) Notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each member or any successor thereof;

(viii) The common parent will file petitions and conduct proceedings before the United States Tax Court, and any such petition shall be considered as also having been filed by each member or any successor thereof;

(ix) Any assessment of tax may be made in the name of the common parent, and an assessment naming the common parent shall be considered as an assessment with respect to each member and any successor thereof; and

(x) Notice and demand for payment of taxes will be given only to the common parent and such notice and demand will be considered as a notice and demand to each member or any successor thereof.

(3) *Matters reserved to subsidiaries.* Notwithstanding the role of the common parent as exclusive agent under paragraph (a)(1) of this section, the following matters shall be reserved to each subsidiary and, if applicable, to a successor of a subsidiary—

(i) The making of the consent required by §1.1502–75(a)(1);

(ii) The making of an election under section 936(e);

(iii) The making of an election to be treated as a DISC under §1.992–2; and

(iv) A change of the annual accounting period pursuant to §1.991–1(b)(3)(ii).

(4) *Term of agency*—(i) *In general.* Except as provided in paragraph (a)(4)(iii) of this section, the common parent for the consolidated return year shall remain the sole agent with respect to that year until its existence terminates, regardless of whether one or more subsidiaries become or cease to be members of the group at any time, whether the group files a consolidated return for any subsequent year, whether the common parent ceases to be the common parent or a member of the group in any subsequent year, or whether the group continues pursuant to §1.1502–75(d) with a new common parent in any subsequent year.

(ii) *Replacement of agent designated by Commissioner.* If the Commissioner replaces a previously designated agent pursuant to paragraph (d)(2)(ii) of this section, the term of the replaced agent shall terminate when the Commissioner designates another agent.

(iii) *New common parent after a group structure change.* If the group continues in existence with a new common parent pursuant to §1.1502–75(d) during a consolidated return year, the common parent at the beginning of the year is the group's sole agent through the date of the transaction, and the new common parent becomes the continuing group's sole agent beginning the day after the transaction.

(5) *Identifying members in notices.* Notwithstanding the provisions of this paragraph (a)—

(i) Any notice of deficiency with respect to the tax for a consolidated return year will name each corporation that was a member of the group during any part of such period (but a failure to include the name of any such member will not affect the validity of the notice of deficiency as to the other members or their successors), and any notice of deficiency that is valid as to a member so named will be valid as to any successor of such member;

(ii) Any notice and demand for payment will name each corporation that was a member of the group during any part of the applicable consolidated return year (but a failure to include the name of any such member will not affect the validity of the notice and demand as to the other members or their successors), and any notice and demand for payment that is valid as to a member so named will be valid as to any successor of such member;

(iii) Any notice of a lien, any levy or any other proceeding to collect the amount of any assessment, after the assessment has been made, will name the taxpayer from which such collection is to be made;

(iv) Any notice described in paragraphs (a)(5)(i) through (iii) of this section that fails to include the name of a member during the consolidated return year shall still be valid as to that member's successor, if such successor is named in the notice; and

(v) If a notice of deficiency fails to name a member or its successor, any assessment of tax based on such notice shall still be a valid assessment as to the other members or their successors.

(6) *Direct dealing with a member.* Notwithstanding the provisions of this paragraph (a), the Commissioner may, upon notifying the common parent, deal directly with any member of the group or any successor of a member with respect to its several liability for the consolidated tax of the group, in which event such member or successor shall have full authority to act for itself.

(b) *Copy of notice of deficiency to corporation which has ceased to be a member of the group.* If a corporation has ceased to be a member of the group during or after a consolidated return year and if such corporation or its successor files written notice of such cessation with the Commissioner, then the Commissioner upon request of such corporation or its successor will furnish a copy of any notice of deficiency with respect to the tax for a consolidated return year for which the corporation was a member or a copy of any notice and demand for payment of such deficiency. The filing of such written notification and request by a corporation or its successor shall not have the effect of limiting the scope of the agency of the common parent provided for in paragraph (a) of this section. Any failure by the Commissioner to comply with such written request shall not have the effect of limiting the tax liability under §1.1502–6 of such corporation or its successor.

(c) *References to member or subsidiary.* For purposes of this section, all references to a member or subsidiary shall include—

(1) Each corporation that was a member of the group during any part of such taxable year (except that any reference to a subsidiary shall not include the common parent); and

(2) Each claimed member the income of which was included in the consolidated return for such taxable year, notwithstanding that the tax liability of any such claimed member should have been computed on the basis of a separate return, or as a member of another consol-

idated group, under the provisions of §1.1502–75.

(d) *Termination of common parent*—(1) *Designation by common parent.* (i) If the common parent will terminate its existence, it shall—

(A) Designate, subject to the approval of the Commissioner, for each consolidated return year for which the period of limitations for assessment, for collection after assessment, or for claiming a credit or refund has not expired, one of the following to act as agent in its place—

(*1*) Any corporation that was a member of the group during any part of the consolidated return year and, except as provided in paragraph (e)(3)(ii) of this section, has not subsequently been disregarded as an entity separate from its owner or reclassified as a partnership for Federal tax purposes; or

(*2*) Any successor (as defined in paragraph (a)(1) of this section) of such a corporation or of the common parent that is a domestic corporation (and, except as provided in paragraph (e)(3)(ii) of this section, is not disregarded as an entity separate from its owner or classified as a partnership for Federal tax purposes), including a corporation that will become a successor at the time that the common parent ceases to exist; and

(B) Notify the Commissioner (under procedures prescribed by the Commissioner) of the designation, including—

(*1*) A statement by the designated corporation agreeing to serve as the group's new agent; and

(*2*) If the designated corporation was not itself a member of the group during the consolidated return year (because the designated corporation is a successor of a member of the group for the consolidated return year), a statement by the designated corporation acknowledging that it is or will be primarily liable for the consolidated tax as a successor of a member.

(ii) A designation under paragraph (d)(1)(i)(A) of this section will not be effective until it is approved by the Commissioner. The Commissioner's approval of such a designation will not be effective before the existence of the common parent terminates.

(2) *Designation by the Commissioner.* (i) In the event the common parent terminates its existence and no designation is made and approved under paragraph (d)(1) of this section, the Commissioner may, with or without the request of any member of the group or its successor, at any time designate, effective immediately, a corporation described in paragraph (d)(1)(i)(A) of this section to act as the agent. The designation will be made in accordance with procedures prescribed by the Commissioner.

(ii) At the request of any member or successor of a member, the Commissioner may, but is not required to, replace an agent previously designated under this paragraph (d)(2) with another corporation described in paragraph (d)(1)(i)(A) of this section.

(iii) The Commissioner and the designated agent shall give notice of any designation to each corporation that was a member of the group during any part of the consolidated return year or its successor. A failure by the Commissioner and/or designated agent to notify any such member of the group or its successor does not invalidate the designation.

(3) *Absence of designation.* Until either a notice in writing designating a new agent has become effective or the Commissioner has designated a new agent, any notice of deficiency or other communication mailed to the common parent, even if no longer in existence, shall be considered as having been properly mailed to the agent of the group; or if the Commissioner has reason to believe that the existence of the common parent has terminated, he may, if he deems it advisable, deal directly with any member or its successor with respect to the member's several liability under §1.1502–6 without having to give notice pursuant to paragraph (a)(6) of this section.

(e) *Termination of a corporation's existence*—(1) *In general.* For purposes of paragraphs (a)(1)(v), (a)(4)(i), and (d) of this section, the existence of a corporation is deemed to terminate if—

(i) It ceases to exist under applicable law; or

(ii) Except as provided in paragraph (e)(3) of this section, it becomes, for Federal tax purposes, either—

(A) An entity that is disregarded as an entity separate from its owner; or

(B) An entity that is reclassified as a partnership.

(2) *Purported agency.* If the group's agent ceases to exist under circumstances described in paragraph (e)(1)(ii) of this section without designating a new agent for the group pursuant to paragraph (d)(1) of this section, and the agent subsequently purports to act as agent for the group, any actions by that purported agent on behalf of the group will, to the extent determined appropriate by the Commissioner, have the same effect as if the agent's existence had not terminated.

(3) *Exceptions where no eligible corporation exists.* (i) For purposes of paragraphs (a)(4)(i) and (d) of this section, if a corporation becomes either disregarded as an entity separate from its owner or reclassified as a partnership for Federal tax purposes, its existence shall not be deemed to terminate if the effect of such termination would be that no corporation remains eligible to serve as the designated agent for the group's consolidated return year.

(ii) Similarly, an entity that is either disregarded as an entity separate from its owner or reclassified as a partnership for Federal tax purposes shall not be precluded from designation as an agent merely because of such classification if the effect of the inability to make such designation would be that no corporation remains eligible to serve as the designated agent for the group's consolidated return year.

(f) *Examples.* The following examples illustrate the principles of this section. In each example, as of January 1 of Year 1, the P group consists of P and its two subsidiaries, S and S-1. P, as the common parent of the P group, files consolidated returns for the P group in Years 1 and 2. On January 1 of Year 1, domestic corporations S-2, U, V, W, W-1, X, Y, Z and Z-1 are not related to P or the members of the P group. All corporations are calendar year taxpayers. Any surviving corporation in a merger is a successor as described in paragraph (a)(1)(iii) of this section. Any notification to the Commissioner of the designation of the P group's new agent also contains a statement signed on behalf of the designated agent that it consents to act as the group's new agent and, in the case of a successor, that it is primarily liable as a successor of a member. The examples are as follows:

Example 1. Disposition of all group members. On December 31 of Year 1, P sells all the stock of S-1 to X. On December 31 of Year 2, P distributes all the stock of S to P's shareholders. P files a separate return for Year 3. Although P is no longer a common

parent after Year 2, P remains the sole agent of the P group for Years 1 and 2. Except as provided in paragraph (a)(6) of this section, for as long as P remains in existence, only P may execute a waiver of the period of limitations on assessment on behalf of the group for Years 1 and 2.

Example 2. Acquisition of common parent by another group. The facts are the same as in *Example 1*, except on January 1 of Year 3, P is acquired by Y. P thereafter joins in the Y group consolidated return as a member of Y group. Although P is a member of Y group in Year 3, P remains the agent of the P group for Years 1 and 2. Except as provided in paragraph (a)(6) of this section, for as long as P remains in existence, only P may execute a waiver of the period of limitations on assessment on behalf of the P group for Years 1 and 2.

Example 3. Merger of common parent—designation of remaining member as new agent. On December 31 of Year 1, P sells all the stock of S-1 to X. On July 1 of Year 2, P acquires all the stock of S-2. On November 30 of Year 2, P distributes all the stock of S to P's shareholders. On January 1 of Year 3, P merges into Y corporation. Just before the merger, P notifies the Commissioner in writing of the planned merger and of its designation of S as the new agent of the P group for Years 1 and 2. S is the only member that P can designate as the new agent for both Years 1 and 2 because it is the only subsidiary that was a member of P group during part of both years. Although S-2 is the only remaining subsidiary of the P group when P merges into Y, S-2 was a member of the P group only in Year 2. For that reason, S-2 cannot be the group's agent for Year 1. Alternatively, P could designate a different agent for each year, selecting S or S-1 as the new agent for Year 1; and S or S-2 as the new agent for Year 2. P could also designate its successor Y as the new agent for both Years 1 and 2.

Example 4. Forward triangular merger of common parent. On January 1 of Year 3, P merges with and into Z-1, a subsidiary of Z, in a forward triangular merger described in section 368(a)(1)(A) and (a)(2)(D). The transaction constitutes a reverse acquisition under §1.1502–75(d)(3)(i) because P's shareholders receive more than 50% of Z's stock in exchange for all of P's stock. Just before the merger, P notifies the Commissioner in writing of the planned merger and its designation of Z-1, the corporation that will survive the planned merger, as the new agent of the P group for Years 1 and 2. Because Z-1 will be P's successor (within the meaning of paragraph (a)(1) of this section) after the planned merger, P may designate Z-1 as the new agent for the P group for Years 1 and 2, pursuant to paragraph (d)(1) of this section. Alternatively, P could have designated S or S-1 as the new agent for the P group for Years 1 and 2. Although Z is the new common parent of the P group, which continues pursuant to §1.1502–75(d)(3)(i), P may not designate Z as the new agent for Years 1 and 2 because Z was not a member of the group during any part of Years 1 or 2 and is not a successor of P or any other member of the group.

Example 5. Reverse triangular merger of common parent. On March 1 of Year 3, W-1, a subsidiary of W, merges into P, in a reverse triangular merger described in section 368(a)(1)(A) and (a)(2)(E). P survives the merger with W-1. The transaction constitutes a reverse acquisition under §1.1502–75(d)(3)(i) because P's shareholders receive more than 50% of W's stock in exchange for all of P's stock. Under paragraph (a) of this section, P remains the agent of the P group for Years 1 and 2, even though the P group continues with W as its new common parent. Because the transaction constitutes a reverse acquisition, the P group is treated as remaining in existence with W as its common parent. Before March 2 of Year 3, P is the sole agent for the P group for Year 3. Beginning on March 2 of Year 3, W becomes the sole agent for the P group with respect to all of Year 3 (including the period through March 1) and subsequent consolidated return years.

Example 6. Reverse triangular merger of common parent—spinoff of common parent. The facts are the same as in *Example 5*, except that on April 1 of Year 3, P distributes the stock of its subsidiaries S and S-1 to W, and W then distributes the stock of P to the W shareholders. Although P is no longer a member of the P group and W is the continuing P group's new common parent, P remains the agent for the P group under paragraph (a) of this section for Years 1 and 2. Before March 2 of Year 3, P is the sole agent for the P group for Year 3. Beginning on March 2 of Year 3, W becomes the sole agent for the P group with respect to Year 3 (including the period through March 1) and subsequent consolidated return years.

Example 7. Qualified stock purchase and section 338 election. On March 31 of Year 2, V purchases the stock of P in a qualified stock purchase (within the meaning of section 338(d)(3)), and V makes a timely election pursuant to section 338(g) with respect to P. Section 338(a)(2) provides that P is treated as a new corporation as of the beginning of the day after the acquisition date for purposes of subtitle A. For purposes of other subtitles, such as subtitle F (Procedure and Administration), however, new P is treated as a continuation of old P. Therefore, new P remains the agent of the P group for Year 1 and the period ending March 31 of Year 2 (short Year 2). Except as provided in paragraph (a)(6) of this section, for as long as new P remains in existence, only new P may execute a waiver of the period of limitations on assessment on behalf of the P group for Year 1 and short Year 2.

Example 8. Fraudulent conveyance of assets. On March 15 of Year 2, P files a consolidated return that includes the income of S and S-1 for Year 1. On December 1 of Year 2, S-1 transfers assets having a fair market value of $100x to U in exchange for $10x. This transfer of assets for less than fair market value constitutes a fraudulent conveyance under applicable state law. On March 1 of Year 5, P executes a waiver extending to December 31 of Year 6 the period of limitations on assessment with respect to the group's Year 1 consolidated return. On February 1 of Year 6, the Commissioner issues a notice of deficiency to P asserting a deficiency of $30x for the P group's Year 1 consolidated tax liability. P does not file a petition for redetermination in the Tax Court, and the Commissioner makes a timely assessment against the P group. P, S and S-1 are all insolvent and are unable to pay the deficiency. On February 1 of Year 8, the Commissioner sends a notice of transferee liability to U, which does not file a petition in the Tax Court. On August 1 of Year 8, the Commissioner assesses the amount of the P group's deficiency against U. Under section 6901(c), the Commissioner may assess U's transferee liability within one year after the expiration of the period of limitations against the transferor S-1. By operation of section 6213(a) and 6503(a), the issuance of the notice of deficiency to P and the expiration of the 90-day period for filing a petition in the Tax Court have the effect of further extending by 150 days the P group's limitations period on assessment from the previously extended date of December 31 of Year 6 to May 30 of Year 7. Pursuant to paragraph (a)(1)(v) of this section, the waiver executed by P on March 1 of Year 5 to extend the period of limitations on assessment to December 31 of Year 6 and the further extension of the P group's limitations period to May 30 of Year 7 (by operation of sections 6213(a) and 6503(a)) have the derivative effect of extending the period of limitations on assessment of U's transferee liability to May 30 of Year 8. By operation of section 6901(f), the issuance of the notice of transferee liability to U and the expiration of the 90-day period for filing a petition in the Tax Court have the effect of further extending the limitations period on assessment of U's liability as a transferee by 150 days, from May 30 of Year 8 to October 27 of Year 8. Accordingly, the Commissioner may send a notice of transferee liability to U at any time on or before May 30 of Year 8 and assess the unpaid liability against U at any time on or before October 27 of Year 8. The result would be the same even if S-1 ceased to exist before March 1 of Year 5, the date P executed the waiver.

(g) *Cross-reference.* For further rules applicable to groups that include insolvent financial institutions, see §301.6402–7 of this chapter.

(h) *Effective date*—(1) *Application.* This section applies with respect to taxable years beginning on or after the date final regulations are published in the **Federal Register**.

(2) *Prior law.* For taxable years beginning before the date final regulations are published in the **Federal Register**, see §1.1502–77A.

Par. 6. Section 1.1502–77T(a) is redesignated as §1.1502–77A(e) and §1.1502–77T is removed.

Par. 7. The amendments to §1.1502–78(a), as contained in the notice of proposed rulemaking (LR–97–79) published in the **Federal Register** on July 31, 1984 (49 F.R. 30528), are withdrawn.

Par. 8. Section 1.1502–78 is amended as follows:

1. Paragraph (a) is revised.

2. Paragraph (b)(1) is amended by adding the language "for the carryback year (or agent designated under §1.1502–77(d) for the carryback year)" at the end of the first sentence.

3. In paragraph (c), the last sentence of *Example (1)* is amended by adding the

language "for the carryback year" after "parent."

4. In paragraph (c), the last sentence of *Example (2)* is amended by removing the language "S-1" and adding "P" in its place.

5. In paragraph (c), *Example (3)*, the seventh sentence is amended by removing "Z must" and adding "X must" in its place.

6. Paragraphs (e) and (f) are added.

The revision and additions read as follows:

§1.1502–78 Tentative carryback adjustments.

(a) *General rule.* If a group has a consolidated net operating loss, a consolidated net capital loss, or a consolidated unused business credit for any taxable year, then any application under section 6411 for a tentative carryback adjustment of the taxes for a consolidated return year or years preceding such year shall be made by the common parent corporation for the carryback year (or agent designated under §1.1502–77(d) for the carryback year) to the extent such loss or unused business credit is not apportioned to a corporation for a separate return year pursuant to §1.1502–21(b), 1.1502–22(b), or 1.1502–79(c). In the case of the portion of a consolidated net operating loss or consolidated net capital loss or consolidated unused business credit to which the preceding sentence does not apply and which is to be carried back to a corporation that was not a member of a consolidated group in the carryback year, the corporation to which such loss or credit is attributable shall make any application under section 6411. In the case of a net capital loss or net operating loss or unused business credit arising in a separate return year which may be carried back to a consolidated return year, after taking into account the application of §1.1502–21(b)(3)(ii)(B) with respect to any net operating loss arising in another consolidated group, the common parent for the carryback year (or agent designated under §1.1502–77(d) for the carryback year) shall make any application under section 6411.

* * * * *

(e) *Cross-reference.* For further rules applicable to groups that include insolvent financial institutions, see §301.6402–7 of this chapter.

(f) *Effective date*—(1) *In general.* This section applies to taxable years to which a loss or credit may be carried back and for which the due date (without extensions) of the original return is after the date final regulations are published in the **Federal Register**.

(2) *Prior law.* For taxable years to which a loss or credit may be carried back and for which the due date (without extensions) is on or before the date final regulations are published in the **Federal Register**, see §1.1502–78 in effect prior to the date final regulations are published in the **Federal Register**, as contained in 26 CFR part 1 revised as of April 1, 2000.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on September 25, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 26, 2000, 65 F.R. 57755)

Form 8870, Information Return for Transfers Associated With Certain Personal Benefit Contracts

Announcement 2000–82

Notice 2000–24, 2000–17 I.R.B. 952, advises organizations that pay premiums on "personal benefit contracts," as that term is used in section 170(f)(10) of the Internal Revenue Code, of the need to file Form 8870, *Information Return for Transfers Associated With Certain Personal Benefit Contracts.* For taxable years beginning prior to January 1, 2000, such organizations must file Form 8870 by the later of 90 days after the date of the Service's announcement in the Internal Revenue Bulletin of the availability of Form 8870, or the date the organization is required to file its annual information return.

This announcement advises organizations of the availability of Form 8870. The 90-day period referred to in the Notice begins on the date of publication of this announcement.

Request for Comments Regarding Need for Guidance Clarifying Application of the Internal Revenue Code to Use of the Internet by Exempt Organizations

Announcement 2000–84

The Internal Revenue Service is considering the necessity of issuing guidance that would clarify the application of the Internal Revenue Code to use of the Internet by exempt organizations. Accordingly, the Service is soliciting public comment concerning the application of Code provisions governing exempt organizations to activities they conduct on the Internet. The Service has made no final decision concerning the need for additional guidance of general applicability and may conclude no further action is necessary.

BACKGROUND

Exempt organizations, like other organizations, are increasingly turning to the Internet to carry on their activities. By publishing a webpage on the Internet, an exempt organization can provide the general public with information about the organization, its activities, and issues of concern to the organization, as well as immediate access to websites of other organizations. An exempt organization can provide information to subscribers about issues of concern to the organization as well as enable people with common interests to share information via the Internet through a variety of methods (such as mailing lists, news groups, listserves, chat rooms, and forums).

General Issues

Exempt organizations use the Internet to carry on activities that otherwise can be conducted through other media, such as radio or television broadcasts, print publications, or direct mailings. The growing use of the Internet by exempt organizations raises questions regarding whether clarification is needed concerning the application of the Code to Internet activities. The questions include the following:

- Does a website constitute a single publication or communication? If not, how should it be separated into distinct pub-

lications or communications?

- When allocating expenses for a website, what methodology is appropriate? For example, should allocations be based on webpages (which, unlike print publications, may not be of equal size)?
- Unlike other publications of an exempt organization, a website may be modified on a daily basis. To what extent and by what means should an exempt organization maintain the information from prior versions of the organization's website?
- To what extent are statements made by subscribers to a forum, such as a listserv or newsgroup, attributable to an exempt organization that maintains the forum? Does attribution vary depending on the level of participation of the exempt organization in maintaining the forum (e.g., if the organization moderates discussion, acts as editor, etc.)?

Political and Lobbying Activities

Charitable organizations described in section 501(c)(3) may not intervene in political campaigns and may only attempt to influence legislation as an insubstantial part of their activities. If the charitable organization makes an election under section 501(h), an expenditure test is applied in determining whether the organization has engaged in substantial lobbying activities, with different limits applicable for direct and grassroots lobbying.

When a charitable organization engages in advocacy on the Internet, questions arise as to whether it is conducting political or lobbying activity, and if so, to what extent. This situation is further complicated by the affiliation of charitable organizations with other organizations engaging in political or lobbying activities on the Internet. The ease with which different websites may be linked electronically (through a "hyperlink") raises a concern about whether the message of a linked website is attributable to the charitable organization. The Service is considering whether clarification is needed on how to apply the prohibition on political campaign intervention and substantial lobbying activity for charitable organizations engaging in activities on the Internet. Questions include the following:

- What facts and circumstances are relevant in determining whether information on a charitable organization's website about candidates for public office constitutes intervention in a political campaign by the charitable organization or is permissible charitable activity consistent with the principles set forth in Rev. Rul. 78–248, 1978–1 C.B. 154, and Rev. Rul. 86–95, 1986–2 C.B. 73 (dealing with voter guides and candidate debates)?
- Does providing a hyperlink on a charitable organization's website to another organization that engages in political campaign intervention result in *per se* prohibited political intervention? What facts and circumstances are relevant in determining whether the hyperlink constitutes a political campaign intervention by the charitable organization?
- For charitable organizations that have not made the election under section 501(h), what facts and circumstances are relevant in determining whether lobbying communications made on the Internet are a substantial part of the organization's activities? For example, are location of the communication on the website (main page or subsidiary page) or number of hits relevant?
- Does providing a hyperlink to the website of another organization that engages in lobbying activity constitute lobbying by a charitable organization? What facts and circumstances are relevant in determining whether the charitable organization has engaged in lobbying activity (for example, does it make a difference if lobbying activity is on the specific webpage to which the charitable organization provides the hyperlink rather than elsewhere on the other organization's website)?
- To determine whether a charitable organization that has made the election under section 501(h) has engaged in grass roots lobbying on the Internet, what facts and circumstances are relevant regarding whether the organization made a "call to action"?
- Does publication of a webpage on the Internet by a charitable organization that has made an election under section 501(h) constitute an appearance in the mass media? Does an email or listserv communication by the organization constitute an appearance in mass media if it is sent to more than 100,000 people and fewer than half of those people are members of the organization?
- What facts and circumstances are relevant in determining whether an Internet communication (either a limited access website or a listserv or email communication) is a communication directly to or primarily with members of the organization for a charitable organization that has made an election under section 501(h)?

Advertising and Other Business Activities

Many exempt organizations receive payment from companies to display advertising messages on the organization's website. Some exempt organizations have banners on their websites containing information about and a link to other organizations in exchange for a similar banner on the other organizations' website.

Exempt organizations may also provide hyperlinks on their websites to companies that sponsor their activities. Some organizations receive payments based upon a percentage of sales for referring customers to another website, while others receive payments based upon the number of persons who use the hyperlink to go to the other webpage. In addition, a number of exempt organizations use the Internet as another outlet for their own sales activity.

Some organizations operate "virtual trade shows," an attempt to replicate trade shows on the Internet. Some of these virtual trade shows simply consist of hyperlinks to industry suppliers' websites, while others also include displays with educational information.

The Service is considering whether clarification is needed regarding whether the income received from these activities is subject to the unrelated business income tax, and if so, how the income and expenses related to the activity are calculated. Questions include the following:

- To what extent are business activities conducted on the Internet regularly carried on under section 512? What facts and circumstances are relevant in determining whether these activities on the Internet are regularly carried on?
- Are there any circumstances under which the payment of a percentage of sales from customers referred by the exempt organization to another website would be substantially related under section 513?

- Are there any circumstances under which an online "virtual trade show" qualifies as an activity of a kind "traditionally conducted" at trade shows under section 513(d)?

Comments concerning the application of section 513(i), which governs the treatment of qualified sponsorship payments, to Internet activities were requested in connection with the Notice of Proposed Rulemaking (REG–209601–92) published in the Federal Register on March 1, 2000.

Solicitation of Contributions

There are numerous Code provisions regulating the solicitation and receipt of charitable contributions. For example, exempt organizations not eligible to receive tax-deductible charitable contributions are required under section 6113 to disclose in certain solicitations for contributions that such contributions are not deductible for federal income tax purposes as charitable contributions. Charitable organizations that receive certain "*quid pro quo*" contributions in excess of $75 are required under section 6115 to provide a written statement to the donor that indicates that the charitable deduction is limited to the amount paid by the donor in excess of the value of the goods or services provided by the organization and that provides a good faith estimate of that value. Under section 170(f)(8), donors making contributions of $250 or more to a charitable organization must substantiate the contribution with a contemporaneous written acknowledgement from the charitable organization in order for the deduction to be allowed.

An increasing number of exempt organizations solicit contributions on the Internet. In some instances, the organization's website merely indicates where to send contributions to the organization. In other cases, the organization is able to accept contributions on the Internet, either directly or through a third party that provides a secure connection for credit card transactions. The Service is considering the need for clarification regarding such activities, including the following:

- Are solicitations for contributions made on the Internet (either on an organization's website or by email) in "written or printed form" for purposes of section 6113? If so, what facts and circumstances are relevant in determining whether a disclosure is in a "conspicuous and easily recognizable format"?
- Does an organization meet the requirements of section 6115 for "*quid pro quo*" contributions with a webpage confirmation that may be printed out by the contributor or by sending a confirmation email to the donor?
- Does a donor satisfy the requirement under section 170(f)(8) for a written acknowledgment of a contribution of $250 or more with a printed webpage confirmation or copy of a confirmation email from the donee organization?

REQUEST FOR PUBLIC COMMENT

The Service is soliciting public comment regarding the need for additional guidance clarifying the application of the Code to exempt organizations' Internet activities. The Service requests comments not only on the situations described above, but also on any other issues concerning application of provisions of the Code in a fair and neutral manner to exempt organizations' Internet activities.

Public comments should be submitted in writing on or before February 13, 2001. Comments should be sent to the following address:

Internal Revenue Service
1111 Constitution Ave, NW
Washington, DC 20224
Attn: Judith E. Kindell
T:EO

Comments may also be sent electronically via the Internet to *TE/GE-Exempt-2@irs.gov.

DRAFTING INFORMATION

The principal author of this announcement is Judith E. Kindell of Exempt Organizations. For further information regarding this announcement contact Judith E. Kindell at (202) 622-6494 (not a toll-free call).

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

Section 832.—Insurance Company Taxable Income

26 CFR 1.832–4: Gross income.

The salvage discount factors are set forth for the 2000 accident year. These factors will be used for computing estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 2000–45, page 417.

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 2000 accident year. These factors will be used for computing discounted unpaid losses under section 846 of the Code. See Rev. Proc. 2000–44, page 409.

26 CFR 1.846–1: Application of discount factors.

The salvage discount factors are set forth for the 2000 accident year. These factors will be used for computing estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 2000–45, page 417.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

Following is a Copy of the News Release Issued by International (U.S. Competent Authority) on April 20, 2000 (IR-INT-2000-9)

Notice 2000-57

AGREEMENT IDENTIFIES U.S. AND DUTCH PENSION PLANS FOR TAX TREATY BENEFITS

Washington – The Competent Authorities of the The Netherlands and the United States reached a mutual agreement on the qualification of certain Dutch and U.S. pensions for treaty benefits under Article 35 of the US-Netherlands Income Tax Treaty. The agreement specifies the procedures for claiming treaty benefits in each country and the methods each country will use to grant treaty benefits.

The agreement constitutes a Mutual Agreement in accordance with the Convention between the Kingdom of the Netherlands and the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on December 18, 1992, and amended by Protocol signed on October 13, 1993.

The agreement is as follows:

Chapter I

Qualification for treaty benefits under article 35 of the 1992 Netherlands-US income tax treaty

Questions have been raised regarding the types of US and Netherlands resident tax exempt trusts, companies or other organisations providing pension or retirement benefits that qualify for treaty benefits under article 35 of the Convention between the Kingdom of the Netherlands and the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 18 December 1992, and amended by Protocol signed on 13 October 1993 (in the following: the Treaty). In practise there are many different types of funds or plans established to provide pension or retirement benefits and it is not always clear which of these funds or plans fulfill the requirements of article 35 of the Treaty. This issue is being discussed between the Netherlands and the US competent authorities under the mutual agreement procedure of article 29 of the Treaty, with the following initial conclusions.

In view of the present uncertainty it has been decided to identify all the different types of US and Netherlands resident tax exempt trusts, companies or other organisations providing pension or retirement benefits that are considered to fall within the scope of article 35 of the Treaty and also to indicate the appropriate procedures for filing a request for an application of treaty benefits under said treaty provision.

In the course of the mutual agreement discussions it became apparent that, whereas with respect to certain types of US and Netherlands resident tax exempt trusts, companies or other organisations providing pension or retirement benefits it is beyond doubt that they fall within the scope of article 35 of the Treaty, with respect to other types of US and Netherlands resident tax exempt trusts, companies or other organisations providing pension or retirement benefits this is less clear. The Netherlands and US authorities concluded that all the different types of Netherlands and US resident tax exempt trusts, companies or other organisations providing pension or retirement benefits mentioned in chapter II and IV of this agreement would be considered to fall within the scope of article 35 of the Treaty.

However, in order to ensure that treaty protection is restricted to qualifying US resident tax exempt trusts providing pension or retirement benefits, the Netherlands competent authority would -at least for the time being- prefer a closer monitoring of all requests filed for an application of treaty benefits under article 35 of the Treaty.

It is understood that for the purpose of this publication the term "Code section" refers to sections of the US Internal Revenue Code and that the term "trust" includes a custodial account treated as a trust for US federal income tax purposes.

Chapter II

US resident tax exempt trusts providing pension or retirement benefits

Subject to the conditions of article 26, article 35, paragraph 2, and article 34, paragraph 4, of the Treaty:

1. a US resident tax exempt trust providing pension or retirement benefits under a Code section 401 (a) qualified pension plan, profit sharing plan or stock bonus plan (including Code section 401 (k) arrangements); or

2. a US resident tax exempt trust providing pension or retirement benefits under a Code section 457(b) pension plan or under a Code section 403(b) plan; or

3. a US resident tax exempt trust which is an Individual retirement account (Code section 408), a Roth Individual retirement account (Code section 408A), or a Simple retirement account, or a US resident tax exempt trust which is providing pension or retirement benefits under a Simplified employee pension plan; or

4. a US resident common trust fund or group trust which is tax exempt under Code section 501 (a) with respect to funds that equitably belong to its participating trusts, all of which are entities mentioned under point 1) above; or

5. a US resident common trust fund or group trust which is tax exempt under the Internal Revenue Code with respect to funds that equitably belong to its participating trusts, some of which are trusts other than those mentioned under point 1) above, but all of which are trusts mentioned under point 1), 2), or 3) above, is considered to qualify for treaty benefits under article 35 of the Treaty and may claim application of treaty benefits with respect to income derived from the Netherlands referred to in article 10 (dividends) of the Treaty. The Netherlands does not apply a withholding tax on outgoing interest payments as meant in article 12 of the Treaty.

However, a US resident tax exempt trust mentioned under point 2) or 3) above will not be considered to qualify for treaty benefits under article 35 of the Treaty in any taxable year if less than 70% of the total amount of the withdrawals from such US trust during that year is used to provide pension, retirement or other employee benefits as meant in article 35 of the Treaty.

Any type of US resident tax exempt trust not mentioned above, which consid-

ers itself to qualify for treaty benefits under article 35 of the Treaty, may present its case to the Netherlands tax unit BPO buitenland, Heerlen (address: P.O. Box 2865, 6401 DJ HEERLEN, The Netherlands), or to the US competent authorities requesting for a competent authority consideration under article 29 of the Treaty.

Chapter III

Appropriate procedures for filing a request for an application of treaty benefits in the Netherlands

The Netherlands has two methods for granting treaty benefits for income referred to in article 10 (dividends) of the Treaty, these methods being: the so-called exemption method (in which case the treaty rate is applied at source) and the so-called refund method.

As a general rule, the Netherlands applies the exemption method when granting treaty benefits in the case of Dutch source dividend income received by a resident of the US, which means that treaty benefits will be granted by means of an exemption from Netherlands withholding tax at source. In view of the Netherlands competent authority's preference for a closer monitoring of all requests filed for an application of treaty benefits under article 35 of the Treaty, a US resident tax exempt trust (including a US common trust fund or group trust) mentioned in point 1) through 5) of chapter II of this publication shall - as a general rule - be required to use the refund method when filing its request for an application of treaty benefits under article 35 of the Treaty. Only if certain conditions are fulfilled, such US resident tax exempt trust may use the exemption method when filing its request for an application of treaty benefits under article 35 of the Treaty.

The Netherlands regulations for the implementation of the Treaty, published in the "Staatscourant" 5 January 1994, nr. 3 and lastly amended on December 1996 ("Staatscourant" 30 December 1996, nr. 250), give a detailed description of the procedures to be applied in the case of respectively the exemption method and the refund method.

The exemption method may be used if the US resident tax exempt trust requesting treaty benefits under article 35 of the Treaty:

* has been issued a certification letter (Form 6166) by the US Internal Revenue Service for the taxable year(s) in question, stating that the trust in question is a trust forming part of a pension, profit sharing, or stock bonus plan qualified under Code section 401 (a) of the Internal Revenue Code (an example of a certification letter (Form 6166) is attached); or

* has been issued a so-called "qualification" certification by the competent Netherlands tax authorities, stating that the trust in question is a US resident tax exempt trust as described in article 35, paragraph 1, of the Treaty.

Requests for a "qualification" certification may be filed with the tax unit BPO buitenland, Heerlen (address: P.O. Box 2865, 6401 DJ HEERLEN, The Netherlands).

A "qualification" certification, issued by the competent Netherlands authorities, is in principle valid indefinitely. However, a "qualification" certification will no longer be valid in the event:

*there is a material change in facts or circumstances; or

*It is determined that the "qualification" certification was issued erroneously; or

*the US resident tax exempt trust in question has not claimed an application of treaty benefits under article 35 of the Treaty for five consecutive calendar years. Since a certification letter (Form 6166) issued by the US Internal Revenue Service is not valid indefinitely, a US resident tax exempt trust which has been issued a certification letter (Form 6166) by the US Internal Revenue Service may also file a request for a "qualification" certificate with the competent Netherlands tax authorities.

Irrespective of the above, use of the refund method is mandatory in any taxable year for a US resident tax exempt trust mentioned under point 2) or 3) of chapter II, if less than 70% of the total amount of the withdrawals from such US trust during that year is used to provide pension or retirement benefits.

Where assets of the pension fund(s) or pension plan(s) are held in custodial accounts, the amended form IB 92 USA will require a certification that the claim for a refund of Dutch dividend tax is filed for the benefit of the custodial accounts in question.

The status of all US resident tax exempt trusts providing pension or retirement benefits and claiming treaty benefits under article 35 of the Treaty may at any time be subject to verification by the competent Netherlands tax authority. If considered necessary, use will be made of the exchange of information procedure (article 30 of the Treaty).

The Netherlands regulations for the implementation of the Treaty (including the "special arrangements" issued by the Netherlands competent authority in the relation to the US) and Form IB 92 USA will - where necessary - be amended in accordance with the above. A model of the "special arrangements" is published in the Infobulletin of 12 January 1999.

The new procedures will become applicable beginning with dividends made payable after 30 June 2000. The presently existing procedures will remain applicable for dividends made payable before or on 30 June 2000.

Chapter IV

Netherlands resident tax exempt companies providing pension or retirement benefits

Subject to the conditions of article 26, article 35, paragraph 2, and article 34, paragraph 4, of the Treaty, a Netherlands resident tax exempt company constituted and operated exclusively to administer or provide benefits as meant in article 5, paragraph b), of the Netherlands corporation tax act (including a Netherlands resident tax exempt company constituted and operated exclusively to administer or provide benefits under a pension plan as meant in article 8, paragraph 1, under f), of the Netherlands income tax act) is considered to qualify for treaty benefits under article 35 of the Treaty and may claim application of treaty benefits with respect to income derived from the United States of America referred to in article 10 (dividends) and in article 12 (interest) of the Treaty.

Any type of Netherlands resident tax exempt company not mentioned above, which considers itself to qualify for treaty benefits under article 35 of the Treaty, may present its case to the United States competent authority, or to the Netherlands competent authority requesting for a competent authority consideration under article 29 of the Treaty.

Chapter V

Appropriate procedures for filing a request for an application of treaty benefits in the United States of America

Under US tax law a Netherlands resident taxpayer (including a Netherlands resident tax exempt company referred to in article 35 of the Treaty) may file for an application of treaty benefits at source, or may claim a refund of US income tax withheld according to regulations set forth under the Internal Revenue Code. The following procedures apply to a Netherlands resident tax exempt company.

A Netherlands resident tax exempt company described in this agreement should claim exemption from US income tax withholding under Article 35 of the 1992 Netherlands-US income tax treaty on dividends or interest income referred to in articles 10 and 12, respectively, of that treaty by providing a properly completed IRS Form W-8BEN to the withholding agent or payer of such income before the income is paid or credited to the company. A company filing Form W-8BEN should cite Article 35 of the treaty on line 10 thereof, and state that it is a Netherlands resident tax exempt company described in this agreement.

Notwithstanding the foregoing, until December 31, 2000, and to the extent provided in transition rules set forth in regulations under Internal Revenue Code section 1441 and Notice 99–25, 1999–20 I.R.B. 75, a Netherlands resident tax exempt company may provide, and a withholding agent may rely upon, other appropriate documentation of the company's exempt status, including, for example, a Form 1001, supplemented by a statement, or a valid Netherlands Form IB 93 USA (certified by the tax inspector competent in the case of the Netherlands tax exempt company in question) stating that the company is a Netherlands resident tax exempt company described in this agreement.

Alternatively, the company may seek a refund of taxes withheld on such dividend or interest income by timely filing a United States income tax return and claiming a refund of such taxes.

The status of all Netherlands resident tax exempt companies providing pension or retirement benefits and claiming treaty benefits under article 35 of the Treaty may be subject to verification by the Internal Revenue Service. If considered necessary, use will be made of the exchange of information procedure (article 30 of the Treaty).

A Netherlands resident tax exempt company as meant in article 5, paragraph b), of the Netherlands corporation tax act (including a Netherlands resident tax exempt company providing pension or retirement benefits as meant in article 8, paragraph 1, under f), of the Netherlands income tax act) may have the Netherlands tax authority concur in its claim of tax exempt status by means of a so-called article 26 declaration (Form IB 93 USA), certified by the tax inspector competent in the case of the Netherlands tax exempt company in question. This will not, however, preclude an audit and determination of the company's substantive liability.

As noted in Article 6 of the Protocol, Article 35(2) of the Treaty provides that dividends from a Real Estate Investment Trust are not eligible for Article 35 benefits. Article 35(2) also provides that income of an exempt pension trust is not exempt under Article 35 if it is received from a related person that is not itself an exempt pension trust. Paragraph VIII of the Agreed Minutes to the Protocol provides the understanding of the negotiators that for purposes of Article 35(2), a person will be considered to be a "related person" if more than 80 percent of the vote or value of any class of shares is owned by the person deriving the income.

Chapter VI

Tax exempt trusts, companies or other organisations providing other employee benefits

In order to determine whether a clarification of the qualification under article 35 of the Treaty for the various types of tax exempt trusts, companies or other organisations providing other employee benefits is also considered necessary, comments or questions regarding this issue are invited and may be sent to to one of the following addresses:

Ministry of Finance of the Netherlands
Directorate for International Tax Policy and Legislation
P.O. Box 20201
2500 EE Den Haag
The Netherlands

Assistant Commissioner
(International)
attn. Tax Treaty Division
Internal Revenue Service
P.O. Box 23598
Washington, D.C. 20024
United States of America

Attachment:
Form 6166 (Rev. 6–96)

CERTIFICATION
PROGRAM

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
PHILADELPHIA, PA 19255

Taxpayer:
EIN:
Tax Year:

I certify that, to the best of our knowledge, the above-named entity is a trust forming part of a pension, profit-sharing, or stock bonus plan qualified under section 401(a) of the U.S. Internal Revenue Code, which is exempt from from U.S. taxation under section 501(a), and is a resident of the United States of America for purposes of U.S. taxation.

Form 6166 (Rev. 6-98)
Catalog No. 43134V

Part III. Administrative, Procedural, and Miscellanous

Weighted Average Interest Rate Update

Notice 2000–55

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 2000 is 5.83 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	2000	5.95	5.35 to 6.24	5.35 to 6.54

Drafting Information

The principal author of this notice is Todd Newman of the 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).

Rabbi Trusts

Notice 2000–56

I. PURPOSE

This notice provides guidance on which entity is treated as the grantor and owner of a grantor trust when a parent corporation contributes its stock to a rabbi trust for the benefit of the employees of a subsidiary.

II. BACKGROUND

(i) Rabbi Trust Model

Rev. Proc. 92–64, 1992–2 C.B. 422, contains a model grantor trust for use in nonqualified executive compensation arrangements that are popularly referred to as "rabbi trust" arrangements. Under that revenue procedure, the Service will not rule on unfunded deferred compensation arrangements that use a trust other than the model trust, except in rare and unusual circumstances. Section 1(d) of the model trust document states that "Any assets held by the Trust will be subject to the claims of the Company's general creditors under federal and state law in the event of Insolvency, as defined in Section 3(a) herein." In the case of a trust that provides benefits to employees of a subsidiary, it is the Service's position that Section 1(d) will not be satisfied unless the assets held by the trust are subject to the claims of the subsidiary's creditors (whether or not those assets are also subject to the claims of the parent's creditors). In this case, it has been the Service's position that the subsidiary is treated as the grantor and owner of the rabbi trust.

(ii) Final Regulations under Section 1032 of the Internal Revenue Code

Section 1032 states that no gain or loss is recognized to a corporation on the receipt of money or other property in exchange for stock of the corporation. Regulations were recently issued under section 1032 of the Internal Revenue Code (*see* 65 F.R. 31073 (May 16, 2000)). Section 1.1032–3(b)(1) of these regulations provides that no gain or loss is recognized on the disposition of the issuing corporation's stock by an acquiring entity if the requirements set forth in Reg. § 1.1032–3(c) are met. Section 1.1032–3(c)(2) requires, among other things, that the acquiring entity transfer the stock of the issuing corporation to another person immediately after acquiring the stock from the issuing corporation (the "immediacy requirement"). Under the regulations, if the requirements of Reg. § 1.1032–3(c), including the immediacy requirement, are met, the transaction is treated as if, immediately before the acquiring entity transfers the stock of the issuing corporation, the acquiring entity purchased the issuing corporation's stock from the issuing corporation for fair market value with cash contributed to the acquiring entity by the issuing corporation (or, if necessary, through intermediate corporations or partnerships). This series of transactions is commonly referred to as the "cash purchase model."

Rabbi trust arrangements typically do not involve an immediate transfer of stock to employees. In the case of a rabbi trust arrangement in which Parent Stock is treated for federal tax purposes as owned by a subsidiary for a period of time before the Parent Stock is transferred to the employees of the subsidiary, the immediacy requirement of Reg. §1.1032–3(c)(2) will not be satisfied when the Parent Stock is transferred from the rabbi trust to employees of the subsidiary. Because the cash purchase model of those Regulations will as a result not apply, the nonrecognition treatment of section 1032 will be inapplicable in such a case, and, thus, the subsidiary typically will recognize gain on the transfer of the Parent Stock from the rabbi trust to employees of the subsidiary.

III. TREATMENT OF PARENT CORPORATION AS GRANTOR OF A RABBI TRUST

The Service and Treasury have determined that when a parent corporation contributes Parent Stock to a rabbi trust to assist a subsidiary in meeting the subsidiary's deferred compensation obligations to its employees or service providers, and the Parent Stock is both subject to the claims of the creditors of the parent corporation and subject to the requirement that any Parent Stock not

transferred to the subsidiary's employees will revert to the parent on termination of the trust, then the parent corporation will be considered the grantor and the owner of the Parent Stock held in the trust, even though the Parent Stock is also subject to the claims of the creditors of the subsidiary. If these conditions are satisfied, the Parent Stock (or other assets) will not be considered transferred to the subsidiary until such time as they are used to satisfy the subsidiary's deferred compensation obligation to its employees or service providers, or when a claim is made against the trust by a creditor of the subsidiary in the case of the subsidiary's insolvency. Thus, the immediacy requirement of Reg. § 1.1032–3(c)(2) would be satisfied with respect to the Parent Stock.

This concept is illustrated in Example 10 of Reg. § 1.1032–3(e). In the example, in Year 1, the issuing corporation, X, forms a trust which it will use to satisfy deferred compensation obligations owed by Y, X's wholly owned subsidiary, to Y's employees. X funds the trust with X stock which would revert to X upon termination of the trust, subject to the employees' rights to be paid the deferred compensation. The creditors of X can reach all trust assets upon the insolvency of X. Similarly, the creditors of Y can reach all trust assets upon the insolvency of Y. In Year 5, the trust transfers X stock to the employees of Y in satisfaction of the deferred compensation obligation. The example states that X is considered to be the grantor of the trust, and, under section 677 of the Code, X is also the owner of the trust. Y is not considered a grantor or owner of the trust corpus at the time X transfers X stock to the trust. Any income earned by the trust would be reflected on X's income tax return. In Year 5, when employees of Y receive X stock in satisfaction of the deferred compensation obligation, no gain or loss is recognized by X or Y on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for fair market value using cash contributed to Y by X. Under section 358, X's basis in its Y stock increases by the amount of cash deemed contributed. Accordingly, when employees or service providers of Y receive X stock in satisfaction of the deferred compensation obligation, the requirements of § 1.1032–3(c) are satisfied, and no gain or loss is recognized by X or Y on the deemed disposition of the X stock by Y.

Similarly, the parent corporation will be treated as the grantor and owner of assets other than Parent Stock that are contributed by the parent corporation to a rabbi trust if the assets are both subject to the claims of the creditors of the parent corporation and subject to the requirement that any such assets not transferred to the subsidiary's employees or service providers will revert to the parent on termination of the trust, even though such assets are also subject to the claims of the creditors of the subsidiary. The cash purchase model applies only to transfers of stock by the parent corporation to the trust. Therefore, when assets other than Parent Stock are transferred from the trust to the employees of the subsidiary, the subsidiary is treated as receiving the other assets from the parent corporation with the parent's carryover basis and the subsidiary will recognize gain or loss (if any) on the transfer of the assets to the subsidiary's employees or service providers.

IV. MODIFICATION TO MODEL TRUST UNDER REV. PROC. 92–64

The Service will rule on a request submitted under Rev. Proc. 92–64 where the model language has been modified to provide that Parent Stock (or other assets) contributed by a parent corporation to a rabbi trust for the benefit of employees or service providers of a subsidiary is subject to the claims of the creditors of both the parent corporation and the subsidiary, and the remaining Parent Stock (or other assets) contributed by the parent corporation reverts to the parent corporation upon termination of the trust.

V. TRANSITION PROVISIONS FOR EXISTING TRUSTS

The Service will not challenge a taxpayer's position that no gain or loss is recognized by a subsidiary upon the rabbi trust's disposition of Parent Stock contributed to the rabbi trust by the parent corporation on or before May 16, 2001, with respect to trusts in existence on or before June 15, 2000.

If the terms of the rabbi trust are amended to provide that assets (including Parent Stock) contributed by the parent corporation to the rabbi trust are subject to claims of the parent corporation's creditors (in addition to being subject to the claims of the subsidiary's creditors) and those assets not transferred to the subsidiary's employees or service providers will revert to the parent corporation upon termination of the rabbi trust, the Service will not treat such amendment as a constructive dividend to the parent corporation, provided the amendment is adopted by May 16, 2001.

VI. EFFECT ON OTHER GUIDANCE

Rev. Proc. 92–64 will not fail to be satisfied if Parent Stock (or other assets) contributed by a parent corporation to a rabbi trust for the benefit of employees or service providers of a subsidiary is subject to the claims of the creditors of the parent corporation and the subsidiary, and the remaining Parent Stock (or other assets) contributed by the parent corporation reverts to the parent corporation upon termination of the trust.

DRAFTING INFORMATION

The principal author of this notice is Susan Lennon of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the Service and the Treasury Department participated in its development. For further information regarding this notice, contact Ms. Lennon at (202) 622-6030 (not a toll-free telephone number).

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26 CFR 1.1503–2 Dual consolidated loss.
26 CFR 301.7121–1 Closing agreements.

Rev. Proc. 2000–42

SECTION 1. PURPOSE

This revenue procedure informs taxpayers of the information they must submit to request a closing agreement under §1.1503–2(g)(2)(iv)(B)(2)(i) to prevent the recapture of dual consolidated losses (DCLs) upon the occurrence of certain triggering events.

Before this revenue procedure, the Internal Revenue Service and the Department of the Treasury had not specified in detail how taxpayers should request these

closing agreements. The Service and Treasury are issuing this revenue procedure to provide taxpayers with guidance on the information and representations they should include in a §1503(d) closing agreement request and to facilitate the process and reduce the time necessary for the Service to process requests.

Appendix A to this revenue procedure is a model closing agreement. The Service intends the model closing agreement to serve as an example of the format and contents of a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement and to aid taxpayers in understanding how the information required by this revenue procedure will be used in the closing agreement. Taxpayers should note, however, that the model agreement is only an example. A taxpayer's actual agreement could differ from the model. Finally, Appendix B is a flow chart of the entities included in the model closing agreement, along with notes explaining the model agreement.

SECTION 2. BACKGROUND

The United States taxes the worldwide income of domestic corporations. The United States allows certain domestic corporations to file consolidated returns with other affiliated domestic corporations. When two or more domestic corporations file a consolidated return, losses that one corporation incurs generally may reduce or eliminate tax on income that another corporation earns.

Because other countries may apply different standards for determining the residence and taxability of a corporation (e.g., based on the management and control of the corporation), some domestic corporations are dual resident corporations and, as such, are also subject to the income tax of a foreign country on their income on a residence basis (and not on a source basis). Foreign countries often have provisions that permit commonly owned entities to combine their income and losses through consolidation or some other form of combined reporting for income tax purposes.

Prior to the Tax Reform Act of 1986, if a dual resident corporation were a resident of a foreign country with tax laws that permitted the losses of the corporation to be used to offset the income of another person (e.g., under a consolidated return provision), then the dual resident corporation could use any losses it generated twice: once to offset the income of affiliates resident in the United States (but not abroad), and again to offset the income of its affiliates resident only in the other country. Thus, such a dual resident corporation could use a single economic loss to offset two separate items of income in two jurisdictions. Congress expressed concerns that this dual use of a loss could result in an undue tax advantage to certain foreign investors that made investments in domestic corporations, and could create an undue incentive for certain foreign corporations to acquire domestic corporations and for domestic corporations to acquire foreign rather than domestic assets. Staff of Joint Committee on Taxation, 99th Cong., 2nd Sess., General Explanation of the Tax Reform Act of 1986, at 1064 – 1065 (1987). As part of the Tax Reform Act of 1986, Congress responded by enacting §1503(d) to prevent the use of DCLs that resulted from consolidation in multiple jurisdictions.

The Treasury and Service issued temporary regulations under §1503(d) in 1989 (T.D. 8261, 1989–2 C.B. 220), and final regulations in 1992 (T.D. 8434, 1992–2 C.B. 240). The final regulations in §1.1503–2 are generally effective for taxable years beginning on or after October 1, 1992; the temporary regulations in §1.1503–2A are effective for taxable years beginning after December 31, 1986, and before October 1, 1992. The temporary regulations were initially designated as §1.1503–2T, but were redesignated as §1.1503–2A by the final regulations.

Section 1503(d) provides that a DCL of a dual resident corporation shall not be allowed to reduce the taxable income of any other member of the corporation's affiliated group for any taxable year. The term dual resident corporation includes a domestic corporation that is subject to the income tax of a foreign country on its worldwide income or on a residence basis and a separate unit of a domestic corporation (e.g., a foreign branch, an interest in a partnership, an interest in a trust, or a disregarded entity that a foreign country taxes at the entity level). *See* Treas. Reg. §1.1503–2(c)(2) – (4). This revenue procedure will collectively refer to dual resident corporations and separate units as "DRCs."

The final §1503(d) regulations permit a taxpayer to elect to use a DCL of a DRC by entering into an agreement under §1.1503–2(g)(2)(i) in which the taxpayer certifies that the DCL has not been, and will not be, used to offset the income of another person under the laws of a foreign country. Certain subsequent events, known as "triggering events" require the taxpayer to recapture the losses as income, including an interest charge. Treas. Reg. §§1.1503–2(g)(2)(iii) and (vii). If a taxpayer fails to comply with the §1503(d) recapture provisions upon the occurrence of a triggering event, then the DRC (or a successor-in-interest) that incurred the DCL generally will not be eligible for relief to use any DCLs incurred in the five (5) taxable years beginning with the year in which recapture is required. Treas. Reg. §1.1503–2(g)(2)(vii)(F)(1).

Triggering events occur when: (1) any portion of the loss taken into account in computing the DCL is used by any means to offset the income of any other person for foreign tax purposes within fifteen (15) years; (2) a DRC or domestic owner of a separate unit ceases to be a member of the consolidated group that filed the agreement at a time when there is a continuing ability to use the DCL to offset income of another person for foreign tax purposes; (3) an unaffiliated DRC or unaffiliated domestic owner of a separate unit becomes a member of a consolidated group, unless there is no continuing ability to use the DCL to offset income of another person for foreign tax purposes; (4) a DRC transfers its assets to a transferee in a transaction that results, under the laws of a foreign country, in a carryover of the losses, expenses, or deductions that make up the DCL; (5) a domestic owner of a separate unit disposes of fifty (50) percent or more of the assets of, or its interest in, the separate unit at a time when there is a continuing ability to use the DCL to offset income of another person for foreign tax purposes; (6) an unaffiliated DRC or unaffiliated domestic owner of a separate unit becomes a foreign corporation in a transaction that, for foreign tax purposes, is not treated as involving a transfer of assets to a new entity, unless there is no continuing ability to use the DCL to offset income of another person for foreign tax purposes; or (7) the taxpayer fails to file an annual certification required under §1.1503–2(g)(2)(vi)(B). Treas. Reg. §1.1503–2(g)(2)(iii)(A).

The final regulations provide two exceptions to events described as triggering events, making the events not triggering events requiring recapture of losses and an interest charge. The first exception, under §1.1503–2(g)(2)(iv)(A), applies when a DRC, or its assets, is acquired by another member of the DRC's consolidated group. The second exception, under §1.1503–2(g)(2)(iv)(B), applies, provided the taxpayer enters into a closing agreement, when a DRC or a domestic owner of a separate unit becomes disaffiliated from its consolidated group, or when an unaffiliated domestic corporation or new consolidated group acquires the DRC or its assets.

The Service is aware that as a result of taxpayers' ability to elect entity classification under the §7701 elective Federal tax classification regulations that became effective as of January 1, 1997 (i.e., the check-the-box regulations), the number of DRCs may increase, and taxpayers may become subject to the §1503(d) DCL provisions, including the recapture provisions. For instance, the conversion of a foreign branch to a foreign corporation may be treated as a triggering event under the final §1503(d) regulations. *See* Treas. Reg. §§1.1503–2(g)(2)(iii)(A)(4) – (7) and Treas. Reg. §301.7701–3(g)(1). Therefore, this procedure is also intended to publicize the Service's procedures and requirements that will prevent certain reorganization and disposition transactions involving DRCs from resulting in §1503(d) recapture consequences.

SECTION 3. SCOPE

.01 General.

This section provides the conditions that must be satisfied for the Service to consider requests from taxpayers for a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement.

.02 Taxpayers Must Be In Compliance And Must First Request Any Treas. Reg. §301.9100 Relief Needed.

Before requesting a closing agreement under §1.1503–2(g)(2)(iv)(B)(2)(i), the taxpayer should ensure that it has complied with the regulations issued under §1503(d), including having filed the requisite agreements, elections, and certifications under §1.1503–2(g)(2) (or §1.1503–2A(c)(3) or (d)(3) if the taxpayer is asking for relief under §1.1503–2A). *See infra*, section 3.07 (which provides when the Service will consider including in a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement, DCLs covered by the temporary §1503(d) regulations). In practical terms, this means that the taxpayer should first request and secure (or at least simultaneously request) any necessary relief under §301.9100 for an extension of time to make any required election or application under the §1503(d) regulations. For example, a taxpayer that has not filed the requisite agreements and elections under §1.1503–2(g)(2)(i) must first request (or simultaneously request) §301.9100 relief to file the elections and agreements.

Under §§1.1503–2(g)(2)(iii)(A) and (iv)(B), a taxpayer must enter into a closing agreement with the Service before the taxpayer files its tax return for the taxable year of a triggering event to prevent the recapture of losses and the accompanying interest charge. Under this revenue procedure, however, a taxpayer can prevent the recapture of losses and the interest charge if the taxpayer submits its request for a closing agreement by the due date of its tax return (including extensions) for the triggering event year and specifies on its tax return that it is requesting a §1503(d) closing agreement.

.03 Statutes Of Limitations.

The Service may request a taxpayer to execute a consent to extend the period of limitations for assessment of tax for the taxable periods related to the DCLs for which the taxpayer has requested a closing agreement.

.04 When And By Whom A Closing Agreements May Be Executed.

Treas. Reg. §1.1503–2(g)(2)(iv)(B)(1) provides that if the requirements of §1.1503–2(g)(2)(iv)(B)(2) are met, the following events will not constitute triggering events requiring the recapture of DCLs: (1) an affiliated DRC or an affiliated domestic owner becomes an unaffiliated domestic corporation or a member of a new consolidated group; (2) an unaffiliated DRC or an unaffiliated domestic owner becomes a member of a consolidated group; (3) assets of a DRC are acquired by an unaffiliated domestic corporation or a member of a new consolidated group; or (4) a domestic owner of a separate unit transfers its interest in the separate unit to an unaffiliated domestic corporation or to a member of a new consolidated group. Treas. Reg. §1.1503–2(g)(2)(iv)(B)(2) requires (among other requirements) that the taxpayers enter into a closing agreement with the Service which provides that the taxpayers will be jointly and severally liable for the total amount of the recapture of the DCLs and an interest charge upon any subsequent triggering event.

The Service may execute a closing agreement under §1.1503–2(g)(2)(iv)(B)(2)(i) and §7121 with the following taxpayers: (1) the consolidated group (i.e., the parent on behalf of the consolidated group), the unaffiliated DRC, or the unaffiliated domestic owner that filed the §1.1503–2(g)(2)(i) agreement for the relevant DCLs, and (2) the unaffiliated domestic corporation or the new consolidated group, provided the requirements of §1.1503–2(g)(2)(iv)(B) are satisfied. This revenue procedure will refer to these taxpayers as the "Taxpayer Parties." Authorized officers of the Taxpayer Parties must sign the closing agreement (generally two originals per party to the agreement).

.05 Taxpayers That Cannot Execute A Closing Agreement.

The Service will not execute a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement with foreign entities/transferees, individuals, or partnerships. Section 1.1503–2 does not provide for closing agreements with such taxpayers.

.06 Losses Must Be DCLs.

The Service will not execute a closing agreement with taxpayers for net operating losses (NOLs) that are not DCLs. Therefore, taxpayers must represent that the losses at issue are DCLs.

.07 Closing Agreements For Losses Under The Temporary Regulations.

The final regulations provide for taxpayers to enter into a §1.1503–2(g)(2)-

(iv)(B)(2)(i) closing agreement with the Service to prevent certain events from resulting in recapture and an interest charge; the temporary regulations do not contain such a provision. In appropriate circumstances, taxpayers may elect to apply the final regulations to DCLs which are otherwise subject to §1.1503–2A. Treas. Reg. §1.1503–2(h). If a taxpayer files a request to enter into a closing agreement for losses covered by the final regulations, under this revenue procedure, the Service will consider a request to include in the closing agreement DCLs otherwise covered by §1.1503–2A for which the taxpayer has not made a §1.1503–2(h) election to apply the final regulations. This revenue procedure's reference to "representations and citations as appropriate under §1.1503–2A," means representations and citations related to a DCL covered by §1.1503–2A.

SECTION 4. PROCEDURE TO ENTER INTO A CLOSING AGREEMENT

.01 General.

The first revenue procedure published each year (the Annual Revenue Procedure) outlines the general procedures of the Service for the issuance of letter rulings and determination letters, including closing agreements entered into under the authority of §7121, by the National Office. *See, e.g.*, Rev. Proc. 2000–1, 2000–1 I.R.B. 4. Taxpayers should note that the Service also publishes an annual revenue procedure, generally in the first Internal Revenue Bulletin of the year, which provides a list of those areas of the Code under the jurisdiction of the Associate Chief Counsel (International), for which the Service will not issue advance letter rulings, (e.g., certain §1503(d) determinations, such as whether the conditions for excepting losses of a DRC from the definition of a DCL are satisfied). *See, e.g.*, Rev. Proc. 2000–7, 2000–1 I.R.B. 227.

The consolidated group (i.e., the parent on behalf of the consolidated group), the unaffiliated DRC, or the unaffiliated domestic owner that filed the agreements under §1.1503–2(g)(2)(i) for the DCLs for which the closing agreement would relate may file a request to enter into a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement by following the procedures of the most recent Annual Revenue Procedure and this revenue procedure. Taxpayers must include the user fee required by the most recent Annual Revenue Procedure.

.02 Additional Information.

Because the information, representations, and documentation necessary to enter into a closing agreement depend on all the facts and circumstances, the Service may require information, representations, and documentation in addition to that set forth in this revenue procedure and the most recent Annual Revenue Procedure. Taxpayers should submit such additional information in accordance with the Annual Revenue Procedure and within the time allowed by the Annual Revenue Procedure. If a taxpayer does not submit the information requested within the time provided, the request will be closed and the taxpayer will be notified in writing. *See, e.g.*, section 10.06(3), Rev. Proc. 2000–1. If while processing a taxpayer's request for a §1503(d) closing agreement, the Service determines that the taxpayer is not in compliance with the §1503(d) regulations and needs relief under §301.9100 to obtain an extension of time to make a required election or application under the §1503(d) regulations, then the taxpayer has thirty (30) days from the date the Service notifies the taxpayer to file a request for relief under §301.9100. If a taxpayer does not submit the §301.9100 request within the thirty-day period, the §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement request will be closed and the taxpayer will be notified in writing.

Taxpayers are responsible for keeping the Service informed of all material changes to the information, representations, and documentation submitted as part of the closing agreement request.

SECTION 5. INFORMATION TAXPAYERS MUST INCLUDE IN REQUEST

.01 General.

This section describes the information, representations, and documentation that taxpayers are expected to provide with a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement request. Taxpayers should organize information and representations following the format of this procedure and should use appropriate descriptive headings. To facilitate the processing of the closing agreement request, taxpayers must also provide a full statement of all relevant facts related to the taxpayers and the DCLs.

Taxpayers must address each item in this section, providing all relevant facts. If an item is not applicable, taxpayers should so state and briefly explain why.

.02 Information Related To Taxpayer Parties, Relevant Members Of The Consolidated Group, And DRCs.

Taxpayers must provide a full statement of the facts, including the following general information, as appropriate, about each Taxpayer Party, relevant member of the consolidated group, and DRC with losses that will be covered by the closing agreement.

1. Name, address, and employer identification number.
2. Type of entity, and date and place of incorporation or other formation.
3. Information about the formation and treatment of disregarded entities directly or indirectly owned by a Taxpayer Party (including the date the entity became or elected to become a disregarded entity under §301.7701–3).
4. Classifications of the entity under §1.1503–2(c)(2) – (4) (e.g., dual resident corporation, foreign branch separate unit, hybrid entity separate unit) before and after any triggering event. If the taxpayer is requesting that the closing agreement include losses covered by the temporary regulations, the taxpayer should classify the entity under §1.1503–2A(b) (e.g., dual resident corporation, foreign branch separate unit, partnership interest separate unit).
5. Detailed explanation of the chain of ownership between the parent of the consolidated group (or in the case where there is no U.S. consolidated group, the unaffiliated domestic owner of the DRC) and the DRC before and after any triggering event (as described in §1.1503–2(g)(2)(iii) or §1.1503–2A(c)(3)(iii), as appropriate).

6. The taxable year of a Taxpayer Party to the closing agreement (both before and after any triggering event). If as a result of a triggering event there is a requirement for filing a short-period return under §1.1502–76(b) or other relevant provision, taxpayer should provide related information and an explanation.
7. The office that has jurisdiction over the Federal income tax returns of a Taxpayer Party to the closing agreement.

.03 Additional Information Related To DRCs.

Taxpayers must provide the following additional information for each DRC with losses that will be covered by the closing agreement:

1. The country or countries that tax the DRC on its worldwide income or on a residence basis. If the DRC is a separate unit, identify the separate unit and name under which it conducts business, and the country in which its principal place of business is located.
2. Description of the principal business activity.
3. Amounts and taxable years of DRC's NOLs.
4. Date the period of limitations on assessment of tax expires related to each DCL.

.04 List And Description Of All Triggering Events.

For all losses to be included in the §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement, taxpayers must provide a list and description of all triggering events described in §1.1503–2(g)(2)(iii) and §1.1503–2A(c)(3)(iii) as appropriate (including specific citations). In particular, taxpayers should explain how the triggering events are treated under the Code, including information about any taxable transfers or any nonrecognition provisions that apply, and should provide information about all parties, stock, and assets involved. Taxpayers should indicate whether any triggering event listed includes a transaction within the meaning of §1.1502–75(d)(2) or (3) whereby the common parent of the consolidated group that filed the §1.1503–2(g)(2)(i) agreements is no longer in existence or whereby the common parent was a party to a reverse acquisition, through which the consolidated group continues.

Taxpayers should state whether an exception to a triggering event applies and should explain the exception in detail and include a citation to the relevant provision (e.g., §1.1503–2(g)(2)(iv)(A), §1.1503–2(g)(2)(iv)(B), or §1.1503–2A(c)(3)(vi)). If a taxpayer has exercised rebuttal rights provided in §§1.1503–2(g)(2)(iii)(A)(2) – (7), taxpayer must provide information related to those rebuttals.

.05 Specific Representations And Agreements Required For Closing Agreement.

Taxpayers must provide the following representations and agreements, when applicable, to secure a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement:

1. That a corporation is a DRC as described in §1.1503–2(c)(2). Taxpayers must provide a representation for each relevant entity, and provide a §1.1503–2A representation as appropriate.
2. That a foreign branch, interest in a partnership, or interest in a trust is a separate unit as described in the appropriate subsection of §1.1503–2(c)(3) and a DRC as described in §1.1503–2(c)(2). Taxpayers must provide a representation for each relevant entity, and provide a §1.1503–2A representation as appropriate.
3. That a hybrid entity separate unit is a hybrid entity separate unit as described in §1.1503–2(c)(4) and a DRC as described in §1.1503–2(c)(2). Taxpayers must provide a representation for each relevant entity, and provide a §1.1503–2A representation as appropriate.
4. That the NOLs described are DCLs under §1.1503–2(c)(5) (or under §1.1503–2A(b)(2) as appropriate).
5. That the requisite elections, agreements, and certifications were timely made under §1.1503–2(g)(2)(i) (or §1.1503–2A(c)(3) or (d)(3) as appropriate).
6. That the DCLs were computed as required under §1.1503–2(d)(1) (or §1.1503–2A(f)(1) as appropriate).
7. That the necessary reporting and certifications were made under §1.1503–2(g)(2)(vi) (or §1.1503–2A(c)(3)(v) as appropriate).
8. That the consolidated group, unaffiliated DRC, or unaffiliated domestic owner will or has filed an election and agreement described in §1.1503–2(g)(2)(i) with its timely filed Federal income tax return for the year(s) of the triggering event(s) described in §1.1503–2(g)(2)(iii). Taxpayers should provide a §1.1503–2A representation as appropriate.
9. That apart from the triggering events listed, no triggering event described in §1.1503–2(g)(2)(iii) (or §1.1503–2A(c)(3)(iii) as appropriate) has occurred applicable to the DCLs.
10. That upon any subsequent triggering event described in §1.1503–2(g)(2)(iii), the Taxpayer Parties will be jointly and severally liable for the total amount of the recapture of the DCLs to which the closing agreement relates and the related interest charge under §1.1503–2 (g)(2)(vii), to the extent the triggering event does not fall under one of the exceptions provided in §1.1503–2(g)(2)(iv)(A) or (B).
11. That the new consolidated group or unaffiliated domestic corporation will treat any potential recapture of the DCLs under §1.1503–2(g)(2)(vii) as unrealized built–in gain for purposes of §384(a), subject to any applicable exceptions thereunder, and will treat the total recapture amount of the described DCLs as recognized built-in gain for purposes of §384(a), subject to any applicable exceptions thereunder.
12. That the new consolidated group or unaffiliated domestic corporation will comply with the reporting requirements described in §1.1503–2(g)(2)(vi) for each DCL for the taxable years covered by the closing agreement.
13. That an election was made (or was not made) under §1.1503–2(h)(2) or (3) for any DCLs incurred in taxable years beginning before October 1, 1992. Taxpayers should provide an explanation for the election provision used.
14. That an event described in

§§1.1503–2(g)(2)(iii)(A)(2) – (7) is not a triggering event under such provision because the transfer did not result in a carryover under foreign law of such losses, or because such losses cannot be used to offset the income of another person under foreign law. Taxpayers should represent the specific requirements under the provision cited. *See, e.g.*, section 3.01(4) and section 4.01(22), Rev. Proc. 2000–7 (the National Office of the Service generally will not make a determination related to the rebuttals).

.06 Documents Required.

As part of the initial submission requesting a §1.1503–2(g)(2)(iv)(B)(2)(i) closing agreement, taxpayers must provide the following documents when applicable:

1. Copies of all elections, agreements and certifications required by §1.1503–2(g)(2) (or §1.1503–2A (c)(3) or (d)(3)).
2. Copies of all ruling letters issued by the Service under §301.9100 providing for an extension of time to make a required election or application under the §1503(d) regulations.
3. Copy of all consents to an extension of the statute of limitations on assessment and collection.
4. Documents supporting the rebuttal of a presumption of a triggering event described in §§1.1503–2(g)(2)(iii)(A)(2) – (7).
5. Other documents as requested by the Service.

SECTION 6. 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 1545-1706.

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 is contained in sections 4 and 5 of this revenue procedure. This information will enable the Service to determine whether to execute a closing agreement under §§1503(d) and 7121 of the Code. The likely respondents are domestic corporations.

The estimated average annual reporting and/or recordkeeping burden is two-thousand (2,000) hours.

The estimated average annual burden per applicant is one-hundred (100) hours. The estimated number of applicants is twenty (20). The estimated frequency of responses is on occasion.

Books and 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 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Camille B. Evans of the Office of the Associate Chief Counsel (International). For further information regarding this revenue procedure contact Camille B. Evans or Kenneth D. Allison of the Office of the Associate Chief Counsel (International) at (202) 622-3860 (not a toll free call).

Appendix A

DEPARTMENT OF THE TREASURY
INTERNAL REVNUE SERVICE

MODEL CLOSING AGREEMENT ON FINAL DETERMINATION COVERING SPECIFIC MATTERS

Under section 7121 of the Internal Revenue Code of 1986, as amended (the Code), Corporation A, 123 Main Street, Wilmington, DE 20000, EIN 11-1234567, a domestic corporation, as common parent on behalf of all the members of a consolidated group (the Corporation A Group); Corporation B, 124 Main Street, Wilmington, DE 20000, EIN 22-1234567, a domestic corporation, as common parent on behalf of all the members of a consolidated group as of January 1, Year 3 (the Corporation B Group); and the Commissioner of Internal Revenue hereby make the following closing agreement (Closing Agreement) based on the representations made by Corporation A and Corporation B, in paragraphs one (1) through fourteen (14) below:

WHEREAS:

(1) Corporation A, a Delaware corporation and party to this Closing Agreement, owned through December 31, Year 2, all of the stock of Corporation B, a Delaware corporation and party to this Closing Agreement. Until December 31, Year 2, Corporation A had outstanding Class X common stock and Class Y common stock. Corporation A is the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis (the Corporation A Group). Corporation B was a member of the Corporation A Group through December 31, Year 2. On January 1, Year 3, Corporation B became the common parent of an affiliated group of corporations that files a consolidated federal income tax return on a calendar year basis (the Corporation B Group).

(2) Corporation B owns all of the stock of Corporation D, a Delaware corporation (EIN 33-1234567) and a member of the Corporation A Group through December 31, Year 2, and of Corporation E, a Delaware corporation (EIN 44-1234567) and a member of the Corporation A Group through December 31, Year 2. Corporation D and Corporation E became members of the Corporation B Group on January 1, Year 3.

(3) Since 1970, Corporation D has maintained assets and operated a widgets business in Country 1 through a branch in Country 1 (Branch 1). Branch 1 is a separate unit as described in Treas. Reg. §1.1503–2(c)(3)(i)(A) and a dual resident corporation (DRC) as defined in Treas. Reg. §1.1503–2(c)(2).

(4) Since 1970, Corporation E has maintained assets and operated a widgets business in Country 2 through a branch in Country 2 (Branch 2). Branch 2 is a separate unit as described in Treas. Reg. §1.1503–2(c)(3)(i)(A) and a DRC as defined in Treas. Reg. §1.1503–2(c)(2).

(5) Since 1975, Corporation E has maintained assets and operated a widgets business in Country 3 through a branch in

Country 3 (Branch 3). Branch 3 is a separate unit as described in Treas. Reg. §1.1503–2(c)(3)(i)(A) and a DRC as defined in Treas. Reg. §1.1503–2(c)(2).

(6) Since 1972, Corporation E has maintained assets and operated a widgets business in Country 4 through a branch in Country 4 (Branch 4). Branch 4 is a separate unit as described in Treas. Reg. §1.1503–2(c)(3)(i)(A) and a DRC as defined in Treas. Reg. §1.1503–2(c)(2).

Branch 1, Branch 2, Branch 3, and Branch 4 will hereinafter collectively be referred to as the "Corporation B Branches."

(7) The income and losses of Branch 4 were included in the Corporation A Group through Date A, Year 2. The income and losses of Branch 1, Branch 2, and Branch 3 were included in the Corporation A Group through December 31, Year 2.

(8) On Date A, Year 2, Corporation E, sold all of the assets of Branch 4 to an unrelated Country 4 company, Corporation 4. Corporation E's sale of Branch 4's assets is not a triggering event under Treas. Reg. §1.1503–2(g)(2)(iii)(A)(5) because the sale did not result in a carryover under Country 4 law of Branch 4's losses, expenses, or deductions to Corporation 4. As a result of this Date A, Year 2 sale, Branch 4 ceased to be a separate unit as described in Treas. Reg. §1.1503–2(c)(3)(i)(A) and a DRC as defined in Treas. Reg. §1.1503–2(c)(2). *See Appendix B, Note 1.*

(9) On December 31, Year 2, Corporation A distributed all of the stock of Corporation B to its Corporation A Class X common stockholders in exchange for all of the Corporation A Class X common stock in a split-off transaction described in Code §355. As a result of this split-off transaction: (a) Corporation B, Corporation D, and Corporation E, and the income and losses of Branch 1, Branch 2, and Branch 3 ceased to be included in the Corporation A Group; (b) Corporation B became the common parent of the Corporation B Group; and (c) the income and losses of Branch 1, Branch 2, and Branch 3 became included with the Corporation B Group. *See Appendix B, Note 2.*

(10) On Date C, Year 3, Corporation E sold the Branch 3 assets to an unrelated Country 3 company, Corporation 3. Corporation E's sale of Branch 3's assets is not a triggering event under Treas. Reg. §1.1503–2(g)(2)(iii)(A)(5) because the sale did not result in a carryover under the laws of Country 3 of Branch 3's losses, expenses, or deductions to Corporation 3. As a result of this Date C, Year 3 sale, Branch 3 ceased to be a separate unit as described in Treas. Reg. §1.1503–2(c)(3)(i)(A) and a DRC as defined in Treas. Reg. §1.1503–2(c)(2). *See Appendix B, Note 3.*

(11) The Corporation B Branches incurred net operating losses (NOLs) for the Year 1 taxable year and the Year 2 taxable year. Such losses were computed in accordance with Treas. Reg. §1.1503–2 (d)(1) and are as follows:

BRANCH	*Year 1 Tax Year*	*Year 2 Tax Year*
Branch 1	$	$
Branch 2	$	$
Branch 3	$	$
Branch 4	$_____	$ N.A. *
TOTAL	$_____	$_____

**See Appendix B, Note 4.*

The Corporation B Branches' NOLs for the Year 1 taxable year and the Year 2 taxable year will hereinafter collectively be referred to as the Corporation B Branches NOLs.

(12) The Corporation A Group used all of the Corporation B Branches NOLs within the meaning of Treas. Reg. §1.1503–2(c)(15).

(13) Corporation A, as common parent of the Corporation A Group, filed the elections and agreements described in Treas. Reg. §1.1503–2(g)(2)(i) for the Corporation B Branches NOLs incurred for the Year 1 taxable year and the Year 2 taxable year.

(14) Excluding the distribution of Corporation B stock to the Corporation A Class X common stockholders in a Code §355 split-off transaction, on December 31, Year 2, (as described in paragraph 9 above), causing Corporation B and its affiliates to cease being members of the Corporation A Group, no triggering event described in Treas. Reg. §1.1503–2 (g)(2)(iii) has occurred that is applicable to the Corporation B Branches NOLs.

THEREFORE, based on the above information and material submitted by Corporation A and Corporation B in connection with this Closing Agreement, and in the absence of other material factual or legal circumstances concerning the events described above, it is determined for federal income tax purposes that with respect to the Corporation B Branches NOLs:

(1) This Closing Agreement is a closing agreement described in Treas. Reg. §1.1503–2(g)(2)(iv)(B)(2)(i).

(2) The Corporation B Branches are separate units as described in Treas. Reg.

§1.1503–2(c)(3)(i)(A) and are dual resident corporations as defined in Treas. Reg. §1.1503–2(c)(2).

(3) The Corporation B Branch NOLs are dual consolidated losses under Treas. Reg. §1.1503–2(c)(5).

(4) But for Treas. Reg. §1.1503–2 (g)(2)(iv)(B)(2), the distribution of Corporation B stock to the Corporation A Class X common stockholders in a Code §355 split-off transaction, causing Corporation B, Corporation D, and Corporation E to cease being members of the Corporation A Group and the income and losses of the Corporation B Branches to cease being included in the Corporation A Group, was a triggering event under Treas. Reg. §1.1503–2(g)(2)(iii)(A)(2) requiring the recapture of Corporation B Branch NOLs as required by Treas. Reg. §1.1503–2(g)(2)(vii).

(5) Under Treas. Reg. §1.1503–2 (g)(2)(iv)(B)(2), the distribution of Corporation B stock to Corporation A Class X common stockholders in a Code §355 split-off transaction, whereby Corporation B, Corporation D, and Corporation E ceased to be members of the Corporation A Group and the income and losses of the Corporation B Branches ceased to be included in the Corporation A Group, is not considered to be a triggering event requiring the recapture of the Corporation B Branch NOLs and an interest charge.

(6) Upon any subsequent triggering event described in Treas. Reg. §1.1503–2(g)(2)(iii), the Corporation A Group and the Corporation B Group will be jointly and severally liable for the total amount of recapture of the dual consolidated losses of the Corporation B Branches and the related interest charge under Treas. Reg. §1.1503–2(g)(2)(vii), to the extent the triggering event does not fall under one of the exceptions provided in Treas. Reg. §1.1503–2(g)(2)(iv)(A) or (B). The character and source of the recapture amount shall be determined pursuant to Treas. Reg. §1.1503-2(g)(2)(vii)(D). An event otherwise constituting a triggering event applicable to the Corporation B Branch NOLs under Treas. Reg. §1.1503–2(g)(2)(iii)(A) shall not constitute a triggering event if it occurs in any taxable year after the fifteenth (15^{th}) taxable year following the year in which the Corporation B Branch NOLs were incurred.

(7) The Corporation B Group will treat any potential recapture amount under Treas. Reg. §1.1503–2(g)(2)(vii) as unrealized built-in gain for purposes of Code §384(a), subject to any applicable exceptions thereunder, and such total recapture amount shall constitute recognized built-in gain of the Corporation B Group for purposes of Code §384(a), subject to any applicable exceptions thereunder.

(8) The Corporation B Group will comply with the reporting requirements described in Treas. Reg. §1.1503–2 (g)(2)(vi) with respect to each Corporation B Branch NOL for the Year 1 taxable year and the Year 2 taxable year.

(9) If the amount of the Corporation B Branch NOLs is adjusted by the Internal Revenue Service, judicial authority, or otherwise in a final determination of taxes for taxable years ending December 31, Year 1, and December 31, Year 2, the provisions of this Closing Agreement will apply *mutatis mutandis* to such final adjusted loss amounts.

NOW THIS CLOSING AGREEMENT WITNESSETH, that Corporation A, Corporation B, and the Commissioner of Internal Revenue hereby mutually agree to the determinations set forth above and further mutually agree that those determinations shall be final and conclusive, subject, however, to reopening in the event of fraud, malfeasance, or misrepresentation of material fact, and provided that any change or modification of applicable statutes or tax conventions shall render this Closing Agreement ineffective to the extent that it is dependent upon such statutes or tax conventions.

IN WITNESS WHEREOF, by signing the foregoing, the above parties signify that they have read and agreed to the terms of this document.

CORPORATION A

By:_____ Date:_____

Title: _____

CORPORATION B

By:_____ Date:_____

Title: _____

COMMISSIONER OF INTERNAL REVENUE

By:_____ Date:_____

Title: Associate Chief Counsel (International)

By:_____ Date:_____

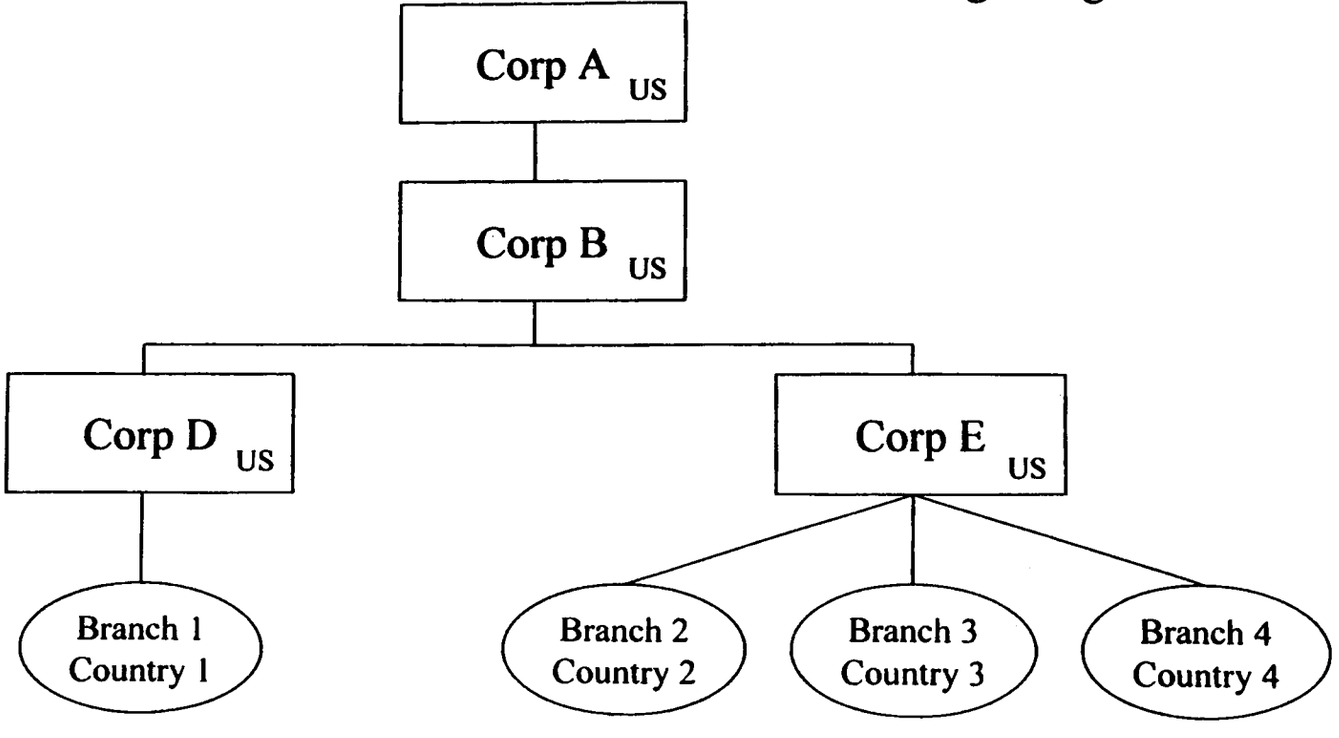
Title: Director, International

Appendix B

DEPARTMENT OF THE TREASURY/ INTERNAL REVENUE SERVICE

MODEL CLOSING AGREEMENT FLOW CHART AND NOTES

Beginning Structure



Note 1 -- Although taxpayer asserts a rebuttal for this listed "triggering event" under §1.1503-2(g)(2)(iii)(A), taxpayer must provide information about such events. *See sections 5.04, 5.05(14), and 5.06(4) of this Revenue Procedure.* Also note that taxpayer must continue to file annual certifications under §1.1503-2(g)(2)(vi)(B) if otherwise required to do so.

Note 2 -- This is the listed "triggering event" that requires a §1.1503-2(g)(2)(iv)(B) closing agreement to be excepted from being treated as a triggering event requiring recapture of losses and an interest charge.

Note 3 -- Although these events occur after the event for which the closing agreement is provided, taxpayer must inform the Service of all triggering events through the execution of the closing agreement and must provide information about such events. *See section 4.02 of this Revenue Procedure.*

Note 4 -- Branch 4 ceased to be a DRC after Date A, Year 2 when Corporation E sold all of the assets of Branch 4 to an unrelated Country 4 company. Branch 4 did not have DCLs through Date A, Year 2.

Prohibition of *Ex Parte* Communications Between Appeals Officers And Other Internal Revenue Service Employees

Rev. Proc. 2000–43

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SECTION 4. EFFECTIVE DATE

SECTION 1. PURPOSE AND SCOPE

Section 1001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. 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."

Notice 99–50, 1999–40 I.R.B. 444 (October 4, 1999), set forth a proposed revenue procedure concerning the ex parte communication prohibition. The proposed revenue procedure provided guidance in the form of a series of questions and answers that address situations frequently encountered by the Service during the course of an administrative appeal and invited public comment. The Department of the Treasury and the Internal Revenue Service have considered all comments received, and the proposed revenue procedure has been modified to take into account the concerns raised. Specifically, the scope of permissible communications has been clarified, limitations have been placed on communications between Appeals and certain employees in the Office of Chief Counsel, concerns about communications that take place in the context of multi-functional meetings have been addressed, and other questions and answers have been modified. In addition, new questions and answers have been included to define key terms and clarify responsibilities of the parties, permit taxpayers/representatives to waive the prohibition, and to address certain management issues.

SECTION 2. BACKGROUND

In 1927, the Internal Revenue Service established an administrative appeal process to resolve tax disputes without litigation. The Appeals mission is to resolve tax controversies, without litigation, on a basis that is fair and impartial to both the Government and the taxpayer. Local Appeals Officers have traditionally reported to different managers than the Service officials who proposed the adjustment. Appeals has historically been able to settle the vast majority of the cases that come within its jurisdiction.

The inventory of cases handled by Appeals falls into two major categories — nondocketed and docketed B determined by whether the case is pending in the United States Tax Court. Nondocketed cases typically involve an administrative protest by the taxpayer of the findings and conclusions of the Examination, Collection, or other IRS function that initially considers a taxpayer's case. The taxpayer's protest is typically followed by a conference, or series of conferences, with the taxpayer or the taxpayer's representative, during which Appeals and the taxpayer attempt to reach resolution of the issues in dispute. Docketed cases involve disputes where the taxpayer has filed a petition in the U.S. Tax Court, contesting a determination made by the Service in a statutory notice of deficiency. Following the filing of the petition, taxpayers who have not previously availed themselves of the opportunity for an Appeals conference generally are afforded an opportunity to resolve their case with Appeals before the case proceeds further in the litigation process. *See generally* Rev. Proc. 87–24, 1987–1 C.B. 720. In both types of disputes, Appeals has broad authority to negotiate settlements by applying a "hazards of litigation" standard.

Proceedings before Appeals have traditionally followed a much less formal course than court proceedings. While proceedings before Appeals are designed to be fair and impartial, they are not subject to judicial rules of evidence or procedure. Some early legislative proposals during 1998 would have required Appeals to adopt more formal and less flexible processes. S. Rep. No. 1669, 105th Cong., 2nd Sess., § 304(a) (Feb. 24, 1998), would have established an independent Office of Appeals in the Internal Revenue Service, the head of which was to be appointed by and report directly to the Oversight Board. Further, this proposal would have barred Appeals from considering issues not "raised" by the originating function and prohibited "any communication" with the originating function unless the taxpayer or taxpayer's representative had an opportunity to be present.

As ultimately enacted, § 1001(a)(4) of RRA 98 did not impose a comprehensive overhaul of Appeals' processes. Instead, that section requires the IRS, as part of its reorganization plan, to establish an independent Office of Appeals "within the Internal Revenue Service." The plan must prohibit ex parte communications "to the extent such communications appear to compromise the independence" of Appeals. When the evolution of § 1001(a)(4) of RRA 98 during the1998 legislative process is considered in light of Appeals longstanding methods of operation, it can be fairly concluded that Appeals must be accorded a significant degree of independence from other IRS components, and should be mindful to avoid ex parte communications with other IRS functions that might appear to compromise that independence. The statutory provision cannot, however, be interpreted as mandating a major redesign of the fundamental processes Appeals has traditionally followed to carry out its dispute resolution mission.

The procedures set forth in this Revenue Procedure are designed to accommodate the overall interests of tax admin-

istration, while preserving operational features that are vital to Appeals' case resolution processes within the structure of the IRS and ensuring more open lines of communication between Appeals and the taxpayer/representative. Thus, in order to preserve the informal give-and-take and flexibilities that have been conducive to achieving settlements in Appeals, the guidance provided in this revenue procedure does not adopt the formal ex parte procedures that would apply in a judicial proceeding. The guidance is designed to ensure the independence of the Appeals organization, while preserving the role of Appeals as a flexible administrative settlement authority, operating within the Internal Revenue Service's overall framework of tax administration responsibilities. For example, as more fully explained in Section 3 below:

- Appeals will retain procedures for (a) returning cases that are not ready for Appeals consideration, (b) raising certain new issues, and (c) seeking review and comments from the originating IRS function with respect to new information or evidence furnished by the taxpayer or representative.
- Appeals will continue to be able to obtain legal advice from the Office of Chief Counsel, subject to limitations designed to ensure that the advice to Appeals is not provided by the same field attorneys who previously gave advice on the same issue to the IRS officials who made the determination Appeals is reviewing. These limitations adopt some of the suggestions received in response to Notice 99–50 and reflect a balance between meeting Appeals' needs for legal assistance and avoiding ex parte communications that might appear to compromise Appeals' independence.
- Finally, the Revenue Procedure makes clear that the Commissioner and others responsible for overall IRS operations (including Appeals) may continue to communicate ex parte with Appeals in order to fulfill their responsibilities.

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 between Appeals and another Service function without the participation of the taxpayer or the taxpayer's representative (taxpayer/representative). While the legislation refers to "appeals officers," the overall intent of the ex parte provision is to ensure the independence of the entire Appeals organization. Ex parte communications between any Appeals employee, *e.g.*, Appeals Officers, Appeals Team Case Leaders, Appeals Tax Computation Specialists, and employees of other Internal Revenue Service offices are prohibited to the extent that such communications appear to compromise the independence of Appeals.

Q-2 Is the prohibition on ex parte communications limited to oral communications?

A-2 No. The prohibition is not limited to oral communications. It applies to any form of communication, oral or written (manually or computer generated).

Q-3 Are communications between Appeals Officers and other Appeals employees subject to the prohibition on ex parte communications?

A-3 No. As indicated in A-1 above, the ex parte communication prohibition was intended to preserve the independence of the Appeals organization as a whole. Intra-Appeals communications during the deliberation process do not compromise or appear to compromise that independence. Appeals employees may communicate freely with other Appeals employees without inviting the taxpayer/representative to participate.

Q-4 Is the administrative file transmitted to Appeals by the office that made the determination which is subject to the Appeals process (the originating function) considered to be an ex parte communication within the context of this revenue procedure?

A-4 No. The administrative file is not considered to be an ex parte communication within the context of this revenue procedure. The administrative file, containing the proposed determination and the taxpayer's protest or other approved means of communicating disagreement with the proposed determination, sets forth the boundaries of the dispute between the taxpayer and the Service and forms the basis for Appeals to assume jurisdiction.

Q-5 Does the prohibition on ex parte communications extend to discussions between Appeals employees and the originating function during the course of preliminary review of a newly assigned case?

A-5 It depends on the nature of the communication. During the preliminary review of a newly assigned case, officials in Appeals may ask questions that involve ministerial, administrative, or procedural matters and do not address the substance of the issues or positions taken in the case. For example, Appeals employees may make the following types of inquiries without involving the taxpayer/representative:

- Questions about whether certain information was requested and whether it was received.
- Questions about whether a document referred to in the workpapers that the Appeals Officer cannot locate in the file is available.
- Questions to clarify the content of illegible documents or writings.
- Questions about case controls on the IRS's management information systems.
- Questions relating to tax calculations that are solely mathematical in nature. Communications with the originating function which extend beyond matters of the type described above and address the substance of the issues in the case are prohibited unless the taxpayer is given the opportunity to participate. Examples of prohibited communications include:
- Discussions about the accuracy of the facts presented by the taxpayer and the relative importance of the facts to the determination.
- Discussions of the relative merits or

alternative legal interpretations of authorities cited in a protest or in a report prepared by the originating function.

- Discussions of the originating function's perception of the demeanor or credibility of the taxpayer or taxpayer's representative.

Q-6 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-6 Yes. The principles applicable to discussions between Appeals employees and officials in other originating functions also apply to discussions between Appeals and Collection employees. Appeals may not engage in discussions of the strengths and weaknesses of the issues and positions in the case, which would appear to compromise Appeals' independence. The taxpayer/representative should be given an opportunity to participate in any discussion that involves matters other than ministerial, administrative or procedural matters.

Section 3401 of RRA 98 (§§ 6320 and 6330 of the Internal Revenue Code), 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 ministerial, administrative or procedural inquiries discussed in A-5 above. Therefore, such communications are not subject to the prohibition on ex parte communications.

Q-7 Does the prohibition on ex parte communications change the criteria for premature referrals?

A-7 As a general rule, there is no change to current criteria or procedures. In essence, RRA 98 reinforces the instructions in Section 8.2.1.2 of the Internal Revenue Manual (IRM) and reaffirms Appeals' role as the settlement arm of the Service. If a case is not ready for Appeals consideration, Appeals may return it for further development or for other reasons described in IRM 8.2.1.2. Appeals may communicate with the originating function regarding the anticipated return of the case, but may not engage in a discussion of matters beyond the types of ministerial, administrative or procedural matters set forth in A-5 as part of a discussion of whether the premature referral guidelines require further activity by the originating function.

Q-8 Is there any change to the Appeals new issue policy?

A-8 No. 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. New issues must continue to meet the "material" and "substantial" tests of IRM 8.6.1.4 and succeeding sections. 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-9 May Appeals continue to have ongoing communication with the originating function during the course of an appeal?

A-9 Yes. However, the prohibition on ex parte communications will affect the manner in which Appeals has traditionally operated during the course of the appeal. Appeals must give the taxpayer/representative the opportunity to participate in any discussions with the originating function which concern matters beyond the ministerial, administrative or procedural matters described in A-5 above.

Q-10 What should Appeals do if new information or evidence is submitted? Can Appeals still return the new material to the originating function for review and comment?

A-10 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 Appeals, may have had an impact on the originating function's findings or which may impact on the Appeals' 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-11 ***Does the prohibition on ex parte communications have any impact on the relationship between Appeals and Counsel?***

A-11 Chief Counsel is the legal adviser to the Commissioner of Internal Revenue and his or her officers and employees (including employees of Appeals) on all matters pertaining to the interpretation, administration and enforcement of the internal revenue laws and related statutes. Attorneys in the Office of Chief Counsel are expected to provide legal advice based on a determination of ". . . the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them," without bias in favor of either the Government or the taxpayer. Rev. Proc. 64–22, 1964–1 C.B. 689. To balance Appeals employees' need to obtain legal advice with the requirement that they avoid ex parte communications that would appear to compromise Appeals' independence, the following limitations will apply to communications between Appeals employees and attorneys in the Office of Chief Counsel in cases not docketed in the United States Tax Court:

Appeals employees should not communicate ex parte regarding an issue in a case pending before them with Counsel

field attorneys who have previously provided advice on that issue in the case to the IRS employees who made the determination Appeals is reviewing. Counsel will assign a different attorney to provide assistance to Appeals. If an Appeals employee believes it is necessary to seek advice from any Counsel field attorney who previously provided advice to the originating function regarding that issue in the case, the taxpayer/representative will be provided an opportunity to participate in any such communications.

Appeals' requests for legal advice that raise questions that cannot be answered with a high degree of certainty by application of established principles of law to particular facts will be referred to the Chief Counsel National Office and will be handled as requests for field service advice or technical advice, as appropriate, in accordance with applicable procedures. The response of the National Office to Appeals will be disclosed to the taxpayer in accordance with § 6110.

Appeals employees are cautioned that, while they may obtain legal advice from the Office of Chief Counsel, they remain responsible for independently evaluating the strengths and weaknesses of the specific issues presented by the cases assigned to them, and for making independent judgments concerning the overall strengths and weaknesses of the cases and the hazards of litigation. Consistent with this assignment of responsibility, Counsel attorneys will not provide advice that includes recommendations of settlement ranges for an issue in a case pending before Appeals or for the case as a whole.

The foregoing limitations on ex parte communications do not apply to cases docketed in the United States Tax Court. Docketed cases will be handled in accordance with Rev. Proc. 87–24, 1987–1 C.B. 720, and the Tax Court Rules of Practice and Procedure.

Q-12 Appeals is required to submit certain cases to the Joint Committee on Taxation for review. On occasion, the Joint Committee (or its staff) will question a settlement or raise a new issue. Are communications with the Joint Committee (or its staff) covered by the ex parte communications prohibition?

A-12 No. The prohibition applies only to communications between Appeals and other Internal Revenue Service employees.

Q-13 Does the prohibition on ex parte communications have any impact on the requirement that Industry Specialization Program (ISP) issues in cases in Appeals jurisdiction be reviewed and approved by the Appeals ISP Coordinator?

A-13 No. Existing procedures for review and approval remain in place. The Appeals ISP Coordinator serves as a resource person for the Appeals organization. The purpose of the review is to ensure consistency of settlements and adherence to approved settlement guidelines. Communications between Appeals employees and the Appeals ISP Coordinator are entirely internal within Appeals, and consequently, the ex parte communications prohibition does not apply.

Q-14 Delegation Order 247, 1996-1 C.B. 356, 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-14 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.

Q-15 Does the prohibition on ex parte communications apply 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-15 Generally, no. Meetings of this type usually involve general discussions of how to handle technical issues or procedural matters. As long as the discussions do not identify specific taxpayers, the prohibition on ex parte communications would not apply. Participants in cross-functional meetings need to remain cognizant of the prohibition on ex parte communications and ensure that discussions do not appear to compromise the independence of Appeals.

Q-16 Does the prohibition on ex parte communications apply to communications between Appeals and the Commissioner or other Service officials who have overall supervisory responsibility for IRS operations?

A-16 No. In accordance with § 7803, the Commissioner is responsible for managing and directing the administration of the internal revenue laws and tax conventions to which the United States is a party. In the course of exercising that statutory responsibility, the Commissioner and those officials, such as the Deputy Commissioner Operations, who have overall supervisory responsibility for IRS operations may communicate with Appeals about specific cases or issues and may direct that other IRS officials participate in meetings or discussions about such cases or issues without providing the taxpayer or representative an opportunity to participate.

Q-17 Does the prohibition on ex parte communications apply to discussions Appeals employees have with personnel in the IRS competent authority office regarding a taxpayer's request for relief under a tax treaty?

A-17 No. Communications between Appeals employees and IRS officials considering relief under competent authority procedures are not subject to the ex parte prohibitions because the Appeals Officer may assume that the competent authority is acting at the request, and with the consent, of the taxpayer.

Q-18 Does the prohibition on ex parte communications have any impact on Appeals communications with the Taxpayer Advocate Service (TAS) on an open case?

A-18 No. Communications by Appeals with the TAS that are initiated by the TAS are not subject to the prohibition because the Appeals Officer may assume that the

TAS is acting at the request, and with the consent, of the taxpayer.

Q-19 Are communications between Appeals and outside consultants or experts under contract to the IRS subject to the ex parte communication prohibition?

A-19 Yes. Under the ex parte rules adopted here, outside consultants or experts under contract to the IRS (other than those employed directly by Appeals) will be treated as "other IRS employees." Therefore, the principles set forth in A-5 will apply. Appeals must give the taxpayer/representative the opportunity to participate in case-specific discussions that concern matters beyond the non-substantive ministerial, administrative or procedural matters described in A-5 above.

Q-20 A number of questions and answers have referred to communications with the "originating function." How is that term defined?

A-20 An "originating function" is an organization within the IRS that makes determinations which are subject to the Appeals process. For purposes of this revenue procedure, the term includes the Examination, Collection, Service Center, International, and Tax Exempt/Government Entities functions, or their successor organizations.

Q-21 Several responses in this document refer to the taxpayer/representative being given an "opportunity to participate." What does this phrase mean?

A-21 It means that the taxpayer/representative will be given a reasonable opportunity to attend a meeting or be a participant in a conference call between Appeals 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-22 May the taxpayer/representative waive the prohibition on ex parte communications?

A-22 Yes. If the taxpayer/representative is given an opportunity to participate in a discussion, but decides that such participation is unnecessary, the prohibition can be waived. Generally, a waiver will be granted on a communication-by-communication basis. However, if the taxpayer/representative so desires, the waiver could encompass all communications that might occur during the course of Appeals' consideration of a specified case. The Appeals Officer should document the waiver in the Case Activity Record.

Q-23 What if the taxpayer/representative declines to participate or seeks to delay the meeting/conference call beyond a reasonable time?

A-23 Appeals should proceed with the meeting or discussion and 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 documenting the reason for proceeding.

Q-24 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 Appeals discuss these errors with the originating function without violating the prohibition on ex parte communications?

A-24 It depends on the nature of the error. 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 the originating function would be advised before a mathematical correction is made.

However, 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 the originating function to discuss the discrepancy. In such cases, there may be instances where the best approach is for Appeals to return the case for further development and correction.

Q-25 Does the prohibition on ex parte communications apply to pre-conference meetings between Appeals and Examination?

A-25 Yes. This is clearly a situation where the intended communications could appear to compromise the independence of Appeals. Pre-conference meetings should not be held unless the taxpayer/representative is given the opportunity to participate.

Q-26 Does the prohibition on ex parte communications apply to post-settlement conferences between Appeals and Examination?

A-26 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.

The tax periods that are the subject of the post-settlement conference have been finalized, and the participants are cautioned to limit discussion to the results in the closed cycle. Discussion of the resolution of issues present in the closed periods does not jeopardize the independence of Appeals. Any discussion that addresses open cycles of the same taxpayer should be postponed, and the guidance provided in this revenue procedure relating to ongoing disputes should be followed.

Q-27 Does the prohibition on ex parte communications alter existing procedures for handling claims filed late in the Appeals process?

A-27 No. 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 about the strengths and weaknesses of the issue, the referral is not subject to the prohibition.

Q-28 How will the Service monitor compliance with the prohibition on ex parte communications?

A-28 Employees will receive training on the contents of this revenue procedure and will be encouraged to seek managerial guidance whenever they have questions about the propriety of an ex parte communication. Managers will consider feedback from other functions and will be responsible for monitoring compliance during their day-to-day interaction with employees, as well as during workload reviews and closed case reviews. Violations will be addressed in accordance with existing administrative and personnel processes.

Q-29 Are IRS employees assigned to functions other than Appeals responsible for complying with the prohibition on ex parte communication?

A-29 Yes. It is recognized that Appeals cannot always fully control communications from other IRS personnel. Appeals will make every effort to promptly terminate any discussion that verges into matters not permitted by these rules. However, all IRS and Counsel employees share the responsibility to ensure that communications do not appear to compromise the independence of Appeals. Violations will be addressed in accordance with existing administrative and personnel processes.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for communications between Appeals Officers and other Internal Revenue Service employees which take place after October 23, 2000, the date this revenue procedure is published in the Internal Revenue Bulletin.

DRAFTING INFORMATION

The principal author of this revenue procedure is David M. Geber, Appeals LMSB Operations, Headquarters Appeals. For further information regarding this revenue procedure, contact Mr. Geber at (202) 694-1827 (not a toll-free number).

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26 CFR 601.201: Rulings and determination letters (Also Part I, Sections 846; 1.846–1.)

Rev. Proc. 2000–44

SECTION 1. PURPOSE

This revenue procedure prescribes the loss payment patterns and discount factors for the 2000 accident year. These factors will be used for computing discounted unpaid losses under § 846 of the Internal Revenue Code. *See* Rev. Proc. 98–11, 1998–1 C.B. 358, 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 2000. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2000, which is 6.09 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 change, taxpayers must discount the unpaid losses on the affected 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. *See* Rev. Proc. 98–11, 1998–1 C. B. 358, section 2, for additional background on discounting under section 846 and the use of the Secretary's tables.

.03 Section V of Notice 88–100, 1988–2 C.B. 439, provides a composite discount factor to be used in determining the discounted unpaid losses for accident years that are not separately reported on the annual statement. Taxpayers that do not use the methodology set forth in section V of Notice 88–100 should instead use the discount factor for the appropriate year in the Secretary's table for that line of business. If such taxpayers have unpaid losses relating to an accident year that is older than the last accident year for which a discount factor is presented in the Secretary's table, those unpaid losses should be discounted using the discount factor for the last accident year in the Secretary's table. *See* section 2.03(3) of Rev. Proc. 98–11.

.04 Tables

Accident and Health (Other Than Disability Income or Credit Disability Insurance)

Discount factor for all years equals 97.0874 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	9.7134	96.5830
AY+ 1	99.3814	9.4384	0.6186	0.5834	94.3008
AY+ 2	N/A	0.3093	0.3093	0.3003	97.0874

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	65.1995	87.8788
AY+ 1	49.8793	24.0718	50.1207	44.3762	88.5386
AY+ 2	67.6592	17.7799	32.3408	28.7654	88.9446
AY+ 3	79.7711	12.1119	20.2289	18.0419	89.1890
AY+ 4	88.2132	8.4421	11.7868	10.4453	88.6190
AY+ 5	93.1778	4.9646	6.8222	5.9679	87.4779
AY+ 6	95.9623	2.7845	4.0377	3.4633	85.7748
AY+ 7	97.0091	1.0468	2.9909	2.5960	86.7980
AY+ 8	97.5719	0.5628	2.4281	2.1744	89.5538
AY+ 9	98.2191	0.6471	1.7809	1.6403	92.1035
AY+10	N/A	0.6471	1.1338	1.0737	94.6950
AY+11	N/A	0.6471	0.4867	0.4725	97.0874

.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	55.4546	85.9243
AY+ 1	59.1449	23.6838	40.8551	34.4374	84.2916
AY+ 2	70.8220	11.6771	29.1780	24.5073	83.9923
AY+ 3	81.9019	11.0799	18.0981	14.5875	80.6022
AY+ 4	86.3688	4.4669	13.6312	10.8749	79.7797
AY+ 5	90.0497	3.6809	9.9503	7.7459	77.8458
AY+ 6	92.7488	2.6991	7.2512	5.4375	74.9880
AY+ 7	93.8259	1.0771	6.1741	4.6593	75.4648
AY+ 8	94.2415	0.4156	5.7585	4.5150	78.4051
AY+ 9	94.8568	0.6153	5.1432	4.1561	80.8087
AY+10	N/A	0.6153	4.5279	3.7755	83.3830
AY+11	N/A	0.6153	3.9125	3.3716	86.1744
AY+12	N/A	0.6153	3.2972	2.9431	89.2617
AY+13	N/A	0.6153	2.6819	2.4886	92.7929
AY+14	N/A	0.6153	2.0665	2.0063	97.0874

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	70.2828	92.6652
AY+ 1	59.0961	34.9421	40.9039	38.5727	94.3008
AY+ 2	N/A	20.4520	20.4520	19.8563	97.0874

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	84.0520	92.6206
AY+ 1	50.5659	41.3146	49.4341	46.6168	94.3008
AY+ 2	N/A	24.7171	24.7171	23.9971	97.0874

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	55.4546	85.9243
AY+ 1	59.1449	23.6838	40.8551	34.4374	84.2916
AY+ 2	70.8220	11.6771	29.1780	24.5073	83.9923
AY+ 3	81.9019	11.0799	18.0981	14.5875	80.6022
AY+ 4	86.3688	4.4669	13.6312	10.8749	79.7797
AY+ 5	90.0497	3.6809	9.9503	7.7459	77.8458
AY+ 6	92.7488	2.6991	7.2512	5.4375	74.9880
AY+ 7	93.8259	1.0771	6.1741	4.6593	75.4648
AY+ 8	94.2415	0.4156	5.7585	4.5150	78.4051
AY+ 9	94.8568	0.6153	5.1432	4.1561	80.8087
AY+10	N/A	0.6153	4.5279	3.7755	83.3830
AY+11	N/A	0.6153	3.9125	3.3716	86.1744
AY+12	N/A	0.6153	3.2972	2.9431	89.2617
AY+13	N/A	0.6153	2.6819	2.4886	92.7929
AY+14	N/A	0.6153	2.0665	2.0063	97.0874

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	77.2316	82.5035
AY+ 1	24.0011	17.6112	75.9989	63.7954	83.9426
AY+ 2	42.6970	18.6959	57.3030	48.4238	84.5048
AY+ 3	58.0610	15.3640	41.9390	35.5479	84.7609
AY+ 4	69.6653	11.6043	30.3347	25.7603	84.9203
AY+ 5	75.6033	5.9380	24.3967	21.2130	86.9502
AY+ 6	81.8786	6.2753	18.1214	16.0413	88.5212
AY+ 7	87.8539	5.9753	12.1461	10.8637	89.4415
AY+ 8	89.5207	1.6668	10.4793	9.8084	93.5982
AY+ 9	94.3025	4.7818	5.6975	5.4805	96.1916
AY+10	N/A	4.7818	0.9157	0.8890	97.0874

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	72.1344	73.6997
AY+ 1	6.4831	4.3592	93.5169	72.0374	77.0314
AY+ 2	15.5987	9.1156	84.4013	67.0354	79.4246
AY+ 3	31.9062	16.3075	68.0938	54.3211	79.7739
AY+ 4	45.0931	13.1868	54.9069	44.0468	80.2208
AY+ 5	50.0751	4.9821	49.9249	41.5977	83.3206
AY+ 6	60.9728	10.8976	39.0272	32.9064	84.3166
AY+ 7	69.2138	8.2411	30.7862	26.4221	85.8247
AY+ 8	72.8658	3.6519	27.1342	24.2698	89.4433
AY+ 9	80.0005	7.1347	19.9995	18.3990	91.9973
AY+10	N/A	7.1347	12.8648	12.1707	94.6050
AY+11	N/A	7.1347	5.7300	5.5631	97.0874

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	21.1962	94.9091
AY+ 1	94.0673	16.4004	5.9327	5.5946	94.3008
AY+ 2	N/A	2.9664	2.9664	2.8800	97.0874

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	74.2142	82.6844
AY+ 1	29.3763	19.1323	70.6237	59.0277	83.5805
AY+ 2	44.4111	15.0349	55.5889	47.1365	84.7949
AY+ 3	67.8197	23.4086	32.1803	25.8963	80.4726
AY+ 4	73.4753	5.6555	26.5247	21.6482	81.6150
AY+ 5	78.8604	5.3852	21.1396	17.4198	82.4039
AY+ 6	83.5027	4.6422	16.4973	13.6992	83.0388
AY+ 7	84.0676	0.5649	15.9324	13.9516	87.5674
AY+ 8	85.2129	1.1453	14.7871	13.6216	92.1180
AY+ 9	90.5992	5.3863	9.4008	8.9033	94.7074
AY+10	N/A	5.3863	4.0145	3.8976	97.0874

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	68.2254	78.9418
AY+ 1	26.3964	12.8213	73.6036	59.1744	80.3960
AY+ 2	40.2725	13.8761	59.7275	48.4857	81.1782
AY+ 3	55.4566	15.1841	44.5434	35.7988	80.3685
AY+ 4	65.3309	9.8742	34.6691	27.8085	80.2112
AY+ 5	74.0647	8.7339	25.9353	20.5062	79.0668
AY+ 6	80.9090	6.8442	19.0910	14.7055	77.0281
AY+ 7	84.3622	3.4532	15.6378	12.0442	77.0197
AY+ 8	84.6163	0.2542	15.3837	12.5159	81.3585
AY+ 9	86.7311	2.1147	13.2689	11.1000	83.6538
AY+10	N/A	2.1147	11.1542	9.5978	86.0463
AY+11	N/A	2.1147	9.0395	8.0041	88.5462
AY+12	N/A	2.1147	6.9247	6.3134	91.1715
AY+13	N/A	2.1147	4.8100	4.5197	93.9645
AY+14	N/A	2.1147	2.6953	2.6168	97.0874

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	39.1921	88.9894
AY+ 1	77.8939	21.9352	22.1061	18.9856	85.8842
AY+ 2	84.0083	6.1144	15.9917	13.8440	86.5701
AY+ 3	91.3188	7.3105	8.6812	7.1573	82.4462
AY+ 4	92.1670	0.8482	7.8330	6.7195	85.7851
AY+ 5	94.3838	2.2168	5.6162	4.8455	86.2767
AY+ 6	96.4959	2.1121	3.5041	2.9651	84.6181
AY+ 7	97.3670	0.8712	2.6330	2.2484	85.3944
AY+ 8	98.0034	0.6364	1.9966	1.7299	86.6410
AY+ 9	98.4059	0.4025	1.5941	1.4207	89.1194
AY+10	N/A	0.4025	1.1916	1.0926	91.6918
AY+11	N/A	0.4025	0.7892	0.7446	94.3565
AY+12	N/A	0.4025	0.3867	0.3754	97.0874

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	31.4101	94.4432
AY+ 1	89.2755	22.5337	10.7245	10.1133	94.3008
AY+ 2	N/A	5.3622	5.3622	5.2061	97.0874

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	56.4356	90.9282
AY+ 1	67.7044	29.7705	32.2956	29.2089	90.4424
AY+ 2	81.5316	13.8272	18.4684	16.7457	90.6722
AY+ 3	89.8898	8.3583	10.1102	9.1565	90.5677
AY+ 4	94.6531	4.7633	5.3469	4.8080	89.9215
AY+ 5	97.1265	2.4734	2.8735	2.5532	88.8539
AY+ 6	98.4587	1.3322	1.5413	1.3366	86.7155
AY+ 7	98.9811	0.5224	1.0189	0.8799	86.3544
AY+ 8	99.2330	0.2519	0.7670	0.6740	87.8739
AY+ 9	99.4067	0.1737	0.5933	0.5362	90.3643
AY+10	N/A	0.1737	0.4196	0.3899	92.9156
AY+11	N/A	0.1737	0.2460	0.2348	95.4492
AY+12	N/A	0.1737	0.0723	0.0702	97.0874

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	75.9026	79.8765
AY+ 1	15.1072	10.1322	84.8928	70.0889	82.5617
AY+ 2	30.9560	15.8488	69.0440	58.0331	84.0523
AY+ 3	38.2420	7.2860	61.7580	54.0627	87.5396
AY+ 4	68.6101	30.3681	31.3899	26.0760	83.0712
AY+ 5	78.5966	9.9865	21.4034	17.3779	81.1923
AY+ 6	88.3971	9.8005	11.6029	8.3417	71.8934
AY+ 7	93.2957	4.8986	6.7043	3.8042	56.7423
AY+ 8	88.3815	-4.9142	11.6185	9.0975	78.3015
AY+ 9	89.6105	1.2290	10.3895	8.3856	80.7125
AY+10	N/A	1.2290	9.1604	7.6304	83.2971
AY+11	N/A	1.2290	7.9314	6.8291	86.1028
AY+12	N/A	1.2290	6.7024	5.9791	89.2095
AY+13	N/A	1.2290	5.4733	5.0774	92.7656
AY+14	N/A	1.2290	4.2443	4.1207	97.0874

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	69.1525	76.0464
AY+ 1	14.9035	5.8382	85.0965	67.3506	79.1462
AY+ 2	29.2591	14.3555	70.7409	56.6660	80.1036
AY+ 3	45.6462	16.3871	54.3538	43.2383	79.5496
AY+ 4	57.5945	11.9483	42.4055	33.5647	79.1518
AY+ 5	63.8634	6.2689	36.1366	29.1518	80.6712
AY+ 6	75.2266	11.3632	24.7734	19.2231	77.5957
AY+ 7	78.2679	3.0413	21.7321	17.2613	79.4274
AY+ 8	78.1898	-0.0781	21.8102	18.3929	84.3316
AY+ 9	81.8722	3.6825	18.1278	15.7201	86.7184
AY+10	N/A	3.6825	14.4453	12.8845	89.1953
AY+11	N/A	3.6825	10.7628	9.8762	91.7625
AY+12	N/A	3.6825	7.0803	6.6847	94.4128
AY+13	N/A	3.6825	3.3979	3.2989	97.0874

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	64.8422	89.0284
AY+ 1	68.7008	41.5340	31.2992	26.0111	83.1046
AY+ 2	70.0362	1.3354	29.9638	26.2197	87.5046
AY+ 3	87.5338	17.4976	12.4662	9.7940	78.5641
AY+ 4	90.2132	2.6794	9.7868	7.6307	77.9687
AY+ 5	91.3751	1.1619	8.6249	6.8986	79.9846
AY+ 6	94.3845	3.0095	5.6155	4.2190	75.1316
AY+ 7	93.3293	-1.0552	6.6707	5.5628	83.3917
AY+ 8	N/A	1.0387	5.6320	4.8317	85.7905
AY+ 9	N/A	1.0387	4.5932	4.0560	88.3049
AY+10	N/A	1.0387	3.5545	3.2332	90.9598
AY+11	N/A	1.0387	2.5158	2.3602	93.8153
AY+12	N/A	1.0387	1.4771	1.4340	97.0874

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	69.1335	74.0951
AY+ 1	22.3944	15.6982	77.6056	57.1746	73.6733
AY+ 2	32.6486	10.2542	67.3514	50.0947	74.3781
AY+ 3	50.2234	17.5748	49.7766	35.0434	70.4014
AY+ 4	53.5839	3.3605	46.4161	33.7162	72.6391
AY+ 5	55.6838	2.0999	44.3162	33.6066	75.8338
AY+ 6	63.6144	7.9306	36.3856	27.4848	75.5376
AY+ 7	66.4211	2.8066	33.5789	26.2678	78.2269
AY+ 8	N/A	2.8066	30.7723	24.9766	81.1660
AY+ 9	N/A	2.8066	27.9656	23.6069	84.4138
AY+10	N/A	2.8066	25.1590	22.1537	88.0547
AY+11	N/A	2.8066	22.3524	20.6120	92.2140
AY+12	N/A	2.8066	19.5457	18.9764	97.0874

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	77.2190	87.2158
AY+ 1	44.5791	33.1169	55.4209	47.8112	86.2692
AY+ 2	63.9134	19.3343	36.0866	30.8085	85.3739
AY+ 3	65.6185	1.7051	34.3815	30.9285	89.9569
AY+ 4	79.9778	14.3593	20.0222	18.0220	90.0101
AY+ 5	88.9152	8.9374	11.0848	9.9140	89.4380
AY+ 6	91.2490	2.3338	8.7510	8.1140	92.7206
AY+ 7	94.7645	3.5155	5.2355	4.9872	95.2564
AY+ 8	N/A	3.5155	1.7200	1.6699	97.0874

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	40.4949	95.2586
AY+ 1	90.5193	33.0297	9.4807	8.9404	94.3008
AY+ 2	N/A	4.7404	4.7404	4.6023	97.0874

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	62.5642	81.9398
AY+ 1	44.8166	21.1705	55.1834	44.5688	80.7648
AY+ 2	57.9652	13.1486	42.0348	33.7399	80.2667
AY+ 3	72.0542	14.0889	27.9458	21.2831	76.1583
AY+ 4	80.5542	8.5000	19.4458	13.8242	71.0909
AY+ 5	84.8876	4.3334	15.1124	10.2026	67.5118
AY+ 6	87.1173	2.2297	12.8827	8.5274	66.1927
AY+ 7	88.2647	1.1473	11.7353	7.8649	67.0194
AY+ 8	88.5404	0.2757	11.4596	8.0599	70.3333
AY+ 9	88.8062	0.2658	11.1938	8.2770	73.9426
AY+10	N/A	0.2658	10.9279	8.5072	77.8484
AY+11	N/A	0.2658	10.6621	8.7515	82.0804
AY+12	N/A	0.2658	10.3963	9.0107	86.6720
AY+13	N/A	0.2658	10.1304	9.2856	91.6604
AY+14	N/A	0.2658	9.8646	9.5773	97.0874

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. Hossofsky at (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. 2000–45

SECTION 1. PURPOSE

This revenue procedure prescribes the salvage discount factors for the 2000 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 2000 accident year. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2000, which is 6.09 percent, and by assuming all estimated salvage is recovered in the middle of each calendar year. *See* Rev. Proc. 98–12, 1998–1 C.B. 367, 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. Taxpayers that do not use the methodology set forth in section V of Notice 88–100 should instead use the discount factors for the appropriate year in the Secretary's table for that line of business. If such taxpayers have unpaid losses relating to an accident year that is older than the last accident year for which a discount factor is presented in the Secretary's table, those unpaid losses should be discounted using the discount factor for the last accident year in the Secretary's table. *See* section 2.03(3) of Rev. Proc. 98–11, 1998–1 C.B. 358.

.04 Tables.

Accident and Health (Other Than Disability Income or Credit Disability Insurance)

Discount factor for all years equals 97.0874 percent.

Auto Physical Damage

Tax Year	Discount Factors (%)
AY+ 0	95.7079
AY+ 1	94.3008
AY+ 2	97.0874

Commercial Auto/Truck Liability/Medical

Tax Year	Discount Factors (%)
AY+ 0	88.4462
AY+ 1	87.6196
AY+ 2	89.3091
AY+ 3	88.6027
AY+ 4	88.4348
AY+ 5	90.7689
AY+ 6	86.1529
AY+ 7	91.6750
AY+ 8	90.1421
AY+ 9	92.6871
AY+10	95.2242
AY+11	97.0874

Composite Discount Factors

Tax Year	Discount Factors (%)
AY+ 0	86.0068
AY+ 1	84.4299
AY+ 2	84.0175
AY+ 3	83.9135
AY+ 4	84.6433
AY+ 5	85.2133
AY+ 6	85.2701
AY+ 7	85.3660
AY+ 8	88.1610
AY+ 9	90.6657
AY+10	93.2331
AY+11	95.7807
AY+12	97.0874

Fidelity/Surety

Tax Year	Discount Factors (%)
AY+ 0	93.0043
AY+ 1	94.3008
AY+ 2	97.0874

Financial Guaranty/Mortgage Guaranty

Tax Year	Discount Factors (%)
AY+ 0	94.8017
AY+ 1	94.3008
AY+ 2	97.0874

International (Composite)

Tax Year	Discount Factors (%)
AY+ 0	86.0068
AY+ 1	84.4299
AY+ 2	84.0175
AY+ 3	83.9135
AY+ 4	84.6433
AY+ 5	85.2133
AY+ 6	85.2701
AY+ 7	85.3660
AY+ 8	88.1610
AY+ 9	90.6657
AY+10	93.2331
AY+11	95.7807
AY+12	97.0874

Medical Malpractice — Claims-Made

Tax Year	Discount Factors (%)
AY+ 0	70.6135
AY+ 1	73.2471
AY+ 2	71.8267
AY+ 3	71.2085
AY+ 4	74.7120
AY+ 5	73.1233
AY+ 6	82.6622
AY+ 7	91.6505
AY+ 8	96.4072
AY+ 9	97.0874

Medical Malpractice — Occurrence

Tax Year	Discount Factors (%)
AY+ 0	64.5191
AY+ 1	67.8389
AY+ 2	72.3139
AY+ 3	76.0455
AY+ 4	72.9166
AY+ 5	78.8620
AY+ 6	83.7311
AY+ 7	86.8009
AY+ 8	91.1931
AY+ 9	93.8108
AY+10	96.4471
AY+11	97.0874

Miscellaneous Casualty

Tax Year	Discount Factors (%)
AY+ 0	95.1290
AY+ 1	94.3008
AY+ 2	97.0874

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	88.5313
AY+ 1	87.5052
AY+ 2	88.2611
AY+ 3	87.9246
AY+ 4	89.0327
AY+ 5	90.4578
AY+ 6	90.4533
AY+ 7	89.4276
AY+ 8	91.7961
AY+ 9	94.4397
AY+10	97.0874

Other (Including Credit)

Tax Year	Discount Factors (%)
AY+ 0	96.1583
AY+ 1	94.3008
AY+ 2	97.0874

Other Liability — Claims-Made

Tax Year	Discount Factors (%)
AY+ 0	77.8928
AY+ 1	83.2885
AY+ 2	82.3182
AY+ 3	80.0331
AY+ 4	82.9792
AY+ 5	87.5716
AY+ 6	86.1171
AY+ 7	91.6842
AY+ 8	93.7737
AY+ 9	96.4015
AY+10	97.0874

Other Liability — Occurrence

Tax Year	Discount Factors (%)
AY+ 0	78.8476
AY+ 1	79.5688
AY+ 2	81.9224
AY+ 3	83.8683
AY+ 4	85.1067
AY+ 5	82.7221
AY+ 6	86.7561
AY+ 7	88.6932
AY+ 8	92.7419
AY+ 9	95.2771
AY+10	97.0874

Private Passenger Auto Liability/Medical

Tax Year	Discount Factors (%)
AY+ 0	91.7145
AY+ 1	91.1741
AY+ 2	90.2569
AY+ 3	89.8777
AY+ 4	89.4206
AY+ 5	89.8689
AY+ 6	88.6823
AY+ 7	89.3993
AY+ 8	90.0819
AY+ 9	92.6259
AY+10	95.1657
AY+11	97.0874

Products Liability — Claims-Made

Tax Year	Discount Factors (%)
AY+ 0	79.2866
AY+ 1	81.3032
AY+ 2	85.7298
AY+ 3	85.6427
AY+ 4	81.3092
AY+ 5	88.2121
AY+ 6	81.0185
AY+ 7	88.3819
AY+ 8	96.8185
AY+ 9	97.0874

Products Liability — Occurrence

Tax Year	Discount Factors (%)
AY+ 0	75.8372
AY+ 1	78.4119
AY+ 2	76.8096
AY+ 3	78.0983
AY+ 4	79.8362
AY+ 5	79.1928
AY+ 6	80.5510
AY+ 7	72.7819
AY+ 8	78.1849
AY+ 9	80.6043
AY+10	83.2009
AY+11	86.0229
AY+12	89.1515
AY+13	92.7357
AY+14	97.0874

Reinsurance A (Nonproportional Property)

Tax Year	Discount Factors (%)
AY+ 0	86.7196
AY+ 1	89.8651
AY+ 2	92.5548
AY+ 3	91.9205
AY+ 4	79.2342
AY+ 5	94.8666
AY+ 6	93.5010
AY+ 7	96.0788
AY+ 8	97.0874

Reinsurance B (Nonproportional Liability)

Tax Year	Discount Factors (%)
AY+ 0	74.9392
AY+ 1	77.1865
AY+ 2	77.9061
AY+ 3	77.3172
AY+ 4	79.7911
AY+ 5	74.9223
AY+ 6	76.6707
AY+ 7	84.0847
AY+ 8	86.4718
AY+ 9	88.9546
AY+10	91.5395
AY+11	94.2379
AY+12	97.0874

Reinsurance C (Financial Lines)

Tax Year	Discount Factors (%)
AY+ 0	81.2986
AY+ 1	83.6608
AY+ 2	86.8994
AY+ 3	92.7099
AY+ 4	91.3004
AY+ 5	93.1619
AY+ 6	89.7226
AY+ 7	96.9751
AY+ 8	97.0874

Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)

Tax Year	Discount Factors (%)
AY+ 0	92.3377
AY+ 1	94.3008
AY+ 2	97.0874

Workers' Compensation

Tax Year	Discount Factors (%)
AY+ 0	78.6954
AY+ 1	81.0988
AY+ 2	82.9848
AY+ 3	84.5349
AY+ 4	84.6485
AY+ 5	84.8143
AY+ 6	85.9824
AY+ 7	86.7267
AY+ 8	89.1111
AY+ 9	91.6840
AY+10	94.3504
AY+11	97.0874

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. Hossofsky at (202) 622-3477 (not a toll-free number).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Nondiscrimination Requirements for Certain Defined Contribution Retirement Plans

REG–114697–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that would prescribe conditions under which certain defined contribution retirement plans (sometimes referred to as "new comparability" plans) are permitted to demonstrate compliance with applicable nondiscrimination requirements based on plan benefits rather than plan contributions. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments, requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for January 25, 2001, at 10 a.m., must be received by January 5, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–114697–00) room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–114697–00), 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/reglist.html. The public hearing will be held in the IRS Auditorium (7th Floor), Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, John T. Ricotta, 202-622-6060 or Linda S. F. Marshall, 202-622-6090; concerning submissions and 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:

Background

This document contains proposed amendments to 26 CFR part 1 under section 401(a)(4) of the Internal Revenue Code of 1986 (Code).

Section 401(a)(4) provides that a plan or trust forming part of a stock bonus, pension or profit-sharing plan of an employer shall not constitute a qualified plan under section 401(a) of the Code unless the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (HCEs) (within the meaning of section 414(q)). Whether a plan satisfies this requirement depends on the form of the plan and its effect in operation.

Section 415(b)(6)(A) provides that the computation of benefits under a defined contribution plan, for purposes of section 401(a)(4), shall not be made on a basis inconsistent with regulations prescribed by the Secretary. The legislative history of this provision explains that, in the case of target benefit and other defined contribution plans, "regulations may establish reasonable earnings assumptions and other factors for these plans to prevent discrimination." Conf. Rep. No. 1280, 93d Cong., 2d Sess. 277 (1974).

Under the section 401(a)(4) regulations, a plan can demonstrate that either the contributions or the benefits provided under the plan are nondiscriminatory in amount. Defined contribution plans generally satisfy the regulations by demonstrating that contributions are nondiscriminatory in amount, through certain safe harbors provided for under the regulations or through general testing.

A defined contribution plan (other than an ESOP) may, however, satisfy the regulations on the basis of benefits by using "cross-testing" pursuant to rules provided in §1.401(a)(4)–8 of the regulations. Under this cross-testing method, contributions are converted to equivalent benefits payable at normal retirement age and tested on the basis of these equivalent benefits. The conversion is done by making an actuarial projection of the benefits payable at normal retirement age that are attributable to the contributions. Thus, this cross-testing method effectively permits nonelective employer contributions under a defined contribution plan to be tested on the basis of the benefits attributable to those contributions, in a manner similar to the testing of employer-provided benefits under a defined benefit plan.

In Notice 2000–14 (2000–10 I.R.B. 737), released February 24, 2000, the IRS and the Treasury Department initiated a review of issues related to use of the cross-testing method by so-called "new comparability plans" and requested public comments on this plan design from plan sponsors, plan participants and other interested parties. In general, new comparability plans are defined contribution plans that have built-in disparities between the allocation rates for classifications of participants consisting entirely or predominately of HCEs and the allocation rates for other employees.

In a typical new comparability plan, HCEs receive high allocation rates, while nonhighly compensated employees (NHCEs), regardless of their age or years of service, receive comparatively low allocation rates. For example, HCEs in such a plan might receive allocations of 18 or 20% of compensation, while NHCEs might receive allocations of 3% of compensation. A similar plan design, sometimes known as a "super-integrated" plan, provides for an additional allocation rate that applies only to compensation in excess of a specified threshold, but the specified threshold (e.g., $100,000) or the additional allocation rate (e.g., 10%) is higher than the maximum threshold and rate allowed under the permitted disparity rules of section 401(*l*).

These new comparability and similar plans rely on the cross-testing method to demonstrate compliance with the nondiscrimination rules by comparing the actuarially projected value of the employer contributions for the younger NHCEs with the actuarial projections of the larger contributions (as a percentage of compensation) for the older HCEs. As a result, these plans are able generally to provide

higher rates of employer contributions to HCEs, while NHCEs are not allowed to earn the higher allocation rates as they work additional years for the employer or grow older. Notwithstanding the analytical underpinnings of cross-testing, the IRS and the Treasury Department are concerned whether new comparability and similar plans are consistent with the basic purpose of the nondiscrimination rules under section 401(a)(4).

A variety of public comments were submitted in response to Notice 2000–14. Some comments expressed the view that changes in the application of the nondiscrimination rules to new comparability plans are unnecessary. These comments noted that in some cases such plans are adopted by employers that previously had no retirement plan for their employees. At the same time, many of these comments advanced suggestions as to the types of conditions that might be imposed on new comparability plans if changes in the rules are in fact proposed.

Other comments expressed the view that the rules need to be changed to increase the contributions made for NHCEs in new comparability plans and similar tax-qualified plan designs. These comments suggested various methods for ensuring that NHCEs receive larger allocations of employer contributions under new comparability plans, including imposing a maximum ratio of the allocation rates for HCEs to those for NHCEs or requiring a minimum allocation rate for the NHCEs.

Still other comments questioned the policy justification for permitting new comparability plans under the nondiscrimination rules governing tax-qualified plans because new comparability plan designs often provide such an overwhelming percentage of total plan allocations to HCEs, with only a modest percentage of the plan allocations going to the NHCEs. Some of these comments expressed concern that new comparability plans in some instances have been marketed as a technique for limiting most employees to lower allocation rates than they would receive under other defined contribution plan designs (such as salary ratio or age-weighted) and allocating the difference to one or more HCEs. They noted that, in some cases, the percentage of total plan allocations provided to the HCEs can exceed 90%.

After consideration of the comments received, the IRS and Treasury are issuing these proposed regulations, which would prescribe conditions that new comparability and similar plans must satisfy if they are to use the cross-testing method. The proposed regulations preserve the existing cross-testing rules of the section 401(a)(4) regulations, and would not affect cross-tested defined contribution plans that provide broadly available allocation rates, as defined in the proposed regulations. The definition of broadly available allocation rates includes plans that base allocations or allocation rates on age or service. In contrast to new comparability plans, these plans provide an opportunity for participants to "grow into" higher allocation rates as they age or accumulate additional service.

These proposed regulations would continue to permit new comparability plans. As suggested in various comments, the proposed regulations would set forth a minimum allocation "gateway" that would constrain the plan designs with the greatest disparity in favor of HCEs, while leaving many new comparability plan designs unchanged. A new comparability plan that satisfies the minimum allocation gateway could continue to use the existing cross-testing rules of the section 401(a)(4) regulations.

The proposed regulations also would prevent circumvention of the minimum allocation gateway by aggregating (for purposes of satisfying the nondiscrimination rules) a new comparability defined contribution plan with a defined benefit plan that provides only minimal benefits or covers only a relatively small number of the employees, or by aggregating a defined contribution plan with a defined benefit plan that benefits primarily HCEs. However, an aggregated defined contribution and defined benefit plan that is primarily defined benefit in character (as defined in the proposed regulations) could test for nondiscrimination on the basis of benefits in the same manner as under current law. Similarly, the ability to test for nondiscrimination on a benefits basis as under current law would be unrestricted if each of the defined contribution and defined benefit portions of the aggregated plan is a broadly available separate plan (as defined in the proposed regulations).

The proposed regulations would not affect defined benefit plans except where a defined contribution plan is aggregated with a defined benefit plan for nondiscrimination purposes and thus is a part of a DB/DC plan (as defined in §1.401(a)(4)–9). The proposed regulations would not apply merely because a plan sponsor maintains both a defined contribution plan and a defined benefit plan. The proposed regulations would not require aggregation of a defined contribution plan with a defined benefit plan or otherwise modify the existing rules regarding when plans are required or permitted to be aggregated.

Explanation of Provisions

A. *Overview*

The basic structure of the proposed regulations permits defined contribution plans with broadly available allocation rates to test on a benefits basis ("cross-test") in the same manner as under current law, and permits other defined contribution plans to cross-test once they pass a gateway that prescribes minimum allocation rates for NHCEs. Similarly, the proposed regulations permit a DB/DC plan to test on a benefits basis in the same manner as under current law if the DB/DC plan either is primarily defined benefit in character or consists of broadly available separate plans. Other DB/DC plans are permitted to test on a benefits basis once they pass a corresponding gateway prescribing minimum aggregate normal allocation rates for NHCEs.

B. *Gateway for Cross-Testing of New Comparability and Similar Plans*

The proposed regulations would require that a defined contribution plan that does not provide broadly available allocation rates (as defined in these proposed regulations) satisfy a gateway in order to be eligible to use the cross-testing rules to meet the nondiscrimination requirements of section 401(a)(4). A plan would satisfy this minimum allocation gateway if each NHCE in the plan has an allocation rate that is at least one third of the allocation rate of the HCE with the highest alloca-

tion rate[1]; however, a plan would be deemed to satisfy this minimum allocation gateway if each NHCE received an allocation of at least 5% of the NHCE's compensation (within the meaning of section 415(c)(3)).

The proposed regulations would not change the general rule prohibiting aggregation of a 401(k) plan or 401(m) plan with a plan providing nonelective contributions. Accordingly, elective contributions and matching contributions would not be taken into account for purposes of the gateway. If an employer also provides a 401(k) plan, however, then to the extent the HCEs are electing contributions under that plan, the highest HCE allocation rate may be lower than it otherwise would be, which, in turn would lower the minimum required allocation for the NHCEs under the gateway. Further, if the employer sponsors a safe harbor 401(k) plan that provides for 3% nonelective contributions, then, as noted in Notice 98–52 (1998–2 C.B. 632), those nonelective contributions may be taken into account in determining the allocation rates for the NHCEs under section 401(a)(4), including the minimum allocation gateway.

C. *Plans with Broadly Available Allocation Rates*

As suggested in Notice 2000–14, a plan that has broadly available allocation rates would not need to satisfy the minimum allocation gateway and may continue to be tested for nondiscrimination on the basis of benefits as under current law. In order to be broadly available, each allocation rate under the plan must be currently available to a group of employees that satisfies section 410(b) (without regard to the average benefit percentage test). Thus, for example, if within one plan an employer provides different allocation rates for nondiscriminatory groups of employees at different locations or different profit centers, the plan would not need to satisfy the minimum allocation gateway in order to use cross testing.

In addition, a plan that provides allocation rates that increase as an employee ages or accumulates additional service would be treated as having broadly available allocation rates, if the schedule of allocation rates satisfies certain conditions that permit participants to "grow into" higher allocation rates. The conditions are that the same schedule of allocation rates is available to all employees in the plan and that the schedule provides for smoothly increasing allocation rates at regular intervals of age or service.

The proposed regulation would provide that in order for a schedule of allocation rates to increase smoothly, the allocation rate for each age or service band cannot be more than 5 percentage points higher than the allocation rate for the immediately preceding band and cannot be more than twice that allocation rate. For example, if the allocation rate for an age or service band were 6%, the allocation rate for the next higher age or service band could not exceed 11% (i.e., the lesser of 11% (6% plus 5%) and 12% (2 times 6%)).

Further, in order for a schedule of allocation rates to be considered to be increasing smoothly, the ratio of the allocation rate for any age or service band to the allocation rate for the immediately preceding band cannot exceed the ratio of the allocation rates between the two immediately preceding bands. The proposed regulations would provide that the intervals for the age or service bands are regular if they are all of the same length (although this requirement generally would not apply to the first and last bands).

The definition of broadly available allocation rates is designed to be sufficiently flexible to accommodate a wide variety of age- and service-based plans (including age-weighted profit-sharing plans that provide for allocations that result in the same equivalent accrual rate for all employees).

The conditions described above relating to a plan's schedule of age-based or service-based allocation rates are intended to exempt from the minimum allocation gateway those plans in which NHCEs actually receive the benefit of higher rates as they attain higher ages or complete additional years of service. Without conditions such as these, plans can be designed to backload allocation rates excessively, providing for lengthy plateau periods in which rates increase little if at all, followed by sharp increases.

Comments are invited on whether there are plans using schedules of allocation rates (such as schedules of rates based on points or otherwise combining age and service) that would fall outside the definition of broadly available allocation rates but that do afford sufficient opportunity for NHCEs to "grow into" higher allocation rates.

D. *Application to Defined Contribution Plans That Are Combined with Defined Benefit Plans*

The proposed regulations would prescribe rules for testing defined contribution plans that are aggregated with defined benefit plans for purposes of sections 401(a)(4) and 410(b). These rules would apply in situations in which the employer aggregates the plans because one of the plans does not satisfy sections 401(a)(4) and 410(b) standing alone.

1. *Gateway for benefits testing of combined plans*

Under the proposed regulations, the combination of a defined contribution plan and a defined benefit plan may demonstrate nondiscrimination on the basis of benefits if the combined plan is primarily defined benefit in character, consists of broadly available separate plans (as these terms are defined in the proposed regulations), or satisfies a gateway requirement. This minimum aggregate allocation gateway is generally similar to the minimum allocation gateway for defined contribution plans that are not combined with a defined benefit plan. To apply this minimum aggregate allocation gateway, the employee's aggregate normal allocation rate is determined by adding the employee's allocation under the defined contribution plan to the employee's equivalent allocation under the defined benefit plan. The use of aggregation would allow an employer that provides both a defined contribution and a defined benefit plan to the NHCEs to take both plans into account in determining whether the minimum aggregate allocation gateway is met.

Under the gateway, if the aggregate normal allocation rate of the HCE with the highest aggregate normal allocation rate under the plan (HCE rate) is less than 15%, the aggregate normal allocation rate for all NHCEs must be at least 1/3 of the

[1]For example, if any HCE had an allocation of 12% of compensation, all NHCEs in the plan would be required to have an allocation of at least 4% of compensation.

HCE rate. If the HCE rate is between 15% and 25%, the aggregate normal allocation rate for all NHCEs must be at least 5%. If the HCE rate exceeds 25%, then the aggregate normal allocation rate for each NHCE must be at least 5% plus one percentage point for each 5-percentage-point increment (or portion thereof) by which the HCE rate exceeds 25% (e.g., the NHCE minimum is 6% for an HCE rate that exceeds 25% but not 30%, and 7% for an HCE rate that exceeds 30% but not 35%, etc.).

In addition, in determining the equivalent allocation rate for an NHCE under a defined benefit plan, a plan is permitted to treat each NHCE who benefits under the defined benefit plan as having an equivalent allocation rate equal to the average of the equivalent allocation rates under the defined benefit plan for all NHCEs benefitting under that plan. This averaging rule recognizes the "grow-in" feature inherent in traditional defined benefit plans (i.e., the defined benefit plan provides higher equivalent allocation rates at higher ages).

Comments are invited on possible special situations involving DB/DC plans, such as situations arising as a result of a merger or acquisition or a situation in which some HCEs in a DB/DC plan have unusually high equivalent normal allocation rates for reasons other than the design of the plan. Comments are invited as to whether the regulations should address such special circumstances and, if so, how (e.g., through a maximum required rate for NHCEs under a DB/DC plan or other approaches).

2. *Primarily defined benefit in character*

A combined plan that is primarily defined benefit in character would not be subject to the gateway requirement and may continue to be tested for nondiscrimination on the basis of benefits as under current law. A combined plan would be primarily defined benefit in character if, for more than 50% of the NHCEs benefitting under the plan, the normal accrual rate attributable to benefits provided under defined benefit plans for the NHCE exceeds the equivalent accrual rate attributable to contributions under defined contribution plans for the NHCE. For example, a DB/DC plan would be primarily defined benefit in character where the defined contribution plan covers only salaried employees, the defined benefit plan covers only hourly employees, and more than half of the NHCEs participating in the DB/DC plan are hourly employees participating only in the defined benefit plan.

3. *Broadly available separate plans*

A combined plan that consists of broadly available separate plans would not be subject to the gateway requirement and may continue to be tested for nondiscrimination on the basis of benefits as under current law. A DB/DC plan consists of broadly available separate plans if the defined contribution plan and the defined benefit plan each would satisfy the requirements of section 410(b) and the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) if each plan were tested separately, assuming satisfaction of the average benefit percentage test of §1.410(b)–5. Thus, the defined contribution plan must separately satisfy the nondiscrimination requirements (taking into account these proposed regulations as applicable), but for this purpose assuming satisfaction of the average benefit percentage test. Similarly, the defined benefit plan must separately satisfy the nondiscrimination requirements, assuming for this purpose satisfaction of the average benefit percentage test. In conducting the required separate testing, all plans of a single type (defined contribution or defined benefit) within the DB/DC plan are aggregated, but those plans are tested without regard to plans of the other type.

This alternative would be useful, for example, where an employer maintains a defined contribution plan that provides a uniform allocation rate for all covered employees at one business unit and a safe harbor defined benefit plan for all covered employees at another unit, where the group of employees covered by each plan is a group that satisfies the nondiscriminatory classification requirement of section 410(b). Because the employer provides broadly available separate plans, it may continue to aggregate the plans and test for nondiscrimination on the basis of benefits, as an alternative to using the qualified separate line of business rules or demonstrating satisfaction of the average benefit percentage test.

E. *Use of Component Plans and Permitted Disparity*

Component plans under the restructuring rules cannot be used for the determination of whether a defined contribution plan provides broadly available allocation rates or satisfies the minimum allocation gateway, or the determination of whether a DB/DC plan satisfies the minimum aggregate allocation gateway, is primarily defined benefit in character, or consists of broadly available separate plans. For purposes of the two gateways and determining whether a DB/DC plan is primarily defined benefit in character, allocation rates and equivalent allocation rates are determined without the use of permitted disparity. For purposes of determining whether a DB/DC plan consists of broadly available separate plans, permitted disparity may be used in the defined contribution plan or the defined benefit plan but not in both plans with respect to each employee who participates in both.

Proposed Effective Date

The regulations are proposed to be applicable for plan years beginning on or after January 1, 2002.

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 Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of 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 electronic or

written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. In addition to the other requests for comments set forth in this document, the IRS and Treasury also 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 January 25, 2001, at 10 a.m. in the IRS Auditorium (7th Floor), 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 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 5, 2001.

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 John T. Ricotta and Linda S. F. Marshall of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury 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. In §1.401(a)(4)–8, paragraph (b)(1) is revised to read as follows:

§1.401(a)(4)–8 Cross-testing.

* * * * *

(b) *Nondiscrimination in amount of benefits provided under a defined contribution plan*—(1) *General rule and gateway*—(i) *General rule.* Equivalent benefits under a defined contribution plan (other than an ESOP) are nondiscriminatory in amount for a plan year if—

(A) The plan would satisfy §1.401(a)(4)–2(c)(1) for the plan year if an equivalent accrual rate, as determined under paragraph (b)(2) of this section, were substituted for each employee's allocation rate in the determination of rate groups; and

(B) For plan years beginning on or after January 1, 2002, if the plan does not have broadly available allocation rates (within the meaning of paragraph (b)(1)(iii) of this section) for the plan year, the plan satisfies the minimum allocation gateway of paragraph (b)(1)(iv) of this section for the plan year.

(ii) *Allocations after testing age.* A plan does not fail to satisfy paragraph (b)(1)(i)(A) of this section merely because allocations are made at the same rate for employees who are older than their testing age (determined without regard to the current-age rule in paragraph (4) of the definition of *testing age* in §1.401(a)(4)–12), as they are made for employees who are at that age.

(iii) *Broadly available allocation rates*—(A) *In general.* A plan has broadly available allocation rates for the plan year if each allocation rate under the plan is currently available during the plan year (within the meaning of §1.401(a)(4)–4(b)(2)), to a group of employees that satisfies section 410(b) (without regard to the average benefit percentage test of §1.410(b)–5). For this purpose, the disregard of age and service conditions described in §1.401(a)(4)–4(b)(2)(ii)(A) applies only if the plan provides an allocation formula under which the allocation rates for all employees benefitting under the plan are determined using a single schedule of rates that are based solely on either age or service, and only if the allocation rates under the schedule increase smoothly at regular intervals, within the meaning of paragraphs (b)(1)(iii)(B) and (C) of this section. A plan does not fail to provide broadly available allocation rates merely because it provides the minimum benefit described in section 416(c)(2).

(B) *Smoothly increasing schedule of allocation rates.* A plan uses a single schedule of allocation rates that are based solely on age or service if it uses a single schedule of allocation rates that consists of a series of either age or service bands under which the same allocation rate applies to all employees whose age is within each age band or whose years of service are within each service band. A schedule of allocation rates increases smoothly if the allocation rate for each age or service band within the schedule is greater than the allocation rate for the immediately preceding band (i.e., the age or service band with the next lower number of years of age or service) but by no more than 5 percentage points. However, a schedule of allocation rates will not be treated as increasing smoothly if the ratio of the allocation rate for any age or service band to the rate for the immediately preceding band is more than 2.0 or if it exceeds the ratio of allocation rates between the two immediately preceding bands.

(C) *Regular intervals.* A schedule of allocation rates has regular intervals of age or service if each age or service band, other than the band associated with the highest age or years of service, is the same length. For this purpose, if the schedule is based on age, the first age band will be deemed to be of the same length as the other bands if it ends at or before age 25. If the first age band ends after age 25, then, in determining whether the length of the first band is the same as the length of other bands, the starting age for the first age band is permitted to be treated as age 25 or any age earlier than 25.

(iv) *Minimum allocation gateway.* A plan satisfies the minimum allocation gateway of this paragraph (b)(1)(iv) if each NHCE has an allocation rate that is at least one third of the allocation rate of the HCE with the highest allocation rate. However, a plan is deemed to satisfy this minimum allocation gateway if each NHCE receives an allocation of at least 5% of the

NHCE's compensation within the meaning of section 415(c)(3).

(v) *Determination of allocation rates.* For purposes of this paragraph (b)(1), allocations and allocation rates are determined under §1.401(a)(4)–2(c)(2), but without taking into account the imputation of permitted disparity under §1.401(a)(4)–7 in applying the minimum allocation gateway of paragraph (b)(1)(iv) of this section.

(vi) *Examples.* The following examples illustrate the rules in this paragraph (b)(1):

Example 1. (i) Plan M is a defined contribution plan that provides an allocation formula under which allocations are provided to all employees according to the following schedule:

Years of Service	Allocation Rate	Ratio of Allocation Rate for Band to Allocation Rate for Immediately Preceding Band
0- 5	3.0%	not applicable
6-10	4.5%	1.50
11-15	6.5%	1.44
16-20	8.5%	1.31
21-25	10.0%	1.18
26 or more	11.5%	1.15

(ii) Because Plan M provides that allocation rates for all employees are determined using a single schedule based solely on service, the plan is permitted to disregard the service requirement in determining whether the allocation rates are broadly available (within the meaning of paragraph (b)(1)(iii) of this section), if the allocation rates under the schedule increase smoothly at regular intervals.

(iii) The schedule of allocation rates under Plan M does not increase by more than 5 percentage points between adjacent bands and the ratio of the allocation rate for any band to the allocation rate for the immediately preceding band is never more than 2.0 and does not increase. Therefore, the allocation rates increase smoothly. In addition, the bands (other than the highest band) are all 5 years long, so the increases occur at regular intervals. Accordingly, the service requirement is disregarded and each allocation rate is broadly available within the meaning of paragraph (b)(1)(iii) of this section, as each allocation rate is currently available to all employees in the Plan.

(iv) Under paragraph (b)(1)(i) of this section, Plan M satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(iv) of this section.

Example 2. (i) Plan N is a defined contribution plan that provides an allocation formula under which allocations are provided to all employees according to the following schedule:

Age	Allocation rate	Ratio of Allocation Rate for Band to Allocation Rate for Immediately Preceding Band
under 25	3.0 %	not applicable
25-34	6.0 %	2.00
35-44	9.0 %	1.50
45-54	12.0%	1.33
55-64	16.0%	1.33
65 or older	21.0%	1.31

(ii) Because Plan N provides that allocation rates for all employees are determined using a single schedule based solely on age, the plan is permitted to disregard the age requirement in determining whether the allocation rates are broadly available (within the meaning of paragraph (b)(1)(iii) of this section), if the allocation rates under the schedule increase smoothly at regular intervals.

(iii) The schedule of allocation rates under Plan N does not increase by more than 5 percentage points between adjacent bands and the ratio of the allocation rate for any band to the allocation rate for the immediately preceding band is never more than 2.0 and does not increase. Therefore, the allocation rates increase smoothly. In addition, the bands are all 10 years long (other than the highest band and the first band, which is deemed to be the same length as the other bands because it ends prior to age 25), so the increases occur at regular intervals. Accordingly, the age requirement is disregarded and each allocation rate is broadly available within the meaning of paragraph (b)(1)(iii) of this section, as each allocation rate is currently available to all employees in the Plan.

(iv) Under paragraph (b)(1)(i) of this section, Plan N satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(iv) of this section.

Example 3. (i) Plan O is a profit-sharing plan maintained by Employer A that covers all of Em-

ployer A's employees, consisting of two HCEs, X and Y, and 7 NHCEs. Employee X's compensation is $170,000 and Employee Y's compensation is $150,000. The allocation for Employees X and Y is $30,000 each, resulting in an allocation rate of 17.6% for Employee X and 20% for Employee Y. Under Plan O, each NHCE receives an allocation of 5% of compensation within the meaning of section 415(c)(3).

(ii) Because the allocation rate for X is not currently available to any NHCE, Plan O does not have broadly available allocation rates and must satisfy the minimum allocation gateway of paragraph (b)(1)(iv) of this section.

(iii) The highest allocation rate for any HCE under Plan O is 20%. Accordingly, Plan O would satisfy the minimum allocation gateway of paragraph (b)(1)(iv) of this section if all NHCEs have an allocation rate of at least 6.67%, or if all NHCEs receive an allocation of at least 5% of compensation within the meaning of section 415(c)(3).

(iv) Under Plan O, each NHCE receives an allocation of 5% of compensation within the meaning of section 415(c)(3). Accordingly, Plan O satisfies the minimum allocation gateway of paragraph (b)(1)(iv) of this section.

(v) Under paragraph (b)(1)(i) of this section, Plan O satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section.

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Par. 3. Section 1.401(a)(4)–9 is amended by adding paragraph (b)(2)(v) and revising paragraph (c)(3)(ii) to read as follows:

§1.401(a)(4)–9 Plan aggregation and restructuring.

* * * * *

(b) * * *

(2) * * *

(v) *Eligibility for testing on a benefits basis*—(A) *General rule.* For plan years beginning on or after January 1, 2002, unless, for the plan year, a DB/DC plan is primarily defined benefit in character (within the meaning of paragraph (b)(2)(v)(B) of this section) or consists of broadly available separate plans (within the meaning of paragraph (b)(2)(v)(C) of this section), the DB/DC plan must satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section for the plan year in order to be permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits.

(B) *Primarily defined benefit in character.* A DB/DC plan is primarily defined benefit in character if, for more than 50% of the NHCEs benefitting under the plan, the normal accrual rate for the NHCE attributable to benefits provided under defined benefit plans that are part of the DB/DC plan exceeds the equivalent accrual rate for the NHCE attributable to contributions under defined contribution plans that are part of the DB/DC plan.

(C) *Broadly available separate plans.* A DB/DC plan consists of broadly available separate plans if the defined contribution plan and the defined benefit plan that are part of the DB/DC plan each would satisfy the requirements of section 410(b) and the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) if each plan were tested separately and assuming that the average benefit percentage test of §1.410(b)–5 were satisfied. For this purpose, all defined contribution plans that are part of the DB/DC plan are treated as a single defined contribution plan and all defined benefit plans that are part of the DB/DC plan are treated as a single defined benefit plan. In addition, if permitted disparity is used for an employee for purposes of satisfying the separate testing requirement of this paragraph (b)(2)(v)(C) for plans of one type, it may not be used in satisfying the separate testing requirement for plans of the other type for the employee.

(D) *Minimum aggregate allocation gateway.* A DB/DC plan satisfies the minimum aggregate allocation gateway of this paragraph (b)(2)(v)(D) if each NHCE has an aggregate normal allocation rate that is at least one third of the aggregate normal allocation rate of the HCE with the highest such rate (HCE rate), or, if less, 5% of the NHCE's compensation, provided that the HCE rate does not exceed 25% of compensation. If the HCE rate exceeds 25% of compensation, then the aggregate normal allocation rate for each NHCE must be 5% increased by one percentage point for each 5-percentage-point increment (or portion thereof) by which the HCE rate exceeds 25% (e.g., the NHCE minimum is 6% for an HCE rate that exceeds 25% but not 30%, and 7% for an HCE rate that exceeds 30% but not 35%). For purposes of this paragraph (b)(2)(v)(D), a plan is permitted to treat each NHCE who benefits under the defined benefit plan as having an equivalent normal allocation rate equal to the average of the equivalent normal allocation rates under the defined benefit plan for all NHCEs benefitting under that plan.

(E) *Determination of rates.* For purposes of this paragraph (b)(2)(v), the normal accrual rate and the equivalent normal allocation rate attributable to defined benefit plans, the equivalent accrual rate attributable to defined contribution plans and the aggregate normal allocation rate are determined under paragraph (b)(2)(ii) of this section, but without taking into account the imputation of permitted disparity under §1.401(a)(4)–7, except as otherwise permitted under paragraph (b)(2)(v)(C) of this section.

(F) *Examples.* The following examples illustrate the application of this paragraph (b)(2)(v):

Example 1. (i) Employer A maintains Plan M, a defined benefit plan, and Plan N, a defined contribution plan. All HCEs of Employer A are covered by Plan M (at a 1% accrual rate), but not covered by Plan N. All NHCEs of Employer A are covered by Plan N (at a 3% allocation rate), but not covered by Plan M. Because Plan M does not satisfy section 410(b) standing alone, Plans M and N are aggregated for purposes of satisfying sections 410(b) and 401(a)(4).

(ii) Because none of the NHCEs participate in the defined benefit plan, the aggregated DB/DC plan is not primarily defined benefit in character within the meaning of paragraph (b)(2)(v)(B) of this section nor does it consist of broadly available separate plans within the meaning of paragraph (b)(2)(v)(C) of this section. Accordingly, the aggregated Plan M and Plan N must satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section in order to satisfy the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits.

Example 2. (i) Employer B maintains Plan O, a defined benefit plan, and Plan P, a defined contribution plan. All of the six employees of Employer B are covered under both Plan O and Plan P. Under Plan O, all employees have a uniform normal accrual rate of 1% of compensation. Under Plan P, Employees A and B, who are HCEs, receive an allocation rate of 15%, and participants C, D, E and F, who are NHCEs, receive an allocation rate of 3%. Employer B aggregates Plans O and P for purposes of satisfying sections 410(b) and 401(a)(4). The equivalent normal allocation and normal accrual rates under Plans O and P are as follows:

Employee	Equivalent Normal Allocation Rates for the 1% Accrual under Plan O (defined benefit plan)	Equivalent Normal Accrual Rates for the 15%/3% Allocations under Plan P (defined contribution plan)
HCE A (age 55)	3.93%	3.82%
HCE B (age 50)	2.61%	5.74%
C (age 60)	5.91%	.51%
D (age 45)	1.73%	1.73%
E (age 35)	.77%	3.90%
F (age 25)	.34%	8.82%

(ii) Although all of the NHCEs benefit under the Plan O (the defined benefit plan), the aggregated DB/DC plan is not primarily defined benefit in character because the normal accrual rate attributable to defined benefit plans (which is 1% for all the NHCEs) is greater than the equivalent accrual rate under defined contribution plans only for Employee C. In addition, because the 15% allocation rate is only available to HCEs, the defined contribution plan cannot satisfy the requirements of §1.401(a)(4)–2 and does not have broadly available allocation rates within the meaning of §1.401(a)(4)–8(b)(1)(iii). Further, the defined contribution plan does not satisfy the minimum allocation gateway of §1.401(a)(4)–8(b)(1)(iv) (3% is less than 1/3 of the 15% HCE rate). Therefore, the defined contribution plan within the DB/DC plan cannot separately satisfy §1.401(a)(4)–1(b)(2) and does not constitute a broadly available separate plan within the meaning of paragraph (b)(2)(v)(C) of this section. Accordingly, the aggregated plans can satisfy the nondiscrimination in amounts requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits only if the aggregated plans satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

(iii) Employee A has an aggregate normal allocation rate of 18.93% under the aggregated plans (3.93% from Plan O plus 15% from Plan P), which is the highest aggregate normal allocation rate for any HCE under the plans. Employee F has an aggregate normal allocation rate of 3.34% under the aggregated plans (.34% from Plan O plus 3% from Plan P) which is less than the 5% aggregate normal allocation rate that Employee F would be required to have to satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

(iv) However, for purposes of satisfying the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section, Employer B is permitted to treat each NHCE who benefits under the Plan O (the defined benefit plan) as having an equivalent allocation rate equal to the average of the equivalent allocation rates under Plan O for all NHCEs benefitting under that plan. The average of the equivalent allocation rates for all the NHCEs under Plan O is 2.19% (the sum of 5.91%, 1.73%, .77%, and .34%, divided by 4). Accordingly, Employer B is permitted to treat all the NHCEs as having an equivalent allocation rate attributable to Plan O equal to 2.19%. Thus, all NHCEs can be treated as having an aggregate normal allocation rate of 5.19% for this purpose (3% from the defined contribution plan and 2.19% from the defined benefit plan) and the aggregated DB/DC plan satisfies the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

* * * * *

(c) * * *

(3) * * *

(ii) *Restructuring not available for certain testing purposes.* The safe harbor in §1.401(a)(4)–2(b)(3) for plans with uniform points allocation formulas is not available in testing (and thus cannot be satisfied by) contributions under a component plan. Similarly, component plans cannot be used for purposes of determining whether a plan provides broadly available allocation rates (as defined in §1.401(a)(4)–8(b)(1)(iii)), or determining whether a plan is primarily defined benefit in character or consists of broadly available separate plans (as defined in paragraphs (b)(2)(v)(B) and (C) of this section). In addition, the minimum allocation gateway of §1.401(a)(4)–8(b)(1)(iv) and the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section cannot be satisfied on the basis of component plans. See §§1.401(k)–1(b)(3)(iii) and 1.401(m)–1(b)(3)(iii) for rules regarding the inapplicability of restructuring to section 401(k) plans and section 401(m) plans.

* * * * *

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 5, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 6, 2000, 65 F.R. 59774)

Monthly Limit for Transit Passes and Transportation in a Commuter Highway Vehicle Provided by an Employer to Employees Under Section 132(f) of the Internal Revenue Code

Announcement 2000–78

This announcement sets forth a clarification to the proposed Treasury Regulations dealing with qualified transportation fringes (Prop. Treas. Reg. § 1.132–9, 65 F.R. 4388). Specifically, when finalized, the regulations will clarify that transit passes may be distributed in advance for more than one month (such as for a calendar quarter). The applicable statutory monthly limit under section 132(f)(2) on the combined amount of transit passes and transportation in a commuter highway vehicle may be calculated by taking into account the monthly limits for all months for which the transit passes are distributed. Thus, for example, the employer may distribute advance transit passes for a subsequent calendar quarter with a value equal to the statutory monthly limit times three months (for 2000, $65 times three equals $195). However, if transit passes are provided in advance and the employee's employment terminates before the beginning of the last month of the period for which the transit passes are provided, the value of transit passes covering the month(s) that begin after the employee's employment terminates is included in the employee's wages for income tax purposes and for employment tax purposes (income tax withholding, FICA and FUTA) to the extent the employer does not recover those transit passes or the value of those passes.

Pending issuance of the final regulations, taxpayers may rely on this announcement. An employer will not be considered to have failed to satisfy employment tax requirements under this announcement for advance transit pass distributions occurring before January 1, 2001.

Prior to issuing final regulations, the Service is requesting comments concerning this announcement. Written comments should be sent to the following address:

Internal Revenue Service
CC:DOM:CORP (ANN 2000–78;
CC:TEGE:EOEG:ET2)
P.O. Box 7604, Ben Franklin Station
Washington, DC 20044

In the alternative, comments may be hand delivered between the hours of 8:00 a.m. and 5:00 p.m. to the courier's desk at 1111 Constitution Avenue, NW., Washington, DC, or submitted electronically via the IRS Internet site at http://www.irs.utreas.gov/tax_regs/regslist.html.

Because the Service and Treasury would like to receive comments with sufficient time to consider them in developing the final regulations, comments should be submitted by November 15, 2000. However, to the extent possible, consideration will be given to comments received after that date.

The principal author of this announcement is John Richards of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this announcement contact John Richards at (202) 622-6040 (not a toll-free call).

Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates; Correction

Announcement 2000–85

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 that was published in the **Federal Register** on Monday, August 7, 2000 (65 F.R. 48198) relating to the recognition of gain on certain transfers to certain foreign trusts and estates.

FOR FURTHER INFORMATION CONTACT: Karen A. Rennie Quarrie at (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking that is the subject of this correction is under section 684 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–108522–00, 2000–34 I.R.B. 187), that was the subject of FR Doc. 00–19896, is corrected as follows:

§1.684–3 [Corrected]

On page 48202, column 1, §1.684–3(f), the first line in *Example 1*, the language "*Example 1. Transfer to owner trust.* In" is corrected to read "*Example 1. Transfer to grantor trust.* In"

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization and Strategic Planning).

(Filed by the Office of the Federal Register on October 2, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 3, 2000, 65 F.R. 58973)

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

Section 527.—Political Organizations

26 CFR 1.527–2: Definitions.
(Also §§ 6012, 6033, 6104, and 6652.)

Reporting requirements for section 527 organizations. This ruling provides questions and answers regarding the notice and reporting requirements for section 527.

Rev. Rul. 2000–49

ISSUES

On July 1, 2000, Pub. L. 106–230 was enacted, amending § 527 of the Code. The new law imposes three reporting and disclosure requirements on political organizations described in § 527: (1) an initial notice of status, (2) periodic reports of contributions and expenditures, and (3) annual returns. This revenue ruling provides questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527.

QUESTIONS AND ANSWERS

I. *Notice of Status*

1. Q. What is the notice of status requirement for an organization described in § 527?

A. Under § 527(i)(1)(A), a political organization is required to give notice both electronically and in writing to the Service that it is a political organization described in § 527.

2.Q. What is the required notice form?

A. The required notice form is Form 8871, *Political Organization Notice of Section 527 Status.*

3. Q. Are all political organizations required to file the Form 8871 notice?

A. No. Under § 527(i)(5) and § 527(i)(6), three types of organizations are not required to file the Form 8871 notice:

(a) Persons required to report under the Federal Election Campaign Act of 1971 (FECA) as a political committee (see 2 U.S.C. § 431(4));

(b) Organizations that reasonably anticipate that their annual gross receipts will always be less than $25,000; and

(c) Organizations described in § 501(c) that are subject to § 527(f)(1) because they have made an "exempt function" expenditure.

All other political organizations, including state and local candidate committees, are required to file the notice.

4. Q. Is a political organization required to file Form 8871 if it does not know whether it will have annual gross receipts of $25,000 or more for any taxable year?

A. A newly established political organization is not required to file Form 8871 if it reasonably anticipates that its annual gross receipts will be less than $25,000 for its first six taxable years. However, if an organization, in fact, does have annual gross receipts of $25,000 or more for any taxable year, it is required to file Form 8871 within 30 days of receiving $25,000.

5.Q. Is the separate segregated fund established under § 527(f)(3) by a § 501(c) organization required to file Form 8871?

A. A § 501(c) organization that is not prohibited from participating in political campaign activity has the option of conducting the activity itself or setting up a separate segregated fund. If the § 501(c) organization conducts the activity itself, it is subject to tax under § 527(f)(1) on the lesser of its investment income or the amount of its political expenditures, but it is not required to file Form 8871 pursuant to § 527(i)(5)(A). If the § 501(c) organization establishes a separate segregated fund, the fund is treated as a separate political organization under § 527(f)(3) and does not qualify for the exception under § 527(i)(5)(A). Therefore, unless it meets one of the other exceptions, the separate segregated fund is required to file Form 8871.

6. Q. Is an organization that finances both federal and non-federal election activity required to file the Form 8871 notice?

A. As a general rule, any political organization (whether or not separately incorporated) that is organized and operated primarily for an exempt function under § 527(e)(2) (see Q&A-17) must file Form 8871 unless it meets one of the exceptions discussed above (see Q&A-3), one of which is being required to report under FECA as a political committee. An organization that finances election activity (within the meaning of FECA) for both federal and non-federal elections may establish a political committee to receive contributions and make expenditures for both federal and non-federal election activity. In that case, the organization must register as a political committee and comply with the FECA contribution limitations and reporting requirements. 11 C.F.R. 102.5(a)(1)(ii). Such an organization is, therefore, not required to file Form 8871.

If, however, the organization sets up separate accounts to conduct its federal election activity and its non-federal election activity, the federal account is treated as a separate political committee that is required to register and report under FECA. 11 C.F.R. 102.5(a)(1)(i). The treatment of the federal account as a separate committee is consistent with the organizational requirements for political organizations under § 527, as discussed below in Q&A-12. Accordingly, the separate federal account is not required to file Form 8871. However, a separate non-federal account is not required to register and report under FECA as a political committee. Therefore, a separate non-federal account that is described in § 527(e)(1) is required to file Form 8871.

7. Q. Are political organizations that are required to report to state or local election agencies excepted from the notice requirement?

A. Section 527(i) does not except political organizations that file reports with state or local election agencies from the notice of status requirement. Therefore, unless the political organization meets one of the exceptions discussed above in Q&A-3, it must file Form 8871 with the Service.

8. Q. When must the organization file Form 8871?

A. Form 8871 must be filed within 24 hours after the date on which the organization was established. See Notice 2000–36, 2000–33 I.R.B. 173 for information about filing requirements for organizations in existence before July 30, 2000.

9. Q. What are the methods of filing Form 8871?

A. Section 527(i)(1)(A) requires that the organization file Form 8871 both electronically and in writing. Therefore, the methods for filing Form 8871 are as follows:

(a) Electronically via the Internal Revenue Service Internet Web Site (IRS Web Site) at www.irs.gov./polorgs, and

(b) In writing by sending a signed copy of Form 8871 to the Internal Revenue Service Center, Ogden, UT 84201. An organization can fill in and print out the form from the IRS Web Site.

10. Q. Must an organization take any additional steps before filing Form 8871?

A. Before filing Form 8871, the political organization must have its own employer identification number (EIN) even if it has no employees. To obtain an EIN, an organization must file Form SS-4, *Application for Employer Identification Number*, with the Service (see Q&A-52).

11. Q. What information must be provided in the Form 8871 notice?

A. Under § 527(i)(3), an organization must provide in its Form 8871 notice its name and address (including any business address, if different) and electronic mailing address; its purpose; the names and addresses of its officers, highly compensated employees, contact person, custodian of records, and members of its Board of Directors; and the name and address of, and relationship to, any related entities (within the meaning of § 168(h)(4)).

12. Q. Does § 527(i) change the organizational requirements for § 527 organizations?

A. No. Section 527 does not require an organization to have formal organizational documents, such as articles of incorporation. Under § 1.527–2(a)(2) of the Income Tax Regulations, a political organization meets the organizational test if it is organized for the primary purpose of carrying on exempt function activities as defined in § 527. The regulation specifically states that the organization need not be formally chartered or established as a corporation, trust, or association. For example, a separate bank account can qualify as a political organization. See Rev. Rul. 79–11, 1979–1 C.B. 207.

The requirement that a § 527 organization include the names and addresses of its officers, highly compensated employees, and members of its Board of Directors does not change the organizational test for § 527. Section 527(i) does not require political organizations to be organized with Boards of Directors, officers and highly compensated employees. It merely requires the organization to provide their names and addresses if it is so organized.

13. Q. What is a "related entity" for this purpose?

A. An entity is a "related entity" within the meaning of § 168(h)(4), which provides that an organization is related to another entity as follows:

(a) The two entities have (i) significant common purposes and substantial common membership or (ii) directly or indirectly substantial common direction or control; or

(b) Either entity owns (directly or through one or more entities) a 50 percent or greater interest in the capital or profits of the other. For this purpose, entities treated as related entities under (a) above shall be treated as one entity.

14. Q. What are "highly compensated employees" for this purpose?

A.Highly compensated employees for this purpose are the five employees (other than officers and directors) who are reasonably expected to have the highest annual compensation over $50,000. Compensation includes both cash and noncash amounts, whether paid currently or deferred, for the 12-month period that began with the date the organization was formed (if the organization was formed after June 30, 2000). If the organization was already in existence on June 30, 2000, it must use the accounting period that includes July 1, 2000.

15. Q. What if an organization described in § 527(e)(1) does not file the Form 8871 notice?

A. An organization described in § 527(e)(1) must file Form 8871 unless it is an organization described in § 527(i)(5) or § 527(i)(6) (see Q&A-3). If the organization fails to file Form 8871 on a timely basis, § 527(i)(4) provides that until the organization satisfies the notice requirement, the taxable income of the organization includes its exempt function income (including contributions received, membership dues, and political fundraising receipts), minus any deductions directly connected with the production of that income. For purposes of computing its taxable income, the organization may not deduct its exempt function expenditures because § 162(e) denies a deduction for political campaign expenditures.

Under § 527(b), the tax is computed by multiplying the organization's taxable income (including its net investment income) by the highest corporate tax rate, currently 35 percent. The organization must file a Form 1120-POL to report the income and pay the tax.

16. Q. When is an organization described in § 527(e)(1)?

A. An organization is described in § 527(e)(1) if it meets both the organizational and operational tests, that is, it must be organized and operated primarily for the purpose of accepting contributions or making expenditures for an exempt function under § 527(e)(2). See § 1.527–2(a).

17. Q. What is an "exempt function" under § 527(e)(2)?

A. "Exempt function" means, under § 527(e)(2), influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

18. Q. Are transfers to political organizations that fail to file Form 8871 subject to the gift tax?

A. Section 2501(a)(5) provides that the gift tax does not apply to transfers of money or other property to political organizations within the meaning of § 527(e)(1). Therefore, transfers to an organization described in § 527(e)(1) (see Q&A-16) are not subject to the gift tax, regardless of whether the organization has filed Form 8871.

19. Q. Is the Form 8871 notice publicly available?

A. Yes. Under § 6104(a), Form 8871 (including any supporting papers), and any letter or other document the Service issues with regard to Form 8871, will be open to public inspection. Copies of Form 8871 that have been filed are currently available at the IRS Web Site at www.irs.gov/polorgs and are considered widely available under § 301.6104(d)–3 of the Procedure and Administration Regulations, as long as the organization provides the IRS Web Site address to the per-

son making the request. In addition, the organization is required to make a copy of these materials available for public inspection during regular business hours at the organization's principal office (and at each of its regional or district offices having at least three paid employees) in the same manner as applications for exemption of § 501(c) organizations are made available. § 6104(d).

20. Q. What is the penalty on the organization for failure to comply with the public inspection requirement?

A. Under § 6652(c)(1)(D), a penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues.

II. Periodic Reporting Requirements

21. Q. What are the periodic reporting requirements imposed upon political organizations?

A. Under § 527(j), a political organization is required to periodically report certain contributions it receives and expenditures it makes.

22. Q. What is the required periodic reporting form?

A. The required periodic reporting form is Form 8872, *Political Organization Report of Contributions and Expenditures.*

23. Q. When are political organizations required to file periodic reports on Form 8872?

A. Under § 527(j)(2), political organizations that accept contributions or make expenditures for an exempt function under § 527 (see Q&A-17) during a calendar year are required to file periodic reports on Form 8872, beginning with the first month or quarter in which they accept contributions or make expenditures. In addition, organizations that make contributions or expenditures with respect to an election for federal office (as defined in § 527(j)(6)) may be required to file pre-election reports for that election.

24. Q. Are all political organizations required to file periodic reports on Form 8872?

A. No, § 527(j)(5) provides that some organizations are not subject to this requirement. The organizations excepted from the filing requirements are as follows:

a) Organizations excepted from the requirement to file a Form 8871 (see Q&A-3);

b) Political committees of a state or local candidate, including political committees of state or local officeholders; and

c) State and local committees of political parties.

All other political organizations, including state and local political action committees, are subject to the reporting requirements of § 527(j), even if they file reports with state or local election agencies.

25. Q. Must a state or local candidate or officeholder organize a formal committee to be excepted from the Form 8872 filing requirements?

A. No. As discussed in Q&A-12, § 527 does not require organizations to have formal organizational documents. Therefore, a candidate or officeholder does not need to organize a formal committee to qualify for the exception under § 527(j)(5) for committees of state or local candidates.

26. Q. Are political organizations that engage in exempt function activities (as defined in § 527(e)(2)) solely with respect to elections for state or local offices excepted from the Form 8872 filing requirements?

A. No. Although the timing of the reports is based upon federal elections (see Q&A-34), the requirement to file the reports is based on accepting contributions or making expenditures for an exempt function under § 527(e)(2) (see Q&A-17). Therefore, unless a political organization meets one of the exceptions discussed above in Q&A-24, it must file Form 8872 with the Service.

27. Q. Is an organization that reasonably anticipated it would not have annual gross receipts of $25,000 or more required to file Form 8872 if it, in fact, receives $25,000 or more in any taxable year?

A. An organization that receives $25,000 in any taxable year no longer qualifies for the exception in § 527(j)(5)(C) and, therefore, must begin filing Form 8872 unless it meets one of the other exceptions discussed in Q&A-24. The organization must file, within 30 days of receiving $25,000, any Form 8872 that would otherwise have been due during the calendar year prior to that date.

28. Q. How often must the Form 8872 be filed?

A. A political organization subject to the periodic reporting requirement may choose to file Form 8872 on a monthly basis or on a quarterly/semi-annual basis, but it must file on the same basis for the entire calendar year.

29. Q. What is an election year and non-election year for purposes of determining the due dates for filing Form 8872?

A. An election year is any year in which a regularly scheduled general election for federal office is held, i.e., any even-numbered year. A non-election year is therefore any odd-numbered year.

30. Q. If an organization chooses to file on a monthly basis, when is Form 8872 due in a non-election year?

A. Pursuant to § 527(j)(2)(B), a political organization that chooses to file monthly must file Form 8872 reports not later than the 20th day after the end of the month, which must be complete as of the last day of the month. December activity is included in the year-end report which is due not later than January 31 of the following year.

31. Q. If an organization chooses to file on a monthly basis, when is Form 8872 due during an election year?

A. Pursuant to § 527(j)(2)(B), in any election year (i.e., even-numbered years), monthly reports are due not later than the 20th day after the end of the month (see Q&A-30), except the organization shall not file the reports regularly due in November and December (i.e., the monthly reports for activity in October and November). Instead, the organization must file a Form 8872 report not later than 12 days before the general election (or 15 days before the general election if posted by registered or certified mail) that contains information through the 20th day before the general election. The organization must also file a report no more than 30 days after the general election which shall contain information through the 20th day after the election. The December activity is included in the year-end report due not later than January 31 of the following year.

32. Q. If an organization chooses not to file on a monthly basis, when is Form 8872 due in a non-election year?

A. Pursuant to § 527(j)(2)(A), a political organization that chooses not to file monthly must file semi-annual reports in non-election years (i.e., odd-numbered years). These reports are due not later

than July 31 for the first half of the year and, for the second half of the year, not later than January 31 of the following year.

33. Q. If an organization chooses not to file on a monthly basis, when is Form 8872 due during an election year?

A. Pursuant to § 527(j)(2)(A), in an election year (even-numbered years), an organization that chooses not to file monthly reports must file quarterly reports not later than the 15th day after the last day of the quarter, except that the return for the final quarter shall be due not later than January 31 of the following year. The organization must also file a post-general election report not later than 30 days after the general election that contains information through the 20th day after the election. In addition, the organization must file a pre-election report for any election for federal office with respect to which the organization makes a contribution or expenditure. These reports shall be filed not later than 12 days before the election (15 days before if posted by registered or certified mail) and must contain information through the 20th day before the election.

34. Q. What is an election for purposes of the reporting deadlines under § 527(j)?

A. For purposes of determining what is an election year and what elections trigger the pre-election and post-general election reports, § 527(j)(6) provides that an "election" is a general, special, primary, or runoff election for a federal office; a convention or caucus of a political party with authority to nominate a candidate for federal office; a primary election to select delegates to a national nominating convention of a political party; or a primary election to express a preference for the nomination of individuals for election to the office of President. Thus, an election for purpose of these reporting deadlines does not include a purely state or local election. When an election involves both candidates for federal office and candidates for state or local offices, it is an election for purposes of the reporting deadlines, but only those organizations that make contributions or expenditures with respect to the candidates for federal office are required to file the pre-election reports for those elections under § 527(j)(2)(A)(i)(II). However, all reports filed under § 527(j) must contain information about the contributions and expenditures within the reporting period, regardless of whether they were accepted or made with respect to candidates for federal, state or local office.

35. Q. What is a general election?

A. A general election is either one of the following:

a) an election for federal office held in even numbered years on the Tuesday following the first Monday in November or

b) an election held to fill a vacancy in a federal office (i.e., a special election) that is intended to result in the final selection of a single individual to the office at stake. See 11 C.F.R. 100.2(b).

36. Q. How will "election" under § 527(j)(6) be interpreted?

A. The definition of "election" under § 527(j)(6) is virtually identical to the definition of "election" under FECA (2 U.S.C. § 431(1)). Organizations may rely on FEC interpretations of the FECA definition in the absence of further guidance from the Service. The FEC publishes information concerning the filing requirements under FECA and the dates for filing those reports, including information on the dates of elections, on its Web Site at http://www.fec.gov/pages/report.htm.

37. Q. What must a Form 8872 report contain?

A. The report must include the name, address, and (if an individual) the occupation and employer, of any person to whom expenditures are made that aggregate $500 or more in a calendar year and the amount of such expenditure. The report must also include the name, address, and (if an individual) the occupation and employer, of any person that contributes in the aggregate $200 or more in a calendar year and the amount of such contribution. However, an organization is not required to report independent expenditures, as defined in § 301 of FECA. Only expenditures made or contributions received after July 1, 2000, that are not made or received pursuant to binding contracts entered into before July 2, 2000, must be reported.

38. Q. What is an independent expenditure under § 301 of FECA?

A. An independent expenditure is an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate for federal office which is made without cooperation or consultation with any candidate for federal office, or any authorized committee or agent of such candidate, and which is not made in concert with, or at the request or suggestion of, any candidate for federal office, or authorized committee or agent of such candidate. See 2 U.S.C. § 431(17).

39. Q. Where is the Form 8872 filed?

A. The report is filed by sending a signed copy of Form 8872 to the Internal Revenue Service Center, Ogden, UT 84201. The form must be signed by an official authorized by the organization to sign the report.

40. Q. What if a political organization that has filed Form 8871 does not file the required Form 8872?

A. Under § 527(j)(1), a political organization that does not file the required Form 8872 or which fails to include the information required on the Form 8872 is subject to a penalty equal to the amount of contributions and expenditures that are not disclosed multiplied by the highest corporate tax rate, currently 35 percent.

41. Q. Is the Form 8872 filed by political organizations publicly available?

A. Yes. Under § 6104(b) and § 6104(d)(6), Form 8872 will be made available for public inspection by the Service. Copies of Form 8872 that have been filed are currently available at the IRS Web Site at www.irs.gov/polorgs and are considered widely available under § 301.6104(d)–3, as long as the organization provides the IRS Web Site address to the person making the request. In addition, under § 6104(d)(1)(A), the organization is required to make a copy of these reports available for public inspection during regular business hours at the organization's principal office (and at each of its regional or district offices having at least three paid employees) in the same manner as applications for exemption of § 501(c) organizations are made available. Pursuant to § 6104(b) and § 6104(d)(3)(A), contributor information must be disclosed to the public.

42. Q. What if the political organization does not make its Form 8872 publicly available?

A. Under § 6652(c)(1)(C), a penalty of $20 per day may be imposed on any

person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one report is $10,000.

III. *Annual Return Requirements*

43. Q. Which political organizations are required to file annual income tax returns?

A. A political organization that has taxable income in excess of the $100 specific deduction allowed under § 527 is required to file an annual income tax return on Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations.* In addition, for taxable years beginning after June 30, 2000, a political organization that has $25,000 or more in gross receipts for the taxable year is also required to file Form 1120-POL, without regard to whether it has taxable income. § 6012(a)(6).

44. Q. When is the Form 1120-POL due?

A. The Form 1120-POL is due on or before the 15th day of the third month after the close of the organization's taxable year. § 6072(b). Thus, for a calendar-year taxpayer, Form 1120-POL is due on March 15 of the following year.

45. Q. Which political organizations are required to file an annual information return?

A. A political organization that is required under § 6012(a)(6) to file an income tax return is also required to file Form 990, *Return of Organization Exempt from Income Tax*, for taxable years beginning after June 30, 2000. § 6033(g). Organizations with gross receipts less than $100,000 and assets less than $250,000 may file Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax.* Organizations with gross receipts of less than $25,000 are not required to file Form 990 or Form 990-EZ.

46. Q. When is the Form 990 due?

A. The Form 990 (or Form 990-EZ) is due on or before the 15th day of the fifth month after the close of the organization's taxable year. Thus, for a calendar-year taxpayer, Form 990 is due on May 15 of the following year.

47. Q. What if the political organization fails to file Form 1120-POL or Form 990?

A. A political organization that fails to file a required Form 1120-POL or Form 900 or fails to include required information on those returns is subject to a penalty of $20 per day for every day such failure continues. The maximum penalty imposed regarding any one return is the lesser of $10,000 or 5 percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding $1,000,000 for any year, the penalty is increased to $100 per day with a maximum penalty of $50,000. § 6652(c)(1)(A).

48. Q. Are the Forms 1120-POL and Forms 990 filed by political organizations publicly available?

A. Yes, the Forms 1120-POL and the Forms 990 filed for taxable years beginning after June 30, 2000 will be made available for public inspection by the Service. § 6104(b). In addition, each political organization must make a copy of its returns available for public inspection during regular business hours at its principal office (and any regional or district offices having at least three paid employees) in the same manner as annual information returns of § 501(c) organizations are made available. It must also provide a copy of the returns to any person requesting a copy in person or in writing without charge other than a reasonable charge for reproduction and postage in the same manner that § 501(c) organizations provide copies of their annual returns. § 6104(d)(1). If an organization's returns are widely available under § 301.6104(d)–3 (such as on the Internet), the organization need not respond to requests for copies so long as it provides the web site address where the returns are available to the person making the request. Returns only need to be made available for three years after filing. § 6104(d)(2). Contributor information must be disclosed to the public. § 6104(d)(3)(A).

49. Q. What if the political organization does not make its Forms 1120-POL and Forms 990 publicly available?

A. A penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one return is $10,000. § 6652(c)(1)(C).

IV. *General*

50. Q. What if the filing date for any of these forms falls on Saturday, Sunday or a holiday?

A. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the report on the next business day.

51. Q. Where can organizations get copies of the various forms?

A. The various forms (Form SS-4, Form 8871, Form 8872, Form 1120-POL, and Form 990) and their instructions are available by calling 1-800-TAX-FORM (1-800-829-3676) or via the Internet at the IRS Web Site at www.irs.gov in the "Forms and Publications" section.

52. Q. What if an organization has questions regarding the notice and reporting requirements or has any problem obtaining an EIN?

A. For more information or if an organization has any problem obtaining an EIN, organizations may call the TE/GE Customer Service Center at 1-877-829-5500.

DRAFTING INFORMATION

The principal author of this announcement is Judith E. Kindell of Exempt Organizations. For further information regarding this announcement contact Judith E. Kindell at (202) 622-6494 (not a toll-free call).

Section 6012.—Persons Required to Make Returns of Income

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6033.—Returns by Exempt Organizations

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6104.—Publicity of Information Required From Certain Exempt Organizations and Certain Trusts

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6652.—Failure to File Certain Information Returns, Registration Statements, Etc.

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6695.— Other Assessable Penalties With Respect to the Preparation of Income Tax Returns for Other Persons

26 CFR 1.6695–2: Preparer due diligence requirements for determining earned income credit eligibility.

T.D. 8905

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

Preparer Due Diligence Requirements for Determining Earned Income Credit Eligibility

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the due diligence requirements under section 6695(g) of the Internal Revenue Code for paid preparers of Federal income tax returns or claims for refund involving the earned income credit (EIC). These regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. The regulations provide guidance to paid preparers who prepare Federal income tax returns or claims for refund claiming the earned income credit.

DATES: *Effective Date.* These regulations are effective October 17, 2000.

Applicability Date. For dates of applicability, see §1.6695–2(d) of these regulations.

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

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information 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 1545-1570. This information is required by the IRS to determine preparer due diligence compliance for purposes of the penalty imposed under section 6695(g). 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 control number assigned by the Office of Management and Budget.

The estimated annual burden per recordkeeper varies depending on individual circumstances. The estimated total annual recordkeeping burden: 507,136 hours with the estimated average annual burden hours per recordkeeper: 5 hours 4 minutes (40 minutes per return or claim for refund, 7.6 returns per preparer). The estimated number of recordkeepers: 100,000.

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

Section 6695(g) was added by section 1085(a)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (11 Stat. 788, 955 (1997)) (the Act), effective for taxable years beginning after December 31, 1996. Section 6695(g) imposes a $100 penalty for each failure by an income tax return preparer to meet the due diligence requirements set forth in regulations prescribed by the Secretary.

On December 22, 1997, the IRS published Notice 97–65 (1997–2 C.B. 326), in which the IRS set forth the preparer due diligence requirements for 1997 returns and claims for refund involving the EIC. To avoid the imposition of the penalty under section 6695(g) for 1997 returns and claims for refund, Notice 97–65 required preparers to meet four requirements: (1) complete the Earned Income Credit Eligibility Checklist attached to Notice 97–65 (Eligibility Checklist), or otherwise record the information necessary to complete the Eligibility Checklist; (2) complete the Earned Income Credit Worksheet (Computation Worksheet), as contained in the 1997 Form 1040 instructions, or otherwise record the computation and information necessary to complete the Computation Worksheet; (3) not know or have reason to know that any information used by the preparer in determining eligibility for, and the amount of, the EIC is incorrect; and (4) retain for three years the Eligibility Checklist and Computation Worksheet (or alternative records), and a record of how and when the information used to determine eligibility for, and the amount of, the EIC was obtained by the preparer. This information may be retained as a paper record, in magnetic media format, or in an electronic storage media system, consistent with applicable IRS revenue procedures.

On December 21, 1998, temporary regulations (TD 8798, 1999–1 C.B. 804) under section 6695(g) were published in the **Federal Register** (63 F.R. 70339). A notice of proposed rulemaking (REG–120168–97, 1999–1 C.B. 809) cross-referencing the temporary regulations was published in the **Federal Register** (63 F.R. 70357) on that same date. The text of the temporary regulations served as the text of the proposed regulations. The requirements set forth in the temporary regulations were substantially similar to those in Notice 97–65.

The notice of proposed rulemaking solicited comments from the public. One comment was received, but no public hearing was requested or held. After consideration of the comment received, the proposed regulations under section 6695(g) are adopted by this Treasury decision, and the corresponding temporary regulations are removed.

Summary of Comments

The commentator expressed concern that requiring the completion of an eligibility checklist and a computation worksheet impose additional recordkeeping burdens on tax return preparers. The commentator did not suggest alternative due diligence requirements.

The additional recordkeeping required by the regulations is necessary to implement congressional intent with respect to section 6695(g). The legislative history accompanying the Act explains that Congress "believes that more thorough efforts by return preparers are important to improving EIC compliance." H.R. Rep. No. 148, 105th Cong., 1st Sess. 512 (1997) and S. Rep. No. 29, 105th Cong., 1st Sess. 125 (1997). The additional information gathering and recordkeeping required by these regulations are intended to ensure that preparers are thorough when determining whether a taxpayer qualifies to claim the EIC credit. Further, the regulations allow preparers the flexibility to use either the prescribed forms or alternative records containing the same information as the prescribed forms to meet the due diligence requirements.

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. Further, it is hereby certified, pursuant to sections 603(a) and 605(b) of the Regulatory Flexibility Act, 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 amount of time necessary to record and retain the required information will be nominal for those income tax return preparers that choose to use the Alternative Eligibility Record and Alternative Computation Record. 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 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 Andrea Tucker, Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

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 "Section 1.6695–2T" and adding an entry in numerical order to read in part as follows:

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

Section 1.6695–2 also issued under 26 U.S.C. 6695(g). * * *

Par. 2. Section 1.6695–2 is added to read as follows:

§1.6695–2 Preparer due diligence requirements for determining earned income credit eligibility.

(a) *Penalty for failure to meet due diligence requirements.* A person who is an income tax return preparer (preparer) of an income tax return or claim for refund under subtitle A of the Internal Revenue Code with respect to determining the eligibility for, or the amount of, the earned income credit (EIC) under section 32 and who fails to satisfy the due diligence requirements of paragraph (b) of this section will be subject to a penalty of $100 for each such failure. However, no penalty will be imposed under section 6695(g) on a person who is an income tax return preparer solely by reason of—

(1) Section 301.7701–15(a)(2) and (b) of this chapter, on account of having given advice on specific issues of law; or

(2) Section 301.7701–15(b)(3) of this chapter, on account of having prepared the return solely because of having prepared another return that affects amounts reported on the return.

(b) *Due diligence requirements.* A preparer must satisfy the following due diligence requirements:

(1) *Completion of eligibility checklist.* (i) The preparer must either—

(A) Complete Form 8867, "Paid Preparer's Earned Income Credit Checklist," or such other form and such other information as may be prescribed by the Internal Revenue Service (IRS)(Eligibility Checklist); or

(B) Otherwise record in the preparer's paper or electronic files the information necessary to complete the Eligibility Checklist (Alternative Eligibility Record). The Alternative Eligibility Record may consist of one or more documents containing the required information.

(ii) The preparer's completion of the Eligibility Checklist or Alternative Eligibility Record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer.

(2) *Computation of credit.* (i) The preparer must either—

(A) Complete the Earned Income Credit Worksheet in the Form 1040 instructions or such other form and such other information as may be prescribed by the IRS (Computation Worksheet); or

(B) Otherwise record in the preparer's paper or electronic files the preparer's EIC computation, including the method and information used to make the computation (Alternative Computation Record). The Alternative Computation Record may consist of one or more documents containing the required information.

(ii) The preparer's completion of the Computation Worksheet or Alternative Computation Record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer.

(3) *Knowledge.* The preparer must not know, or have reason to know, that any in-

formation used by the preparer in determining the taxpayer's eligibility for, or the amount of, the EIC is incorrect. The preparer may not ignore the implications of information furnished to, or known by, the preparer, and must make reasonable inquiries if the information furnished to, or known by, the preparer appears to be incorrect, inconsistent, or incomplete.

(4) *Retention of records.* (i) The preparer must retain—

(A) A copy of the completed Eligibility Checklist or Alternative Eligibility Record;

(B) A copy of the Computation Worksheet or Alternative Computation Record; and

(C) A record of how and when the information used to complete the Eligibility Checklist or Alternative Eligibility Record and the Computation Worksheet or Alternative Computation Record was obtained by the preparer, including the identity of any person furnishing the information.

(ii) The items in paragraph (b)(4) of this section must be retained for three years after the June 30th following the date the return or claim for refund was presented to the taxpayer for signature, and may be retained on paper or electronically in the manner prescribed in applicable regulations, revenue rulings, revenue procedures, or other appropriate guidance (see §601.601(d)(2) of this chapter).

(c) *Exception to penalty.* The section 6695(g) penalty will not be applied with respect to a particular income tax return or claim for refund if the preparer can demonstrate to the satisfaction of the IRS that, considering all the facts and circumstances, the preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements of paragraph (b) of this section, and the failure to meet the due diligence requirements of paragraph (b) of this section with respect to the particular return or claim for refund was isolated and inadvertent.

(d) *Effective date.* This section applies to income tax returns and claims for refund due on or after October 17, 2000.

§1.6695–2T [Removed]

Par. 3. Section 1.6695–2T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by removing the entry for "1.6695–2T" and adding the following 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.
* * * * *	
1.6695–2	1545-1570
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved October 6, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 16, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2000, 65 F.R. 61268)

Part III. Administrative, Procedural, and Miscellanous

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 2000–46

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 2000–3, 2000–1 I.R.B. 103, which sets forth areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel in which the Internal Revenue Service will not issue advance rulings or determination letters.

SECTION 2. BACKGROUND

Section 5 of Rev. Proc. 2000–3 sets forth those areas under extensive study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise.

Section 301.7701–1(a)(1) provides that whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the entity is recognized as an entity under local law.

Section 301.7701–1(a)(2) provides that a joint undertaking or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. If such an entity is a business entity (i.e., is not a trust) with two or more members, the entity is classified for federal tax purposes either as a partnership or a corporation.

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. Sections 1031(a)(2)(B) and 1031(a)(2)(D) provide exceptions from the application of section 1031(a)(1) for stock and interests in a partnership, respectively.

The Service recently has become aware, in part through several requests for advance rulings, that taxpayers are taking the position that certain arrangements where taxpayers acquire undivided fractional interests in real property do not constitute separate entities for federal tax purposes and therefore the fractional interests may be the subject of tax-free exchanges under section 1031(a)(1). The Service intends to study further the facts and circumstances relevant to the determination of whether such arrangements are separate entities for federal tax purposes.

SECTION 3. PROCEDURE

Rev. Proc. 2000–3 is amplified by adding the following to section 5.10.

Section 1031. - Exceptions. - Whether an undivided fractional interest in real property is an interest in an entity that is not eligible for tax-free exchange under section 1031(a)(1).

Section 7701. - Definitions. - Whether arrangements where taxpayers acquire undivided fractional interests in real property constitute separate entities for federal tax purposes.

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. 2000–3 is amplified.

SECTION 6. REQUEST FOR COMMENTS

The Service requests comments concerning this revenue procedure. In particular, comments are requested with respect to the relevance and impact of the following factors to the determination of whether arrangements where taxpayers acquire undivided fractional interests in real property constitute separate entities for federal tax purposes: (1) the terms of any leasing or management agreements entered into with respect to the property and the relationships between the parties to such agreements and the promoter or organizer of the arrangement; (2) the terms of any agreements between the promoter or organizer of the arrangement and the holders of the fractional interests or among the holders of the fractional interests, including any contractual restrictions to which the fractional interests are subject, such as waivers of the right to partition, rights of first refusal, and options to put and/or call the fractional interests; and (3) the overall economics of the arrangements, including the sharing of profits and losses from operating the property as well as of appreciation and depreciation in the value of the property. An original and eight copies of written comments should be sent to:

Internal Revenue Service
Attn: CC:MSP:R (Rev. Proc. 2000–46)
Room 5228 (PSI:Br1)
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand delivered between the hours of 8 a.m. and 5 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:MSP:R (Rev. Proc. 2000–46)
Room 5228 (PSI:Br1)
1111 Constitution Avenue, NW
Washington, DC

Alternatively, taxpayers may submit comments electronically at: Joel.S.Rutstein@M1.IRSCounsel.treas.gov.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jeanne Sullivan of the Office of the Associate Chief Counsel, Passthroughs & Special Industries. However, other personnel from the IRS and Treasury participated in its development. For further information, contact Jeanne Sullivan at (202) 622-3050 (not a toll-free number).

Part IV. Items of General Interest

Withdrawal of Previous Proposed Rulemaking, Notice of Proposed Rulemaking, and Notice of Public Hearing

Information Reporting Requirements for Certain Payments Made on Behalf of Another Person, Payments to Joint Payees, and Payments of Gross Proceeds From Sales Involving Investment Advisers

REG–246249–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of previous notice of proposed rulemaking; notice of proposed rulemaking; and notice of public hearing.

SUMMARY: This document withdraws a previous notice of proposed rulemaking (LR–62–84 [1984–2 C.B. 900]) published May 29, 1984 (49 F.R. 22343). This document contains proposed regulations under section 6041 that clarify who is the payee for information reporting purposes if a check or other instrument is made payable to joint payees, provide information reporting requirements for escrow agents and other persons making payments on behalf of another person, and clarify that the amount to be reported paid is the gross amount of the payment. This document also contains proposed regulations under section 6045 that remove investment advisers from the list of exempt recipients. In addition, this document provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 17, 2001. Requests to speak (with outlines of oral comments) at a public hearing scheduled for February 7, 2001, at 10 a.m. must be submitted by January 24, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–246249–96), 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:M&SP:RU (REG–246249–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the IRS Internet site at http://www.irs.gov/tax_regs/regslist.html. The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Nancy L. Rose, (202) 622-4910; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy R. Traynor, (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 Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer,W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collection of information should be received by December 19, 2000. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper operation 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 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 service to provide information.

The collection of information in these proposed regulations is in §§1.6041–1(e) and 1.6045–1(c)(3). This information is required to determine if taxpayers have properly reported amounts received as income. The collection of information is mandatory. The likely respondents are businesses and other for-profit institutions.

The estimate of the reporting burden in proposed §1.6041–1 is reflected in the burden of Form 1099-MISC, *Miscellaneous Income*, which is currently 14 minutes per form. The estimate of the reporting burden in proposed §1.6045–1 is reflected in the burden of Form 1099-B, *Proceeds of Broker and Barter Exchange Transactions*, which is currently 15 minutes per form.

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 the 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

1. *Proposed Regulations Under Section 6041*

Section 6041 provides that all persons engaged in a trade or business that make certain payments in the course of that trade or business to another person of $600 or more in a taxable year must report the amount of the payments and the name and address of the recipient.

Section 3406(a) provides that a payor must withhold tax from reportable payments under certain circumstances, for example, if the payee has failed to furnish

a valid taxpayer identification number to the payor in the manner required. "Reportable payments" include payments that are required to be reported under sections 6041 and 6045. Section 3406(b)(3)(A) and (C). The party that is responsible for reporting the payments under sections 6041 and 6045 is also responsible for any backup withholding required under section 3406.

These proposed regulations address certain issues identified by the Commissioner's Information Reporting Program Advisory Committee (IRPAC) and take into account comments and information provided by IRPAC members representing the banking, real estate, insurance, and securities industries.

a. Payments to Joint Payees

The proposed regulations clarify the definition of fixed and determinable income in §1.6041–1(c) when a payment is made payable to joint payees. This issue was discussed in papers presented at IRPAC meetings in May 1994 and May 1995. The regulations provide that a payment made jointly to two or more payees may be fixed and determinable income to one payee even though the payment is not fixed and determinable income to another payee. For example, when a payment in consideration for services is made payable to joint payees, one of whom is the service provider, an information return must be made showing the service provider as the payee if the payment is fixed and determinable income to the service provider, even if the payment is not fixed and determinable income to the other payee. See, e.g., Situation 2 of Rev. Rul. 70–608 (1970–2 C.B. 286).

b. Identification of Payor

A payment reportable under section 6041 may be made by a person on behalf of another person that is the actual source of the funds. Under certain circumstances this so-called middleman, and not the person that provided the funds, is the payor obligated to report the payment under section 6041. See, e.g., Rev. Rul. 93–70 (1993–2 C.B. 294).

Consistent with Rev. Rul. 93–70, the proposed regulations add a new paragraph (e)(1) to §1.6041–1 that provides that a person that makes a payment on behalf of another person and performs a management or oversight function in connection with, or has a significant economic interest in, the payment must report under section 6041. A management or oversight function is an activity that is more than merely administrative or ministerial. For example, a person that merely writes checks at the direction of others in connection with a transaction, sometimes referred to as a paying agent, is performing only an administrative or ministerial function and is not a payor. In contrast, a person that exercises discretion or supervision in connection with a payment is performing a management or oversight function and is a payor. A significant economic interest in a payment is an economic interest that would be compromised if the payment were not made. For example a bank has a significant economic interest in a payment to a contractor when damage occurs to property securing a mortgage held by the bank. With this standard, which was also discussed in the IRPAC papers of May 1994 and May 1995, the proposed regulations attempt to replace disparate revenue rulings with a consistent and easily administrable rule that can be applied to a variety of factual situations involving middlemen.

Section 1.6041–1(e)(2) of the proposed regulations provides an exception to the general rule of §1.6041–1(e)(1) by referencing the procedures in Rev. Proc. 84–33 (1984–1 C.B. 502) for an optional method for payors to designate a paying agent to file information returns and backup withhold.

The proposed regulations include examples, derived primarily from revenue rulings and private letter rulings, which are intended to be all-inclusive. Rulings that are factually encompassed by the proposed regulations will be obsoleted. Comments are requested identifying other factually relevant rulings or suggesting appropriate additional examples.

The proposed regulations make two changes to §1.6041–3 (to be effective January 1, 2001). They revise §1.6041–3(d) to conform the cross-reference to §1.6041–1 to the language effective January 1, 2001, and to clarify the current rule that real estate agents who manage rental property and make payments of rent to landlords are payors and continue to be subject to the general requirements of §1.6041–1. The proposed regulations also remove §1.6041–3(n), which provides an exception to the information reporting requirements of section 6041 for amounts that a bank or similar institution collects on behalf of, and pays over or credits to the account of, the actual owner of the funds, but only if it does not collect the items on a regular and continuing basis. Rev. Rul. 77–53 (1977–1 C.B. 368) further restricted this limitation to banks that collect items on a regular and continuing basis and also assume a management function or perform more than the mere collection and payment or crediting of funds to a customer's account. This holding is consistent with the "management and oversight" standard of the proposed regulations. Accordingly, *Example 11* of the proposed regulations preserves the holding of Rev. Rul. 77–53. Section 1.6041–3(n) is removed to avoid confusion and redundancy. However, its removal will change current requirements by imposing a reporting requirement on a bank that collects and pays or credits funds on behalf of a customer on an infrequent or isolated basis if it performs a management or oversight function in connection with the payment, a transaction that is currently within the §1.6041–3(n) exception.

The proposed regulations also remove paragraphs (b) and (c) of §31.3406(a)–2. These paragraphs provide a standard for information reporting by a so-called middleman that is inconsistent with the standard in the proposed regulations. As amended, §31.3406(a)–2 reiterates the general rule of section 3406(h) (also stated in §35a.9999-3, Q & A 1) that the definition of payor for information reporting purposes determines who is the payor for backup withholding purposes as well.

c. Amount to be Reported When Fees, Expenses or Commissions are Deducted From a Payment

The proposed regulations add a new paragraph (f) to §1.6041– 1 that clarifies that the amount to be reported as paid to a payee is the gross amount of the payment or payments before fees, commissions, expenses, or other amounts owed by the payee to another person have been de-

ducted. See, e.g., Rev. Rul. 67–197 (1967–1 C.B. 319); Rev. Rul. 54–571 (1954–2 C.B. 235). The rule, which applies whether the payment is made jointly or separately to the payee and another person, is also cross-referenced in *Example 6* and *Example 8* of §1.6041–1(e)(3).

The rule of §1.6041–1(f) is illustrated by two examples involving payment of taxable damages by a defendant to a plaintiff. These examples, read with *Example 8* of §1.6041– 1(e)(3), are, in part, inconsistent with *Example 2* of the proposed regulations at §1.6045–5(f), published on May 21, 1999 (64 FR 27730). *Example 2* states that a defendant that pays a settlement to a plaintiff and knows the amount of the plaintiff's attorney fees included in the payment is required to report the payment of the attorney fees under section 6041 and not the gross proceeds under section 6045(f). However, under §1.6041–1(e) of these regulations, the defendant is not exercising management or oversight in connection with, and therefore is not required to make an information return under section 6041 for, the payment to the attorney. The plaintiff, not the defendant, is required to report the payment of attorney fees to plaintiff's attorney under section 6041 (assuming that the payment is made in the course of the plaintiff's trade or business and that the other requirements of section 6041 apply). Accordingly, *Example 2* in the final regulations under section 6045(f) will be revised to provide that the defendant is not required to make an information return under section 6041 but is required to make an information return under section 6045(f), even if the defendant knows the amount of plaintiff's attorney fees.

d. Revenue Rulings to Become Obsolete

As discussed above, the proposed regulations apply to the factual situations addressed in the following revenue rulings, which will become obsolete:

Rev. Rul. 93–70 (1993–2 C.B. 294)
Rev. Rul. 85–50 (1985–1 C.B. 345)
Rev. Rul. 77–53 (1977–1 C.B. 368)
Rev. Rul. 73–232 (1973–1 C.B. 541)
Rev. Rul. 70–608, Situations 1, 2, and 5 (1970–2 C.B. 286)
Rev. Rul. 69–595 (1969–2 C.B. 242)
Rev. Rul. 67–197 (1967–1 C.B. 319)
Rev. Rul. 65–129 (1965–1 C.B. 519)
Rev. Rul. 64–36 (1964–1 C.B. 446)
Rev. Rul. 59–328 (1959–2 C.B. 379)
Rev. Rul. 55–606 (1955–2 C.B. 489)
Rev. Rul. 54–571 (1954–2 C.B. 235)

2. *Proposed Regulations Under Section 6045*

Section 6045 provides that a broker must file an information return showing the name and address of the broker's customer and other details, such as the amount of the gross proceeds of the transaction, as the Secretary may require. Section 6045(c) defines a broker as a dealer, a barter exchange, or any other person who, for a consideration, regularly acts as a middleman with respect to property or services.

Section 1.6045–1(a)(2) provides that a customer is the person who makes a sale effected by a broker, if the broker acts as (i) an agent for the customer in the sale, (ii) a principal in the sale, or (iii) the party in the sale responsible for paying or crediting the proceeds to the customer. Under §1.6045–1(h), a broker must treat the person whose name appears on the broker's books and records as the principal.

Section 5f.6045–1(c)(3), also published as proposed regulations (49 F.R. 22343), provides that no return of information is required with respect to a sale effected for a customer that is an exempt recipient. Among the categories of exempt recipients is a person registered under the Investment Advisers Act of 1940 who regularly acts as a broker (an investment adviser).

Section 5f.6045–1(c)(3)(iii) provides that, in a cash on delivery or similar transaction, only the broker that receives the gross proceeds against delivery of the securities sold is required to report a sale, unless the broker's customer is another broker (a second-party broker) that is an exempt recipient. In that case, only the second-party broker is required to report.

One effect of these provisions is to shift the reporting requirement in a cash on delivery transaction from the broker that receives the gross proceeds against delivery of the securities to an investment adviser. For example, in §5f.6045–1(c)(4) *Example (4)*, an investment adviser instructs a broker/dealer to sell securities owned by the investment adviser's customer and to pay the proceeds of the sale to a custodian bank. The custodian bank is instructed to deliver the securities to the broker/dealer against delivery of the proceeds of the sale. The investment adviser, and not the broker/dealer or the custodian bank, is required to report the payment of the proceeds of the sale to the investment adviser's customer, because (1) the broker/dealer paid the gross proceeds of the sale to the custodian bank against delivery of the securities sold, and (2) the custodian bank's customer was the investment adviser, an exempt recipient.

Commentators on the proposed regulations objected to the imposition of the reporting obligation under section 6045(a) on investment advisers because (1) investment advisers generally do not have first-hand knowledge that a sale has been completed, and (2) investment advisers generally do not handle the proceeds of a sale and, consequently, cannot comply with the backup withholding requirements of section 3406. Investment adviser reporting issues were also the subject of IRPAC papers presented at meetings in November 1995 and October 1997.

These proposed regulations withdraw the 1984 proposed regulations. In general, they propose to incorporate the provisions of §5f.6045–1 into §1.6045–1(c)(3) and (4). The proposed regulations also remove investment advisers from the list of exempt recipients and revise current §5f.6045–1(c)(4) *Examples 4* and *5* to clarify that, under the revised rules, an investment adviser that initiates a sale on behalf of a customer is required to make a return of information only if the sale relates to an investment account in the investment adviser's name (i.e., the identity of the customer is not disclosed to the account custodian).

Proposed Effective Date

The provisions of these regulations under sections 6041 and 3406 are proposed to be applicable for payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations. The provisions of these regulations under section 6045 are proposed to be applicable for sales effected on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as 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 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. An initial regulatory flexibility analysis has been prepared for the collection of information in this notice of proposed rulemaking under 5 U.S.C. section 603. The analysis is set forth in this preamble under the heading "Initial Regulatory Flexibility Analysis." 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.

Initial Regulatory Flexibility Analysis

The collection of information proposed in §1.6041–1(e) is needed to clarify the requirements for filing an information return under section 6041 when a person makes a payment on behalf of another person or to joint payees. The objectives of the proposed regulations are to provide uniform, practicable, and administrable rules under section 6041 for persons making payments on behalf of another person or to joint payees. The types of small entities to which the proposed regulations may apply are small businesses. An estimate of the number of small entities affected is not feasible because of the large variety of entities and transactions to which the proposed regulations may apply. However, in 1997 a total of 73,273,621 Forms 1099-MISC were filed with the IRS. The number of 1997 Forms 1099-MISC that related to transactions that involved payments made on behalf of another person or to joint payees cannot be determined. The current estimated reporting burden relating to Form 1099-MISC is 14 minutes per form. No special professional skills are necessary for preparation of the reports or records. There are no known Federal rules that duplicate, overlap, or conflict with these proposed regulations. The regulations proposed are considered to have the least economic impact on small entities of all alternatives considered.

The collection of information in proposed §1.6045–1(c)(3) will not have a significant economic impact on a substantial number of small entities. The proposed regulations will relieve investment advisers of the requirement to make information returns under section 6045(a), and few, if any, financial custodians that may be affected by the regulations are small entities.

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 (in the manner described in the ADDRESSES caption) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules 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 7, 2001, beginning at 10 a.m. in the IRS Auditorium, Seventh Floor, 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 the 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 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 24, 2001. 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 Donna M. Crisalli, Office of the Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (LR–62–84) amending 26 CFR part 1 that was published in the **Federal Register** on May 29, 1984 (49 F.R. 22343) is withdrawn. In addition, 26 CFR parts 1, 5f, and 31 are 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 1.6041–1 also issued under 26 U.S.C. 6041(a). * * *

Par. 2. Section 1.6041–1 is amended by:

1. Removing the language "paragraph (g)" in the second sentence of paragraph (b)(1) and adding the language "paragraph (i)" in its place.

2. Adding two sentences after the fourth sentence of paragraph (c).

3. Redesignating paragraphs (e) through (g) as paragraphs (g) through (i).

4. Adding new paragraphs (e) and (f), and (j).

The additions and revisions read as follows:

§1.6041–1 Return of information as to payments of $600 or more.

* * * * *

(c) * * * A payment made jointly to two or more payees may be fixed and determinable income to one payee even though the payment is not fixed and determinable income to another payee. For example, property insurance proceeds paid jointly to the owner of damaged property and to a contractor that repairs the prop-

erty may be fixed and determinable income to the contractor but not fixed and determinable income to the owner. * * * * * * * *

(e) *Payment made on behalf of another person*—(1) *In general.* A person that makes a payment in the course of its trade or business on behalf of another person is the payor that must make a return of information under this section with respect to that payment if the payment is described in paragraph (a) of this section and, under all the facts and circumstances, that person—

(i) Performs management or oversight functions (i.e., performs more than mere administrative or ministerial functions) in connection with the payment; or

(ii) Has a significant economic interest in the payment.

(2) *Optional method to report.* A person that makes a payment on behalf of another person but is not required to make an information return under paragraph (e)(1) of this section may elect to do so pursuant to the procedures established in Rev. Proc. 84–33 (1984–1 C.B. 502) (optional method for a paying agent to report and deposit amounts withheld for payors under the statutory provisions of backup withholding) (see §601.601(d)(2) of this chapter).

(3) *Examples.* The provisions of this paragraph (e) are illustrated by the following examples:

Example 1. Bank B provides financing to C, a real estate developer, for a construction project. B puts the funds in an escrow account and makes disbursements from the account for labor, materials, services, and other expenses related to the construction project. In connection with the payments, B performs the following functions on behalf of C: approves payments to the general contractor or subcontractors; ensures that loan proceeds are properly applied and that all approved bills are properly paid to avoid mechanics or materialmen's liens; conducts site inspections to determine whether work has been completed (but does not check the quality of the work); evaluates and assesses the cost of the project, including costs of changes; and communicates resulting concerns to C or to the general contractor so that modifications can be made or additional funding obtained. B is performing management or oversight functions in connection with the payment and is subject to the information reporting requirements of section 6041 with respect to payments from the escrow fund.

Example 2. Mortgage company D holds a mortgage on business property owned by E. When the property is damaged by a storm E's insurance company issues a check payable to both D and E in settlement of E's claim. Pursuant to the contract between D and E, D holds the insurance proceeds in an escrow account and makes disbursements according to E's instructions to contractors and subcontractors performing repairs on the property. D is not performing management or oversight functions, but D has a significant economic interest in the payments because the purpose of the arrangement is to ensure that property on which D holds a mortgage is repaired or replaced. D is subject to the information reporting requirements of section 6041 with respect to the payments to contractors.

Example 3. Settlement agent F provides real estate closing services to real estate brokers and agents. F deposits money received from the buyer or lender in an escrow account and makes payments from the account to real estate agents or brokers, appraisers, land surveyors, building inspectors, or similar service providers according to the provisions of the real estate contract and written instructions from the lender. F may also make disbursements pursuant to verbal instructions of the seller or purchaser at closing. F is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041. For the rules relating to F's obligation to report the gross proceeds of the sale, see section 6045(e) and §1.6045–4.

Example 4. Assume the same facts as in *Example 3*, except that the seller instructs F to hire a contractor to perform repairs on the property. F selects the contractor, negotiates the cost, monitors the progress of the project, and inspects the work to ensure it complies with the contract. With respect to the payments to the contractor, F is performing management or oversight functions and is subject to the information reporting requirements of section 6041.

Example 5. Real estate agent G manages certain rental property on behalf of property owner H. In addition to collecting the rent G arranges for various services that are needed to maintain the property (e.g., painting, repairs, lawn mowing, etc.), determines that the services have been satisfactorily performed, and pays the service providers. G is performing management or oversight functions and is subject to the information reporting requirements of section 6041 with respect to the payments to the service providers. With respect to the payments of rent to H, see §1.6041–3(d).

Example 6. Literary agent J receives a payment from publisher L of fees earned by J's client, author K. J deposits the payment into a bank account in J's name and pays K the net amount after subtracting J's commission. From time to time and as directed by K, J also makes payments to attorneys, managers, and other third parties from these funds for services rendered to K. J does not order or direct the provision of services by the third parties to K, and J exercises no discretion in making the payments to them. J is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041 in connection with the payments to K or to the third parties. For the rules relating to L's obligation to report the payment of the fees to K, see paragraphs (a)(1)(i) and (f) of this section. For the rules relating to K's obligation to report the payment of the commission to J and the payments to the third parties for services, see paragraphs (a)(1)(i) and (d)(2) of this section.

Example 7. Attorney P deposits into a client trust fund a settlement payment from R, the defendant in a breach of contract action for lost profits in which P represented plaintiff Q. P makes payments from the client trust fund to service providers such as expert witnesses and private investigators for expenses incurred in the litigation. P decides whom to hire, negotiates the amount of payment, and determines that the services have been satisfactorily performed. In the event of a dispute with a service provider, P withholds payment until the dispute is settled. With respect to payments to the service providers P is performing management or oversight functions and is subject to the information reporting requirements of section 6041.

Example 8. Assume the same facts as in *Example 7*, except that after paying the service providers and deducting his legal fee, P pays Q the remaining funds that P had received from the settlement with R. With respect to the payment to Q, P is not performing management or oversight functions and does not have a significant economic interest in the payment, and is not subject to the information reporting requirements of section 6041. For the rules relating to R's obligation to report the payment of the settlement proceeds to P, see section 6045(f) and §1.6045–5. For the rules relating to R's obligation to report the payment of the settlement proceeds to Q, see paragraphs (a)(1)(i) and (f) of this section. For the rules relating to Q's obligation to report the payment of attorney fees to P, see paragraphs (a)(1)(i) and (d)(2) of this section.

Example 9. Medical insurer S operates as the administrator of a health care program under a contract with a state. S makes payments of government funds to health care providers who provide care to eligible patients. S receives and reviews claims submitted by patients or health care providers, determines if the claims meet all the requirements of the program (e.g., that the care is authorized and that the patients are eligible beneficiaries), and determines the amount of payment. S is performing management or oversight functions and is subject to the information reporting requirements of section 6041 with respect to the payments.

Example 10. Race track employee T holds deposits made by horse owner U in a special escrow account in U's name. U enters into a contract with jockey V to ride U's horse in a race at the track. As directed by U, T pays V the fee for riding U's horse from U's escrow account. T is not performing management or oversight functions and does not have a significant economic interest in the payment, and is not subject to the information reporting requirements of section 6041. For the rules relating to U's obligation to report the payment of the fee to V, see paragraph (a)(1)(i) of this section.

Example 11. Bank W collects payments from mortgagors and remits the amounts to the mortgagees or credits their accounts. W performs no other task with respect to the mortgage payments and has no other interest in the accounts. Although W collects payments on a regular and continuing basis, W is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041 with respect to the payments.

(f) *Amount to be reported when fees, expenses or commissions are deducted*— (1) *In general.* The amount to be reported as paid to a payee is the gross amount of the payment or payments before fees, commissions, expenses, or other amounts owed by the payee to another person have been deducted, whether the payment is made jointly or separately to the payee and the other person.

(2) *Examples.* The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. Attorney P represents client Q in a breach of contract action for lost profits against defendant R. R settles the case for $100,000 damages and $40,000 for attorney fees. R issues a check payable to P and Q in the amount of $140,000. R is required to make an information return reporting a payment to Q in the amount of $140,000.

Example 2. Assume the same facts as in *Example 1*, except that R issues a check to Q for $100,000 and a separate check to P for $40,000. R is required to make an information return reporting a payment to Q in the amount of $140,000.

* * * * *

(j) *Effective date.* The provisions of paragraphs (b), (c), (e), and (f) apply to payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations.

§1.6041–3 [Amended]

Par. 3. Section 1.6041–3, as in effect on January 1, 2001, is amended as follows:

1. In paragraph (d), removing the language "(but the agent is subject to the requirements of paragraph (a)(1)(ii) and (2)(ii) of §1.6041–1)" and adding the language "(but the agent is required to report payments of rent to the landlord in accordance with §1.6041–1(a)(1)(i)(B) and (2)" in its place.

2. Removing paragraph (n) and redesignating paragraphs (o) through (q) as paragraphs (n) through (p).

Par. 4. Section 1.6045–1, as in effect on January 1, 2001, is amended as follows:

1. Revising paragraph (a) introductory text.

2. Revising paragraphs (c)(3) and (c)(4).

3. Removing the language "5f.6045–1 (c)(3)(ii) of this chapter" and adding the language "paragraph (c)(3)(iii) of this section" in its place in each place it appears in paragraph (g)(4) *Examples 1, 4, 5, 6,* and *7*(i).

The revisions read as follows:

§1.6045–1 Returns of information of brokers and barter exchanges.

(a) *Definitions.* The following definitions apply for purposes of this section and §1.6045–2:

* * * * *

(c) * * *

(3) *Exceptions*—(i) *Sales effected for exempt recipients*— (A) *In general.* No return of information is required with respect to a sale effected for a customer that is an exempt recipient under paragraph (c)(3)(i)(B) of this section.

(B) *Exempt recipient defined.* The term *exempt recipient* means—

(*1*) A corporation as defined in section 7701(a)(3), whether domestic or foreign;

(*2*) An organization exempt from taxation under section 501(a) or an individual retirement plan;

(*3*) The United States or a State, the District of Columbia, a possession of the United States, a political subdivision of any of the foregoing, a wholly-owned agency or instrumentality of any one or more of the foregoing, or a pool or partnership composed exclusively of any of the foregoing;

(*4*) A foreign government, a political subdivision thereof, an international organization, or any wholly-owned agency or instrumentality of the foregoing;

(*5*) A foreign central bank of issue as defined in §1.895–1(b)(1) (i.e., a bank that is by law or government sanction the principal authority, other than the government itself, issuing instruments intended to circulate as currency);

(*6*) A dealer in securities or commodities registered as such under the laws of the United States or a State;

(*7*) A futures commission merchant registered as such with the Commodity Futures Trading Commission;

(*8*) A real estate investment trust (as defined in section 856);

(*9*) An entity registered at all times during the taxable year under the Investment Company Act of 1940 (15 U.S.C. 80a-1, *et seq.*);

(*10*) A common trust fund (as defined in section 584(a)); or

(*11*) A financial institution such as a bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, industrial loan association or bank, or other similar organization.

(C) *Exemption certificate.* A broker may treat a person described in paragraph (c)(3)(i)(B) of this section as an exempt recipient based on a properly completed exemption certificate (as provided in §31.3406(h)–3) of this chapter or on the broker's actual knowledge that the payee is a person described in paragraph (c)(3)(i)(B) of this section. A broker may require an exempt recipient to file a properly completed exemption certificate and may treat an exempt recipient that fails to do so as a recipient that is not exempt.

(ii) *Excepted sales.* No return of information is required with respect to a sale effected by a broker for a customer if the sale is an excepted sale. For this purpose, a sale is an excepted sale if it is so designated by the Internal Revenue Service in a revenue ruling or revenue procedure (see §601.601(d)(2) of this chapter).

(iii) *Multiple brokers.* If a broker is instructed to initiate a sale by a person that is an exempt recipient described in paragraph (c)(3)(i)(B)(*6*), (*7*), or (*11*) of this section, no return of information is required with respect to the sale by that broker. In a redemption of stock or retirement of securities, only the broker responsible for paying the holder redeemed or retired, or crediting the gross proceeds on the sale to that holder's account, is required to report the sale.

(iv) *Cash on delivery transactions.* In the case of a sale of securities through a cash on delivery account, a delivery versus payment account, or other similar account or transaction, only the broker that receives the gross proceeds from the sale against delivery of the securities sold is required to report the sale. If, however, the broker's customer is another broker (second-party broker) that is an exempt recipient, then only the second-party broker is required to report the sale.

(v) *Fiduciaries and partnerships.* No return of information is required with respect to a sale effected by a custodian or trustee in its capacity as such or a redemption of a partnership interest by a partnership provided the sale is otherwise reported by the custodian or trustee on a properly filed Form 1041, or the redemp-

tion is otherwise reported by the partnership on a properly filed Form 1065, and all Schedule K-1 reporting requirements are satisfied.

(vi) *Sales at issue price.* No return of information is required with respect to a sale of an interest in a regulated investment company (within the meaning of section 851) that computes its current price per share for purposes of distributions, redemptions, and purchases so as to stabilize the price per share at a constant amount that approximates its issue price or the price at which it was originally sold to the public.

(vii) *Obligor payments on certain obligations.* No return of information is required with respect to payments representing obligor payments on—

(A) Nontransferable obligations (including savings bonds, savings accounts, checking accounts, and NOW accounts);

(B) Obligations as to which the entire gross proceeds are reported by the broker on Form 1099 under provisions of the Internal Revenue Code other than section 6045 (including stripped coupons issued prior to July 1, 1982); or

(C) Retirement of short-term obligations (i.e., obligations with a fixed maturity date not exceeding 1 year from the date of issue) that have original issue discount, as defined in section 1273(a)(1).

(viii) *Callable obligations.* No return of information is required with respect to payments representing obligor payments on demand obligations that also are callable by the obligor and that have no premium or discount.

(ix) *Foreign currency.* No return of information is required with respect to a sale of foreign currency other than a sale pursuant to a forward contract or regulated futures contract that requires delivery of foreign currency.

(x) *Fractional share.* No return of information is required with respect to a sale of a fractional share of stock if the gross proceeds on the sale of the fractional share are less than $20.

(xi) *Certain retirements.* No return of information is required from an issuer or its agent with respect to the retirement of book entry or registered form obligations as to which the relevant books and records indicate that no interim transfers have occurred.

(xii) *Cross reference.* For an exception for certain sales of agricultural commodities and certificates issued by the Commodity Credit Corporation after January 1, 1993, see paragraph (c)(7) of this section.

(xiii) *Effective date.* The provisions of this paragraph (c)(3) apply for sales effected on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations.

(4) *Examples.* The following examples illustrate the application of the rules in paragraph (c)(3) of this section:

Example 1. P, an individual who is not an exempt recipient, places an order with B, a person generally known in the investment community to be a federally registered broker/dealer, to sell P's stock in a publicly traded corporation. B, in turn, places an order to sell the stock with C, a second broker, which will execute the sale. B discloses to C the identity of the customer placing the order. C is not required to make a return of information with respect to the sale because C was instructed by B, an exempt recipient as defined in paragraph (c)(3)(i)(B)(6) of this section, to initiate the sale. B is required to make a return of information with respect to the sale because P is B's customer and is not an exempt recipient.

Example 2. Assume the same facts as in *Example 1* except that B has an omnibus account with C so that B does not disclose to C whether the transaction is for a customer of B or for B's own account. C is not required to make a return of information with respect to the sale because C was instructed by B, an exempt recipient as defined in paragraph (c)(3)(i)(B)(6) of this section, to initiate the sale. B is required to make a return of information with respect to the sale because P is B's customer and is not an exempt recipient.

Example 3. D, an individual who is not an exempt recipient, enters into a cash on delivery stock transaction by instructing K, a federally registered broker/dealer, to sell stock owned by D, and to deliver the proceeds to L, a custodian bank. Concurrently with the above instructions, D instructs L to deliver D's stock to K (or K's designee) against delivery of the proceeds from K. The records of both K and L with respect to this transaction show an account in the name of D. Pursuant to paragraph (h)(1) of this section, D is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because D is L's customer and is not an exempt recipient.

Example 4. Assume the same facts as in *Example 3* except that E, a federally registered investment adviser, instructs K to sell stock owned by D and to deliver the proceeds to L. Concurrently with the above instructions, E instructs L to deliver D's stock to K (or K's designee) against delivery of the proceeds from K. The records of both K and L with respect to the transaction show an account in the name of D. Pursuant to paragraph (h)(1) of this section, D is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because D is L's customer and is not an exempt recipient.

Example 5. Assume the same facts as in *Example 4* except that the records of both K and L with respect to the transaction show an account in the name of E. Pursuant to paragraph (h)(1) of this section, E is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because E is L's customer and is not an exempt recipient. E is required to make a return of information with respect to the sale because D is E's customer and is not an exempt recipient.

Example 6. F, an individual who is not an exempt recipient, owns bonds that are held by G, a federally registered broker/dealer, in an account for F with G designated as nominee for F. Upon the retirement of the bonds, the gross proceeds are automatically credited to the account of F. G is required to make a return of information with respect to the retirement because G is the broker responsible for making payments of the gross proceeds to F.

* * * * *

§1.6045–2 [Amended]

Par. 5. In §1.6045–2, paragraph (b)(2)(ii), is amended by removing the language "§5f.6045–1(c)(3)(i)(B) of the Temporary Income Tax Regulations under the Tax Equity and Fiscal Responsibility Act of 1982" and adding the language "§1.6045– 1(c)(3)(i)(B)" in its place.

Par. 6. In §1.6049–4, as in effect on January 1, 2001, paragraph (a)(2) is revised to read as follows:

§1.6049–4 Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.

(a) * * *

(2) *Payor.* For payments made on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations, a payor is a person described in paragraph (a)(2)(i) or (ii) of this section.

(i) Every person who makes a payment of the type and of the amount subject to reporting under this section (or under an applicable section under this chapter) to any other person during a calendar year.

(ii) Every person who collects on behalf of another person payments of the type and of the amount subject to reporting under this section (or under an applicable section under this chapter), or who otherwise acts as a middleman (as defined in paragraph (f)(4) of this section) with respect to such payment.

* * * * *

PART 5f—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

Par. 7. The authority citation for part 5f is amended by removing the authority citation for Sec. 5f.6045–1 to read in part as follows:

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

§5f.6045–1 [Removed]

Par. 8. Section 5f.6045–1 is removed.

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

Par. 9. The authority citation for part 31 continues to read in part as follows:

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

Par. 10. Section 31.3406–0 is amended by:

1. Revising the entry for §31.3406(a)–2, paragraph (b).

2. Adding an entry for §31.3406(a)–2, paragraph (d).

The revision and addition read as follows:

§31.3406–0 Outline of the backup withholding regulations.

* * * * *

§31.3406(a)–2 Definition of payors obligated to backup withhold.

* * * * *

(b) Persons treated as payors.

* * * * *

(d) Effective date.

* * * * *

Par. 11. Section 31.3406(a)–2 is revised to read as follows:

§31.3406(a)–2 Definition of payors obligated to backup withhold.

(a) *In general. Payor* means the person that is required to make an information return under section 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, or 6050N, with respect to any reportable payment (as described in section 3406(b)), or that is described in paragraph (b) of this section.

(b) *Persons treated as payors.* The following persons are treated as payors for purposes of section 3406—

(1) A grantor trust established after December 31, 1995, all of which is owned by two or more grantors, and for this purpose spouses filing a joint return are considered to be one grantor;

(2) A grantor trust with ten or more grantors established on or after January 1, 1984 but before January 1, 1996;

(3) A common trust fund; and

(4) A partnership or an S corporation that makes a reportable payment.

(c) *Persons not treated as payors.* The following persons are not treated as payors for purposes of section 3406 if the person does not have a reporting obligation under the section on information reporting to which the payment relates—

(1) A trust (other than a grantor trust as described in paragraph (b)(1) or (2) of this section) that files a Form 1041 containing information required to be shown on an information return, including amounts withheld under section 3406; or

(2) A partnership making a payment of a distributive share or an S corporation making a similar distribution.

(d) *Effective date.* The provisions of this section apply to payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations.

§31.3406(a)–4 [Amended]

Par. 12. Section 31.3406(a)–4 is amended as follows:

1. In paragraph (c)(1), first sentence, removing the language "Any middleman (as defined in §31.3406(a)–2(b))" and adding the language "A middleman payor (as defined in §31.3406(a)–2(b) or in the section on information reporting to which the payment relates)" in its place.

2. In paragraph (c)(3), first sentence, removing the language "§31.3406(a)–2(b)(4)" and adding the language "§31.3406(a)–2(b)(1) or (2)" in its place.

§31.3406(b)(3)–2 [Amended]

Par. 13. In §31.3406(b)(3)–2, paragraph (b)(5) is amended by removing the language "§5f.6045–1(c)(3)(ix)" and adding the language "§1.6045–1(c)(3)(x)" in its place.

§31.3406(d)–4 [Amended]

Par. 14. In §31.3406(d)–4, paragraph (a)(1) introductory text is amended by removing the language "the payor of the instrument (as defined in §31.3406(a)–2(b)(3))," and adding the language "a broker holding a security (including stock) for a customer in street name," in its place.

§31.3406(h)–1 [Amended]

Par. 15. In §31.3406(h)–1, paragraph (c), second sentence, is amended by removing the language "§5f.6045–1(c)(3)(ii) and (iii)" and adding the language "§1.6045–1(c)(3)(iii) and (iv)" in its place.

§31.3406(h)–2 [Amended]

Par. 16. Section 31.3406(h)–2 is amended as follows:

1. In paragraph (c), third sentence, removing the language "with two or more grantors described in §31.3406(a)–2(b)(4), which is treated as a middleman payor" and adding the language "described in §31.3406(a)–2(b)(1) or (2), which is treated as a payor" in its place.

2. In paragraph (d), first sentence, removing the language "A middleman payor (as defined in §31.3406(a)–2(b)" and adding the language "A middleman payor (as defined in §31.3406(a)–2(b) or in the section on information reporting to which the payment relates)" in its place.

3. In paragraph (f)(6), removing the language "§31.3406(a)– 2(a)" and adding the language "§31.3406(a)–2" in its place.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 16, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2000, 65 F.R. 61292)

Notice of Proposed Rulemaking and Notice of Public Hearing

Exclusion of Gain From Sale or Exchange of a Principal Residence

REG–105235–99

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 exclusion of gain from the sale or exchange of a taxpayer's principal residence. These proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997, as amended by the Internal Revenue Service Restructuring and Reform Act of 1998. These proposed regulations generally affect taxpayers who sell or exchange their principal residences.

DATES: Written or electronically generated comments must be received by January 9, 2001. Requests to speak (with outlines of oral comments) to be discussed at the public hearing scheduled for January 23, 2001 at 10 a.m., must be submitted by January 3, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–105235–99), 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:M&SP:RU (REG–105235–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., 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 the IRS Auditorium, Seventh Floor, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Sara P. Shepherd, (202) 622-4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, contact Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

1. *Section 121 Exclusion*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 121 of the Internal Revenue Code relating to the exclusion of gain from the sale or exchange of a taxpayer's principal residence. These proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788 (TRA 1997)), as amended by the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 805 (RRA 1998)).

Prior to the repeal by TRA 1997, section 1034 provided that gain from the sale or exchange of a principal residence (old residence) was recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeded the taxpayer's cost of purchasing a new residence within the replacement period (generally 2 years before or after the date of sale).

Prior to amendment by TRA 1997, former section 121 provided that a taxpayer could make a one-time election to exclude up to $125,000 of gain from the sale or exchange of property. To qualify for the exclusion, the taxpayer must have (1) been age 55 or older on the date of the sale or exchange, and (2) owned and used the property as the taxpayer's principal residence for at least 3 years during the 5-year period ending on the date of the sale or exchange.

TRA 1997 amended section 121 and repealed section 1034 for sales and exchanges of principal residences after May 6, 1997 (except, at the election of the taxpayer, to a sale or exchange (1) made on or before August 5, 1997, (2) made pursuant to a binding contract in effect on August 5, 1997, or (3) that would qualify under section 1034 by reason of a new residence acquired on or before August 5, 1997 or pursuant to a binding contract in effect on August 5, 1997). Under section 121 as amended, a taxpayer generally excludes up to $250,000 ($500,000 for certain joint returns) of gain realized on the sale or exchange of property if the property was owned and used as the taxpayer's principal residence for at least 2 years during the 5-year period ending on the date of the sale or exchange. The exclusion applies regardless of the age of the taxpayer, and the full exclusion can be used only once every 2 years. A taxpayer who fails to meet these requirements by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances may be entitled to a reduced exclusion.

RRA 1998 amended TRA 1997 to clarify that the reduced exclusion amount under section 121(c) is a portion of the maximum limitation amount ($250,000 or $500,000 for certain joint returns), not a portion of the realized gain. See H.R. Rep. No. 356, 105th Cong., 1st Sess. 17 (1997); S. Rep. No. 174, 105th Cong., 2d Sess. 150 (1998). In addition, the amendments provided that for married taxpayers filing jointly but failing to meet the ownership, use, or timing requirements of section 121(b)(2)(A), the maximum limitation amount will be the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. S. Rep. No. 174, 105th Cong., 2d Sess. 151 (1998); H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 337 (1998). Lastly, the amendments clarified that a taxpayer may elect to apply prior law under section 1034 or former section 121 to a sale or exchange occurring on as well as before the date of enactment, August 5, 1997. H.R. Rep. No. 356, 105th Cong., 1st Sess. 18 (1997); S. Rep. No. 174, 105th Cong., 2d Sess. 151 (1998).

2. *Section 121 Exclusion in Individuals' Title 11 Cases*

This document also contains proposed amendments to the Income Taxation Regulations (26 CFR part 1) under section 1398 of the Internal Revenue Code. Under the authority provided in section 1398(g)(8), the regulations add the section 121 exclusion to the list of tax attributes of the debtor that the bankruptcy estate of an individual in a chapter 7 or 11 bankruptcy case under title 11 of the United States Code succeeds to and takes into account in computing the taxable income of the estate. Although these regulations are proposed to be applicable on or after the date they are published as final regulations in the **Federal Register**, in view of the IRS's acquiescence in the case

of *Internal Revenue Service v. Waldschmidt (In re Bradley)*, AOD CC-1999-009 (August 30, 1999), and Chief Counsel Notice (35)000-162 (August 10, 1999), the IRS will not challenge the position taken prior to the effective date of these regulations that a bankruptcy estate may use the section 121 exclusion if the debtor would otherwise satisfy the section 121 requirements.

Explanation of Provisions

1. *Section 121 Exclusion*

Section 1.121–1(b) of the proposed regulations addresses the definition of principal residence. This section provides that whether or not property is the taxpayer's residence, and whether or not property is used by the taxpayer as the taxpayer's principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all the facts and circumstances. If a taxpayer alternates between two properties, using each as a residence for successive periods of time, the property that the taxpayer uses a majority of the time during the year will ordinarily be considered the taxpayer's principal residence.

Section 1.121–1(c) of the proposed regulations addresses the use requirement under section 121(a). This section provides that, in order for a taxpayer to satisfy the use requirement under section 121(a), the taxpayer must occupy the residence (except for short temporary absences) for at least 2 years during the 5-year period ending on the date of the sale or exchange. See H.R. Rep. No. 148, 105th Cong., 1st Sess. at 348 (1997); S. Rep. No. 33, 105th Cong., 1st Sess. at 37 (1997); H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. at 386 (1997).

Section 1.121–1(d) provides that the section 121 exclusion does not apply to so much of the gain from the sale or exchange of property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of the property.

Section 1.121–1(e) of the proposed regulations provides that if a taxpayer satisfies the use requirement only with respect to a portion of the property sold or exchanged, section 121 will apply only to the gain from the sale or exchange allocable to that portion. Thus, if the residence was used partially for residential purposes and partially for business purposes, only that part of the gain allocable to the residential portion is excludable under section 121. Furthermore, the section 121 exclusion does not apply to the extent that depreciation attributable to periods after May 6, 1997, exceeds gain allocable to the business-use portion of the property.

Under section 121(c), a reduced exclusion is available for a taxpayer who sells or exchanges property used as the taxpayer's principal residence but fails to satisfy the ownership and use requirements described in section 121(a) or the 2-year limitation described in section 121(b)(3). Section 1.121–3(a) of the proposed regulations provides that the reduced exclusion applies only if the sale or exchange is necessitated by a change in place of employment, health, or, to the extent provided in forms, instructions, or other appropriate guidance including regulations and letter rulings, unforeseen circumstances. The IRS and the Treasury Department request written comments regarding what should qualify as an unforeseen circumstance for purposes of determining whether a taxpayer is eligible to claim the reduced exclusion available under section 121(c).

Under section 121(d)(8), a taxpayer must make an election to have the section 121 exclusion apply to a sale or exchange of a remainder interest in the taxpayer's principal residence. Section 1.121–4(f)(3) provides that the taxpayer makes the election by filing a return for the taxable year of the sale or exchange that does not include the gain from the sale or exchange of the remainder interest in the taxpayer's gross income.

Under section 121(f), a taxpayer must make an election to have the section 121 exclusion not apply to a sale or exchange of the taxpayer's principal residence. Section 1.121–4(h) provides that the taxpayer makes the election by filing a return for the taxable year of the sale or exchange that includes the gain from the sale or exchange of the residence in the taxpayer's gross income.

2. *Section 121 Exclusion in Individuals' Title 11 Cases*

Section 1.1398–3 of the proposed regulations provides that the bankruptcy estate of an individual in a chapter 7 or 11 bankruptcy case under title 11 of the United States Code succeeds to and takes into account the individual's section 121 exclusion if the individual satisfies the requirements of section 121.

3. *Proposed Effective Date*

These regulations are proposed to be applicable for sales or exchanges that occur on or after the date they 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 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 of written comments) that are submitted timely (in the manner described in the ADDRESSES caption) to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules 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 23, 2001, beginning at 10 a.m. in the IRS Auditorium, Seventh Floor, 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 the 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 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 3, 2001. A period of 10 minutes will be allotted to each person 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 Sara P. Shepherd, 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.

* * * * *

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 1.1398–3 also issued under 26 U.S.C. 1398(g).

Par. 2. Sections 1.121–1, 1.121–2, 1.121–3 and 1.121–4 are revised to read as follows:

§1.121–1 Exclusion of gain from sale or exchange of a principal residence.

(a) *In general.* Section 121 provides that, under certain circumstances, gross income does not include gain realized on the sale or exchange of property that was owned and used by a taxpayer as the taxpayer's principal residence. Subject to the other provisions of section 121, a taxpayer will exclude gain only if, during the 5-year period ending on the date of the sale or exchange, the taxpayer owned and used the property as the taxpayer's principal residence for periods aggregating 2 years or more.

(b) *Principal residence.* Whether or not property is used by the taxpayer as the taxpayer's residence, and whether or not property is used by the taxpayer as the taxpayer's principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all the facts and circumstances. If a taxpayer alternates between two properties, using each as a residence for successive periods of time, the property that the taxpayer uses a majority of the time during the year will ordinarily be considered the taxpayer's principal residence. A property used by the taxpayer as the taxpayer's principal residence may include a houseboat, a house trailer, or stock held by a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b)(1) and (2)), if the dwelling that the taxpayer is entitled to occupy as a stockholder is used by the taxpayer as the taxpayer's principal residence. Property used by the taxpayer as the taxpayer's principal residence does not include personal property, that is not a fixture under local law.

(c) *Ownership and use requirements.* The requirements of ownership and use for periods aggregating 2 years or more may be satisfied by establishing ownership and use for 24 full months or for 730 days (365 x 2). The requirements of ownership and use may be satisfied during nonconcurrent periods if both the ownership and use tests are met during the 5-year period ending on the date of the sale or exchange. In establishing whether a taxpayer has satisfied the 2-year use requirement, occupancy of the residence is required. However, short temporary absences, such as for vacation or other seasonal absence (although accompanied with rental of the residence), are counted as periods of use.

(d) *Depreciation taken after May 6, 1997.* The section 121 exclusion does not apply to so much of the gain from the sale or exchange of property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of the property.

(e) *Property used in part as a principal residence.* If a taxpayer satisfies the use requirement only with respect to a portion of the property sold or exchanged, section 121 will apply only to the gain from the sale or exchange allocable to that portion. Thus, if the residence was used partially for residential purposes and partially for business purposes, only that part of the gain allocable to the residential portion is excludable under section 121. Furthermore, the section 121 exclusion does not apply to the extent that depreciation attributable to periods after May 6, 1997, exceeds gain allocable to the business-use portion of the property. See *Example 8* in paragraph (f) of this section.

(f) *Examples.* The provisions of paragraphs (a) through (e) of this section are illustrated by the following examples:

Example 1. Taxpayer A has owned and used his house as his principal residence since 1986. On January 1, 1998, A moves to another state. A leases his house from that date until April 18, 2000, when he sells it. A is eligible for the section 121 exclusion because he has owned and used the house as his principal residence for at least 2 years out of the 5 years preceding the sale.

Example 2. Taxpayer B owned and used a house as her principal residence from 1986 to the end of 1997. On January 1, 1998, B moved to another state and ceases to use the house. B's move was not necessitated by a change in place of employment, health, or unforeseen circumstances. B's son moved into the house in March 1999 and used the residence until it was sold on July 1, 2001. Taxpayer B may not exclude gain from the sale under section 121 because she did not use the property as her principal residence for at least 2 years out of the 5 years preceding the sale.

Example 3. Taxpayer C lived in a townhouse that he rented from 1993 through 1997. On January 1, 1998, he purchased this townhouse. On February 1, 1998, C moved into his daughter's home. On March 1, 2000, while still living in his daughter's home, C sold his townhouse. The section 121 exclusion will apply to gain from the sale because C owned the townhouse for at least 2 years out of the 5 years preceding the sale (from January 1, 1998 until March 1, 2000) and he used the townhouse as his principal residence for at least 2 years during the 5-year period preceding the sale (from March 1, 1995 until February 1, 1998).

Example 4. Taxpayer D, a college professor, purchased and moved into a house on May 1, 1997. He used the house as his principal residence continuously until September 1, 1998, when he went abroad for a 1-year sabbatical leave. On October 1, 1999, 1 month after returning from the leave, D sold the house. Because his leave is not considered to be a short temporary absence for purposes of section 121 (see paragraph (c) of this section), the period of

the leave may not be included in determining whether D used the house for periods aggregating 2 years during the 5-year period ending on the date of the sale. Consequently, D is not entitled to exclude gain under section 121 because he did not use the residence for the requisite period.

Example 5. Taxpayer E purchased a house on February 1, 1998, that he used as his principal residence. During 1998 and 1999, E left his residence for a 2-month summer vacation. E sold the house on March 1, 2000. Although, in the 5-year period preceding the date of sale, the total time E used his residence is less than 2 years (21 months), the section 121 exclusion will apply to gain from the sale of the residence because the 2-month vacations are short temporary absences and are counted as periods of use in determining whether E used the residence for the requisite period.

Example 6. On July 1, 1999, Taxpayer F moves into a house that he owns and had rented to tenants since July 1, 1997. F took depreciation deductions totaling $14,000 for the period that he rented the property. After using the residence as his principal residence for 2 full years, F sells the property on August 1, 2001. F's gain realized from the sale is $40,000. F had no capital losses for 2001. Only $26,000 ($40,000 gain realized - $14,000 depreciation deductions) may be excluded under section 121. The $14,000 of gain recognized by F is unrecaptured section 1250 gain within the meaning of section 1(h).

Example 7. Taxpayer G, an attorney, uses a portion of her principal residence as a law office for a period in excess of 3 years out of the 5 years preceding the sale of the property. Because G did not use the law office portion of the property as her residence, the section 121 exclusion does not apply to the gain from the sale that is allocable to the law office portion of the property.

Example 8. Taxpayer H buys a house in 1998. For 5 years, H uses a portion of the property as his principal residence and a portion of the property for business purposes. H claims depreciation deductions of $20,000 for the business use of the property. H sells the property in 2003, realizing a gain of $50,000. H had no other section 1231 or capital gains or losses for 2003. H determines that $15,000 of the gain is allocable to the business-use portion of the property and that $35,000 of the gain is allocable to the portion of the property used as his residence. H must recognize $15,000 of the gain allocable to the business-use portion of the property. This $15,000 of gain is unrecaptured section 1250 gain within the meaning of section 1(h). In addition, the section 121 exclusion does not apply to the extent that H's post-May 6, 1997 depreciation ($20,000) exceeds the gain allocable to the business-use portion of the property ($15,000). Therefore, H may exclude $30,000 of the gain from the sale of the property. The remaining $5,000 of gain is recognized by H as unrecaptured section 1250 gain within the meaning of section 1(h).

Example 9. Taxpayer J buys a house in 1998. For 5 years, J uses a portion of the property as her principal residence and a portion of the property for business purposes. J claims depreciation deductions of $10,000 for the business use of the property. J sells the property in 2003, realizing a gain of $50,000. J had no other section 1231 or capital gains or losses for 2003. J determines that $15,000 of the gain is allocable to the business-use portion of the property and that $35,000 of the gain is allocable to the portion of the property used as her residence. J must recognize the $15,000 of gain allocable to the business-use portion of the property ($10,000 of which is unrecaptured section 1250 gain within the meaning of section 1(h), and $5,000 of which adjusted net capital gain). J may exclude $35,000 of the gain from the sale of the property.

Example 10. Taxpayer K owns two residences, one in New York and one in Florida. From 1999 through 2003, he lives in the New York residence for 7 months and the Florida residence for 5 months. Thus, K used the New York residence a majority of the time in each year from 1999 through 2003. Therefore, in the absence of facts and circumstances indicating otherwise, the New York residence is his principal residence, and only the New York residence would be eligible for the 121 exclusion if it were sold at the end of 2003.

Example 11. Taxpayer L owns two residences, one in Virginia and one in Maine. During 1999 and 2000, she lives in the Virginia residence. During 2001 and 2002, L lives in the Maine residence. During 2003, she lives in the Virginia residence. Her principal residence during 1999, 2000, and 2003 is the Virginia residence. Her principal residence during 2001 and 2002 is the Maine residence. Either residence would be eligible for the 121 exclusion if it were sold during 2003.

(g) *Effective date.* This section and §§1.121–2 through 1.121–4 are applicable for sales and exchanges that occur on or after the date these regulations are published as final regulations in the **Federal Register**.

§1.121–2 Limitations.

(a) *Dollar limitations.* A taxpayer may exclude from gross income up to $250,000 of gain from the sale or exchange of the taxpayer's principal residence. If taxpayers jointly own a principal residence but file separate returns, each taxpayer will exclude from gross income up to $250,000 of gain that is attributable to each taxpayer's interest in the property, if the requirements of section 121 have otherwise been met.

(b) *Special rules for joint returns*— (1) *In general.* A husband and wife who make a joint return for the year of the sale or exchange may exclude up to $500,000 of gain if—

(i) Either spouse meets the 2-year ownership requirements of §1.121–1(a);

(ii) Both spouses meet the 2-year use requirements of §1.121–1(a); and

(iii) Neither spouse excluded gain from a prior sale or exchange of property under section 121 within the last 2 years (as determined under paragraph (c) of this section).

(2) *Other joint returns.* For taxpayers filing jointly, if the spouses fail to meet the requirements of paragraph (b)(1) of this section, the maximum limitation amount to be claimed by the couple will be the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. For this purpose, each spouse will be treated as owning the property during the period that either spouse owned the property.

(3) *Examples.* The provisions of this paragraph (b) are illustrated by the following examples:

Example 1. Married taxpayers H and W sell their residence and the gain realized from the sale is $256,000. H and W meet the requirements of section 121 and file a joint return for the year of the sale. The entire amount of gain from the sale of their principal residence is excluded from gross income because the gain realized from the sale does not exceed the limitation amount of $500,000 available to taxpayers filing a joint return.

Example 2. During 1999, married taxpayers H and W each sell a residence that each had separately owned and used as a principal residence before their marriage. Each spouse meets the ownership and use tests for his or her respective residence. Neither spouse meets the use requirement for the other spouse's residence. H and W file a joint return for the year of the sales. The gain realized from the sale of H's residence is $200,000. The gain realized from the sale of W's residence is $300,000. Because the ownership and use requirements are met for each residence by each respective spouse, H and W are eligible to exclude up to $250,000 of gain from the sale of each of their residences. However, W may not use H's unused exclusion to exclude gain in excess of her exclusion amount. Therefore, H and W must recognize $50,000 of the gain realized on the sale of W's residence.

Example 3. Married taxpayers H and W sell their residence and file a joint return for the year of the sale. Section 1.121– 3 (relating to the reduced exclusion) does not apply to the sale of their residence. W, but not H, satisfies the requirements of section 121. They are eligible to exclude up to $250,000 of the gain from the sale of the residence because that is the sum of each spouse's dollar limitation amount determined on a separate basis as if they had not been married ($0 for H, $250,000 for W).

Example 4. Married taxpayers H and W have owned and used their principal residence since 1998. On February 16, 2001, H dies. On September 21, 2001, W sells the residence and realizes a gain of $350,000. Pursuant to section 6013(a)(3), W and H's executor make a joint return for 2001. All $350,000 of the gain from the sale of the residence may be excluded.

Example 5. Married taxpayers H and W have owned and used their principal residence since 1998. On February 16, 2001, H dies. W sells the residence on March 30, 2002. Because W's filing

status for the taxable year of the sale is single, the special rules for joint returns under paragraph (b) of this section do not apply and W may exclude only $250,000 of the gain.

(c) *Application of section 121 to only 1 sale or exchange every 2 years*—(1) *In general.* Except as otherwise provided in §1.121–3 (relating to the reduced exclusion), a taxpayer may not exclude from gross income gain from the sale or exchange of a principal residence if, during the 2-year period ending on the date of the sale or exchange, the taxpayer sold or exchanged other property for which gain was excluded under section 121. For purposes of this paragraph (c)(1), any sale or exchange before May 7, 1997 is disregarded.

(2) *Example.* The following example illustrates the rules of this paragraph (c):

Example. Taxpayer A owned a townhouse that he used as his principal residence for two full years, 1998 and 1999. A then bought a house in 2000 that he owned and used as his principal residence. A sells the townhouse in 2002 and excludes gain realized on its sale under section 121. A sells the house in the next year, 2003. Section 1.121–3 (relating to the reduced exclusion) does not apply to the sale of the house. Although A meets the 2-year ownership and use requirements of section 121, A is not eligible to exclude gain from the sale of the house because A excluded gain within the last 2 years under section 121 from the sale of the townhouse.

§1.121–3 Reduced exclusion.

(a) *Reduced exclusion for taxpayers failing to meet certain requirements: In general.* A reduced exclusion is available for a taxpayer who sells or exchanges property used as the taxpayer's principal residence but fails to satisfy the ownership and use requirements described in §1.121–1(a) or the 2-year limitation described in §1.121–2(c). This reduced exclusion applies only if the sale or exchange is necessitated by a change in place of employment, health, or, to the extent provided in forms, instructions, or other appropriate guidance including regulations and letter rulings, unforeseen circumstances. The reduced exclusion is computed by multiplying the maximum dollar limitation of $250,000 ($500,000 for certain joint filers) by a fraction. The numerator of the fraction is the shortest of the period of time that the taxpayer owned the property as the taxpayer's principal residence during the 5-year period ending on the date of the sale or exchange; the period of time that the taxpayer used the property during the 5-year period ending on the date of the sale or exchange; or the period of time between the date of a prior sale or exchange of property for which the taxpayer excluded gain under section 121 and the date of the current sale or exchange. The numerator of the fraction may be expressed in days or months. The denominator of the fraction is 730 days or 24 months (depending on the measure of time used in the numerator).

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

Example 1. Taxpayer A purchases a house that she uses as her principal residence. Twelve months after the purchase, A sells the house due to a change in place of her employment. A has not excluded gain under section 121 on a prior sale or exchange of property within the last 2 years. A is eligible to exclude up to $125,000 of the gain from the sale of her house (12/24 x $250,000).

Example 2. (i) Taxpayer H owned a house that he used as his principal residence since 1996. On January 15, 1999, H and W marry and W begins to use H's house as her principal residence. On January 15, 2000, H sells the house due to a change in H's and W's place of employment. Neither H nor W has excluded gain under section 121 on a prior sale or exchange of property within the last 2 years.

(ii) Because H and W have not both used the house as their principal residence for at least 2 years during the 5-year period preceding its sale, the maximum dollar limitation amount that may be claimed by H and W will not be $500,000, but the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. (See §1.121–2(b)(2).)

(iii) H is eligible to exclude up to $250,000 of gain because he meets the requirements of section 121. W is not eligible to exclude the maximum dollar limitation amount. Instead, W is eligible to claim a reduced exclusion. Because the sale of the house is due to a change in place of employment, W is eligible to exclude up to $125,000 of the gain (365/730 x $250,000). Therefore, H and W are eligible to exclude up to $375,000 of gain ($250,000 + $125,000) from the sale of the house.

§1.121–4 Special rules.

(a) *Property of deceased spouse*—(1) *In general.* For purposes of satisfying the ownership and use requirements of section 121, a taxpayer is treated as owning and using property as the taxpayer's principal residence during any period that the taxpayer's deceased spouse owned and used the property as a principal residence before death if—

(i) The taxpayer's spouse is deceased on the date of the sale or exchange of the property; and

(ii) The taxpayer has not remarried at the time of the sale or exchange of the property.

(2) *Example.* The provisions of this paragraph (a) are illustrated by the following example:

Example. Taxpayer H has owned and used a house as his principal residence since July 1, 1987. H and W marry on July 1, 1999 and from that date they use H's house as their principal residence. H dies on August 15, 2000, and W inherits the property and continues to use the property as her principal residence. W sells the property on September 1, 2000, at which time she has not remarried. Although W has owned and used the house for less than 2 years, W will be considered to have satisfied the ownership and use requirements of section 121 because W's period of ownership and use includes the period that H owned and used the property before death.

(b) *Property owned by spouse or former spouse*—(1) *Property transferred to individual from spouse or former spouse.* If a taxpayer obtains property from a spouse or former spouse in a transaction described in section 1041(a), the period that the taxpayer owns the property will include the period that the spouse or former spouse owned the property.

(2) *Property used by spouse or former spouse.* A taxpayer is treated as using property as the taxpayer's principal residence for any period that the taxpayer has an ownership interest in the property and the taxpayer's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71(b)(2)), provided that the spouse or former spouse uses the property as a principal residence.

(c) *Tenant-stockholder in cooperative housing corporation.* A taxpayer who holds stock as a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b)(1) and (2)) may be eligible to exclude gain under section 121 on the sale or exchange of the stock. In determining whether the taxpayer meets the requirements of section 121, the ownership requirements are applied to the holding of the stock and the use requirements are applied to the house or apartment that the taxpayer was entitled to occupy by reason of the taxpayer's stock ownership.

(d) *Involuntary conversions*—(1) *In general.* For purposes of section 121, the destruction, theft, seizure, requisition, or condemnation of property is treated as a sale of the property.

(2) *Application of section 1033.* In applying section 1033 (relating to involuntary conversions), the amount realized from the sale or exchange of property used as the taxpayer's principal residence

is treated as being the amount determined without regard to section 121, reduced by the amount of gain excluded from the taxpayer's gross income under section 121.

(3) *Property acquired after involuntary conversion.* If the basis of the property acquired as a result of an involuntary conversion is determined (in whole or in part) under section 1033(b) (relating to the basis of property acquired through involuntary conversion), then for purposes of satisfying the requirements of section 121, the taxpayer will be treated as owning and using the acquired property as the taxpayer's principal residence during any period of time that the taxpayer owned and used the converted property as the taxpayer's principal residence.

(4) *Example.* The provisions of this paragraph (d) are illustrated by the following example:

Example. (i) On February 18, 1999, fire destroys Taxpayer A's house that had an adjusted basis of $80,000. A had owned and used this property as her principal residence for 20 years prior to its destruction. A's insurance company paid A $400,000 for the house. Thus, A realized a gain of $320,000 ($400,000 - $80,000). On August 27, 1999, A purchases a new house at a cost of $100,000.

(ii) Because the destruction of the house is treated as a sale for purposes of section 121, A will exclude $250,000 of the realized gain from A's gross income. For purposes of section 1033, the amount realized is then treated as being $150,000 ($400,000 - $250,000) and the gain realized is $70,000 ($150,000 amount realized - $80,000 basis). A elects under section 1033 to recognize only $50,000 of the gain ($150,000 amount realized - $100,000 cost of new house). The remaining $20,000 of gain is deferred and A's basis in the new house is $80,000 ($100,000 cost - $20,000 gain not recognized).

(iii) A will be treated as owning and using the new house as A's principal residence during the 20-year period that A owned and used the destroyed house.

(e) *Determination of use during periods of out-of-residence care.* If a taxpayer has become physically or mentally incapable of self-care and the taxpayer sells or exchanges property that the taxpayer owned and used as the taxpayer's principal residence for a period aggregating at least 1 year during the 5-year period preceding the sale or exchange, the taxpayer is treated as using the property as the taxpayer's principal residence for any period of time during the 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

(f) *Sales of remainder interests*—(1) *In general.* A taxpayer may elect to have the section 121 exclusion apply to gain from the sale or exchange of a remainder interest in the taxpayer's principal residence.

(2) *Limitations*—(i) *Sale or exchange of any other interest.* If a taxpayer elects to exclude gain from the sale or exchange of a remainder interest in the taxpayer's principal residence, the section 121 exclusion will not apply to a sale or exchange of any other interest in the residence that is sold or exchanged separately.

(ii) *Sales to related parties.* Paragraph (f)(1) of this section will not apply to a sale or exchange by any person who bears a relationship to the taxpayer which is described in section 267(b) or 707(b).

(3) *Election.* The taxpayer makes the election under this paragraph (f) by filing a return for the taxable year of the sale or exchange that does not include the gain from the sale or exchange of the remainder interest in the taxpayer's gross income.

(g) *No exclusion for expatriates.* The section 121 exclusion will not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) (relating to the treatment of expatriates) applies to the individual.

(h) *Election to have section not apply.* A taxpayer may elect to have the section 121 exclusion not apply to a sale or exchange of property. The taxpayer makes the election by filing a return for the taxable year of the sale or exchange that includes the gain from the sale or exchange of the taxpayer's principal residence in the taxpayer's gross income.

(i) *Residences acquired in rollovers under section 1034.* If a taxpayer acquires property (section 121 property) in a transaction that qualifies under section 1034 for the nonrecognition of gain realized on the sale or exchange of another property (section 1034 property) and later sells or exchanges the section 121 property, in determining the period of the taxpayer's ownership and use of the sold or exchanged section 121 property, the taxpayer may include the periods that the taxpayer owned and used the section 1034 property as the taxpayer's principal residence (and each prior residence taken into account under section 1223(7) in determining the holding period of the 1034 property).

§1.121–5 [Removed]

Par. 3. Section 1.121–5 is removed.

Par. 4. Section 1.1398–3 is added to read as follows:

§1.1398–3 Treatment of section 121 exclusion in individuals' title 11 cases.

(a) *Scope.* This section applies to cases under chapter 7 or chapter 11 of title 11 of the United States Code, but only if the debtor is an individual.

(b) *Definition and rules of general application.* For purposes of this section, section 121 exclusion means the exclusion of gain from the sale or exchange of a debtor's principal residence available under section 121.

(c) *Estate succeeds to exclusion upon commencement of case.* The bankruptcy estate succeeds to and takes into account the section 121 exclusion with respect to the property transferred into the estate.

(d) *Effective date.* This section is applicable for sales or exchanges that occur on or after the date 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 October 6, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 10, 2000, 65 F.R. 60136)

Notice of Proposed Rulemaking and Notice of Public Hearing

Classification of Certain Pension and Employee Benefit Trusts, and Other Trusts

REG–108553–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed amendments to the regulations defining a domestic or foreign trust for federal tax purposes. The proposed regu-

lations will affect certain specified employee benefit trusts and investment trusts. The proposed amendments provide that these employee benefit trusts and investment trusts are deemed to satisfy the control test for domestic trust treatment if United States trustees control all of the substantial decisions of the trust made by the trustees of the trust. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 10, 2001. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for January 31, 2001, at 10 a.m. must be submitted by January 10, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–108553–00), 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:M&SP:RU (REG–108553–00), 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 Internal Revenue Service Auditorium, 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

Section 401(a) requires a trust forming part of a pension, profit-sharing, or stock bonus plan (qualified plan trust) to be created or organized in the United States in order to be a qualified trust. Similarly, section 408(a) requires an individual retirement account trust (IRA trust), which also includes a trust for a Simple IRA described in section 408(p) and a trust for a Roth IRA described in section 408A, to be created or organized in the United States. Section 1.401–1(a)(3)(i) further provides that a trust will not constitute a qualified trust under section 401(a) unless the trust is maintained at all times as a domestic trust in the United States. Under §1.408–2(b), a similar requirement applies to an IRA trust.

Prior to the enactment of the Small Business Job Protection Act (SBJPA), Public Law 104–188 (110 Stat. 1755) (August 20, 1996), the status of a qualified plan trust as a domestic trust generally turned on a facts and circumstances determination that the trust was a resident trust and was subject to the continuous jurisdiction of the United States. See, for example, Rev. Rul. 70–242 (1970–1 C.B. 89) regarding the determination of domestic trust status for purposes of section 401(a).

The SBJPA and the Taxpayer Relief Act of 1997 (TRA 97), Public Law 105–34 (111 Stat. 788) (August 5, 1997), amended section 7701(a)(30) to provide objective criteria for determining whether a trust is a domestic trust. New section 7701(a)(30)(E) provides that a trust will be treated as a domestic trust if: (1) a court within the United States is able to exercise primary supervision over the administration of the trust (court test), and (2) one or more United States persons have the authority to control all substantial decisions of the trust (control test). These changes are generally effective for taxable years beginning after December 31, 1996.

Section 301.7701–7, published in the **Federal Register** on February 2, 1999 (64 FR 4967), provides guidance under section 7701(a)(30)(E) in determining whether a trust is treated as a United States person and therefore as a domestic trust for federal tax purposes. The regulations are generally effective for taxable years ending after February 2, 1999, but may be applied by taxpayers for taxable years beginning after December 31, 1996. In addition, section 1907(a)(3) of the SBJPA, as amended by the TRA 97, generally provides that, to the extent prescribed in regulations, a trust that was in existence on August 20, 1996, and that was treated as a United States person on August 19, 1996, may elect to continue to be treated as a United States person. Section 301.7701–7(f) provides rules governing this election to continue to be treated as a United States person.

Section 301.7701–7(d) provides guidance on the application of the control test, including defining United States persons, substantial decisions, and control. Generally, for purposes of the control test, all persons with any power over substantial decisions of the trust, whether acting in a fiduciary capacity or not, must be counted for purposes of the control test.

However, §301.7701–7(d)(1)(iv) provides a special rule for certain employee benefit trusts listed therein. These trusts are required to be created or organized in the United States and are subject to other detailed requirements for qualification under the Internal Revenue Code (Code). Therefore, §301.7701–7(d)(1)(iv) provides that these trusts are deemed to satisfy the control test, provided that United States fiduciaries control all of the substantial decisions of the trust that are made by the trustees or fiduciaries. Section 301.7701–7(d)(1)(iv) authorizes the Commissioner to designate additional categories of trusts subject to the special rule in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin.

Explanation

The IRS and the Treasury Department have become aware of two additional categories of trusts that should qualify for the special control test rule in §301.7701–7(d)(1)(iv).

The first category is group trusts consisting of qualified plan trusts and IRA trusts, as described in Rev. Rul. 81–100 (1981–1 C.B. 326). If the requirements set forth in Rev. Rul. 81–100 are met, a group trust is itself exempt from tax, and the tax-exempt status of the participating trusts is not affected by the pooling of their funds in the group trust. One of the requirements is that the group trust must be created or organized in the United States and must be maintained at all times as a domestic trust in the United States. Because these trusts are required to be created or organized in the United States and are subject to other detailed requirements, they are similar to the other categories of employee benefit trusts listed in §301.7701–7(d)(1)(iv). Therefore, the proposed regulations add group trusts de-

scribed in Rev. Rul. 81–100 to the categories of trusts that may use the special control test rule.

The second category is certain investment trusts that are classified as trusts under §301.7701–4(c)(1). An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets in the trust, is classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders. In addition, an investment trust with multiple classes of ownership interests, in which there is no power under the trust agreement to vary the investment of the certificate holders, is classified as a trust if the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose. These trusts are treated as owned by the investors under the grantor trust rules of subpart E, part I, subchapter J, chapter 1 of the Code.

The proposed regulations add investment trusts classified as trusts under §301.7701–4(c)(1) to the categories of trusts that may use the special control test rule, provided the investment trusts meet the conditions described in §301.7701–7(d)(1)(iv)(I). These trusts are subject to reporting requirements as domestic grantor trusts, and each investor must report the items of income, deduction, and credit that are attributable to the investor's portion of the trust. The conditions set forth in the proposed regulations are intended to ensure that all trustees are United States persons including at least one institutional United States trustee, the sponsors (persons who exchange investment assets for beneficial interests with a view to selling the beneficial interests) are United States persons, and the beneficial interests are widely offered for sale primarily in the United States to United States persons. An investment trust that satisfies these conditions is deemed to satisfy the control test even though one or more investors may be foreign persons with the power to make a substantial decision of the trust.

In addition, the IRS and the Treasury Department have become aware of concerns expressed by taxpayers in applying the special rule of §301.7701–7(d)(1)(iv) with respect to determining whether a person is or is not a fiduciary for purposes of the control test. For example, under section 3(14)(A) of the Employee Retirement Income Security Act of 1974 (ERISA), Public Law 93–406 (88 Stat. 829) (September 2, 1974), a variety of persons in addition to the trustee(s) is considered fiduciaries with respect to an employee benefit trust. In contrast, under ordinary trust principles the fiduciary of a trust is generally considered to be the trustee holding legal title to the trust assets on behalf of those having a beneficial interest therein. Section 301.7701–6(b). Therefore, these regulations propose to amend §301.7701–7(d)(1)(iv) relating to the application of the control test of section 7701(a)(30)(E) to clarify that employee benefit trusts and certain investment trusts identified in the regulations are deemed to satisfy the control test if United States trustees control all of the substantial decisions of the trust made by the trustees of the trust.

Taxpayers concerned with maintaining domestic trust status should also note that, in appropriate cases, it may still be possible to elect pursuant to §301.7701–7(f) to treat a trust existing on August 19, 1996, as a United States person.

Application to Certain Pension Trusts Created or Organized in Puerto Rico

Section 1022(i)(1) of ERISA provides for tax exemption for certain trusts created or organized in Puerto Rico that form part of a pension, profit-sharing, or stock bonus plan. Section 1022(i)(2) and §1.401(a)–50 generally provide that the administrator of such a trust may elect to have the trust treated as a trust created or organized in the United States for purposes of section 401(a). In light of the changes made to section 7701(a)(30) in the SBJPA and the TRA 97, and the ensuing regulations, some taxpayers have expressed concerns regarding the continuing application of sections 1022(i)(1) and (2) and §1.401–50 to a pension trust created or organized in Puerto Rico that is not a domestic trust within the meaning of section 7701(a)(30). Because the application of these provisions is not restricted to trusts that are domestic trusts within the meaning of section 7701(a)(30), the 1996 and 1997 amendments to section 7701(a)(30) and the ensuing regulations do not affect the application of these provisions.

Proposed Effective Date

The amendments to the regulations are proposed to be applicable to trusts for taxable years ending on or after the date on which these regulations are published as final regulations in the **Federal Register**. It is anticipated that the final regulations will provide that trusts will be able to rely on the final regulations for taxable years beginning after December 31, 1996, and for electing trusts under section 1907(a)(3)(B) of the SBJPA for taxable years ending after August 20, 1996. In addition, for taxable years beginning after December 31, 1996, and taxable years ending before these regulations are finalized, or for electing trusts under section 1907(a)(3)(B) of the SBJPA for taxable years ending after August 20, 1996, and before these regulations are finalized, the status of a trust as a qualified plan trust under section 401(a), an IRA trust under section 408(a), or any other employee benefit trust described in §301.7701–7(d)(1)(iv) of these proposed regulations will not be challenged by the IRS based on a failure of the trust to satisfy the control test of section 7701(a)(30)(E)(ii) and, therefore, a failure to be maintained at all times as a domestic trust in the United States, if the trust satisfies the control test safe harbor set forth in §301.7701–7(d)(1)(iv) of these proposed regulations or §301.7701–7(d)(1)(iv) of the final regulations published in the **Federal Register** on February 2, 1999.

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 the 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 January 31, 2001, at 10 a.m. in the Internal Revenue Service Auditorium, 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 January 10, 2001, 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 January 10, 2001.

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 Associate 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 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 * * *

Par. 2. Section 301.7701–7 is amended as follows:

1. Paragraph (d)(1)(iv) introductory text is revised.

2. Paragraph (d)(1)(iv)(H) is redesignated as paragraph (d)(1)(iv)(J).

3. New paragraphs (d)(1)(iv)(H) and (I) are added.

4. Paragraph (d)(1)(v) *Example 1* is revised and *Example 5* is added.

5. The first sentence of paragraph (e)(1) is revised.

6. Paragraph (e)(3) is added.

The revisions and additions read as follows:

§301.7701–7 Trusts—domestic and foreign.

* * * * *

(d) * * * (1) * * *

(iv) *Safe harbor for certain employee benefit trusts and investment trusts.* Notwithstanding the provisions of this paragraph (d), the trusts listed in this paragraph (d)(1)(iv) are deemed to satisfy the control test set forth in paragraph (a)(1)(ii) of this section, provided that United States trustees control all of the substantial decisions made by the trustees of the trust—

* * * * *

(H) A group trust described in Rev. Rul. 81–100 (1981–1 C.B. 326) (See §601.601(d)(2) of this chapter);

(I) An investment trust classified as a trust under §301.7701–4(c), provided that the following conditions are satisfied—

(*1*) All trustees are United States persons and at least one of the trustees is a bank, as defined in section 581, or a United States Government-owned agency or United States Government-sponsored enterprise;

(*2*) All sponsors (persons who exchange investment assets for beneficial interests with a view to selling the beneficial interests) are United States persons; and

(*3*) The beneficial interests are widely offered for sale primarily in the United States to United States persons;

* * * * *

(v) * * *

Example 1. Trust is a testamentary trust with three fiduciaries, *A*, *B*, and *C*. *A* and *B* are United States citizens and *C* is a nonresident alien. No persons except the fiduciaries have authority to make any decisions of the trust. The trust instrument provides that no substantial decisions of the trust can be made unless there is unanimity among the fiduciaries. The control test is not satisfied because United States persons do not control all the substantial decisions of the trust. No substantial decisions can be made without *C*'s agreement.

* * * * *

Example 5. *X*, a foreign corporation, conducts business in the United States through various branch operations. *X* has United States employees and has established a trust as part of a qualified employee benefit plan under section 401(a) for these employees. The trust is established under the laws of State *A*, and the trustee of the trust is *B*, a United States bank governed by the laws of State *A*. *B* holds legal title to the trust assets for the benefit of the trust beneficiaries. A plan committee makes decisions with respect to the plan and the trust. The plan committee can direct *B*'s actions with regard to those decisions and under the governing documents *B* is not liable for those decisions. Members of the plan committee consist of United States persons and nonresident aliens, but nonresident aliens make up a majority of the plan committee. Decisions of the plan committee are made by majority vote. In addition, *X* retains the power to terminate the trust and to replace the United States trustee or to appoint additional trustees. This trust is deemed to satisfy the control test under paragraph (d)(1)(iv) of this section because *B*, a United States person, is the trust's only trustee. Any powers held by the plan committee or *X* are not considered under the safe harbor of paragraph (d)(1)(iv) of this section. In the event that *X* appoints additional trustees including foreign trustees, any powers held by such trustees must be considered in determining whether United States trustees control all substantial decisions made by the trustees of the trust.

* * * * *

(e) *Effective date*—(1) *General rule.* Except for the election to remain a domestic trust provided in paragraph (f) of this section and except as provided in paragraph (e)(3) of this section, this section is applicable to taxable years ending after February 2, 1999.

* * * * *

(3) *Effective date of safe harbor for certain employee benefit trusts and investment trusts.* Paragraphs (d)(1)(iv) and (v) *Examples 1* and *5* of this section apply to trusts for taxable years ending on or after the date of publication of final regulations in the **Federal Register**. Paragraphs (d)(1)(iv) and (v) *Examples 1* and *5* of this section may be relied on by trusts for taxable years beginning after December 31, 1996, and also may be relied on by

trusts whose trustees have elected to apply sections 7701(a)(30) and (31) to the trusts for taxable years ending after August 20, 1996, under section 1907(a)(3)(B) of the SBJP Act.

* * * * *

David A. Mader,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 10, 2000, 3:31 p.m., and published in the issue of the Federal Register for October 12, 2000, 65 F.R. 60821)

Amendment of Qualified Plans for Final Regulations Under § 411(d)(6)

Announcement 2000–71

Final regulations under § 411(d)(6) of the Code were published in the Federal Register on September 6, 2000. The regulations grant relief under § 411(d)(6) by permitting qualified defined contribution plans to be amended, under certain conditions, to eliminate some alternative forms of payment and to eliminate or limit the right to receive certain in-kind distributions. The final regulations also permit certain transfers between plans that were not previously permitted. The regulations generally apply to amendments adopted, and transfers made, on or after September 6, 2000.

Effective September 6, 2000, plan sponsors may adopt plan amendments that are permitted under the final regulations under § 411(d)(6). Determination letters that are issued with respect to plans for which an application is filed with the Service on or after September 6, 2000, may be relied upon with respect to whether a plan satisfies the requirements of the final regulations.

Some plans might contain language that would necessitate a change to conform to the final regulations (as described below). Such a plan must be amended, in connection with its application for a determination letter, to satisfy the final regulations. See below regarding the effective date of the amendment.

Plan sponsors that have determination letter applications on file with the Service which were submitted before September 6, 2000, should contact the Service if they wish to amend their plans and have the provisions of the final regulations taken into account in their determination letters. Plan sponsors should contact the EP specialist who has been assigned to review their application, if possible. Otherwise, they should contact Customer Service at 1-877-829-5500. In these cases, the Service will try to accommodate the plan sponsor's request to have the provisions of the final regulations taken into account in the determination letter. However, if the EP specialist assigned to review the application has already completed that review, the Service will not be able to accommodate the plan sponsor's request and a new application and user fee will be required.

In general, the final regulations expand the permitted changes that may be made to alternative forms of payment and in-kind distributions under a defined contribution plan and, in the case of voluntary direct transfers between plans, the circumstances under which elimination of optional forms of benefit is permitted. Generally, therefore, plan sponsors may choose to amend their plans as a result of these changes, but are not required to do so, except as provided below.

The regulations under § 411(d)(6), as in effect prior to September 6, 2000, ("the 1988 regulations") permitted elimination of optional forms of benefit in connection with voluntary direct transfers between plans, provided certain requirements were satisfied. Section 401(a)(31), which was added after the 1988 regulations, requires that participants be able to elect a direct rollover to an IRA or other eligible retirement plan of any eligible rollover distribution. Because the requirements of § 411(d)(6) do not apply to amounts distributed, including those amounts directly rolled over under § 401(a)(31), the voluntary direct transfer rules in the 1988 regulations produce the same § 411(d)(6) result with respect to an eligible rollover distribution as a direct rollover under § 401(a)(31).

The final regulations under § 411(d)(6) generally eliminate this duplication. The final regulations provide, in part, that relief from the requirements of § 411(d)(6) is not available under the voluntary transfer rules where the participant is entitled to elect a § 401(a)(31) direct rollover because the participant is eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of § 401(a)(31)(C). This provision of the final regulations is effective for transfers occurring on or after January 1, 2002.

Some plans might contain pre-existing provisions that permit elimination of optional forms of benefit pursuant to the voluntary direct transfer rules as in effect under the 1988 regulations. To the extent that these plan provisions are inconsistent with the final regulations under § 411(d)(6), as described in the preceding paragraph, the plan must be amended. The amended plan must provide that the benefit of a participant described in the preceding paragraph may be voluntarily transferred only through a § 401(a)(31) direct rollover.

Any plan amendment required to conform the plan terms to the final § 411(d)(6) regulations does not have to be adopted prior to the end of the plan's GUST remedial amendment period, as described in Rev. Proc. 2000–27, 2000–26 I.R.B. 1272, and Rev. Proc. 2000–20, 2000–6 I.R.B. 553. However, as provided above, if a determination letter application for the plan is filed on or after September 6, 2000, the required plan amendment must be adopted in connection with the application. In any case, the plan amendment must be effective no later than January 1, 2002.

Changes to Codes for IRAs on the 2001 Form 1099–R

Announcement 2000–86

Purpose: The purpose of this announcement is to advise payers making distributions from IRAs of changes to the distribution codes entered in box 7 on the 2001 Form 1099–R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

Changes to Distribution Codes

1. Notice 2000–30, 2000–25 I.R.B. 1266, specifies a new method for reporting recharacterizations and reconversions occurring after 2000.

Result. Because of Notice 2000–30, the following changes are being made to the distribution codes:

- **Code N** is added for reporting a "Recharacterized IRA contribution made for 2001."
- **Code R** is changed to report a "Recharacterized IRA contribution made for 2000."

2. Only two distribution codes can be entered in box 7 on Form 1099-R. Therefore, payers were only able to report a distribution as the result of an excess contribution to a Roth IRA by using Code J with Code 8 or P. Payers could not use Code 1, 2, 3, or 4 if Codes J and 8 or P applied.

Result. To alleviate this reporting problem, the following changes are being made to the distribution codes:

- **Code J** is changed to report an "Early distribution from a Roth IRA, no known exception."
- **Code T** is added to report a "Roth IRA distribution, exception applies."

Therefore, payers can only use the following codes for a Roth IRA distribution:

- Code J for an early distribution from a Roth IRA, no known exception. (Do not use Code 1 with Code J. However, you must use Code 5, 8, or P, if applicable.)
- Code T for a distribution from a Roth IRA, exception applies. (Do not use Code 2, 3, 4, or 7 with Code T. However, you must use Code 5, 8, or P, if applicable.)

Foundations Status of Certain Organizations

Announcement 2000–87

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:

Acorn International, Inc., Waterbury, VT
Actex Foundation, Inc., Winsted, CT
Adventure Education of Vermont, Burlington, VT
Ahepa 250-III, Inc., Groton, CT
Alliance for the Commonwealth, Inc., Boston, MA
American Bilingual Community Association, Inc., Richmond Hill, NY
American Dream Houses Association, Inc., Baltimore, MD
American Safe Boating Foundation, Inc., Mentor, OH
Apollonian Society, Chicago, IL
Arts in Motion, Conway, NH
Artspans, Dunbarton, NH
Association for the Advancement of Psychosynthesis, St. Louis, MO
Attleboro Friends of Cats, Inc., Attleboro, MA
Balamand Educational Foundation, Inc., Winchester, MA
Balkan Studies Institute, Inc., Newton, MA
Baystate Affordable Housing Agency, Inc., Somerville, MA
Bennington Foster Parent Association, Bennington, VT
Berkley Athletic Association, Inc., Berkley, MA
Biblical Counseling Center, Farmington, NM
100 Black Men of Bridgeport, Inc., Bridgeport, CT
Blackfriars School of Fence, Inc., Paso Robles, CA
Boston Public Sailing, Inc., Winthrop, MA
Boston Urological Society, Inc., Boston, MA
Brattleboro Area Affordable Housing Corporation, Brattleboro, VT
Briar Crest I Affordable Housing Corp., St. Joseph, MI
Brockton Hispanic Community Center, Brockton, MA
Brownsville Housing Opportunity Corporation, Brownsville, TX
Brunswick Bambino Baseball League, Brunswick, ME
Bryan Elementary PTO, Bryan, OH
Bucket Full of Friends, Inc., Clinton, CT
Build the Monument Foundation, Inc., Bedford, NH
Camping and City Children, Inc., Lynn, MA
Care Works, Inc., Medford, MA
Caroline County Community Action Agency, Inc., Bowling Green, VA

Carosello Musicale Italiano, Inc., Hartford, CT
Center for Security and Social Progress, Inc., Waban, MA
Central City Economic Development Corporation, Inc., Los Angeles, CA
Central Vermont Memorial Civic Center, Inc., Montpelier, VT
Central Vermont Supervised Visitation Center, Montpelier, VT
Centre for Successful Aging Foundation, Inc., Stamford, CT
Chamblee Foundation, Ltd., Glendale, CA
Charis Institute, Inc., Danvers, MA
Charity Foundation, Inc., Boston, MA
Charlotte Land Trust, Inc., Charlotte, VT
Child Charitable Development Association, New Canaan, CT
Children of the Middle Passage, Inc., New York, NY
Children of Today International Youth Center, Detroit, MI
Childrens Annex Ellenville Child Care Center, Inc., Ellenville, NY
Childrens Lighthouse, Inc., Charlestown, MA
Childrens Television Consortium, Inc., Hyannis, MA
Chinese Culture Development and Promotion Council, Inc., Quincy, MA
Christian Stewardship Fund, Inc., Boston, MA
Christians Building Urban Communities, Inc., Chicago, IL
Cindi Foundation, Coventry, RI
Civil War Roundtable of the Merrimack, Inc., Newburyport, MA
Coachella Valley Society for the Prevention of Cruelty to Animals, Palm Desert, CA
Columbus County Dream Cntr., Inc., Whiteville, NC
Comite Pro Festival Latino-Americano De Queens, Jackson Heights, NY
Community Collaborative of Bridgeport, Inc., Bridgeport, CT
Community Eyecare Services, Ltd., Charlottesville, VA
Community Improvement Program, Inc., Roxbury, MA
Community Mobilization Team, Inc., Portland, ME
Community Organized Prevention Effort (COPE), Deerfield, NH
Companion Resource Corp., Buffalo, NY
Compost Charitable Corporation, Jamaica Plain, MA
Concerned Child Care Providers, New Bedford, MA
Concerned Maine Families Foundation, Portland, ME
Creative Gifts, Inc., Hartford, CT
Cultural Resources, Inc., Blue Hill, ME
Dare to Dream Educational Farm Program, Inc., Orange, MA
Desfile Puertorriqueno, Trenton, NJ
Disabled Individuals for Recreational Activities (DIRA), S. Dartmouth, MA
Dive 4 Life, Inc., Chicago, IL
Elm Terrace Development Corporation, New Haven, CT
Emanuel Baptist Church Jamaica Square Alliance, Elmont, NY
Environmental Council of Alabama, Inc., Highland Home, AL
Faces Foundation for World Peace, Inc., Ridgefield, CT
Families and Friends of People with Special Needs, Inc., Bronx, NY
Family Day Care Association of Suffolk County, Inc., W. Babylon, NY
Fathers of Imani, Inc., Milwaukee, WI
Festival Italiano, Inc., New London, CT
Florida Stars for Children, Inc., St. Petersburg, FL
Fontana Academy of Martial Arts, Fontana, CA
Foundation for the Seventh Fire, Groton, MA
Foundation of Youth, Luray, VA
Francophone Broadcasting Corporation, Woburn, MA
Friends of Atlantic Theatre Festival Society, Ltd., Cohasset, MA
Friends of BHS Girls Ice Hockey, Inc., Boston, MA
Friends of CAP, Cranston, RI
Friends of North Star Academy Charter School, Inc., Springfield, MA
Friends of the Capen-Reynolds Farm, Inc., Stoughton, MA
Friends of the Holmes School Mural, Inc., Westport, CT
Friends of the Mashpee National Wildlife Refuge, Inc., Mashpee, MA
Friends of the Union for Infants Protection in Lebanon, Rego Park, NY
Friends of the West River Trail, Jamaica, VT
Friends of the Wolfeboro Community Bandstand, Inc., Wolfeboro, NH
Friends of the Yankee Brass, Inc., White River Jct, VT
Gamma ETA Educational Foundation, Inc., Tallahasee, FL
Gateway Babe Ruth League, Inc., Wareham, MA
Geauga County Mounted Unit, Inc., Novelty, OH
GLO of Hartford, Inc., Hartford, CT
Global Commission to Fund the United Nations, St. Augustine, FL
Gloucester Fishermans Wives Development Programs, Inc., Gloucester, MA
Goshen Soccer Club, Inc., Torrington, CT
Greater New York Association of Holocoust, Woodsburgh, NY
Green Olive Tree, Inc., Crozet, VA
Greenforest Community Development, Incorporated, Decatur, GA
Dr. Grover C. Hunter University of North Carolina Dental Trust Fund, Atlanta, GA
H3, Inc., Cambridge, MA
Happy Prayer House, Tehachapi, CA
Harrington School Foundation, American Fork, UT
Haven, Inc., Braintree, MA
He is the Bright and Morning Star Ministries, Milwaukee, WI
Heartstone Alzheimers Foundation, Inc., Wellesley, MA
Henry & Yorelis Alvarez Ministries, Inc., Weslaco, TX
Heritage Preservation Committee of Monroe, Inc., Monroe, NY
Hispanic Association for Bilingual Literacy and Education of Conn., Inc., Southington, CT
Hockey for Caribou, Caribou, ME
Hodges Village Environmental Education Association, Oxford, MA
Holyoke Power, Inc., Holyoke, MA
Hope Ministries, Inc., Medford, MA
Houses to Homes, Inc., Somerville, MA
Hudson Highlands Music Festival, Inc., Garrison, NY
Institute for Fundamental Sciences, Irvine, CA
Interfaith Council for Elders, Inc., Needham, MA
Interfaith Volunteer Caregivers of Greater Bridgeport, Inc., Bridgeport, CT
Israel Center for International Environmental Studies-US, Inc., Needham, MA
Itasca Rotary Student Partnership, Grand Rapids, MN
Jamaica Plain Youth Soccer, Inc., Jamaica Plain, MA

Jeffrey P. Nelen Memorial Golf Tournament, Inc., Springfield, MA
Jessi's Gift, Biddeford, ME
Just Do It Youth Services, Oakland, CA
Karnei Shomrom Foundation, Inc., New York, NY
Knox Booster Club, Knox, ME
Laborers in the Harvest, Inc., Magnolia, AR
Las Manos Foundation, Healdsburg, CA
Ledyard Girls Softball League, Ledyard, CT
Life Enhancement Seminars, Inc., Wynnwood, PA
Lincoln Little League, Inc., Lincoln, RI
Linda McDonald Ministries, Castle Rock, CO
Lords Manna, Los Angeles, CA
Loring Memorial Park Development Association, Inc., Portland, ME
Lubbock Therapeutic Center, Inc., Lubbock, TX
Lunenburg Hockey Association, Lunenburg, MA
Lyceum Educational Corporation, Milford, CT
Manderlee Productions, Inc., Rocky Hill, CT
Mariana Braceti and Rincon De Gautier Institute, Inc., Springfield, MA
Marion Road Athletic Association, Macon, GA
Matthew Twenty-Five Foundation, Inc., Arlington, TX
Melrose East New Directions, Inc., Baton Rouge, LA
Meriden Arts Council, Inc., Meriden, CT
Metro IAF, Inc., Rego Park, NY
Micah Foundation, Highland Park, IL
Middlesex Law Libraries Foundation, Inc., Cambridge, MA
Milford Pop Warner Association, Inc., Milford, MA
Minority Business Association, Inc., Burlington, VT
Mission Impossible, Spanaway, WA
Missisquoi Health Center, Swanton, VT
Montesano Football Parents Club, Montesano, WA
Move Over Broadway Productions, Inc., Canfield, OH
National Affordable Housing Foundation Charlotte II, Inc., Boston, MA
National Housing & Development Non-Profit Corporation, Hartford, CT
NCOBPS, Inc., North Oaks, MN
New England Corporate Aids Consortium, Inc., Lexington, MA
New Hampshire Harm Reduction Alliance, Manchester, NH
New Traveller Fund, Santa Monica, CA
New York Presbytery of the Korean Presbyterian Church in America, Staten Island, NY
North Andover 350th Anniversary, North Andover, MA
North Coast Express Academy of Basketball, Alameda, CA
North Country Thresholds & Decisions NCTD, Enfield, NH
North Suffolk Foundation, Inc., Smithtown, NY
Northern New England Transplant Alliance, Portland, ME
Norwich Communications and Technology Learning Center, Inc., Norwich, CT
Optimist International Chester South Chester Pennsylvania Club, Chester, PA
Orange County Pro Bono Legal Services, Inc. Goshen, NY
Orford Village Housing Development Corporation, Manchester, CT
Organization for the Poor People in Haiti, Inc., S. Ozone Pk, NY
Otter Creek Research Corporation, Springport, MI
Otter Valley Football Club, Ltd., Brandon, VT
Owen L. Wells Foundation, Inc., Boston, MA
Ozark Harvest, Inc., Gravette, AR
Mike Pagliarulo Foundation, Inc., Winchester, MA
Pentucket Regional School District Parent Alliance, Inc., W. Newbury, MA
People Helping People, Inc., Newport, VT
People Promoting Progress, Inc., Los Angeles, CA
Phase I Recovery House, Inc., Brattleboro, VT
Philadelphia Center for Organizational Dynamics, Melrose Park, PA
Photography Preservation Society, St. Louis, MO
Pinardville Booster Club, Goffstown, NH
PLAY, Inc., Lincoln, RI
Pomfret Emergency Services Corporation, N. Pomfret, VT
Pregnancy Help Center of Wayne County, Goldsboro, NC
Prison Families of New York, Inc., Albany, NY
Project Play, Inc., North Haven, CT
Provincetown Repertory Theatre, Inc., Provincetown, MA
Public Utility Policy Institute, Concord, NH
Quincy Transportation, Inc., Quincy, MA
Raylynmor Opera, Peterborough, NH
Red Ribbon Foundation, Inc., Greenwich, CT
Revived Theatre Inc., Those People Who Put on Plays, Seekonk, MA
Rhode Island Committee for Non-Violence Initiatives, Inc., Providence, RI
Rhode Island Council of Family Mediators, Warwick, RI
Rising Stars Therapeutic Riding, Inc., W. Hartford, CT
Riverside Academy, Ltd., Lowell, MA
Rosh Hodesh Exchange, Somerville, MA
Roundtable Center, Portland, ME
Roxbury South End Tenants Association, Inc., Boston, MA
Rural Opportunity Fund, Poteau, OK
Rural School and Community Trust, Washington, DC
Sabor Foundation, San Antonio, TX
Sabrinnas Angels, Carmel, NY
Scandanavian Collectors Club, Rockville, MD
Schoolworks Foundation, Inc., Westport, CT
Seeds of Change Education Fund, Inc., Somerville, MA
Sellecca-Tesh Foundation for the Forgotten Generation, Los Angeles, CA
SHA Development Corp, Seymour, CT
Shiloh Manor, Inc., Middletown, CT
Shots Across Texas Coalition, Austin, TX
Siloam Mission Worldwide, Los Angeles, CA
Society Affects Students, Incorportated, Middletown, RI
Southeastern Area Lacrosse, Inc., Mystic, CT
Spirit of Truth Foundation, Washington, DC
Springfied Armory National Park, Tr, Southport, CT
Staff, Inc., North Haven, CT
Stand By Me, Inc., Waterbury, CT
Steven B. Fox Foundation, Inc., Brattleboro, VT
Stinesville Renaissance Group, Stinesville, IN
Stop the Violence, Olympia, WA
Strong-Cuevas Foundation, Inc., New York, NY

Stylettes Drill Team and Drum Corp, West Haven, CT
Suffolk County Society for the Prevention of Cruelty to Animals, Huntington, NY
Team Connecticut, New Haven, CT
Technology for Learning, Inc., Providence, RI
Tender Loving Care Mercy Ministries, Detroit, MI
Theatre for Dramatic Development, New York, NY
Thoughtform Research Institute, Bountiful, UT
Transcription Technologies, Inc., Vernon, CT
Tri County Partnership, Inc., Spencer, WV
Tripod Foundation, Williamstown, MA
U.S. Peace 2000, Nashville, TN
Vera Arterburn Memorial Scholarship Fund, Inc., Glastonbury, CT
31 Verdun St., Inc., Dorchester, MA
Vermont Center Economic Environmental & Social Justice, Inc., Burlington, VT
Vermont Financial Research Institute, Burlington, VT
Vetiver Network, Bellingham, WA
Vineyard Initiative for Teaching & Alternative Education, Inc., Oak Bluffs, MA
Virtual Reality Foundation, Inc., Cambridge, MA
Virtually Wired Educational Foundation, Boston, MA
Vital Live Center for Adolescence, Lake Forest, CA
Vitas Gerulaitis Youth Foundation, New York, NY
Walk the Walk Trust, Bayside, NY
Walnut Square Tower Clock Foundation, Inc., Haverhill, MA
Wareham Babe Ruth League, Inc., Wareham, MA
Warmline of Northeastern Connecticut, Inc., Willimantic, CT
Watson Park Playground Project, Inc., E. Braintree, MA
Wedum-Presbyterian Homes Affordable Housing, Inc., Arden Hills, MN
West Point Park and Recreation Association, West Point, CA
Westside Girls Softball, Pueblo, CO
What Would Jesus Do, Inc., Citrus Heights, CA
Wheel-eez, Inc., Feeding Hills, MA
Widowed Persons Service of Greater Bridgeport, Inc., Fairfield, CT
Widowed Persons Service of Marion County, Inc., Silver Springs, FL
Willing to Help, Chicago, IL
Windhorse Publications USA, Missoula, MT
Winter Park Christian School, Inc., Fraser, CO
WIT Productions, Inc., Boston, MA
Women and Children First, Inc., Wallingford, CT
Worchester Institute of Contemporary Issues & Affairs, Inc., Worchester, MA
Word Ambassadors, Fort Worth, TX
WSC Community Development Corp., Philadelphia, PA
Yella Gal Productions, Huntsville, AL
Zion Community Empowerment Center, College Park, GA

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.

Rules for Property Produced in a Farming Business; Correction

Announcement 2000-88

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to removal of final regulations.

SUMMARY: This document contains corrections to a removal of final regulations relating to the application of section 263A of the Internal Revenue Code to property production in the trade or business of farming. This document was published in the **Federal Register** on August 21, 2000 (65 F.R. 50638).

EFFECTIVE DATE: August 21, 2000

FOR FURTHER INFORMATION CONTACT: Grant D. Anderson (202) 622-4970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Need for Correction

As published, the final regulations (TD 8897, 2000–36 I.R.B. 234) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (TD 8897), which were the subject of FR Doc. 00-21103, is corrected as follows:

1. On page 50638, column 3, in the preamble under the paragraph heading, "Background", line 3, the language proposed rulemaking (REG-208151-91) is corrected to read "proposed rulemaking (REG-209316-86)".

2. On page 50640, column 3, paragraph 1, line 14, the language "I.R.B. (Sept. 5, 2000)) issued" is corrected to read "I.R.B. 256 (Sept. 5, 2000)) issued".

Part 1–[CORRECTED]

§1.263A–1 [CORRECTED]

3. On page 50644, column 2, in amendatory instruction Par. 5., remove item designations for items "1." and "2." and correctly designate the items "2." and "3.", respectively.

Add new item "1." to read as follows:

1. The last sentence of paragraph (a)(3)(v) is revised.

4. On page 50644, column 2, §1.263A-1, remove the five asterisks following the section heading and add the following language for the last sentence of paragraph (a)(3)(v) to read as follows:

§1.263A-1 Uniform capitalization of costs.

(a) * * *
(3) * * *
(v) * * * See sections 263A(d) and 263A(e) and §1.263A-4 for rules relating to taxpayers engaged in a farming business.

* * * * *

§1.263A–4 [CORRECTED]

5. On page 50644, column 3, §1.263A-4, paragraph (a)(2)(i)(B), line 3, the language "disbursements method under section" is corrected to read "disbursements method of accounting (cash method) under section".

6. On page 50648, column 3, § 1.263A-4, paragraph (d)(2), line 5 from the top of the column, the language "required to use the accrual method" is corrected to read "required to use an accrual method".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel (Modernization & Strategic Planning).

(Filed by the Office of the Federal Register on October 13, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 16, 2000, 65 F.R. 61091)

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 2000. See Rev. Rul. 2000–50, on this page .

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2000. See Rev. Rul. 2000–50, 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 November 2000. See Rev. Rul. 2000–50, 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 November 2000. See Rev. Rul. 2000–50, 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 November 2000. See Rev. Rul. 2000–50, 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 November 2000. See Rev. Rul. 2000–50, 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 November 2000. See Rev. Rul. 2000–50, 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 2000. See Rev. Rul. 2000–50, 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 2000. See Rev. Rul. 2000–50, 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 2000. See Rev. Rul. 2000–50, 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 2000. See Rev. Rul. 2000–50, on this page.

Section 1274.—Determiation 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 November 2000.

Rev. Rul. 2000–50

This revenue ruling provides various prescribed rates for federal income tax purposes for November 2000 (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. 2000–50 TABLE 1

Applicable Federal Rates (AFR) for November 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	6.15%	6.06%	6.01%	5.98%
110% AFR	6.78%	6.67%	6.62%	6.58%
120% AFR	7.40%	7.27%	7.21%	7.16%
130% AFR	8.04%	7.88%	7.80%	7.75%
Mid-Term				
AFR	6.01%	5.92%	5.88%	5.85%
110% AFR	6.62%	6.51%	6.46%	6.42%
120% AFR	7.23%	7.10%	7.04%	7.00%
130% AFR	7.85%	7.70%	7.63%	7.58%
150% AFR	9.08%	8.88%	8.78%	8.72%
175% AFR	10.63%	10.36%	10.23%	10.14%
Long-Term				
AFR	6.09%	6.00%	5.96%	5.93%
110% AFR	6.71%	6.60%	6.55%	6.51%
120% AFR	7.33%	7.20%	7.14%	7.09%
130% AFR	7.95%	7.80%	7.73%	7.68%

REV. RUL. 2000–50 TABLE 2

Adjusted AFR for November 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.39%	4.34%	4.32%	4.30%
Mid-term adjusted AFR	4.63%	4.58%	4.55%	4.54%
Long-term adjusted AFR	5.39%	5.32%	5.29%	5.26%

REV. RUL. 2000–50 TABLE 3

Rates Under Section 382 for November 2000

Adjusted federal long-term rate for the current month	5.39%
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.)	5.41%

REV. RUL. 2000–50 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for November 2000

Appropriate percentage for the 70% present value low-income housing credit	8.42%
Appropriate percentage for the 30% present value low-income housing credit	3.61%

REV. RUL. 2000–50 TABLE 5

Rate Under Section 7520 for November 2000

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 Discounts on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2000. See Rev. Rul. 2000–50, page 462.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2000. See Rev. Rul. 2000–50, page 462.

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 2000. See Rev. Rul. 2000–50, page 462.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Estate Tax Return; Form 706, Extension To File

REG–106511–00

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 filing of an application for an automatic 6-month extension of time to file an estate tax return (Form 706). The proposed regulations provide guidance to executors of decedents' estates on how to properly file the application for the automatic extension. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by January 19, 2001. Outlines of topics to be discussed at the public hearing scheduled for January 24, 2001, at 10 a.m., must be received by January 3, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–106511–00), 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:M&SP:RU (REG–106511–00), 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 4716, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Mary A. Berman, (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) 622-7180 (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, W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collection of information should be received by December 19, 2000. Comments are specifically requested concerning:

Whether the proposed 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 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 service to provide information.

The collection of information in this proposed regulation is in §20.6081–1(b). To receive an extension of time to file an estate tax return, the executor of a decedent's estate must file Form 4768, "Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes." This information is required to obtain a benefit (an automatic 6-month extension of time to file an estate tax return). The collection of information is mandatory if the extension is requested. The likely respondents are executors of decedents' estates.

The reporting burden contained in §20.6081–1(b) is reflected in the burden of Form 4768, "Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes."

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 information are confidential, as required by 26 U.S.C. 6103.

Background

In 1970, Congress amended section 6075(a) to provide that the Federal estate tax return is to be filed within 9 months after the date of the decedent's death. Section 6081(a) provides that the Secretary may grant a reasonable extension of time for filing any return; however, except in the case of taxpayers who are abroad, no such extension may be for more than 6 months.

Under the current regulations, the district director or the service center has the discretion to grant an extension of time to file an estate tax return upon a showing of "good and sufficient cause." Except in the case of executors who are abroad, the extension may not be granted for more than 6 months. Requests for an extension of time to file are made by completing Form 4768, "Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes." Upon receipt of a Form 4768, the IRS reviews the application, makes a determination, and notifies the applicant as to whether an extension is approved and, if so, the length of the extension.

In 1998, 110,100 estate tax returns were filed. In a significant number of these cases, the executors requested an extension of time to file. A majority of the applications requested and received the maximum 6-month extension allowed by the statute and the regulations. The IRS and the Treasury Department believe that executors of decedents' estates would benefit from the certainty created by an automatic 6-month extension of time to file Form 706 and that it is appropriate to provide for the extension.

Explanation of Provisions

Under the proposed regulations the executor of a decedent's estate will be allowed an automatic 6-month extension of time to file Form 706, "United States Estate (and Generation-Skipping Transfer) Tax Return," beyond the 9 months provided for by section 6075(a). The application for the automatic extension must be submitted on Form 4768 (or in any other manner as may be prescribed by the Commissioner). The application must be filed with the IRS on or before the date prescribed by section 6075(a) for filing the Form 706 and it must include an estimate of the full amount of tax due. The automatic extension of time does not apply to filers of Forms 706-A, 706-D or 706-NA who will continue to use Form 4768 to request extensions of time to file and pay estate taxes. The automatic extension of time also does not apply to filers of Form 706-QDT who will continue to request any extension of time as provided in the instructions for Form 706-QDT. The proposed regulations continue to permit executors who are abroad to request extensions beyond the automatic 6-month period.

A return as complete as possible must be filed before the expiration of the automatic 6-month extension period. The return as filed will be the return required by section 6018(a)(1). An extension of time for filing the return does not operate to extend the time for payment of the tax.

The proposed regulations also revise §20.6075–1 to conform to the changes proposed in §20.6081–1.

Special Analysis

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 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 January 24, 2001, at 10 a.m. in Room 4716, 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 January 3, 2001, 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 January 3, 2001. 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 Mary A. Berman, Office of the Associate 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 20 is proposed to be amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. 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 20.6081–1 also issued under 26 U.S.C. 6081(a). * * *

Par. 2. Section 20.6075–1 is revised to read as follows:

§20.6075–1 Returns; time for filing estate tax return.

The estate tax return required by section 6018 must be filed on or before the due date. The due date is the date on or before which the return is required to be filed in accordance with the provisions of section 6075(a) or the last day of the period covered by an extension of time as provided in §20.6081–1. The due date, for a decedent dying after December 31, 1970, is, unless an extension of time for filing has been obtained, the day of the ninth calendar month after the decedent's death numerically corresponding to the day of the calendar month on which death occurred, except that, if there is no numerically corresponding day in such ninth month, the last day of the ninth month is the due date. For example, if the decedent dies on July 31, 2000, the estate tax return and tax payment must be made on or before April 30, 2001. When the due date falls on Saturday, Sunday, or a legal holi-

day, the due date for filing the return is the next succeeding day that is not Saturday, Sunday, or a legal holiday. For the definition of a legal holiday, see section 7503 and §301.7503–1 of this chapter. As to additions to the tax in the case of failure to file the return or pay the tax within the prescribed time, see section 6651 and §301.6651–1 of this chapter. For rules with respect to the right to elect to have the property valued as of a date or dates subsequent to the decedent's death, see section 2032 and §20.2032–1, and section 7502 and §301.7502–1 of this chapter. This section applies to estates of decedents dying after August 16, 1954.

Par. 3. Section 20.6081–1 is revised to read as follows:

§20.6081–1 Extension of time for filing the return.

(a) *Extensions of time for good cause shown.* Where it is impossible or impracticable to file a reasonably complete return within the time prescribed by statute, the person required to file the return may request an extension of time for filing. Except as provided in paragraph (b) of this section, an extension of time for filing an estate tax return is not automatic and is within the discretion of the Internal Revenue Service. Unless the person required to file the return is abroad, an extension may not be granted for more than 6 months from the filing date prescribed by statute. Requests for an extension of time for filing are made by submitting Form 4768, "Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes." The application must contain a full recital of the causes for the delay. It should be filed with the Internal Revenue Service office designated in the application's instructions (except as provided in §301.6091–1(b) of this chapter for hand-carried documents). The application should, where possible, be filed sufficiently early to permit the Internal Revenue Service time to consider the matter and reply before what otherwise would be the due date of the return. Failure to file the application before the expiration of the time within which the return otherwise must be filed may indicate negligence and constitute sufficient cause for denial of the extension.

(b) *Automatic extension*—(1) *Application for extension.* Executors who are required to file Form 706, "United States Estate (and Generation-Skipping Transfer) Tax Return," may request an automatic 6-month extension of time beyond the date prescribed in section 6075(a) for filing the return by submitting Form 4768, "Application for Extension of Time To File a Return and/or Pay U. S. Estate (and Generation-Skipping Transfer) Taxes." An automatic extension will be allowed if—

(i) The application is filed on or before the date prescribed in section 6075(a) for filing the return;

(ii) The application is filed with the Internal Revenue Service office designated in the application's instructions (except as provided in §301.6091–1(b) of this chapter for hand-carried documents); and

(iii) The application includes an estimate of the amount of estate and generation-skipping transfer tax liability with respect to the estate.

(2) *Executors who are abroad.* If an executor who is abroad has received an automatic 6-month extension, the executor may request an additional extension of time by following the procedures in paragraph (a) of this section.

(c) *Filing the return.* A return as complete as possible must be filed before the expiration of the extension period. The return thus filed will be the return required by section 6018(a), and any tax shown on the return will be the amount determined by the executor as the tax referred to in section 6161(a)(2), or the amount shown as the tax by the taxpayer upon the taxpayer's return referred to in section 6211(a)(1)(A). The return cannot be amended after the expiration of the extension period although supplemental information may subsequently be filed that may result in a finally determined tax different from the amount shown as the tax on the return.

(d) *Payment of the tax.* An extension of time for filing a return does not operate to extend the time for payment of the tax. See §20.6151–1 for the time for payment of the tax, and §§20.6161–1 and 20.6163–1 for extensions of time for payment of the tax.

(e) *Effective date.* This section applies to estates of decedents dying after August 16, 1954, except for paragraph (b) of this section which applies to estate tax returns due after the date these regulations are published as a final regulation in the **Federal Register**.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 19, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 20, 2000, 65 F.R. 63025)

New U.S.–Ukraine Income Tax Treaty (Addition to Publications 515 and 901)

Announcement 2000–89

The United States recently exchanged instruments of ratification for a new income tax treaty with Ukraine. The provisions for taxes withheld on interest, dividends, and royalties are effective for amounts paid or credited on or after August 1, 2000. For other taxes, the provisions are effective for tax periods beginning on or after January 1, 2001.

Previously, residents of Ukraine were covered under the treaty between the United States and the former Soviet Union. A person entitled to benefits under that treaty can elect to have that treaty apply in its entirety for the first tax year for which the new treaty would otherwise apply. A person claiming benefits under Article III(1)(d) of the treaty between the United States and the former Soviet Union can elect to have the treaty apply in its entirety for the duration of the period of benefits provided by that subparagraph.

This announcement provides additions to Tables 1 and 2 in Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations (For Withholding in 2000),* and Publication 901, *U.S. Tax Treaties*, to reflect the provisions of the new treaty. The footnotes in Publication 515 that relate to the column headings in these tables generally apply to this new treaty.

Table 1. **Withholding Tax Rates on Income Other Than Personal Service Income Under Chapter 3, Internal Revenue Code, and Income Tax Treaties—For Withholding in 2000**

Income code number		1	2	3	6	7	9	10	11	12	13	14
Country of residence of payee					Dividends paid by				Copyright royalties			
Name	Code	Interest paid by U.S. obligors General	Interest on real property mortgages	Interest paid to controlling foreign corporations	U.S. Corporations General	U.S. subsidiaries to foreign parent corporations	Capital Gains	Industrial Royalties	Motion Pictures and Television	Other	Real Property Income and Natural Resources Royalties	Pensions and Annuities
Ukraine	UP	[a]0	[a,c]0	[a]0	[a,d]15	[a,d]5	[a,e]0	[a]10	[a]10	[a]10	30	[b]0

[a] Under the treaty the exemption or reduction in rate does not apply if the recipient has a permanent establishment in the United States and the property giving rise to the income is effectively connected with this permanent establishment. Exemption or reduction in rate also does not apply if the property producing the income is effectively connected with a fixed base in the United States from which the recipient performs independent personal services.

[b] Exemption does not apply to U.S. Government (federal, state, or local) pensions and annuities; a 30% rate applies to these pensions and annuities.

[c] Exemption or reduced rate does not apply to an excess inclusion for a residual interest in a real estate mortgage investment conduit (REMIC).

[d] The rate in column 6 applies to dividends paid by a regulated investment company (RIC). Dividends paid by a real estate investment trust (REIT) are subject to a 30% rate.

[e] Gain on real or personal property attributable to a permanent establishment or a fixed base is subject to U.S. tax. See Publication 515 for when withholding is required.

Table 2. **Compensation for Personal Services Performed in United States Exempt from Withholding and U.S. Income Tax Under Income Tax Treaties**

Country (1)	Code (2)	Category of Personal Services Purpose (3)	Maximum Presence in U.S. (4)	Required Employer or Payer (5)	Maximum Amount of Compensation (6)	Treaty Article Citation (7)
Ukraine	15	Scholarship or fellowship grant[1]	5 years[2]	Any U.S. or foreign resident[3]	No limit	20
	16	Independent personal services[4,6]	No limit	Any contractor	No limit	14
	17	Dependent personal services[5,6,8]	183 days	Any foreign resident	No limit	15
	19	Studying and training: Remittances or allowances[7]	5 years[2]	Any foreign resident	No limit	20

[1] Applies to grants, allowances, and other similar payments received for studying or doing research.

[2] The 5-year limit pertains only to training or research.

[3] Grant must be from a nonprofit organization. The exemption also applies to amounts from either government.

[4] Exemption does not apply to the extent income is attributable to the recipient's fixed U.S. base.

[5] Fees paid to a resident of Ukraine for services as a director of a U.S. corporation are subject to U.S. tax, unless the services are rendered in Ukraine.

[6] The exemption does not apply if the employee's compensation is borne by a permanent establishment (or a fixed base) that the employer has in the United States.

[7] Does not apply to compensation for research work primarily for private benefit.

[8] The exemption does not apply to income received for performing services in the United States as an entertainer or a sportsman. However, this income is exempt for U.S. income tax if the visit is (a) substantially supported by public funds of Ukraine, its political subdivisions, or local authorities, or (b) made under a specific arrangement agreed to by the governments of the treaty countries.

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

Section 29.—Credit for Producing Fuel From a Nonconventional Source

May a taxpayer obtain a private letter ruling under section 29(c)(1)(C) that a solid fuel (other than coke and solid fuel produced from waste coal fines) is a qualified fuel? See Rev. Proc. 2000–47, page 482.

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

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

LIFO; price indexes; department stores. The September 2000 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, 2000.

Rev. Rul. 2000–51

The following Department Store Inventory Price Indexes for September 2000 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, 2000.

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	Sep. 1999	Sep. 2000	Percent Change from Sep. 1999 to Sep. 2000[1]
1. Piece Goods	543.6	496.1	-8.7
2. Domestics and Draperies	629.3	609.3	-3.2
3. Women's and Children's Shoes	645.4	660.6	2.4
4. Men's Shoes	883.1	913.6	3.5
5. Infants' Wear	633.6	633.7	0.0
6. Women's Underwear	566.1	584.9	3.3
7. Women's Hosiery	326.7	342.9	5.0
8. Women's and Girls' Accessories	536.2	540.0	0.7
9. Women's Outerwear and Girls' Wear	408.9	400.2	-2.1
10. Men's Clothing	619.3	606.3	-2.1
11. Men's Furnishings	618.4	624.8	1.0
12. Boys' Clothing and Furnishings	498.5	481.7	-3.4
13. Jewelry	960.4	933.7	-2.8
14. Notions	767.0	788.0	2.7
15. Toilet Articles and Drugs	982.5	969.9	-1.3
16. Furniture and Bedding	696.6	707.2	1.5
17. Floor Coverings	602.8	614.8	2.0
18. Housewares	796.1	777.5	-2.3
19. Major Appliances	235.7	230.6	-2.2
20. Radio and Television	64.6	58.3	-9.8
21. Recreation and Education[2]	96.4	92.3	-4.3
22. Home Improvements[2]	127.8	128.3	0.4
23. Auto Accessories[2]	107.1	106.5	-0.6
Groups 1 - 15: Soft Goods	605.2	600.3	-0.8
Groups 16 - 20: Durable Goods	450.6	438.9	-2.6
Groups 21 - 23: Misc. Goods[2]	102.7	99.8	-2.8
Store Total[3]	547.0	539.4	-1.4

[1] Absence of a minus sign before the percentage change in this column signifies a 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 Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (202) 622-4970 (not a toll-free call).

Section 752.—Treatment of Certain Liabilities

26 CFR 1.752–3: Partner's share of nonrecourse liabilities.

T.D. 8906

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Allocation of Partnership Debt

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the allocation of nonrecourse liabilities by a partnership. The final regulations revise tier three of the three-tiered allocation structure contained in the current nonrecourse liability regulations, and also provide guidance regarding the allocation of a single nonrecourse liability secured by multiple properties.

DATES: *Effective Date*: These regulations are effective October 31, 2000.

Applicability Date: For dates of applicability of these regulations, see §1.752–5(a).

FOR FURTHER INFORMATION CONTACT: Dan Carmody, (202) 622-3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Introduction

This document revises §1.752–3 of the Income Tax Regulations (26 CFR part 1) relating to the allocation by a partnership of nonrecourse liabilities.

Background

On January 13, 2000, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–103831–99, 2000–5 I.R.B. 452 [65 F.R. 2084]) to provide guidance relating to the allocation of nonrecourse liabilities by a partnership. The IRS and Treasury received public comments concerning the proposed regulations, and a public hearing was held on May 3, 2000. After consideration of the comments received, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Revisions and Summary of Comments

1. *In General*

Treasury regulation §1.752–3 currently provides a three-tiered system for allocating nonrecourse liabilities. The three-tiered system applies sequentially. Under the first tier, a partner is allocated an amount of the liability equal to that partner's share of partnership minimum gain under section 704(b). See §1.704–2 (g)(1). Under the second tier, to the extent the entire liability has not been allocated under the first tier, a partner will be allocated an amount of liability equal to the gain that partner would be allocated under section 704(c) if the partnership disposed of all partnership property subject to one or more nonrecourse liabilities in full satisfaction of the liabilities (section 704(c) minimum gain). Under the third tier, a partner is allocated any excess nonrecourse liabilities (i.e., nonrecourse liabilities in excess of the portion allocable in the first and second tiers) under one of several methods (i.e., partner's share of profits or certain reasonably expected deductions) that the partnership may choose.

The proposed regulations modified the third tier to allow an additional method under which a partnership may allocate an excess nonrecourse liability based on the excess section 704(c) gain (i.e., the excess of the amount of section 704(c) built-in gain attributable to an item of property over the amount of section 704(c) minimum gain on that property) attributable to the properties that are subject to the liability. In addition, for purposes of determining section 704(c) minimum gain under the second tier, the proposed regulations provided that if a partnership holds multiple properties subject to a single liability, the liability may be allocated among the properties based on any reasonable method. A method is not reasonable under the proposed regulations if it allocates to any property an amount that exceeds the fair market value of the property.

2. *Allocation of Debt in Accordance With Reverse Section 704(c) Gain*

One commentator noted that the additional method provided in the proposed regulations under the third tier covers only built-in gain on section 704(c) property, which includes built-in gain (i.e., book value minus adjusted basis) attributable to contributed property, but not built-in gain attributable to property subject to a revaluation (pursuant to §1.704–1(b)(2)(iv)(*f*)) (i.e., reverse section 704(c) gain). The commentator noted that this distinction is not made in allocating nonrecourse liabilities in accordance with section 704(c) minimum gain under the second tier and questioned the policy reason for excluding the reverse section 704(c) gain in applying the third tier. In response to this comment, the final regulations provide that an excess nonrecourse liability may be allocated under the third tier in accordance with excess section 704(c) gain as well as excess reverse section 704(c) gain (i.e., the excess of the amount of reverse section 704(c) gain attributable to an item of property over the section 704(c) minimum gain on that property) with respect to property that is subject to such liability.

3. *Interplay With the Disguised Sales Rules*

One commentator noted that the proposed amendments to §1.752–3 would impact the disguised sales rules relating to transfers of encumbered property. The disguised sale rules treat a contribution of property encumbered by a "non-qualified" liability (generally, a liability incurred within two years of the contribution to the partnership that is incurred in anticipation of such contribution) as a disguised sale to the extent that the amount of the liability exceeds the contributing partner's share of the liability immediately after the contribution. Section 1.707–5(a)(2)(ii) provides that a partner's share of a nonrecourse liability, for purposes of the disguised sale rules, is determined by applying the same percentage used to determine the partner's share of the excess nonrecourse liability under §1.752–3(a)(3).

Because the proposed amendments to §1.752–3(a)(3) would allow excess nonrecourse liabilities to be allocated according to an amount, rather than a percentage, the potential for ambiguity exists. The commentator suggested that the disguised sale rules should be modified to define a partner's share of a nonrecourse liability by cross-reference to §1.752–3(a), rather than limiting the definition to the third tier. The commentator noted that maintaining separate definitions for the same term was burdensome and confusing for practitioners, and noted that the disguised sale rules provide consistency between sections 707(a) and 752 with respect to the definition of a partner's share of a recourse liability by reference to §1.752–2 without limitation.

The preamble to §1.707–5 explains that the cross-reference defining a partner's share of nonrecourse liabilities is limited to the third tier of §1.752–3(a) because the adoption of the full three-tier approach in the disguised sale context would provide an inverse relationship between the gain inherent in the contributed property and the extent to which a disguised sale of the property results from the encumbrance. See preamble (57 F.R. 44974). The contributing partner's share of the liability under §1.752–3(a) generally will increase as the amount of built-in gain on the property increases, which in turn would reduce the extent to which the contribution would be treated as a disguised sale.

The same problem would exist if the proposed modifications to the third tier were taken into account for purposes of §1.707–5(a)(2)(ii). To the extent that excess section 704(c) gain exists with respect to a property, the partnership could

allocate excess nonrecourse liabilities to the contributing partner. The greater the built-in gain with respect to a property, the less likely it would be that a disguised sale would result from the contribution. In order to avoid this inappropriate result, the final regulations clarify that the modifications made to the third tier do not apply for purposes of §1.707–5(a)(2)(ii). Thus, for purposes of the disguised sale rules, the partner's share of nonrecourse liabilities continues to be determined under the third tier by reference to the partner's share of profits or certain reasonably expected deductions.

4. *Treatment of "Extra" Excess Section 704(c) Gain*

Rev. Rul. 95–41 (1995–1 C.B. 132) holds that if a partnership determines the partners' interests in partnership profits based on all of the facts and circumstances relating to the economic arrangement of the partners, excess section 704(c) gain is one factor, but not the only factor, to be considered under §1.752–3(a)(3). The preamble to the proposed regulations provides that this holding will remain relevant where a partnership does not allocate nonrecourse debt under the third tier based on the excess section 704(c) gain attributable to the property that is subject to the debt. The preamble also provides that once a partnership has allocated nonrecourse indebtedness pursuant to the rule in the proposed regulations based upon excess section 704(c) gain, that excess section 704(c) gain cannot again be considered in determining a partner's interest in partnership profits.

One commentator asked, in situations where the amount of a liability allocated to a partner under the third tier pursuant to the rule contained in the proposed regulations is less than the partner's share of excess 704(c) gain, whether the remaining excess 704(c) gain should be taken into account for purposes of determining a partner's interest in partnership profits under the third tier with regard to other liabilities.

The statement contained in the preamble regarding the impact of the proposed regulations on Rev. Rul. 95–41 reflects a concern on the part of IRS and Treasury that taxpayers might count the same excess section 704(c) gain in applying the rule in the proposed regulations and then again in determining a partner's interest in partnership profits under the third tier. To the extent that a portion of excess section 704(c) gain remains after a liability has been fully allocated, there is no double-counting, and the remaining portion of the gain should be taken into account as one factor to be considered in determining a partner's interest in partnership profits under §1.752–3(a)(3) and Rev. Rul. 95–41.

5. *Applicability of §1.752–3(b) to Third-Tier Allocations*

The proposed regulations provide rules regarding the allocation of a single liability among multiple properties. The proposed regulations generally provide that if a partnership has multiple properties subject to a single liability, for purposes of determining the amount of section 704(c) minimum gain in applying the second tier, the partnership may allocate to each property an amount of the liability that, when combined with any other liabilities allocated to the property, do not exceed the property's fair market value. The portion of the liability allocated to each property will be treated as a separate loan in determining the section 704(c) minimum gain attributable to the property.

One commentator asked that the rule for allocating a single liability among multiple properties under the second tier also apply to third tier allocations. For purposes of the second tier, where nonrecourse debt is cross-collateralized, it is necessary to determine how much of the nonrecourse debt is attributable to each partnership property, since debt is allocated among the partners under that tier based upon the amount by which the debt attributable to each specific property exceeds the tax basis of such property. (See §1.704–3(a)(2), which provides that, except in limited circumstances, section 704(c) applies on a property-by-property basis.) Under the proposed modification to the third tier, any remaining nonrecourse liability of the partnership could be allocated to a partner up to the excess section 704(c) gain allocable to the partner on property subject to that liability. There is no need to bifurcate cross-collateralized debt under this tier, since excess section 704(c) gain is not limited by the amount of debt attributable to specific partnership property. So long as a partner's share of excess section 704(c) gain is attributable to property that is "subject to" the debt being allocated, the debt may be allocated in accordance with that partner's share of such excess section 704(c) gain. Multiple properties may be "subject to" the same indebtedness. Bifurcating the debt among multiple properties so that each property is treated as subject to only a portion of the debt actually would limit taxpayers' flexibility and narrow the scope of the proposed change to the third tier. Accordingly, the commentator's recommendation is not adopted. However, the final regulations add an example which clarifies the operation of this rule.

6. *Retroactive Effective Date*

One commentator suggested that the regulations should apply on a retroactive basis. This suggestion has not been adopted. However, the final regulations respond to this recommendation by providing an optional effective date for those taxpayers who wish to apply the rules currently to liabilities incurred prior to the issuance of these regulations.

7. *Additional Comments Requested*

The preamble to the proposed regulations requested comments regarding the allocation of a single liability among multiple partnerships. Although no formal comments were submitted on this issue, several commentators have indicated that additional guidance regarding appropriate methods of allocating such liabilities would be helpful. The IRS and Treasury again request comments regarding this issue.

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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations and, 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 its impact on small business.

Drafting Information

The principal author of these regulations is Christopher T. Kelley, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury 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 1.752–3 is amended as follows:

1. Paragraph (a)(3) is amended by adding three sentences immediately before the last sentence in the paragraph.

2. Paragraph (b) is redesignated as paragraph (c).

3. New paragraph (b) is added.

4. Newly designated paragraph (c) is amended by revising the introductory text and adding a new *Example 3.*

The revisions and addition read as follows:

§1.752–3 Partner's share of nonrecourse liabilities.

(a) * * *

(3) * * * Additionally, the partnership may first allocate an excess nonrecourse liability to a partner up to the amount of built-in gain that is allocable to the partner on section 704(c) property (as defined under §1.704–3(a)(3)(ii)) or property for which reverse section 704(c) allocations are applicable (as described in §1.704–3(a)(6)(i)) where such property is subject to the nonrecourse liability to the extent that such built-in gain exceeds the gain described in paragraph (a)(2) of this section with respect to such property. This additional method does not apply for purposes of §1.707–5(a)(2)(ii). To the extent that a partnership uses this additional method and the entire amount of the excess nonrecourse liability is not allocated to the contributing partner, the partnership must allocate the remaining amount of the excess nonrecourse liability under one of the other methods in this paragraph (a)(3). * * *

(b) *Allocation of a single nonrecourse liability among multiple properties*—(1) *In general.* For purposes of determining the amount of taxable gain under paragraph (a)(2) of this section, if a partnership holds multiple properties subject to a single nonrecourse liability, the partnership may allocate the liability among the multiple properties under any reasonable method. A method is not reasonable if it allocates to any item of property an amount of the liability that, when combined with any other liabilities allocated to the property, is in excess of the fair market value of the property at the time the liability is incurred. The portion of the nonrecourse liability allocated to each item of partnership property is then treated as a separate loan under paragraph (a)(2) of this section. In general, a partnership may not change the method of allocating a single nonrecourse liability under this paragraph (b) while any portion of the liability is outstanding. However, if one or more of the multiple properties subject to the liability is no longer subject to the liability, the portion of the liability allocated to that property must be reallocated among the properties still subject to the liability so that the amount of the liability allocated to any property does not exceed the fair market value of such property at the time of reallocation.

(2) *Reductions in principal.* For purposes of this paragraph (b), when the outstanding principal of a partnership liability is reduced, the reduction of outstanding principal is allocated among the multiple properties in the same proportion that the partnership liability originally was allocated to the properties under paragraph (b)(1) of this section.

(c) *Examples.* The following examples illustrate the principles of this section:

* * * * *

Example 3. Allocation of liability among multiple properties. (i) A and B are equal partners in a partnership (PRS). A contributes $70 of cash in exchange for a 50-percent interest in PRS. B contributes two items of property, X and Y, in exchange for a 50-percent interest in PRS. Property X has a fair market value (and book value) of $70 and an adjusted basis of $40, and is subject to a nonrecourse liability of $50. Property Y has a fair market value (and book value) of $120, an adjusted basis of $40, and is subject to a nonrecourse liability of $70. Immediately after the initial contributions, PRS refinances the two separate liabilities with a single $120 nonrecourse liability. All of the built-in gain attributable to Property X ($30) and Property Y ($80) is section 704(c) gain allocable to B.

(ii) The amount of the nonrecourse liability ($120) is less than the total book value of all of the properties that are subject to such liability ($70 + $120 = $190), so there is no partnership minimum gain. §1.704–2(d). Accordingly, no portion of the liability is allocated pursuant to paragraph (a)(1) of this section.

(iii) Pursuant to paragraph (b)(1) of this section, PRS decides to allocate the nonrecourse liability evenly between the Properties X and Y. Accordingly, each of Properties X and Y are treated as being subject to a separate $60 nonrecourse liability for purposes of applying paragraph (a)(2) of this section. Under paragraph (a)(2) of this section, B will be allocated $20 of the liability for each of Properties X and Y (in each case, $60 liability minus $40 adjusted basis). As a result, a portion of the liability is allocated pursuant to paragraph (a)(2) of this section as follows:

Partner	*Property*	*Tier 1*	*Tier 2*
A	X	$0	$0
	Y	$0	$0
B	X	$0	$20
	Y	$0	$20

(iv) PRS has $80 of excess nonrecourse liability that it may allocate in any manner consistent with paragraph (a)(3) of this section. PRS determines to allocate the $80 of excess nonrecourse liabilities to the partners up to their share of the remaining section 704(c) gain on the properties, with any remaining amount of liabilities being allocated equally to A and B consistent with their equal interests in partnership profits. B has $70 of remaining section 704(c) gain ($10 on Property X and $60 on Property Y), and thus will be allocated $70 of the liability in accordance with this gain. The remaining $10 is divided equally between A and B. Accordingly, the overall allocation of the $120 nonrecourse liability is as follows:

Partner	*Tier 1*	*Tier 2*	*Tier 3*	*Total*
A	$0	$0	$5	$5
B	$0	$40	$75	$115

Par. 3. In §1.752–5, paragraph (a) is amended by adding three sentences after the first sentence:

Section 1.752–5 Effective dates and transition rules.

(a) *In general.* * * * However, §1.752–3(a)(3) fifth, sixth, and seventh sentences, (b), and (c) *Example 3*, do not apply to any liability incurred or assumed by a partnership prior to October 31, 2000. Nevertheless, §1.752–3(a)(3) fifth, sixth, and seventh sentences, (b), and (c) *Example 3*, may be relied upon for any liability incurred or assumed by a partnership prior to October 31, 2000 for taxable years ending on or after October 31, 2000. * * *

* * * * *

David A. Mader,
Acting Deputy Commissioner of Internal Revenue.

Approved October 11, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 30, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 31, 2000, 65 F.R. 64888)

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

EMBASSY OF THE
UNITED STATES OF AMERICA

No. 201

The Embassy of the United States of America presents its compliments to the Ministry of Foreign Affairs of the State of Bahrain and has the honor to propose that the two Governments conclude an agreement to exempt from income tax, on a reciprocal basis, certain income derived from the international operation of a ship or ships and aircraft as follows:

The Government of the United States of America, in accordance with sections 872(b) and 883(a) of the U.S. internal revenue code of 1986, agrees to exempt from U.S. federal income tax gross income derived from the international operation of a ship or ships or aircraft by individuals who are residents of Bahrain (other than U.S. citizens or residents) and corporations that are organized in Bahrain, in each case, that are engaged in the international operation of a ship or ships or aircraft. This exemption shall be granted on the basis of equivalent exemptions granted by Bahrain to individual residents of the United States and to corporations organized in the United States.

In the case of a Bahrain corporation, the exemption shall apply only if the corporation meets the ownership or public trading requirements of U.S. Law. For purposes of such ownership requirements, the Government of Bahrain shall be treated as an individual resident of Bahrain.

Gross income derived from the international operation of a ship or ships or aircraft includes:

--(i) income from the rental on a full (time or voyage) basis of a ship or ships or aircraft used in international transport;

--(ii) income from the rental on a bareboat basis of a ship or ships or aircraft used in international transport;

--(iii) income from the rental of containers and related equipment used in international transport that is incidental to income from the international operation of a ship or ships or aircraft;

--(iv) gains from the sale or other alienation of a ship or ships or aircraft used in international transport; and

--(v) income derived by an individual or corporation otherwise engaged in the international operation of a ship or ships or aircraft from active participation in a pool, an alliance, joint venture, international operating agency, or other venture, that is itself engaged in the international operation of a ship or ships or aircraft

The Embassy, on behalf of the Government of the United States of America, proposes that if the foregoing is acceptable to the Government of Bahrain, this note and the Ministry's reply note shall constitute an agreement between the two Governments, which shall enter into force on the date of the Ministry's reply note and shall have effect with respect to taxable years beginning on or after January 1, 1999. It shall remain in force until terminated by either Government giving written notice to the other Government through diplomatic channels.

The Embassy of the United States avails itself of this opportunity to renew to the Ministry of Foreign Affairs of the State of Bahrain the assurance of its highest consideration.

Embassy of the United States of America

Manama, September 1, 1999.

STATE OF BAHRAIN

MINISTRY OF FOREIGN AFFAIRS

دولة البحرين
وزارة الخارجية

Ref. 6/100/231- 13306 ..... الرقم

Date 12th September, 1999 ..... التاريخ

Note Verbale

The Ministry of Foreign Affairs of the State of Bahrain presents its compliments to the Embassy of the United States of America to the State of Bahrain and has the honour to acknowledge receipt of the Embassy's note of 1st September, 1999 proposing an agreement to exempt from Bahrain tax gross income derived from the international operation of a ship or ships or aircraft by individual residents of the United States and by corporations organized in the United States, in each case, that are engaged in the international operation of a ship or ships or aircraft. This exemption shall be granted on the basis of equivalent exemptions granted by the United States to individuals who are residents of Bahrain (other than U.S. citizens or residents) and to corporations that are organized in Bahrain.

The terms of the agreement are as follows:

The Government of Bahrain agrees to exempt from Bahrain tax gross income derived from the international operation of a ship or ships or aircraft by individuals who are residents of the United States and corporations that are organized in the United States, in each case, that are engaged in the international operation of a ship or ships or aircraft.

This exemption is granted on the basis of equivalent exemptions granted by the United States under the terms of your note of 1st September, 1999.

Gross income derived from the international operation of a ship or ships or aircraft includes:

(i) income from the rental on a full (time or voyage) basis of ship or ships or aircraft used in international transport;
(ii) income from the rental on a bareboat basis of a ship or ships or aircraft used in international transport;

(iii) income from the rental of containers and related equipment used in international transport that is incidental to income from the international operation of a ship or ships or aircraft;

(iv) gains from the sale or other alienation of a ship or ships or aircraft used in international transport; and

(v) income derived by an individual or corporation otherwise engaged in the international operation of a ship or ships or aircraft from active participation in a pool, in alliance, joint venture, international operating agency, or other venture, that is itself engaged in the international operation of a ship or ships or aircraft.

The Ministry of Foreign Affairs of the State of Bahrain confirms that the Government of Bahrain accepts the proposal contained in the Embassy's Note No.201 and that the Embassy's note and this note in reply constitute an agreement between the two Governments, which shall enter into force on the date of this note and shall have effect with respect to taxable years beginning on or after January 1, 1999. It shall remain in force until terminate by either Government giving written notice to the other Government through diplomatic channels.

The Ministry of Foreign Affairs of the State of Bahrain takes this opportunity to renew to the Embassy of the United States of America the assurances of its highest consideration.

Ministry of Foreign Affairs
State of Bahrain

12th September 1999

Part III. Administrative, Procedural, and Miscellaneous

Tables for Figuring Amount Exempt From Levy on Wages, Salary, and Other Income

Notice 2000–47

1. Table for Figuring Amount Exempt From Levy on Wages, Salary, and Other Income

(Forms 668-W(c) & 668-W(c)(DO)) 2001

Publication 1494, shown below, provides tables that show the amount of an individual's income that is exempt from a notice of levy used to collect delinquent tax in 2001.
(Amounts are for each pay period.)

Filing Status: Single							
Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6	More Than 6
Daily	28.65	39.81	50.96	62.12	73.27	84.42	17.50 plus 11.54 for each exemption
Weekly	143.27	199.04	254.81	310.58	366.35	422.12	87.50 plus 55.77 for each exemption
Biweekly	286.54	398.08	509.62	621.15	732.69	844.23	175.00 plus 111.54 for each exemption
Semi-monthly	310.42	431.25	552.08	672.92	793.75	914.58	189.58 plus 120.83 for each exemption
Monthly	620.83	862.50	1104.17	1345.83	1587.50	1829.17	379.17 plus 241.67 for each exemption

Filing Status: Unmarried Head of Household							
Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6	More Than 6
Daily	36.73	47.88	59.04	70.19	81.35	92.50	25.58 plus 11.54 for each exemption
Weekly	183.65	239.42	295.19	350.96	406.73	462.50	127.88 plus 55.77 for each exemption
Biweekly	367.31	478.85	590.38	701.92	813.46	925.00	255.77 plus 111.54 for each exemption
Semi-monthly	397.92	518.75	639.58	760.42	881.25	1002.08	277.08 plus 120.83 for each exemption
Monthly	795.83	1037.50	1279.17	1520.83	1762.50	2004.17	554.17 plus 241.67 for each exemption

Filing Status: Married Filing Joint (and Qualifying Widow(er)s)							
Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6	More Than 6
Daily	40.38	51.54	62.69	73.85	85.00	96.15	29.23 plus 11.54 for each exemption
Weekly	201.92	257.69	313.46	369.23	425.00	480.77	146.15 plus 55.77 for each exemption
Biweekly	403.85	515.38	626.92	738.46	850.00	961.54	292.31 plus 111.54 for each exemption
Semi-monthly	437.50	558.33	679.17	800.00	920.83	1041.67	316.67 plus 120.83 for each exemption
Monthly	875.00	1116.67	1358.33	1600.00	1841.67	2083.33	633.33 plus 241.67 for each exemption

Filing Status: Married Filing Seperate							
Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6	More Than 6
Daily	25.77	36.92	48.08	59.23	70.38	81.54	14.62 plus 11.54 for each exemption
Weekly	128.85	184.62	240.38	296.15	351.92	407.69	73.07 plus 55.77 for each exemption
Biweekly	257.69	369.23	480.77	592.31	703.85	815.38	146.15 plus 111.54 for each exemption
Semi-monthly	279.17	400.00	520.83	641.67	762.50	883.33	158.33 plus 120.83 for each exemption
Monthly	558.33	800.00	1041.67	1283.33	1525.00	1766.67	316.67 plus 241.67 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	3.46	17.31	34.62	37.50	75.00
	2	6.92	34.62	69.23	75.00	150.00
	3	10.38	51.92	103.85	112.50	225.00
	4	13.85	69.23	138.46	150.00	300.00

* 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 $254.81 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, $275.96 is exempt from this levy ($254.81 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 $515.38 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, $584.61 is exempt from this levy ($515.38 plus $69.23).

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, section 29.)

Rev. Proc. 2000–47

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 2000–3, 2000–1 I.R.B. 103, which sets forth areas of the Internal Revenue Code in which the Internal Revenue Service will not issue advance rulings or determination letters.

SECTION 2. BACKGROUND

Section 5 of Rev. Proc. 2000–3 sets forth those areas under extensive study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise.

The purpose of § 29 of the Internal Revenue Code is to reduce United States dependence on imported energy. S. Rep. No. 394, 96th Cong., 1st Sess. 87 (1979), 1980–3 C.B. 131, 205.

Section 29 provides a credit against income tax for the production and sale of "qualified fuels" produced from a nonconventional source. Section 29(c)(1)(C) provides that qualified fuels include liquid, gaseous, or solid synthetic fuels produced from coal (including lignite).

Rev. Rul. 86–100, 1986–2 C.B. 3, adopts for purposes of § 29(c)(1)(C) the definition of synthetic fuel in § 1.48–9(c)(5) of the Income Tax Regulations because of the similar purpose and language of § 29 and former § 48(l) of the Internal Revenue Code of 1954. Section 1.48–9(c)(5)(ii) provides that, to be "synthetic," a fuel must differ significantly in chemical composition, as opposed to physical composition, from the substance used to produce it.

The Service has issued a number of rulings that allow taxpayers to claim the § 29 credit with respect to coke and solid fuels produced from waste coal and coal fines. Concern has been raised that taxpayers are also claiming the § 29 credit for processing coal in other ways that may not have been intended by the Congress. The Treasury Department and the Service are seeking information concerning the processes currently used in producing solid fuel for which the credit is claimed.

SECTION 3. PROCEDURE

Rev. Proc. 2000–3 is amplified by adding the following to section 5:

Section 29.—Credit for Production and Sale of Qualified Fuels.—Whether a solid fuel other than coke or a fuel produced from waste coal is a qualified fuel under § 29(c)(1)(C). Waste coal for this purpose is limited to waste coal fines from normal mining and crushing operations and does not include fines produced (for example, by crushing run-of-mine coal) for the purpose of claiming the credit.

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 publication of this revenue procedure. Taxpayers that have pending ruling requests involving solid fuel other than coke but whose ruling requests do not indicate that the fuel is produced from waste coal fines may modify their ruling requests if they meet the standard described in section 3 of this revenue procedure so that the Service may continue to consider their requests.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2000–3 is amplified.

SECTION 6. REQUEST FOR COMMENTS

The Service requests comments concerning this revenue procedure and the standard to be applied in determining whether fuel produced from coal is a solid synthetic fuel. In particular, the Service requests comments on whether significant chemical change is an appropriate test and, if so, what constitutes such a change. The Service also requests comments on whether, in the case of solid fuels other than coke, additional or alternative tests are needed. Comments are specifically requested with respect to the following: (1) should the § 29 credit for solid synthetic fuel under § 29(c)(1)(C) be allowed only where domestic energy production is increased; (2) under what circumstances should the § 29 credit for solid synthetic fuel under § 29(c)(1)(C) be allowed with respect to fuel produced from waste coal and coal fines; and (3) must a solid synthetic fuel have a market value that is significantly greater than the market value of the coal and any additives from which it is produced.

To facilitate speedy resolution, the Service requests that comments be submitted by November 27, 2000. An original and eight copies of written comments should be mailed to:

Internal Revenue Service
Attn: CC:MSP:R (Rev. Proc. 2000–47)
Room 5228 (PSI:Br6)
PO Box 7604
Ben Franklin Station
Washington, DC 20044

or hand delivered between the hours of 8:00 a.m. and 5:00 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:MSP:R (Rev. Proc. 2000–47)
Room 5228 (PSI:Br6)
1111 Constitution Avenue, NW
Washington, DC

In addition, comments may be submitted electronically at:
joel.s.rutstein@m1.irscounsel.treas.gov.

DRAFTING INFORMATION

The principal author of this revenue procedure is David McDonnell of the Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury participated in its development. For further information regarding this revenue procedure contact Mr. McDonnell at (202) 622-3110 (not a toll-free call).

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 2000–91

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:

Afghanistan Peace Association, Inc., Flushing, NY
Alameda County Cancer League, Inc., Piedmont, CA
Alameda Ladies Relief Society, Alameda, CA
Alfred J. Friend Memorial Fund, Inc., Rockville Centre, NY
Alliance for Advanced Coatings Research, Rolla, MO
Alternative Home Care, Inc., Mount Sinai, NY
American Friends of Birkat Peretz, Brooklyn, NY
American Friends of Gifted Young Musicians in Israel, Inc., New York, NY
American Friends of Ora, Brooklyn, NY
American Friends of Yeshiva Nezer Hatorah, Inc., Brooklyn, NY
American Friends of Yeshivat Imrei Datt, Inc., Brooklyn, NY
American Philharmonic & Theatre Company, Inc., New York, NY
Angels on Earth, Inc., Lawrence, NY
Another Door, Ltd., Glencove, NY
Appomattox Primary School Parent-Teacher Organization, Appomattox, VA
Arizona Hispanic Association, Apache Junction, AZ
Arkansas Osteopathic Foundation, Little Rock, AR
Association for Legal Learning, Pelham, NY
Atlanta Outreach Foundation for the Homeless, Atlanta, GA
B. Stephen Demchuk Foundation, South Salem, NY
Bakersfield Storm Soccer Club, Bakersfield, CA
Bath Civil War Preservation Society, Inc., Bath, ME
Battered Womens Resource Center, Inc., Brooklyn, NY
Benjamin Church Development Corporation, Bristol, RI
Bishop Henry B. Hucles Nursing Home, Inc., Uniondale, NY
Bluff City Middle School Athletic Booster Club, Bluff City, TN
Boles Junior High Athletic Booster Club, Inc., Arlington, TX
Bosnian Refugees Association, Corp., Long Island City, NY
Brain Injury Association Texas Gulf Coast Area, Houston, TX
Brass Band of Minot, Milnot, ND
Brazilian Community Center, Malden, MA
Break O'Day Farm and Metcalfe Museum, Inc., Durham, OK
Bridges of Milwaukee, Inc., Wauwatosa, WI
Brookdale Residence Housing Development Fund Corporation, Brooklyn, NY
Brotherhood for HIV Economic Support, Inc., Evansville, IN
Buckeye Academic Booster Club, Buckeye, AZ
Buenos Aires Yoga School Foundation, Chicago, IL
Building Blocks Non-Profit Housing Corporation, Royal Oak, MI
California Capital Access Forum, Inc., San Francisco, CA
Catch and Release Foundation, Inc., Pound Ridge, NY
Catholics for Life, Inc., Deer Park, NY
C C L Chinese-American Culture Learning Center, Inc., Flushing, NY
Cedarburg Junior Womans Club, Inc., Cedarburg, WI
Center for Childrens Advocacy, Inc., Nutley, NJ
Center for Policy Studies in Russia, Monterey, CA
Center for the Urban Environment, Inc., Brooklyn, NY
Chassidic Discover Center, Inc., Brooklyn, NY
Chen V'Chesed, Brooklyn, NY
Child Identification & Data Services, Incorporated, Brooklyn, NY
Children Mishnayos Memorial Foundation, Inc., Brooklyn, NY
Childrens Fund USA, Inc., Brooklyn, NY
Christmas in April - El Paso, Inc., El Paso, CA
Christmas in the Valley, Arcadia, MO
City Club of Boise, Inc., Boise, ID
Clinton Residence, Inc., Hempstead, NY
Coalition for Pregnant Teens Services for Youth and Families, West Hempstead, NY
Community Ministries of Virginia, Inc., Newport News, VA
Contemporary Chamber Opera of Minnesota, Inc., Minneapolis, MN
Contending for the Faith Bible Study, Tampa, FL
Corporate Kingdom, Ltd., Garden City, NY
Corporation for Musical Development, Middle Village, NY
Counsel of Substance Abuse Professionals, Inc., Rome, GA
Cultural Center of the Taino Nation of the Antilles, Inc., New York, NY
Cystic Fibrosis Support Group of Oregon, Clackamas, OR
Dark Horse Productions, Inc., Amagansett, NY
David Rosenthal Foundation, Great Neck, NY
Deaf and Hearing Ventures, Incorporated, Birmingham, AL
DEAF, Inc., New York, NY
Desnick Family Charitable Foundation, Chicago, IL
Disability Group, Inc., Los Angeles, CA
Donation for Life Coalition, Inc., San Francisco, CA
Earthspan, Stewartstown, PA
East Central Upper Peninsula Health and Education Foundation, Newberry, MI
Ebony Zawadi, Inc., Brandywine, MD
Elderly Housing Services, Inc., Johnson City, TN
Emilys Store, Inc., Columbia, MD
End Time Full Gospel Harvestors, Inc., Floral Park, NY
Families of Abused Children Traumatized Sexually, Inc., Virginia Beach, VA
Family Link-up, Inc., Brooklyn, NY

Far Rockaway Panther Football, Inc., Far Rockaway, NY
Farm Workers Development Center, Granger, WA
Fathers and Mothers in Legal Yearning, Inc., Tucson, AZ
Flatbush Youth Association, Inc., Brooklyn, NY
Focus Information Service, Ltd., Dayton, OH
Fontana Academy of Martial Arts, Fontana, CA
Foundation for Clean Air Progress, Washington, DC
Foundation for Peace, Inc., Brookville, NY
Foundation for the Children of Haiti, Dix Hills, NY
Foundation for the Prevention and Recovery of Missing Children, Boca Raton, FL
Friends of Beth Yisrael Institutions, Brooklyn, NY
Friends of Rye Brook, Inc., Rye Brook, NY
Friends of the William Floyd Estate, Inc., Patchogue, NY
Frontier Fertilizer Superfund Oversight Group, Davis, CA
Fund for the Children of Chernobyl Northwest United States of America, Kent, WA
Garland Genealogical Society, Inc., Garland, TX
Give a Helping Hand Corporation, Bay Shore, NY
Griffin-Spalding Clean Community Commission, Inc., Griffin, GA
Habitat for Elderly & Handicapped, Inc., Shirley, NY
Hampton Roads Boys-Girls Club Alumni Association, Newport News, VA
Hashevaynu, Inc., Monsey, NY
Health Care Resources Interlink, Inc., Care Resources, San Jose, CA
High Thoughts Ministries, Inc., Newbury Park, CA
Hmong American Womens Association, Milwaukee, WI
Homeowners Assistance Corporation of New York, St. Albans, NY
Inner-Outer Partnership, Pacific Palisades, CA
Institute for Community Leadership Training, Inc., Brooklyn, NY
Institute of World Traditional Medicine, Santa Monica, CA
Interactive Trust - A Foundation for America, Des Moines, IA
International Center for Jewish Peoplehood, Memphis, TN
International Skating Center of Connecticut Scholarship Foundation, Avon, CT
International Used Oil Research Institute, Mobile, AL
Internet Nonprofit Center, Inc., Brooklyn, NY
Irish Services, Inc., Woodside, NY
Island Park Playground Fund Organization, Inc., Island Park, NY
It Takes a Village, Inc., Chicago, IL
Jesus the Living Word Ministries, Inc., Hughson, CA
Jim Clark Community Services, Inc., Inglewood, CA
June and Roy Metcalf Elementary Parent-Teacher Organization, Houston, TX
Kansas Community Corporation, Kansas, IL
Keeping Brothers in School, Inc., Brooklyn, NY
Keren Aniyai Irchoh, Inc., Brooklyn, NY
Kids Instilled with Dignity Survive Kids, Inc., Ponte Verde, FL
Kids Nutritional Services, Slidell, LA
Kincraig Housing, Inc., Brooklyn, NY
King Kekaulike High School Band Boosters, Pukalani, HI
Koakos Syllogos Ippocrates, Inc., Astoria, NY
Kolel Zichron Yoseph, Inc., Brooklyn, NY
Laneville Christmas Light Display, Laneville, TX
Lantern Theatre, Inc., Wantagh, NY
Law Review, Inc., Edina, MN
League of Muslim Women of Rochester, Rochester, NY
Light to the Nations, Inc., Brooklyn, NY
Long Island Counseling Center, Inc., Mineola, NY
Machne Menachem, Inc., Brooklyn, NY
Marcus High School Basketball Booster Club, Flower Mound, TX
Masumeen Charitable Trust, North Reading, MA
Maumee High School Ice Hockey Association, Maumee, OH
Mesorah Center for Jewish Studies Charitable Trust, Highland Park, NJ
Mindpaint Workshop, Lincoln, NE
Mishkan Yaakov Charitable Trust, New York, NY
Mission Crusade, Inc., Forest Hills, NY
Moharil Ashlag Torah Center, Inc., Brooklyn, NY
Monsignor Michael Fleming Catholic Youth Foundation, Inc., Bayside, NY
Moscow State University Center for Social Services and Humanities, Arlington, VA
MRC Housing Development Fund Company, Inc., Brooklyn, NY
Municipal Training Center Queens, Inc., Jamaica, NY
Nassau Community Outreach Consortium, Inc., Lawrence, NY
National Educator Foundation, Los Angeles, CA
National Independence Day Parade, Inc., Washington, DC
National Organization for Von Willebrand Patients & Carriers, Inc., Cockeysville, MD
Neurodegenerative Disease Foundation, Inc., Huntington, NY
New Creation Ministries, Wenatchee, WA
New Dialogue Study Group, Inc., Rego Park, NY
New Horizon Childrens Enrichment Center, Dothan, AL
New York Guard Foundation, Inc., White Plains, NY
Northeast Community Feed-a-Meal Program, Mer Rouge, LA
North Haven Historical Cemetary Association, Inc., Sag Harbor, NY
North Posey Athletic Booster Club, Inc., Poseyville, IN
Oklahoma Association of Urban Bankers, Oklahoma City, OK
Olympic Peninsula Intertribal Cultural Advisory Committee, Kingston, WA
Osage Resident Council Association, Skiatook, OK
Outreach Childrens Home, Nashville, TN
Oxbridge Study Abroad Center, Washington, DC
Palm Beaches Alive, Inc., West Palm Beach, FL
Parker Youth, Inc., Parker, CO
Parsippany High School Wrestling Boosters Parents Association, Parsippany, NJ
Pathways Spiritual Foundation, Laguna Beach, CA
Project Destiny International Scholarship Foundation, Inc., Jamaica, NY
Project Intercept, Inc., St. Paul, MN
Project Pass, St. Louis, MO

Protestant Lawyers Association of New York Scholarship Fund, Inc., Brooklyn, NY
Pursuit Soccer Club, Spring, TX
Quick Social Services, Inc., Wyandanch, NY
Quota Club of Tulsa Charitable and Educational Foundation, Inc., Talala, OK
Rabbi Yisroel Aryeh Leib Research Institute on Moshiach and the Scie, Brooklyn, NY
Rabbinical Study - Ohel Shlomo, Inc., Brooklyn, NY
Radcliffe Sorority Sisters, Inc., Radcliffe, IA
Reach Foundation, Shaker Heights, OH
Reaching Out the African-American Youth Mentoring Service, Tacoma, WA
Rebel Alliance Theatre, Inc., Oshkosh, WI
Renaissance Alano Club, Santa Ana, CA
Rhode Island Breast Cancer Coalition, Inc., Coventry, RI
River Run Arts - Earth Studies Camp, Inc., Peninsula, OH
Rivers Bend Playhouse, Inc., Evansville, IN
Rosemary Fund, Inc., Franklin Sq, NY
Rwanda Reconstruction Fund, Inc., Rockville, MD
Santa Paula Foundation for Youth, Ventura, CA
Sarajevo Fund, Incorporated, New York, NY
Save Our Selves, Inc., Bowie, MD
Save our Smile SOS, Inc., Dix Hills, NY
Save the Horse, Inc., Old Bethpage, NY
Scholar Athletes, Inc., Westbury, NY
Selig Gourson Tapemobile, Inc., Brooklyn, NY
Seven Loaves & Five Fishes, Inc., Mission, Brooklyn, NY
Seventh Principle, Inc., South Orange, NJ
Sigma Phi Omega National Honor Society, Washington, DC
Sixty-Five Roses Auxiliary, Inc., Phoenix, AZ
Sonoma County Braillists, Inc., Santa Rosa, CA
Southern California Support for Children, Inc., Yucaipa, CA
Special Forces Ministries, Inc., Brusly, LA
Starbrite Foundation, Phoenix, AZ
Stillwater Volunteer Fire Association, Cincinnati, OH
Stonewall Jackson Middle School, Mechanicsville, VA
Stop Abuse, Inc., Canoga Park, CA
Supportive Living Program, Inc., Quincy, MA
Substainable Communities, Inc., Santa Fe, NM
Tanitas, Inc., Chevy Chase, MD
Tax History Foundation and Museum, Northfield, IL
Teal Lost Land & Ghost Lakes Improvement Assn., Hayward, WI
Telos Institute, Inc., Candor, NY
Toaster Museum Foundation, Inc., Charlottesville, VA
Tov-Roi Foundation, Inc., Brooklyn, NY
TRRE Foundation, Seattle, WA
Tulsa Area Wheelchair Sports Association, Inc., Tulsa, OK
Tunbridge Engine Company, Inc., Tunbridge, VT
United Ethiopian Services, Inc., Cambridge, MA
Universal Peace Mission, Inc., Pittsburgh, PA
Vaad L'Hatzolas Nidchei Yisroel, Inc., Brooklyn, NY
Valley Coalition for the Homeless, San Benito, CA
Vermilion Schools Athletic Boosters, Inc., Vermilion, OH
Veuhsesuh Hayushor Vehatov, Inc. Monroe, NY
Victorious Overcomers Community Alliance, Inc., Amityville, NY
Vietnam Veterans for Christ, Phoenix, AZ
Walk for a Cure Foundation, Salem, OR
Wellness Education Foundation, Carlsbad, CA
Wellston Community Support Assoc., St. Louis, MO
Whiteman Officers Wives Club, Warrensburg, MO
Worldwide Gospel Tracts, Inc., Pasadena, CA
Yamim, Inc., New York, NY
Yeshiva Chasidei Belz of Jerusalem, Brooklyn, NY
Yeshiva Shalom Rav, Far Rockaway, NY
Youth Frontiers, Inc., Bronx, NY
YSI International, Hollywood, FL
Yvettes Creative Learning, Inc., Marietta, GA
Zomet, Woodmere, NY
1884 Oakhurst Links Foundation, White Sulphur Springs, WV

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.

Tax Treatment of Cafeteria Plans; Correction

Announcement 2000–92

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking.

SUMMARY: This document contains a correction to proposed regulations that were published in the **Federal Register** on Thursday, March 23, 2000 (65 F.R. 15587), relating to tax treatment of cafeteria plans.

FOR FURTHER INFORMATION CONTACT: Christine L. Keller at (202) 622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking that is the subject of this correction is under section 125 of the Internal Revenue Code.

Need for Correction

As published, the proposed regulations contain an error that may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the proposed regulations (REG–117162–99, 2000–15 I.R.B. 871), that were the subject of FR Doc. 00–5818, is corrected as follows:

On page 15587, column 2, the regulation heading in the middle of the column, line 5, the "RIN 1545–AX59" is corrected to read "RIN 1545–AY23".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization and Strategic Planning)

(Filed by the Office of the Federal Register on October 24, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 25, 2000, 65 F.R. 63824)

IRS and George Washington University to Sponsor Institute on International Tax Issues

Announcement 2000–93

Director, International, LMSB, Carol A. Dunahoo has announced the Thirteenth Annual Institute on Current Issues in International Taxation, jointly sponsored by the Internal Revenue Service and The George Washington University, to be held on December 7 and 8, 2000 at the J.W. Marriott Hotel in Washington, DC. Registration is currently underway for the Institute, which is intended for professionals in international tax law.

The program will present a unique opportunity for top IRS and Treasury officials and tax experts, as well as leading private sector specialists, to address breaking issues and present key perspectives on new developments. The Institute will open with an address by Jeffrey Owens, Head of Fiscal Affairs Division, Organisation for Economic Co-operation and Development. The first day will also feature sessions on corporate tax shelters from an international perspective, new ways of handling tax controversies, and inbound and outbound updates. Competent Authority officials from Canada, Japan, the United Kingdom, and the United States will discuss current and emerging issues. Larry Langdon, Commissioner of the IRS Large and Mid-Size Business Division, will provide the luncheon address.

The second day will focus on international tax issues in the New Economy, including character of income and permanent establishment, e-commerce implications for Subpart F, income sourcing rules and transfer pricing, e-commerce and the EU VAT proposal, and virtual relationships in an e-commerce world. Jonathan Talisman, Acting Assistant Secretary for Tax Policy, Department of the Treasury, will provide the luncheon address. The second day will also include an "Ask the IRS" panel.

Those interested in attending or obtaining more information should contact The George Washington University, Conference Management Services, by phone at (202) 973-1110 or by visiting their web site at *http://www.gwu.edu/~cms/iti13.*

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

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; 2001. Covered compensation tables for the year 2001 are provided for use in determining contributions to defined benefit plans and permitted disparity.

Rev. Rul. 2000–53

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 2001 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 2001 year the taxable wage base is $80,400.

The following tables provide covered compensation for 2001:

2001 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2001 COVERED COMPENSATION TABLE II
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
1926	1991	19,728
1927	1992	21,192
1928	1993	22,716
1929	1994	24,312
1930	1995	25,920

2001 COVERED COMPENSATION TABLE—continued

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2001 COVERED COMPENSATION TABLE II
1931	1996	27,576
1932	1997	29,304
1933	1998	31,128
1934	1999	33,060
1935	2000	35,100
1936	2001	37,212
1937	2002	39,312
1938	2004	43,464
1939	2005	45,540
1940	2006	47,616
1941	2007	49,656
1942	2008	51,648
1943	2009	53,568
1944	2010	55,452
1945	2011	57,312
1946	2012	59,148
1947	2013	60,936
1948	2014	62,580
1949	2015	64,140
1950	2016	65,580
1951	2017	66,960
1952	2018	68,232
1953	2019	69,444
1954	2020	70,620
1955	2022	72,756
1956	2023	73,764
1957	2024	74,700
1958	2025	75,528
1959	2026	76,296
1960	2027	77,004
1961	2028	77,664
1962	2029	78,228
1963	2030	78,780
1964	2031	79,284
1965	2032	79,704
1966	2033	80,052
1967	2034	80,280
1968 or later	2035	80,400

2001 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	48,000
1941 - 1942	51,000
1943 - 1944	54,000
1945	57,000
1946 - 1947	60,000
1948 - 1949	63,000
1950 - 1951	66,000
1952 - 1953	69,000
1954 - 1955	72,000
1956 - 1959	75,000
1960 - 1963	78,000
1964 or later	80,400

Drafting Information

The principal author of this revenue ruling is Todd Newman of Employee Plans Actuarial Group 1 of the Tax Exempt and Government Entities 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).

Part III. Administrative, Procedural, and Miscellaneous

Qualified Subchapter S Subsidiary Election Form

Notice 2000–58

The Small Business Job Protection Act of 1996, Public Law 104–188, 110 Stat. 1755, amended section 1361 of the Internal Revenue Code to permit an S corporation (1) to own 80 percent or more of the stock of a C corporation, and (2) to elect to treat a wholly owned subsidiary as a Qualified Subchapter S Subsidiary (QSUB).

In Notice 97–4, 1997–1 C.B. 351, the Internal Revenue Service prescribed temporary election procedures for S corporations to elect QSUB treatment for a subsidiary. Those procedures included use of Form 966, *Corporate Dissolution or Liquidation,* to make the QSUB election.

Effective January 20, 2000, final regulations (TD 8869, 2000–6 I.R.B. 498 [65 F. R. 3843]) were published relating to QSUBS and other subsidiaries of S corporations. The final regulations provided that QSUB elections shall be made by filing the form to be provided for that purpose. In the preamble to those final regulations, taxpayers were instructed to continue following the instructions in Notice 97–4 until a new QSUB election form was available.

This notice supersedes Notice 97–4. The Internal Revenue Service has released the new QSUB election form, Form 8869, *Qualified Subchapter S Subsidiary Election.* Form 8869 should be used by all S corporations wishing to elect QSUB treatment for wholly owned corporate subsidiaries as directed in the instructions to the form.

DRAFTING INFORMATION

The principal author of this notice is Jeanne Sullivan of the office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Jeanne Sullivan at 202-622-3050 (not a toll-free call).

Publication 1239 (Rev. 2000)
Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips Magnetically/Electronically

Rev. Proc. 2000–49

Reprinted from IR Bulletin 2000–47
dated November 20, 2000
(and containing copies of Forms 4419, 4802, 4804, 8508, and 8809 for taxpayers' use)

NOTE: Use this revenue procedure to prepare Forms 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
- Tape Cartridges
- 8mm, 4mm and Quarter Inch-Cartridges (QIC)
- 3 1/2-inch Diskette
- 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.

Beginning in calendar year 2003 for Tax Year 2002, 9 track magnetic tape will no longer be an acceptable method for submitting Forms 8027 to IRS/MCC. See Part A, Sec. 03 and Part B, Sec. 2. In addition, IRS/MCC will no longer return problem media in need of replacement. See Part A, Sec. 2 .06 for details.

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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. 99–46 published as Publication 1239 (Rev. 03–2000), Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically. This revenue procedure is effective for Forms 8027 due the last day of February 2001 and any returns filed thereafter.

SEC. 2. NATURE OF CHANGES

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:

.01 Part A, Sec. 3, the street address for mailing magnetic returns and correspondence has changed to 240 Murall Dr.

.02 Part A, Sec. 7, Test Files was added to the publication.

.03 PART B, SEC. 2, TAPE SPECIFICATIONS, BEGINNING IN CALENDAR YEAR 2003 FOR TAX YEAR 2002, IRS/MCC WILL NO LONGER ACCEPT 9 TRACK TAPE FOR FILING FORMS 8027.

.04 Electronic filing specifications are in Part C. Numerous changes have been made to these instructions. Please read this part carefully.

.05 Part D is new and contains miscellaneous information on contacting IRS/MCC in a centralized location within the publication.

.06 BEGINNING IN CALENDAR YEAR 2002 FOR TAX YEAR 2001, IRS/MCC WILL NO LONGER RETURN PROBLEM MEDIA IN NEED OF REPLACEMENT. Filers will continue to receive a tracking form, listing and letter detailing the reason(s) their media could not be processed. Filers will be expected to send in replacement media within the prescribed time frame. This makes it **imperative** that filers maintain backup copies and/or recreate capabilities for their information return files.

SEC. 3. WHERE TO FILE AND HOW TO CONTACT THE IRS, MARTINSBURG COMPUTING CENTER

.01 All Forms 8027 filed magnetically are processed at IRS/MCC and are to be sent to the following address:

IRS-Martinsburg Computing Center
Information Reporting Program
240 Murall Drive
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 W2 **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. FORM 8508, 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 case-by-case 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. FORM 4419, APPLICATION FOR FILING INFORMATION RETURNS MAGNETICALLY/ELECTRONICALLY

.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 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. TEST FILES

.01 IRS/MCC encourages new filers to submit test files for review in advance of the filing season. Employers or transmitters must be approved to file magnetically/electronically before a test file is submitted (See Part A, Sec. 6 for application procedures.)

.02 All test files must be submitted between October 1 and December 15 of the year before the returns are due. *If you are filing* ***electronically*** *you may submit a test file through February 15 of the year the returns are due.*

SEC. 8. FILING FORMS 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 could 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. 13 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.

(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 C 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. 9. 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. 10. EXTENSION OF TIME

.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 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. 11. PROCESSING OF INFORMATION RETURNS MAGNETICALLY/ELECTRONICALLY

.01 All data received at the 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. ***Beginning in calendar year 2002 for Tax Year 2001, IRS/MCC will no longer return problem media in need of replacement.***

.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.

☛**Note: Correction should only be made to records that have been submitted incorrectly, not the entire file.**

(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.

☛**Note 1: Filers should never send anything to IRS/MCC marked "Replacement" unless IRS/MCC returned media to them.**

☛**Note 2:** ***Beginning in calendar year 2002 for Tax Year 2001, IRS/MCC will no longer return problem media in need of replacement.*** *Filers will continue to receive a tracking slip, listing and letter detailing the reason(s) their media could not be processed. Filers will be expected to send in replacement media within the prescribed time frame. This makes it* ***imperative*** *that filers maintain backup copies and/or recreate capabilities for their information return files.*

SEC. 12. 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. 13. CORRECTED RETURNS, SUBSTITUTE FORMS, AND COMPUTER-GENERATED 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 "Cor-

rected 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. 11.05 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 computer-generated forms that are exact facsimiles of the official form (except for minor page size or print style deviations), may be submitted without obtaining 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. 14.01. Corrected paper returns are identified by marking the "AMENDED" check box on Form 8027.

SEC. 14. EFFECT ON PAPER RETURNS

.01 If you are filing more than one paper Form 8027, you must attach a completed Form 8027-T, 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. 15. DEFINITION OF TERMS

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. Use the same name and EIN you used on your Forms W-2 and Forms 941.
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.
Employee 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 file that IRS/MCC has returned to the transmitter due to errors encountered during processing.

☛*Note: Beginning in calendar year 2002 for Tax Year 2001, IRS/MCC will no longer return problem media in need of replacement.*

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. 6, applies to both magnetic and electronic files.

SEC. 2. TAPE SPECIFICATIONS

☛**Note:** ***Beginning in calendar year 2003 for Tax Year 2002, IRS/MCC will no longer accept 9 track tapes for filing Forms 8027.***

.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: Type of tape - 1/2 inch (12.7mm) wide, computer grade magnetic tape on reels up to 2,400 feet (731.52 m) within the following specifications:

(a) Tape thickness: 1.0 or 1.5 mils

(b) Reel diameter: 10.5 inch (26.67 cm), 8.5 inch (21.59 cm), or 7 inch (17.78 cm) or 6-inch.

.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 COMPUTER-GENERATED 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. TAPE CARTRIDGE SPECIFICATION

.01 In most instances, IRS/MCC can process tape cartridges that meet the following specifications:

(a) Must be IBM 3480, 3490, 3490E, *3590, 3590E*, or AS400 compatible.

(b) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Tape cartridges must be 1/2-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 1/2-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 18-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:

(b) Created from an AS400 operating system only.

(c) 8mm (.315-inch) tape cartridges must be 2 1/2-inch by 3 3/4-inch.

(d) 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

(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) 4 mm cassettes must be 2 1/4-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).

(e) The general specifications for 8mm cartridges will also apply to the 4 mm cassettes.

.08 Various Quarter-Inch Cartridges (QIC)(1/4-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.

☛**Note:** ***Advanced Metal Evaporated (AME) cartridges are not acceptable.***

SEC 5. 3 1/2-INCH DISKETTE SPECIFICATIONS

IRS/MCC has discontinued processing 5 1/4-inch diskettes. Filers who use 5 1/4-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 1/2-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 three-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	96tp	hd	512

.02 IRS requires that 3 1/2-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.

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 (use P O Box only 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.**
112-113	Establishment State	2	**REQUIRED.** Enter state code of the establishment; must be one of the following:

STATE	CODE
Alabama	AL
Alaska	AK
Arizona	AZ
Arkansas	AR
California	CA
Colorado	CO
Connecticut	CT
Delaware	DE
District of Columbia	DC
Florida	FL
Georgia	GA
Hawaii	HI
Idaho	ID
Illinois	IL
Indiana	IN
Iowa	IA
Kansas	KS
Montana	MT
Nebraska	NE
Nevada	NV
New Hampshire	NH
New Jersey	NJ
New Mexico	NM
New York	NY
North Carolina	NC
North Dakota	ND
Ohio	OH
Oklahoma	OK
Oregon	OR
Pennsylvania	PA
Rhode Island	RI
South Carolina	SC
South Dakota	SD
Tennessee	TN

FORM 8027 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks

STATE	CODE	STATE	CODE
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 (use P O Box only 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.

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	Charge 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

FORM 8027 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks
			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 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. 69–28, 1969–1 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., bussers, 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.**
296-307	Direct Tips Reported	12	**REQUIRED.** Enter the total amount of tips reported by directly tipped employees (e.g., servers, 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

FORM 8027 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks
			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 Gross Receipts	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. **If no entry, 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.**
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. **If no entry, 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: 0) if allocated tips are equal to zero 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.

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 full-time 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 full-time 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.**

FORM 8027 RECORD FORMAT

Field Position	Field Title	Length	Description and Remarks
365-369	Transmitter Control Code (TCC)	5	**REQUIRED.** Enter the five-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 return/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

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

PART C. ELECTRONIC FILING SPECIFICATIONS

SEC. 1 BACKGROUND

01. *All electronic filing of information returns are received at IRS/MCC via the FIRE (Filing Information Returns Electronically) System. The FIRE System can be accessed via analog and ISDN BRI connections. The system is designed to support the electronic filing of information returns only. The telephone number for electronic filing is* ***(1-304-262-2400).*** *Publications and forms are no longer available electronically from MCC. Users needing publications and forms will need to download them from the IRS's Internet Web Site at www.irs.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) Results available within 10 workdays as to the acceptability of the data transmitted. It is the filer's responsibility to dial back in and check results.

(2) Later due date of March 31 for electronically filed Forms 8027.

(3) Better customer service due to on-line availability of transmitter's files for research purposes.

(4) Additional testing time through February 15.

SEC. 3. GENERAL

.01 Electronic filing of Forms 8027, 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. 10, explains procedures for requesting extensions of time. Filers are encouraged to file their data as soon as possible.

.05 The format is 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.

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. 6, 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 For 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 *new electronic filers to test hardware and software connectivity.* If filers wish to submit an electronic test file, it **must** be submitted to IRS/MCC **no earlier than** October and **no later than** December 15 the year before the returns are due.

.02 If a filer encounters problems while transmitting the electronic test file, 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 10 workdays 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 ***The FIRE System will be down from December 29, 2000, through January 7, 2001.*** This will allow time for IRS/MCC to update its system to reflect current year changes.

.03 Data compression is encouraged when submitting information returns electronically. *WinZip and PKZip are acceptable compression packages. UNIX COMPRESS may be acceptable; however, a test file is recommended to verify compatibility. IRS/MCC cannot accept self-extracting zip files or compressed files containing multiple files.*

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.	3 1/2 Min.	33 Min.
128K (ISDN)	8 Sec.	1 Min.	10 Min.

.04 Files submitted electronically will be assigned a unique filename by the *FIRE* System (the users may name files anything they choose from their end). The *filename assigned by the FIRE System* 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 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.

SEC. 7. TRANSMITTAL REQUIREMENTS

☛***Note: In the future, Form 4804 may not be required for ELECTRONIC filing of Forms 8027. See the bulletin area of the FIRE system for updates on this and other items of importance.***

.01 The results of the electronic transmission will be available in the File Status area of the electronic system within 10 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, which is located in the back of this publication, 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.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 your file is the TCC which must appear on the transmittal Form 4804.

.04 Forms 4804 should 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
240 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 FIRE System is designed exclusively for the filing of Forms 1042-S, 1099, 1098, 5498, 8027, W2-G and W-4.

.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 *It is the filer's responsibility to dial back to verify the acceptability of files submitted by checking the file status area of the system.* These reports will be available on the electronic system in 10 workdays after the transmission is received by IRS/MCC.

.04 Contact the FIRE 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 *(see Section 9)* or communications software *(see Section 10).* 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 is provided that can be accessed via communication software *such as Hyperterminal, Procomm, PCAnywhere, etc.*

SEC. 9. DIAL-UP NETWORK/BROWSER SPECIFICATIONS (WEB INTERFACE)

.01 The following are some general instructions (many of these settings may already be set by default in your software):

Dial-up network settings:

(a) Set dial-up server type to PPP

(b) Set network protocol to TCP/IP

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 *(Remember, this is a point-to-point connection, not the Internet.)*

.02 *Due to the large number of communication products available, it is impossible to provide specific information on all software/hardware configurations. However, since most of our filers use Windows 95, 98 or NT software, the following instructions are geared toward those products:*

UPLOADING FILES WITH DIAL-UP NETWORKING/WEB BROWSER IN WINDOWS 95/98

(1) This is a point-to-point connection – not the Internet.

(2) Your browser must be capable of file uploads, i.e., Internet Explorer 4.0 or Netscape Navigator 2.0 or higher.

(3) If you currently access the Internet via a LAN or a PROXY server, you will need to disable those options in your browser and enable 'Connect to the Internet using a modem'.

Select ***Programs***
Accessories
Communications *(Windows 98)*
Dial-Up Networking

First time connecting with Dial-Up Network *(If you have logged on previously, skip to Subsequent Dial-up Network Connections.)*

The first time you dial-in, you will need to configure your Dial-Up Networking.

Select ***'Make new connection'.***
Type a descriptive name for the system you are calling.
Select your modem.
Click ***'Next'.***
Enter area code ***304*** *and telephone number* ***262-2400.***
Click ***'Next'.***
When you receive a message that you have successfully created a new Dial-Up Networking connection, click ***'Finish'.***
Click ***'Connect'*** *to dial. If you are prompted for a user name and password, complete according to local procedures; otherwise, click* ***'OK'.***

When you receive the message that you have connected to our system, click on your Web Browser ***(remember, you are not connecting via the Internet – this is a point-to-point connection).***
In the URL Address enter ***http://10.225.224.2*** *and press* ***ENTER.***

Subsequent Dial-Up Network connections

*Click **'Connect'**.*
*If prompted for user name and password, complete according to local procedures; otherwise, click **'OK'**.*
*When you receive 'Connection Complete', click **'OK'**.*
*Click on your Web Browser **(remember, you are not connecting via the Internet).***
*In the URL Address enter **http://10.225.224.2** and press **ENTER**.*

First time connection to The FIRE System *(If you have logged on previously, skip to Subsequent Connections to the FIRE System.)*

*Click **'Create New Account'**.*
*Fill out the registration form and click **'Create'**.*
*Enter your **logon name** (most users logon with their first and last name).*
*Enter your **password** (the password is user assigned and is case sensitive).*
*Click **'Create'**.*
*If you receive the message 'account created', click **'OK'**.*
*Click **'Start the FIRE Application'***

Subsequent connections to The FIRE System

*Click **'Log On'**.*
*Enter your **logon name** (most users logon with their first and last name).*
*Enter your **password** (the password is user assigned and is case sensitive).*

At Menu Options:

*Click **'Information Returns'***
*Enter your **TCC:***
*Enter your **EIN:***
*Click **'Submit'**.*

*The system will then display the company name, address, city, state, ZIP code and phone number. This information will be used to contact or send any correspondence regarding this transmission. Update as appropriate and/or click **'Accept'**.*

Click one of the following:

Original File
Correction File
Test File
Replacement File *(if you select this option, select one of the following):*

FIRE Replacement (file was originally transmitted on this system) Click file to be replaced

Magnetic Media Replacement File
Enter the alpha character from Form 9267, Media Tracking Slip, that was returned with your magnetic media shipment.
*Click **'Submit'**.*
*Enter the **drive/path/filename** of the file you want to upload or click **'Browse'** to locate the file.*
*Click **'Upload'**.*

When the upload is complete, the screen will display the total bytes received and the file name to be recorded on your Form 4804, Box 7b.

If you have more files to upload for that TCC:
*Click **'File Another'**; otherwise,*
*Click **'Back to Main Menu'**.*

It is your responsibility to check the acceptability of your file; therefore, be sure to dial back into the system in 10 business days.

At the Main Menu:
Click **'File Stats'**.
Enter your ***TCC:***
Enter your ***EIN:***

Click ***'Search'***.

If 'Results' indicate:

'File Good' *and you agree with the 'Count of Payees' and have mailed your Form 4804, you are finished with this file. (Form 4804 is not needed on a replacement file unless the number of payees has changed from the original/correction file.)*

'File Bad' *- Correct the errors and resubmit the file as a 'replacement'.*

'Not Yet Processed' *- File has been received, but we do not have results available yet. Please check back in a few days.*

Click on the desired file for a detailed report of your transmission.
When finished viewing your files, click on ***'Main Menu'****.*
Click ***'Log Off'****.*
Close your Web Browser.

IMPORTANT

Go back into your Dial-Up Network and click 'hang-up'; otherwise, you may stay connected and incur unnecessary phone charges.

SEC. 10. COMMUNICATION SOFTWARE SPECIFICATIONS (TEXT INTERFACE)

.01 Communications software settings must be:
- No parity
- Eight data bits
- One stop bit

.02 *Terminal Emulation must be VT100.*

.03 *Due to the large number of communication products available, it is impossible to provide specific information on all software/hardware configurations. However, since most of our filers use Windows 95, 98 or NT software, the following instructions are geared toward those products (Procomm, PCAnywhere and many other communications packages are also acceptable and the product does not necessarily need to be Windows based.):*

Uploading Files Using Hyperterminal in Windows 95, 98 or NT

Select ***Programs***
Accessories
Communications *(Windows 98)*
Hyperterminal

The first time you log on, select ***Hyperterminal, Hyperterm*** *or* ***Hyperterm.exe****, whichever is available on your system. Thereafter, you can just select the icon that you have saved.*

A box will appear titled ***'Connection Description'****.*

Enter a name and choose an icon *for the connection:*
Country Code: United States of America
Area Code: ***304***
Phone Number: ***262-2400***
Connect Using: (default)
(If you need to modify the phone number, select ***File,*** *then* ***Properties*** *to enter defaults for the area code, phone numbers and/or special access codes.)*

Click on ***Dial****.*

A 'Connect' box will appear to show the status.

Once you have connected to The FIRE System, if you do not get a menu within a few seconds, press the ***ENTER*** *key one time.*

First Time Logon

When you have connected to the system, enter ***'new'*** *to create your logon name and password.*
Complete the registration information and enter ***'y'*** *to create account.*

Logon Name and Password

Logon Name*: Enter a logon name. Most users enter their first and last name as the logon name.*

***Password**: Enter a password of your choosing (1-8 alpha/numerics - case sensitive).*

After entering the password, you will go to the Main Menu.

Transferring Your Electronic File

*Enter '**A**' for Electronic Filing.*
*After reading Information Notice, press **ENTER**.*
*Enter '**A**' for Forms 1098, 1099, 5498, W-2G, 1042-S, 8027 and Questionable Forms W-4.*
*Press the Tab key to advance to TCC box; otherwise, enter '**E**' to exit.*
*Enter your **TCC**:*
*Enter your **EIN**:*

*The system will then display the company name, address, city, state, ZIP code, and phone number. This information will be used to contact or send correspondence (if necessary) regarding this transmission. If you need to update, enter '**n**' to change information; otherwise, enter '**y**' to accept.*

Select one of the following:

*'**A**' for an Original file*
*'**B**' for a Replacement file*
*'**C**' for a Correction file*
*'**D**' for a Test file*

If you selected 'B' for a replacement file, select one of the following:

*'**A**' Replacement Files For This System*
This option is to replace an original/correction file that was submitted electronically on this system but was bad and needs to be replaced. Select the file needing replaced.

*'**B**' Magnetic media replacement files*
Enter the alpha character from Form 9267, Media Tracking Slip, that was returned with your magnetic media shipment.

Choose one of the following protocols (Hyperterminal is normally set to Zmodem by default):
***X** - Xmodem*
***Y** - Ymodem*
***Z** - Zmodem (Zmodem will normally give you the fastest transfer rate.)*

At this point, you must start the upload from your PC.
To send a file:
Go to the hyperterminal menu bar.
*Click on **Transfer**.*
*Click on **Send file**.*
A box will appear titled 'Send File'.
*Enter the drive/path/filename or click on **Browse** to locate your file.*
*Click on **Send**.*

When the upload is complete, the screen will display the total bytes received and the file name to be recorded on your Form 4804, Box 7b.

*Press **ENTER** to continue.*
*If you have more files to send for the same TCC/EIN, enter '**y**'; otherwise, enter '**n**'.*

It is your responsibility to check the acceptability of your file; therefore, be sure to dial back into the system in 10 business days.

At the Main Menu:
*Enter '**B**' for file status.*
*Press the Tab key to advance to TCC box; otherwise, enter '**E**' to exit.*
*Enter your **TCC:***
*Enter your **EIN:***
Choose the appropriate option.

*Tab to the file you want to look at and press **ENTER**.*

If 'Results' indicate:

***'File Good'** and you agree with the 'Count of Payees' and have mailed your Form 4804, you are finished with this file. (Form 4804 is not needed on a replacement file unless the number of payees changes from the original/correction file.)*

***'File Bad'** - Correct the errors and resubmit the file as a replacement.*

***'Not Yet Processed'** - File has been received, but we do not have results available yet. Please check back in a few days.*

*When you are finished, enter **'E'** from the Main Menu to logoff.*

*Enter **'2'** to hang-up.*

SEC. 11. MODEM CONFIGURATION

.01 Hardware features
- **(a)** Enable hardware flow control
- **(b)** Enable modem error control
- **(c)** Enable modem compression

SEC. 12. COMMON PROBLEMS ASSOCIATED WITH ELECTRONIC FILING

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 still need to mail a signed Form 4804 by the due date of the return. See Part C, Section 7.04, for the mailing address.

2. Transmitter does not dial back to the electronic system to determine file acceptability.

The results of your file transfer are posted to the FIRE System within ten business days. It is your responsibility to verify file acceptability and, if the file contains errors, you can get an online listing of the errors. Date received and number of payee records are also displayed.

3. Incorrect file is not replaced timely.

If your file is bad, correct the file and timely resubmit as a replacement.

4. 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.

5. 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. 11, for the definition of replacement.)

6. 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.

7. File is formatted as EBCDIC.

All files submitted electronically must be in standard ASCII code.

Part D. Miscellaneous Information

Sec. 1. Addresses for Martinsburg Computing Center

To submit an application to file, Form 4840, 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
240 Murall Drive
Kearneysville, WV 25430

To submit magnetically filed and paper extension and waiver requests, 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

Telecommunication Device for the Deaf (TDD): 304-267-3367

Between 8:30 a.m. and 4:30 p.m. Eastern Time
Monday through Friday

Electronic Filing via FIRE - 1-304-262-2400

Information Returns FAX Machine: 304-264-5602

HOURS OF OPERATION – FIRE SYSTEM & FAX
24 HOURS A DAY
7 DAYS A WEEK

This is the end of Publication 1239 for Tax Year 2000.

Part IV. Items of General Interest

Registration Still Underway for the International Taxation Institute

ANNOUNCEMENT 2000–90

Registration is currently underway for the Thirteenth Annual Institute on Current Issues in International Taxation, to be held on December 7 and 8, 2000, at the J.W. Marriott Hotel in Washington, DC. The Internal Revenue Service and The George Washington University are jointly sponsoring the Institute, which is designed for professionals in international tax law. The program will offer a unique opportunity for top IRS and Treasury officials and tax experts, as well as leading private sector specialists, to present their perspectives on breaking issues in international taxation. For more information on topics and speakers, please refer to Internal Revenue Bulletin 2000–46, dated November 13, 2000, Announcement 2000–93. Those interested in attending or obtaining detailed information should contact The George Washington University, Conference Management Services, by telephone at (202) 973-1110 or by visiting their web site at http://www.gwu.edu/~cms/iti13.

Deletions from Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2000–94

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 November 20, 2000, 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, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

International Christian Fellowship, Inc.
Ponderay, ID
World University
Benson, AZ
World University Roundtable
Benson, AZ

Section 995.—Taxation of DISC Income to Shareholders

2000 base period T-bill rate. The "base period T-bill rate" for the period ending September 30, 2000, is published, as required by section 995(f) of the Code.

Rev. Rul. 2000–52

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 equivalent 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, 2000, is 5.96 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 2000 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; Rev. Rul. 98–55, 1998–2 C.B. 665; and Rev. Rul. 99–52, 1999–50 I.R.B. 652.

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 at (202) 622-3850 (not a toll-free call).

2000 ANNUAL RATE COMPOUNDED DAILY

DAYS	5.96 PERCENT FACTOR
1	.000162842
2	.000325710
3	.000488604
4	.000651525
5	.000814473
6	.000977447
7	.001140448
8	.001303475
9	.001466529
10	.001629609
11	.001792716
12	.001955849
13	.002119009
14	.002282196
15	.002445409
16	.002608649
17	.002771915
18	.002935208
19	.003098528
20	.003261874
21	.003425247
22	.003588646
23	.003752072
24	.003915524
25	.004079003
26	.004242509
27	.004406042
28	.004569601
29	.004733186
30	.004896799
31	.005060437
32	.005224103
33	.005387795
34	.005551514
35	.005715260
36	.005879032
37	.006042831
38	.006206656
39	.006370509
40	.006534387
41	.006698293
42	.006862225
43	.007026184
44	.007190170
45	.007354182
46	.007518222
47	.007682287
48	.007846380
49	.008010499
50	.008174645
51	.008338818
52	.008503017
53	.008667243
54	.008831496
55	.008995776
56	.009160082
57	.009324416
58	.009488775
59	.009653162
60	.009817576
61	.009982016
62	.010146483
63	.010310977
64	.010475497
65	.010640045
66	.010804619
67	.010969220
68	.011133848
69	.011298502
70	.011463184
71	.011627892
72	.011792627
73	.011957389
74	.012122177
75	.012286993

DAYS	5.96 PERCENT FACTOR	DAYS	5.96 PERCENT FACTOR	DAYS	5.96 PERCENT FACTOR
76	.012451835	126	.020728270	176	.029072361
77	.012616704	127	.020894487	177	.029239937
78	.012781600	128	.021060731	178	.029407540
79	.012946523	129	.021227002	179	.029575170
80	.013111473	130	.021393300	180	.029742828
81	.013276450	131	.021559625	181	.029910512
82	.013441453	132	.021725977	182	.030078225
83	.013606484	133	.021892357	183	.030245964
84	.013771541	134	.022058763	184	.030413731
85	.013936625	135	.022225197	185	.030581525
86	.014101736	136	.022391658	186	.030749347
87	.014266874	137	.022558146	187	.030917195
88	.014432039	138	.022724660	188	.031085072
89	.014597230	139	.022891203	189	.031252975
90	.014762449	140	.023057772	190	.031420906
91	.014927694	141	.023224368	191	.031588864
92	.015092967	142	.023390991	192	.031756850
93	.015258266	143	.023557642	193	.031924862
94	.015423592	144	.023724320	194	.032092903
95	.015588945	145	.023891024	195	.032260970
96	.015754325	146	.024057756	196	.032429065
97	.015919732	147	.024224516	197	.032597187
98	.016085166	148	.024391302	198	.032765337
99	.016250627	149	.024558115	199	.032933514
100	.016416115	150	.024724956	200	.033101719
101	.016581630	151	.024891824	201	.033269951
102	.016747171	152	.025058719	202	.033438210
103	.016912740	153	.025225641	203	.033606497
104	.017078336	154	.025392590	204	.033774811
105	.017243958	155	.025559567	205	.033943152
106	.017409608	156	.025726570	206	.034111521
107	.017575284	157	.025893601	207	.034279917
108	.017740988	158	.026060659	208	.034448341
109	.017906718	159	.026227745	209	.034616792
110	.018072476	160	.026394857	210	.034785271
111	.018238260	161	.026561997	211	.034953777
112	.018404072	162	.026729164	212	.035122310
113	.018569910	163	.026896358	213	.035290871
114	.018735776	164	.027063579	214	.035459459
115	.018901668	165	.027230828	215	.035628075
116	.019067588	166	.027398104	216	.035796719
117	.019233534	167	.027565407	217	.035965389
118	.019399508	168	.027732737	218	.036134087
119	.019565508	169	.027900095	219	.036302813
120	.019731536	170	.028067479	220	.036471566
121	.019897591	171	.028234892	221	.036640347
122	.020063672	172	.028402331	222	.036809155
123	.020229781	173	.028569797	223	.036977991
124	.020395917	174	.028737291	224	.037146854
125	.020562080	175	.028904813	225	.037315744

DAYS	5.96 PERCENT FACTOR
226	.037484662
227	.037653608
228	.037822581
229	.037991582
230	.038160610
231	.038329665
232	.038498749
233	.038667859
234	.038836998
235	.039006163
236	.039175357
237	.039344578
238	.039513826
239	.039683102
240	.039852406
241	.040021737
242	.040191096
243	.040360482
244	.040529896
245	.040699337
246	.040868806
247	.041038303
248	.041207827
249	.041377379
250	.041546959
251	.041716566
252	.041886200
253	.042055863
254	.042225553
255	.042395270
256	.042565016
257	.042734788
258	.042904589
259	.043074417
260	.043244273
261	.043414157
262	.043584068
263	.043754007
264	.043923973
265	.044093967
266	.044263989
267	.044434039
268	.044604116
269	.044774221
270	.044944353
271	.045114514
272	.045284702
273	.045454918
274	.045625161
275	.045795432

DAYS	5.96 PERCENT FACTOR
276	.045965731
277	.046136058
278	.046306412
279	.046476794
280	.046647204
281	.046817642
282	.046988107
283	.047158600
284	.047329121
285	.047499670
286	.047670246
287	.047840851
288	.048011483
289	.048182142
290	.048352830
291	.048523545
292	.048694289
293	.048865060
294	.049035858
295	.049206685
296	.049377539
297	.049548422
298	.049719332
299	.049890270
300	.050061235
301	.050232229
302	.050403250
303	.050574300
304	.050745377
305	.050916482
306	.051087615
307	.051258775
308	.051429964
309	.051601180
310	.051772425
311	.051943697
312	.052114997
313	.052286325
314	.052457681
315	.052629065
316	.052800477
317	.052971916
318	.053143384
319	.053314879
320	.053486403
321	.053657954
322	.053829533
323	.054001140
324	.054172776
325	.054344439

DAYS	5.96 PERCENT FACTOR
326	.054516130
327	.054687849
328	.054859596
329	.055031371
330	.055203174
331	.055375005
332	.055546863
333	.055718750
334	.055890665
335	.056062608
336	.056234579
337	.056406578
338	.056578605
339	.056750659
340	.056922742
341	.057094853
342	.057266992
343	.057439159
344	.057611354
345	.057783577
346	.057955828
347	.058128107
348	.058300415
349	.058472750
350	.058645113
351	.058817505
352	.058989924
353	.059162372
354	.059334847
355	.059507351
356	.059679883
357	.059852443
358	.060025031
359	.060197647
360	.060370291
361	.060542963
362	.060715664
363	.060888392
364	.061061149
365	.061233934
366	.061406747
367	.061579588
368	.061752457
369	.061925354
370	.062098280
371	.062271234

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 2000–59

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 2000 is 5.80 percent.[1]

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	2000	5.94	5.34 to 6.23	5.34 to 6.53

Drafting Information

The principal author of this notice is Todd Newman of the 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).

[1]In Notice 2000–55, 2000–43 I.R.B. 393, which is the weighted average interest rate update notice for October 2000, the month referred to in this paragraph should have been September 2000.

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Stock Transfer Rules: Carryover of Earnings and Taxes

REG–116050–99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations addressing transactions described in section 367(b) of the Internal Revenue Code (section 367(b) transactions). A section 367(b) transaction includes a corporate reorganization, liquidation, or division involving one or more foreign corporations. The proposed regulations address the carryover of certain tax attributes, such as earnings and profits and foreign income tax accounts, when two corporations combine in a section 367(b) transaction. The proposed regulations also address the allocation of certain tax attributes when a corporation distributes stock of another corporation in a section 367(b) transaction. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written or electronic comments and requests to speak (with outlines of oral comments) at a public hearing scheduled for March 13, 2001 must be received by February 20, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–116050–99), 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:M&SP:RU (REG–116050–99), 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/regslist.html. The public hearing will be held in room 7218, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Anne O'Connell Devereaux, at (202) 622-3850; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, at (202) 622-7180 (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, W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collection of information should be received by January 16, 2001. 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 §1.367(b)–1. This collection of information is required by the IRS to verify compliance with the regulations under section 367(b) relating to exchanges described therein. The likely respondents are corporations that are affected by such exchanges.

Estimated total annual reporting burden: 1,800 hours.

The estimated annual burden per respondent is 3 hours.

Estimated number of respondents: 600.

Estimated annual frequency of responses: One.

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 December 27, 1977, the IRS and Treasury issued proposed and temporary regulations under section 367(b) of the Code. Subsequent guidance updated and amended the 1977 temporary regulations several times over the next 14 years. On August 26, 1991, the IRS and Treasury issued proposed regulations §§1.367(b)–1 through 1.367(b)–6 (the 1991 proposed regulations). Final regulations under section 367(b) of the Internal Revenue Code (Code) were issued in June 1998 and January 2000 and the 1977 temporary regulations and the 1991 proposed regulations were generally removed. The preamble to the January 2000 final regulations refers to proposed regulations that would be issued at a later date to address the carryover of certain corporate tax attributes in transactions involving one or more foreign corporations. Those proposed regulations are set forth in this document.

Overview

A. *General Policies of Section 367(b)*

In general, section 367 governs corporate restructurings under sections 332,

351, 354, 355, 356, and 361 (Subchapter C nonrecognition transactions) in which the status of a foreign corporation as a "corporation" is necessary for the application of the relevant nonrecognition provisions. Other provisions in Subchapter C (Subchapter C carryover provisions) apply to such transactions in conjunction with the enumerated provisions and detail additional consequences that occur in connection with the transactions. For example, sections 362 and 381 govern the carryover of basis and earnings and profits from the transferor corporation to the transferee corporation in applicable transactions and section 312 governs the allocation of earnings and profits from a distributing corporation in a transaction described in section 355.

The Subchapter C carryover provisions generally have been drafted to apply to domestic corporations and U.S. shareholders, and thus do not fully take into account the cross-border aspects of U.S. taxation. For example, sections 381 and 312 do not take into account source and foreign tax credit issues that arise when earnings and profits move from one corporation to another.

Congress enacted section 367(b) to ensure that international tax considerations in the Code are adequately addressed when the Subchapter C provisions apply to an exchange involving a foreign corporation in order to prevent the avoidance of U.S. taxation. Because determining the proper interaction of the Code's international and Subchapter C provisions is "necessarily highly technical," Congress granted the Secretary broad regulatory authority to provide the "necessary or appropriate" rules rather than enacting a complex statutory regime. H.R. Rep. No. 658, 94th Cong., 1st Sess. 241 (1975). Thus, section 367(b)(2) provides in part that the regulations "shall include (but shall not be limited to) regulations . . . providing . . . the extent to which adjustments shall be made to earnings and profits, basis of stock or securities, and basis of assets."

The proposed regulations provide rules regarding the movement of certain corporate tax attributes between corporations in a Subchapter C nonrecognition transaction involving one or more foreign corporations. Generally, the regulations continue to apply the principles of the Subchapter C carryover provisions with modifications as necessary or appropriate to preserve international tax policies of the Code and to prevent material distortions of income.

The remainder of this Overview section is divided by specific categories of section 367(b) transactions and describes the relevant Subchapter C and international policies and provisions. The "Details of Provisions" portion of this preamble describes the proposed regulations' principal operative rules that implement the policies and reconcile the provisions described in the Overview portion of this preamble. The IRS and Treasury welcome comments regarding both the general approach and the specific provisions of the proposed regulations.

B. *Specific Policies Related to Inbound Nonrecognition Transactions (Prop. Reg. §1.367(b)–3)*

Proposed §1.367(b)–3 addresses acquisitions by a domestic corporation (domestic acquiring corporation) of the assets of a foreign corporation (foreign acquired corporation) in a section 332 liquidation or an asset acquisition described in section 368(a)(1), such as a C, D, or F reorganization (inbound nonrecognition transaction).

The preamble to the January 2000 final regulations generally describes international policy issues that can arise in an inbound nonrecognition transaction. The preamble states that the "principal policy consideration of section 367(b) with respect to inbound nonrecognition transactions is the appropriate carryover of attributes from foreign to domestic corporations. This consideration has interrelated shareholder-level and corporate-level components." The final regulations address the carryover of certain attributes, such as the carryover of foreign taxes, earnings and profits, and basis. However, the carryover of earnings and profits and basis are addressed only to the extent attributable to earnings and profits accumulated during a U.S. shareholder's holding period, i.e., "the all earnings and profits amount," as defined in §1.367(b)–2(d).

The preamble to the final regulations also notes that it would be consistent with the policy considerations of section 367(b) for future regulations to provide further rules with respect to the extent to which attributes carry over from a foreign corporation to a U.S. corporation. The proposed regulations do not comprehensively address this issue. Compare Modify Treatment of Built-In Losses and Other Attribute Trafficking, General Explanations of the Administration's Fiscal Year 2001 Revenue Proposals at 205. However, the proposed regulations do provide additional rules concerning several attributes, specifically net operating loss and capital loss carryovers, and earnings and profits that are not included in income as an all earnings and profits amount (or a deficit in earnings and profits). The proposed regulations generally provide that these tax attributes carry over from a foreign acquired corporation to a domestic acquiring corporation only to the extent that they are effectively connected to a U.S. trade or business (or attributable to a permanent establishment, in the case of an applicable U.S. income tax treaty).

C. *Specific Policies Related to Foreign 381 Transactions (Prop. Reg. §1.367(b)–7)*

Proposed regulation §1.367(b)–7 applies to an acquisition by a foreign corporation (foreign acquiring corporation) of the assets of another foreign corporation (foreign target corporation) in a transaction described in section 381 (foreign 381 transaction) and addresses the manner in which earnings and profits and foreign income taxes of the foreign acquiring corporation and foreign target corporation carry over to the surviving foreign corporation (foreign surviving corporation). This would include, for example, a C or D reorganization or a section 332 liquidation between two foreign corporations.

The international provisions of the Code distinguish between categories of foreign corporations. A foreign acquiring, target, or surviving corporation can be a controlled foreign corporation as defined in section 957 (CFC), a noncontrolled section 902 corporation as defined in section 904(d)(2)(E) after 2003, the effective date of section 1105(b) of Public Law 105-34 (111 Stat. 788) (the 1997 Act) (look-through 10/50 corporation and, together with CFCs, look-through corporations), a noncontrolled section 902 corporation before 2003 (non-look-through

10/50 corporation and, together with look-through 10/50 corporations, 10/50 corporations), or a foreign corporation that is neither a CFC nor a 10/50 corporation (less-than-10%-U.S.-owned foreign corporation).

The principal Code sections implicated by the carryover of earnings and profits and foreign income taxes in a foreign 381 transaction are sections 381, 902, 904, and 959. Section 381 generally permits earnings and profits (or deficit in earnings and profits) to carry over to a surviving corporation, thus enabling "the successor corporation to step into the 'tax shoes' of its predecessor. . . . [and] represents the economic integration of two or more separate businesses into a unified business enterprise." H. Rep. No. 1337, 83rd Cong., 2nd Sess. 41 (1954). However, a deficit in earnings and profits of either the transferee or transferor corporation can only be used to offset earnings and profits accumulated after the date of transfer (hovering deficit rule). Section 381(c)(2)(B). The hovering deficit rule is a legislative mechanism designed to deter the trafficking in favorable tax attributes that the IRS and courts had repeatedly encountered. See, e.g., *Commissioner v. Phipps*, 336 U.S. 410 (1949). The proposed regulations adopt the principles of section 381 but adapt its operation in consideration of the international provisions that address foreign corporations' earnings and profits and their related foreign income taxes, such as sections 902, 904, and 959.

Section 902 generally provides that a deemed paid foreign tax credit is available to a domestic corporation that receives a dividend from a foreign corporation in which it owns 10 percent or more of the voting stock (i.e., a look-through corporation or non-look-through 10/50 corporation). The Code modifies the general last-in, first-out (LIFO) rule of section 316 and provides that look-through corporations and non-look-through 10/50 corporations pay dividends out of multi-year pools of earnings and profits and foreign income taxes for earnings and profits accumulated (and related foreign income taxes paid or deemed paid) in taxable years beginning after December 31, 1986, or the first day after which a domestic corporation owns 10 percent or more of the voting stock of a foreign corporation, whichever is later. Section 902(c). (The Code and regulations refer to pooled earnings and profits and foreign income taxes as post-1986 undistributed earnings and post-1986 foreign income taxes even though a particular corporation may begin to pool after 1986. Sections 902(c)(1) and (2), §1.902–1(a)(8) and (9).)

Congress enacted the pooling rules because it believed that averaging of foreign income taxes was fairer than distributions out of annual layers. Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 (Public Law 99–514) (1986 Bluebook) at 870. Averaging prevents taxpayers from inflating their foreign income tax rate for a particular year in order to obtain artificially enhanced foreign tax credits. Id. Averaging also prevents the trapping of foreign income taxes in years in which a taxpayer may have no earnings and profits. Id. However, Congress enacted pooling on a limited basis. Earnings and profits accumulated (and related foreign income taxes paid or deemed paid) while a foreign corporation is a less-than-10%-U.S.-owned foreign corporation and pre-1987 earnings and profits accumulated (and related foreign income taxes paid or deemed paid) by a look-through corporation or non-look-through 10/50 corporation are not pooled. Rather, such earnings and profits (and related foreign income taxes) are maintained in separate annual layers. Section 902(c)(6). (The Code and regulations refer to earnings and profits and foreign income taxes in annual layers as pre-1987 accumulated profits and pre-1987 foreign income taxes even though a particular corporation may have annual layers for years after 1986. Section 902(c)(6); §1.902–1(a)(10).)

A distribution of earnings and profits is first out of pooled earnings and profits and then, only after all pooled earnings and profits have been distributed, out of annual layers of earnings and profits on a LIFO basis. Section 902(a) and (c). The retention of annual layers beneath pooled earnings and profits limits the need to recreate tax histories, an administrative burden that is more significant for periods during which a corporation had limited nexus to the U.S. taxing jurisdiction and for pre-1987 earnings and profits when pooling was not required.

The section 904 foreign tax credit limitation ensures that taxpayers can use foreign tax credits only to offset U.S. tax on foreign source income. The limitation is computed separately with respect to different categories of income (baskets). The purpose of the baskets is to limit taxpayers' ability to cross-credit taxes from different categories of foreign source income. Congress was concerned that, without separate limitations, cross-crediting opportunities would distort economic incentives to invest in the United States versus abroad. 1986 Bluebook at 862.

A dividend received by a U.S. shareholder that owns less than 10 percent of the stock of a foreign corporation is categorized as passive income because such a dividend is in the nature of a portfolio investment. 1986 Bluebook at 866.

A dividend received by a U.S. shareholder that owns 10 percent or more of a foreign corporation is subject to other limitations. Dividends paid by a non-look-through 10/50 corporation to a 10 percent or greater U.S. corporate shareholder are currently subject to a separate basket limitation on a corporation-by-corporation basis. Congress initially separately basketed dividends from each 10/50 corporation because it believed a minority investment in a foreign corporation did not create sufficient identity of interest to justify look-through treatment and that cross-crediting of taxes among investments in 10/50 corporations was inappropriate because the foreign companies were not parts of a single economic unit. 1986 Bluebook at 868. In addition, Congress was concerned about the administrability of applying the look-through rules to 10/50 corporations. 1986 Bluebook at 868.

In 1997, Congress amended the Code's treatment of dividends from 10/50 corporations to provide that dividends paid after taxable years beginning after December 31, 2002 by a look-through 10/50 corporation out of earnings and profits accumulated before 2003 are subject to a single separate basket limitation for all 10/50 corporations, while dividends paid out of earnings and profits accumulated after 2003 are treated as income in a basket based on the ratio of the earnings and profits attributable to income in such basket to the foreign corporation's total earnings and profits (the so-called "look-through" approach). Earnings and profits accumulated after 2003 by a look-through

10/50 corporation are distributed before earnings and profits accumulated by that same foreign corporation before 2003. Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997 (1997 Bluebook) at 303.

The legislative history indicates that Congress changed its view with respect to 10/50 corporations because the separate basket limitation for dividends from each 10/50 corporation imposed a substantial recordkeeping burden and discouraged minority investments in foreign joint ventures. 1997 Bluebook at 302. However, as described above, the 1997 Act enacted look-through treatment for 10/50 corporation dividends only on a limited basis. Furthermore, Congress provided regulatory authority regarding the treatment of distributions out of earnings and profits for periods prior to a taxpayer's acquisition of stock in a look-through 10/50 corporation because of concerns that look-through treatment could provide inappropriate opportunities to traffic in foreign tax credits.

Dividends paid by a CFC out of earnings and profits accumulated while the corporation was not a CFC are treated as a distribution from a 10/50 corporation while dividends paid out of earnings and profits accumulated while the corporation was a CFC are eligible for look-through treatment. Section 904(d)(2)(E)(i) and (d)(3). As in the case of a look-through 10/50 corporation, pooled earnings and profits of a CFC that are eligible for look-through treatment are distributed before other pooled earnings and profits. Prop. Reg. §1.904–4(g)(3)(iii). Congress provided look-through treatment for dividends paid by CFCs in order to provide greater parity between the treatment of income earned through a branch and a subsidiary. 1986 Bluebook at 866.

Before 1997, except as otherwise provided in regulations, dividend distributions to a 10 percent U.S. shareholder of a CFC did not obtain look-through treatment unless the distributed earnings and profits accrued while the shareholder was a 10 percent U.S. shareholder and the corporation was a CFC. Section 904(d)(2)(E)(i), as in effect before the 1997 Act. This rule was intended to prevent trafficking in foreign income taxes related to preacquisition earnings and profits. However, because of the administrative issues presented by maintaining shareholder-level earnings and profits accounts, Congress modified the rule in 1997 to provide that look-through treatment applies with respect to CFC earnings and profits without regard to whether a 10 percent U.S. shareholder was a shareholder at the time accumulated. However, pre-CFC earnings and profits continue to be treated as earnings and profits of a 10/50 corporation because of foreign tax credit trafficking concerns.

The section 904 basketing rules reflect Congress' concern with respect to cross-crediting opportunities and its intent to limit the benefit of look-through treatment to appropriate circumstances. Where Congress determined that look-through is inappropriate, a dividend is treated as passive income or is subject to a separate limitation for 10/50 corporations (whether separately or collectively). Regulations have not yet been issued with respect to preacquisition earnings and profits of a look-through 10/50 corporation and the effect, if any, on the treatment of pre-CFC earnings and profits described in section 904(d)(2)(E)(i). The IRS and Treasury solicit comments as to the appropriate treatment of such earnings and profits after 2003 in light of Congress' anti-trafficking concerns, as well as the impact that such rules should have on the section 367(b) regulations.

Another international provision implicated by the movement of earnings and profits in foreign 381 transactions is section 959. Section 959 governs the distribution of earnings and profits that have been previously taxed to U.S. shareholders under section 951(a) (PTI). After studying the interaction of section 367(b) and the PTI rules, the IRS and Treasury determined that more guidance under section 959 would be useful before issuing regulations to address PTI issues that arise under section 367(b). Accordingly, the IRS and Treasury have opened a separate regulations project under section 959 and expect to issue regulations that address PTI issues under section 959 as well as section 367(b) in the future. The fundamental issue under consideration in that project is whether earnings and profits that are treated as PTI should be distributable to another shareholder, as well as the various implications that result from that determination. The IRS and Treasury invite comments with respect to these issues. Accordingly, the proposed regulations reserve on section 367(b) issues related to PTI.

Other sections may have also applied to characterize pre-transaction earnings of a foreign acquiring corporation or a foreign target corporation for certain purposes of the Code. For example, certain earnings may have been subject to characterization as U.S. source earnings under section 904(g), effectively connected earnings and profits under section 884, or post-1986 undistributed U.S. earnings under section 245. The characterization of such earnings carry over to the foreign surviving corporation for purposes of applying the relevant Code sections. See *Georday Enterprises v. Commissioner*, 126 F.2d 384 (4th Cir. 1942).

D. *Specific Policies Related to Foreign Divisive Transactions (Prop. Reg. §1.367(b)–8)*

Proposed regulation §1.367(b)–8 addresses the allocation of earnings and profits and foreign income taxes in a transaction described in section 312(h) (that is, a section 355 distribution whether or not in connection with a section 368(a)(1)(D) reorganization) in which either or both the distributing or the controlled corporation is a foreign corporation (foreign divisive transaction). The scope of proposed §1.367(b)–8 thus encompasses three situations: a domestic distributing corporation that distributes stock of a foreign controlled corporation, a foreign distributing corporation that distributes stock of a domestic controlled corporation, and a foreign distributing corporation that distributes stock of a foreign controlled corporation. The proposed regulations generally adopt the principles embodied in the regulations under section 312(h) but modify their application in consideration of the international provisions such as the source and foreign tax credit rules.

Regulations under section 312(h) reflect the principle that a pro rata portion of a distributing corporation's earnings and profits should be reduced to account for the distribution of a portion of its assets. §1.312–10. Furthermore, the earnings and profits of a controlled corporation should include the portion of the distributing corporation's earnings and profits allocable to

any assets transferred to the controlled corporation in connection with a section 368(a)(1)(D) reorganization (D reorganization) that immediately precedes the section 355 distribution (together with a D reorganization, a D/355 distribution). §1.312–10(a). If a section 355 distribution is not preceded by a D reorganization, the earnings and profits of the controlled corporation are at least equal to the amount of the reduction in the distributing corporation's earnings and profits. §1.312–10(b). It is likely that this rule was included to prevent taxpayers from using a section 355 distribution as a device to facilitate a bailout of earnings and profits through the controlled corporation. (The §1.312–10 rules are derived from the Senate's directions to the IRS and Treasury in implementing the regulatory authority in section 312(h); the Senate Report does not, however, explain its reasons for these rules. Senate Finance Committee, Report on H.R. 8300 (1954), at 249.)

The application of the §1.312–10 rules to foreign divisive transactions implicates the Code's international provisions because earnings and profits are moving in the cross-border context and because the earnings and profits of controlled foreign corporations are being adjusted. In transactions involving a domestic distributing corporation and a foreign controlled corporation, the foreign controlled corporation may succeed to earnings and profits of the domestic distributing corporation. A post-transaction distribution by the foreign controlled corporation out of earnings and profits it receives from the domestic distributing corporation is generally eligible for the dividends received deduction and treated as U.S. source income under sections 243(e) and 861(a)(2)(C). This treatment is appropriate because the earnings and profits have already been subject to U.S. corporate taxation and should not be subject to a second level of U.S. corporate tax upon repatriation if the earnings and profits would have qualified for the dividends received deduction if distributed before the section 355 distribution. H.R. Rep. No. 2101, at 3 (1960). In addition, such earnings and profits should not increase a domestic distributee's foreign tax credit limitation under section 904.

In circumstances where the foreign controlled corporation makes a post-transaction distribution to foreign shareholders, the foreign divisive transaction should not alter the character of earnings and profits allocated from the domestic distributing corporation. Otherwise, the section 355 distribution may serve as a vehicle to avoid U.S. tax, including U.S. withholding tax. Accordingly, the proposed regulations provide that a post-transaction distribution out of earnings and profits of a distributing corporation that carry over to a foreign controlled corporation is generally treated as a U.S. source dividend for purposes of Chapter 3 of subtitle A of the Code. See *Georday Enterprises v. Commissioner*, 126 F.2d 384 (4th Cir. 1942).

Foreign divisive transactions involving a foreign distributing corporation and a domestic controlled corporation are similar to inbound nonrecognition transactions to the extent the domestic controlled corporation receives assets of a foreign corporation. Current regulations under §1.367(b)–3 require direct and indirect U.S. shareholders in an inbound asset reorganization to include an all earnings and profits amount in income in order to ensure, in part, that the bases of assets repatriated to the United States reflect an after-tax amount. Section 1.367(b)–3(d) and proposed §1.367(b)–3(f) provide further rules regarding the carryover of earnings and profits and foreign income taxes from a foreign corporation to a domestic corporation. Those rules should also apply to a section 355 distribution involving a foreign distributing corporation and a domestic controlled corporation. These transactions also implicate the current rules under §1.367(b)–5, because a reduction in a foreign distributing corporation's earnings and profits can directly affect the post-transaction application of section 1248 with respect to U.S. shareholders of the distributing corporation.

Foreign divisive transactions involving a foreign distributing corporation and a foreign controlled corporation raise issues similar to those raised in the context of a foreign 381 transaction described in §1.367(b)–7, to the extent the controlled corporation succeeds to earnings and profits (and related foreign income taxes) of the distributing corporation. Accordingly, the proposed regulations adopt the principles of §1.367(b)–7 to determine the manner in which the foreign controlled corporation succeeds to the earnings and profits (and related foreign income taxes) of a foreign distributing corporation. These transactions also implicate the §1.367(b)–5 rules concerning diminutions in U.S. shareholders' section 1248 amounts.

The proposed regulations under §1.367(b)–8 balance the §1.312–10 rules and policies with the interests and concerns of the relevant international provisions of the Code. However, the IRS and Treasury recognize that the mechanics of §1.312–10 as applied in the international context can be cumbersome and complex. The IRS and Treasury solicit comments as to whether the mechanical difficulties of applying the section 312 rules in the cross-border context outweigh the benefits and, if so, whether there are simpler alternative regimes that would address the international policy concerns without compromising the Subchapter C policies embodied in §1.312–10.

Details of Provisions

A. *Prop. Reg. §1.367(b)–1*

The proposed regulations supplement the current §1.367(b)–1 notice requirements in consideration of the transactions addressed by proposed §§1.367(b)–7 and 1.367(b)–8. Accordingly, foreign surviving corporations described in proposed §1.367(b)–7 and distributing and controlled corporations involved in transactions described in proposed §1.367(b)–8 are included within the scope of the §1.367(b)–1 notice requirement.

B. *Prop. Reg. §1.367(b)–3*

The proposed regulations address the carryover of net operating loss and capital loss carryovers, and earnings and profits that are not included in income as an all earnings and profits amount (or a deficit in earnings and profits). The proposed regulations generally provide that these tax attributes do not carry over from a foreign acquired corporation to a domestic acquiring corporation unless they are effectively connected to a U.S. trade or business (or attributable to a permanent establishment, in the context of a relevant U.S. income tax treaty).

The limitations on the carryover of these attributes prevent inappropriate or anomalous results. For example, net op-

erating loss and capital loss carryovers are eligible to carry over from a foreign acquired corporation to a domestic acquiring corporation only to the extent the underlying deductions or losses were allowable under Chapter 1 of subtitle A of the Code. Thus, only a net operating loss or capital loss carryover that is effectively connected to a U.S. trade or business (or attributable to a permanent establishment) may carry over. Inappropriate or anomalous results are thus avoided because losses incurred by a foreign acquired corporation outside the U.S. taxing jurisdiction should not be available to offset the future U.S. tax liability of a domestic acquiring corporation. Otherwise, a taxpayer would have an incentive to import losses into the United States in order to shelter future income from U.S. tax.

The carryover of earnings and profits (or a deficit in earnings and profits) of the foreign acquired corporation can create similarly inappropriate results. For example, the policies underlying the section 243(a) dividends received deduction are not present with respect to a subsequent distribution by the domestic acquiring corporation out of earnings and profits accumulated by the foreign acquired corporation because those earnings and profits are not generally subject to a U.S. corporate level of tax. On the other hand, if the foreign acquired corporation has PTI, those earnings should not be taxed again when distributed to U.S. shareholders to whom the PTI is attributable regardless of whether or not the U.S. shareholder is eligible for the dividends received deduction. A deficit in earnings and profits can also be used to avoid tax, such as in the case of a foreign shareholder of a domestic acquiring corporation that imports a deficit and therefore is not subject to U.S. withholding tax on subsequent corporate distributions.

As a result of the issues raised by a carryover of earnings and profits and given that §1.367(b)–3 already requires U.S. shareholders to include in income as a deemed dividend the all earnings and profits amount, the proposed regulations provide that earnings and profits (or deficit in earnings and profits) of the foreign acquired corporation do not carry over to the domestic acquiring corporation except to the extent effectively connected to a U.S. trade or business (or attributable to a permanent establishment, in the context of a relevant U.S. income tax treaty).

C. *Prop. Reg. §1.367(b)–7*

Proposed §1.367(b)–7 provides the manner in which a foreign surviving corporation succeeds to and takes into account the earnings and profits and foreign income taxes of a foreign acquiring corporation and a foreign target corporation. The proposed regulation attempts to preserve the character of earnings and profits and foreign income taxes to the extent possible in light of the applicable statutory limitations, as well as the relevant policy and administrative concerns. Compare §1.381(c)(2)–1(a)(3) (ensuring that earnings and profits accumulated before March 1, 1913 retain their character as pre-1913 earnings and profits after a section 381 transaction). Accordingly, the proposed rules provide that, to the extent possible, pooled earnings and profits (and foreign income taxes) remain pooled, earnings and profits (and foreign income taxes) in annual layers remain in annual layers, foreign income taxes trapped before the transaction remain trapped after the transaction, and earnings and profits (and foreign income taxes) remain in the same basket before and after the transaction.

The proposed regulation also respects the section 902 preference for distributing pooled earnings and profits before earnings and profits in annual layers. Accordingly, proposed §1.367(b)–7 provides that a foreign surviving corporation's pooled earnings and profits are distributed first (even though earnings and profits in the annual layers may have been accumulated after earnings and profits in the pool) and annual layers are distributed on a LIFO basis. Similarly, the proposed regulation also incorporates the section 904 preference for distributing pooled earnings and profits eligible for look-through before other pooled earnings and profits.

However, in certain cases, an overriding statutory policy requires that the proposed regulation modify the character of earnings and profits (and related foreign income taxes). For example, if a CFC combines with a non-look-through 10/50 corporation in a foreign 381 transaction and the foreign surviving corporation is a non-look-through 10/50 corporation, dividends paid by the surviving non-look-through 10/50 corporation are required to be separately basketed and do not obtain the benefit of look-through. Thus, earnings and profits of a CFC that would have obtained the benefit of look-through if distributed before the foreign 381 transaction are not eligible for look-through after the transaction. (The loss of look-through in connection with this type of foreign 381 transaction is somewhat ameliorated by a U.S. shareholder's section 1248 amount inclusion under §1.367(b)–4 with respect to earnings and profits that accrued during its holding period.)

Proposed regulation §1.367(b)–7 also provides rules regarding the carryover of deficits in earnings and profits from one foreign corporation to another. The purpose of the hovering deficit rule in the domestic context is to prevent the trafficking of deficits in earnings and profits. Otherwise, a corporation with positive earnings and profits may acquire or be acquired by another corporation with a deficit in earnings and profits and make distributions out of capital rather than earnings and profits.

In transactions involving foreign corporations, similar concerns exist regarding the trafficking of deficits in earnings and profits. The ability to benefit from combining positive and deficit earnings and profits among foreign corporations is different than in the domestic context, however, because of the nature of the foreign tax credit rules. In a reorganization involving two domestic corporations, the hovering deficit rule applies to a corporation with a net accumulated deficit in earnings and profits because the relevant statutory rules do not distinguish among classes of earnings and profits. In contrast, the foreign tax credit rules require further subcategorization of earnings and profits according to the pooling and basketing rules. Because of these distinctions, taxpayers may inappropriately benefit by trafficking in an earnings and profits deficit in a basket, pool, or particular annual layer, even though a corporation may have net positive earnings and profits. Accordingly, the proposed regulations apply the hovering deficit principle to the relevant subcategories of earnings and profits and provide that foreign income taxes related to the deficit are not added to the foreign surviving corpora-

tion's foreign income tax accounts until all of the deficit has been offset with post-transaction earnings. (Under proposed §1.367(b)–9 (which is described below), these hovering deficit rules do not apply to F reorganizations and foreign 381 transactions in which either the foreign target corporation or the foreign acquiring corporation is newly created.)

Because the treatment of distributions by a foreign surviving corporation depends on whether it is a look-through corporation, a non-look-through 10/50 corporation, or a less-than-10%-U.S.-owned foreign corporation, proposed §1.367(b)–7 is divided according to these categories. The proposed regulation uses the term surviving corporation in order to prevent confusion between the acquiring corporation and the foreign surviving entity. In addition, the term highlights the proposed regulation's general approach that provides the same results regardless of whether a corporation is the ostensible acquiring or target corporation.

1. *Look-through surviving corporation*

Where the foreign surviving corporation is a look-through corporation, the proposed regulation generally preserves the character of earnings and profits and foreign income taxes. For example, if a CFC (CFC1) acquires the assets of another CFC (CFC2) in a foreign 381 transaction and the surviving corporation is a CFC, then the corporations' positive amounts of earnings and profits and foreign income taxes would carry over in a manner that combines the look-through earnings and profits pools (and related foreign income taxes) of each corporation on a basket-by-basket basis. Thus, for example, CFC1's passive basket would be combined with CFC2's passive basket, CFC1's general basket would be combined with CFC2's general basket, and so forth.

If CFC1 or CFC2 has pooled earnings and profits or foreign income taxes that do not qualify for look-through treatment (non-look-through pool) (for example, earnings and profits accumulated during a period when the corporation was not a CFC and that are subject to a separate 10/50 limitation), such earnings and profits and foreign income taxes would be distributed only after all of the look-through earnings and profits pool has been distributed. This rule is consistent with the ordering rule in Prop. Reg. §1.904–4(g)(3)(iii), which provides that when a 10/50 corporation becomes a CFC, pooled earnings and profits accumulated and foreign income taxes paid or accrued while the corporation is a CFC are distributed before pooled earnings and profits accumulated and foreign income taxes paid or accrued while the corporation was a 10/50 corporation. (If the foreign surviving corporation is instead a look-through 10/50 corporation, this rule is also consistent with the earnings and profits in the look-through pool being distributed before earnings and profits in the non-look-through pool.)

When earnings and profits from the non-look-through pool are distributed, the earnings and profits will be distributed pro rata out of the non-look-through pools of CFC1 and CFC2 (if any) and placed in two separate baskets under section 904(d)(1)(E). This preserves the character of the earnings and profits and related foreign income taxes and is consistent with the policy of section 904(d)(1)(E) to maintain separate baskets for each 10/50 corporation. After 2003, these earnings and profits will continue to be distributed pro rata from separate non-look-through pools but will be combined into a single 10/50 basket in the hands of the distributee. Maintaining separate pools prevents the refreshing of foreign income taxes that would have been trapped had the foreign 381 transaction not occurred. (The same rules apply in the case of a foreign surviving corporation that is a look-through 10/50 corporation.)

If CFC1 or CFC2 has pre-1987 accumulated profits (i.e., annual layers of earnings and profits) or foreign income taxes, then those earnings and profits are distributed only after the distribution of all pooled earnings and profits and taxes, regardless of whether those earnings and profits may have been accumulated after the pooled earnings and profits of the other corporation. Such earnings and profits are distributed on a LIFO basis and pro rata out of the respective corporation's annual layers if both companies have earnings and profits in the same year that are treated as pre-1987 accumulated profits and foreign income taxes. This rule respects two international policies. First, pooled earnings and profits are distributed before earnings and profits in annual layers. Second, earnings and profits in annual layers should not be pooled unless they are distributed to an upper-tier entity. Compare §1.902–1(a)(8)(ii) (providing that distributions out of pre-1987 earnings and profits by a lower-tier corporation are included in the post-1986 earnings and profits of an upper-tier corporation). This rule is also consistent with the section 902 rule that traps foreign income taxes in annual layers in which there are no earnings and profits.

These results preserve the character of earnings and profits and taxes because pooled earnings and profits and taxes remain pooled, earnings and profits and taxes retain the same character under the look-through provisions, and foreign income taxes that were trapped before the foreign 381 transaction remain trapped. The rules are also consistent with concerns about limiting the administrative burden of requiring taxpayers to recreate tax histories.

Because of the foreign tax credit considerations presented by foreign 381 transactions, §1.367(b)–7 applies the hovering deficit rule to subcategories of earnings and profits. Thus, deficits in the look-through pool, non-look-through pool, and net deficits in annual layers can offset only future earnings and profits of the foreign surviving corporation. In addition, a hovering deficit cannot be used to reduce current earnings and profits of the foreign surviving corporation and, as a result, does not reduce subpart F income. Foreign income taxes related to a hovering deficit do not enter the foreign income tax accounts of the surviving corporation until the entire hovering deficit offsets post-transaction earnings and profits. However, foreign income taxes related to the post-transaction earnings that are offset by the hovering deficit immediately enter the foreign income tax accounts of the foreign surviving corporation.

2. *Non-look-through 10/50 surviving corporation*

The proposed regulation's rules with respect to a non-look-through 10/50 corporation apply if the foreign surviving corporation is a 10/50 corporation before 2003. The principal statutory limitation of a non-look-through 10/50 corporation

is that a dividend distribution is not eligible for look-through treatment and is instead separately basketed for each 10/50 corporation. As a result, earnings and profits of an acquiring or target corporation that would have been eligible for look-through (assuming the corporation qualified under the look-through rule) if distributed before the foreign 381 transaction lose their look-through character after the transaction.

For example, suppose a CFC combines with a non-look-through 10/50 corporation in a foreign 381 transaction in 2001 and the surviving entity is a non-look-through 10/50 corporation. Prior to the transaction, the CFC maintained earnings and profits and foreign income tax accounts expecting that the look-through rules would apply on a distribution of earnings and profits to U.S. shareholders. However, after the foreign 381 transaction, section 904(d)(1)(E) requires that a distribution from the surviving 10/50 corporation will be deemed to be paid out of a single pool of earnings and profits that will be separately basketed. In order to address the carryover of attributes to a non-look-through 10/50 corporation in a manner consistent with section 904(d)(1)(E), the proposed regulations combine the net positive earnings and profits and foreign income taxes in the respective pools of the acquiring and target corporations. (Thus, the separate baskets of pooled earnings and profits and foreign income taxes of the CFC would be netted into a single pool along with the non-look-through 10/50 corporation's pooled earnings and profits and foreign income taxes.)

Annual layers of the acquiring and target corporations are carried over to the foreign surviving corporation under the same rules as described above with respect to look-through corporations. Hovering deficit rules similar to those described with respect to a look-through corporation's non-look-through pool and annual layers also apply to surviving non-look-through 10/50 corporations.

Look-through treatment of earnings and profits and foreign income taxes does not re-emerge if the corporation later becomes a look-through corporation. For example, if the surviving non-look-through 10/50 corporation becomes a CFC, all of the earnings and profits and foreign income taxes of the surviving non-look-through 10/50 corporation remain as earnings and profits to which the look-through rules do not apply. Look-through only applies to earnings and profits accumulated after the corporation becomes a CFC. The IRS and Treasury believe that this rule is appropriate because of the administrative difficulties posed by recreating tax histories. In addition, earnings and profits and foreign income taxes of a CFC accumulated during a U.S. shareholder's holding period are generally deemed distributed (and the look-through rules apply) if a U.S. shareholder includes a section 1248 amount in income under §1.367(b)–4 in connection with the foreign 381 transaction.

3. *Less-than-10%-U.S.-owned foreign surviving corporation*

Proposed §1.367(b)–7 also determines the manner in which earnings and profits and foreign income taxes of the acquiring and target corporation are combined if the foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation. Generally, rules similar to the rules provided for annual layers of look-through corporations and non-look-through 10/50 corporations apply with respect to the annual layers of the acquiring and target corporation, but the rules take into account the possibility that one of the corporations may have been a CFC or 10/50 corporation immediately prior to the foreign 381 transaction.

If either the acquiring or target corporation is a CFC or a 10/50 corporation, its pooled earnings and profits and foreign income taxes are treated as earnings and profits and foreign income taxes accumulated in the annual layer of the applicable corporation immediately before the foreign 381 transaction. For example, suppose a less-than-10%-U.S.-owned foreign corporation combines with a 10/50 corporation and the foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation. The foreign surviving corporation is an entity that has never been required to pool earnings and profits and foreign income taxes under section 902(c)(3). Accordingly, distributions from the foreign surviving corporation are out of annual layers on a LIFO basis. Rather than recreating the tax history of the acquired 10/50 corporation for each year, the proposed regulation places all pooled earnings and profits and foreign income taxes of the 10/50 corporation into a single annual layer that closes immediately before the foreign 381 transaction. This rule is intended to ameliorate administrative burdens while respecting the policy that earnings and profits and foreign income taxes are distributed from annual layers for a less-than-10%-U.S.-owned foreign corporation. Because of concerns about neutrality, the same result applies regardless of whether the 10/50 corporation is the ostensible acquiring or target corporation.

If the surviving less-than-10%-U.S.-owned foreign corporation later becomes a non-look-through 10/50 corporation or a look-through corporation, earnings and profits and foreign income taxes that were pooled or obtained the benefit of look-through prior to the foreign 381 transaction are not recreated. Instead, those earnings and profits and foreign income taxes remain as earnings and profits accumulated and foreign income taxes paid or deemed paid while the corporation was a less-than-10%-U.S.-owned foreign corporation. As in the case of a surviving non-look-through 10/50 corporation that later becomes a look-through corporation, this rule is provided because of administrative issues associated with recreating tax histories. In addition, earnings and profits and foreign income taxes of a CFC accumulated during a shareholder's holding period generally would have been deemed distributed (and the look-through rules would have applied) if the shareholder was required to include a section 1248 amount in income under §1.367(b)–4 in connection with the foreign 381 transaction.

D. *Prop. Reg. §1.367(b)–8*

Section 1.367(b)–8 provides rules applicable to foreign divisive transactions. The regulation is divided into four sections. Section 1.367(b)–8(b) provides rules that are generally applicable to foreign divisive transactions. The other three sections describe the application of the general rules to specific situations. Section 1.367(b)–8(c) applies to a distribution by a domestic distributing corporation of the stock of a foreign controlled corporation, §1.367(b)–8(d) applies to a distribution by a foreign distributing cor-

poration of the stock of a domestic controlled corporation, and §1.367(b)–8(e) applies to a distribution by a foreign distributing corporation of the stock of a foreign controlled corporation.

1. *General rules applicable to foreign divisive transactions*

Section 1.367(b)–8(b) provides that the rules of §1.312–10 generally apply to determine the allocation of earnings and profits between a distributing and a controlled corporation, as well as to determine the reduction in the earnings and profits of a distributing corporation. The rules of §1.312–10 are, however, subject to certain modifications.

In a D/355 distribution involving a controlled corporation that is newly created as part of the transaction, §1.312–10(a) allocates the pre-transaction earnings and profits of the distributing corporation between the distributing and controlled corporations based upon a comparison of the fair market values of the assets received by the controlled corporation and the assets retained by the distributing corporation after the D reorganization. Section 1.312–10(a) provides that, "in a proper case," this allocation should be based on the relative net bases of the assets transferred and retained by the distributing corporation, or based on another "appropriate" method.

The proposed regulations generally adopt the rule of §1.312–10(a), except that the allocation is based upon relative net adjusted bases of assets transferred and retained in all cases. This rule reflects the view that net basis is the most accurate measure of the appropriate amount of earnings and profits that should be allocated to the assets transferred by a distributing corporation in the D reorganization. For example, in cases where the controlled corporation recognizes gain on a later sale or distribution of appreciated property that it receives from the distributing corporation an allocation based upon relative bases prevents a misallocation of earnings and profits to the controlled corporation.

In a section 355 distribution that is not preceded by a D reorganization, §1.312–10(b) provides that the earnings and profits of the distributing corporation are decreased by an amount equal to the lesser of (i) the amount by which the earnings and profits of the distributing corporation would have been decreased if it had transferred the stock of the controlled corporation to a new corporation in a D/355 distribution, and (ii) the net worth of the controlled corporation. For this purpose, net worth is defined as "the sum of the bases of all of the properties plus cash minus all liabilities." If "the earnings and profits of the controlled corporation immediately before the transaction are less than the amount of the decrease in earnings and profits of the distributing corporation . . . the earnings and profits of the controlled corporation, immediately after the transaction, shall be equal to the amount of such decrease. If the earnings and profits of the controlled corporation immediately before the transaction are more than the amount of the decrease in the earnings and profits of the distributing corporation, they shall remain the same."

Section 1.312–10(b) reflects the principle that a pro rata portion of a distributing corporation's earnings and profits should be reduced to account for the distribution of the controlled corporation. In addition, the requirement that the earnings and profits of the controlled corporation at least equal the reduction in the distributing corporation's earnings and profits appears intended to prevent a bailout of earnings and profits through the controlled corporation, while preventing the potential double counting of earnings and profits in situations where the distributing corporation did not organize the controlled corporation.

In consideration of the complexities raised by the cross-border application of the §1.312–10(b) adjustment to the controlled corporation's earnings and profits, taken together with the current rules that prevent the potential bailout of earnings and profits in the international context (such as the §1.367(b)–5 requirement that a shareholder include in income a reduction in its section 1248 amount), the IRS and Treasury have concluded that the §1.312–10(b) rules should be modified when applied to section 367(b) transactions. Accordingly, the proposed regulations provide that the earnings and profits of the distributing corporation are decreased in an amount equal to the amount by which the earnings and profits of the distributing corporation would have been decreased if it had transferred the stock of the controlled corporation to a new corporation in a D/355 distribution. However, the earnings and profits of the controlled corporation are not increased or replaced. The reduction in earnings and profits (and related foreign income taxes) of the distributing corporation disappears unless otherwise included in income, such as under §1.367(b)–5.

Section 1.312–10 does not specifically address the allocation and reduction of earnings and profits in connection with a D/355 distribution that involves a preexisting controlled corporation. The proposed regulations provide that, in such a case, the distributing corporation's earnings and profits are reduced in a manner that incorporates both the rules applicable to a D/355 distribution with a newly created controlled corporation and a section 355 distribution that is not preceded by a D reorganization. The rule thus accounts for a decrease in earnings and profits attributable to assets transferred to the controlled corporation as part of the D reorganization as well as a decrease in earnings and profits attributable to the distribution of stock of a preexisting controlled corporation (without regard to the D reorganization). The controlled corporation succeeds only to those earnings and profits allocable to the property it receives in the D reorganization.

In consideration of the international provisions' distinctions among classes and categories of earnings and profits, proposed §1.367(b)–8(b) specifically addresses the determination of which earnings and profits of the distributing corporation are affected by a foreign divisive transaction. The proposed regulation provides that an allocation or reduction in earnings and profits shall generally be pro rata out of a cross-section of the distributing corporation's tax history (except to the extent it is included in income as a deemed dividend such as under §1.367(b)–3 or §1.367(b)–5). This rule determines the earnings and profits (and related foreign income taxes, where applicable) that remain in the distributing corporation after the transaction as well as any earnings and profits (and related foreign income taxes, where applicable) to which the controlled corporation succeeds in a D reorganization.

The proposed §1.367(b)–8(b) cross-section rule decreases the earnings and

profits of a distributing corporation without regard to the type of income generated by the assets of the controlled corporation. This is consistent with the general assumption in §1.312–10 and the proposed regulations that the earnings and profits of the distributing corporation should be decreased proportionately to reflect the transfer or distribution of assets, rather than by some other measure, such as by determining the earnings and profits attributable to the income generated by assets transferred or distributed (a tracing model) or by decreasing most recently accumulated earnings and profits to the extent of assets transferred or distributed (a dividend model).

2. *Branch profits tax considerations*

Notwithstanding the above-described rules, the proposed regulations provide that an allocation or reduction in a distributing corporation's earnings and profits shall not reduce the distributing corporation's effectively connected earnings and profits or non-previously taxed accumulated effectively connected earnings and profits, as defined in the branch profits rule in section 884 (branch earnings). Both a domestic or foreign distributing corporation can potentially have branch earnings that are subject to the branch profits tax.

In the case of a foreign divisive transaction that does not include a D reorganization, a U.S. branch of a foreign distributing corporation would be retained by the foreign distributing corporation. Accordingly, §1.367(b)–8 should not reduce the foreign distributing corporation's branch earnings because such a reduction would improperly decrease the earnings subject to the branch profits tax upon the section 355 distribution (which would trigger the branch profits tax under section 884). The same issues arise in the case of a D/355 distribution in which a foreign distributing corporation transfers the assets that are not part of a U.S. branch to a controlled corporation. The IRS and Treasury do not believe that it is appropriate to reduce the earnings that could give rise to a subsequent branch profits tax under these circumstances.

Different issues arise in a foreign divisive transaction in which a foreign distributing corporation transfers the assets of a U.S. branch to a controlled corporation as part of a D/355 distribution. While the branch profits rules permit a deferral of the branch profits tax in certain instances (by allowing branch earnings to be allocated to the domestic transferee in proportion to the assets transferred when a branch is incorporated in a section 351 exchange in a domestic corporation (see §1.884–2T(d)(1)), the branch profits tax is triggered in any event if stock of the incorporated branch is later distributed to its shareholders. See §1.884–2T(d)(5). Accordingly, because foreign divisive transactions include a section 355 distribution immediately following the D reorganization, it would be unnecessary and inappropriate to attribute branch earnings to a domestic controlled corporation under proposed §1.367(b)–8.

Similar branch profits issues can arise with respect to a domestic distributing corporation. While branch earnings are accumulated by a foreign corporation, such earnings may have been carried over to a domestic corporation in a prior section 351 or 381 transaction. See §1.884–2T(c)(4). Accordingly, the proposed regulations treat domestic distributing corporations in the same manner as foreign distributing corporations with respect to branch earnings.

3. *Domestic corporation distributes stock of a foreign corporation*

In foreign divisive transactions involving a domestic distributing corporation and a foreign controlled corporation, the foreign controlled corporation may succeed to earnings and profits of the domestic distributing corporation. The regulations provide that sections 243(e) and 861(a)(2)(C) apply to earnings and profits allocated to the foreign controlled corporation that were accumulated by a domestic corporation. In addition, a post-transaction distribution out of earnings and profits allocated to the foreign controlled corporation is generally treated as a U.S. source dividend under section 904(g) and for purposes of Chapter 3 of subtitle A of the Code. See *Georday Enterprises v. Commissioner*, 126 F.2d 384 (4th Cir. 1942).

4. *Foreign corporation distributes stock of a domestic corporation*

In foreign divisive transactions involving a foreign distributing corporation and a domestic controlled corporation, two issues arise in determining the appropriate reduction in the foreign distributing corporation's earnings and profits and its effects on the earnings and profits of the domestic controlled corporation. First, it should be determined whether it is appropriate to reduce PTI of the foreign distributing corporation and, if so, in what manner (e.g., if the foreign distributing corporation has earnings and profits that are PTI and not PTI, should the reduction in earnings and profits be out of PTI first, last, pro rata, or depending on the identity of the controlled corporation's shareholders). As in the case of §1.367(b)–7, §1.367(b)–8 reserves on PTI issues, and the IRS and Treasury solicit comments with respect to the appropriate treatment of these amounts.

Second, a domestic corporation succeeds to the earnings and profits of a foreign corporation if the section 355 distribution is preceded by a D reorganization. Because earnings and profits are allocable from foreign corporate solution to U.S. corporate solution, U.S. shareholders are required to include in income the all earnings and profits amount attributable to earnings and profits that carry over to the controlled corporation. The proposed regulations provide rules that coordinate the proposed §1.367(b)–8 and the current §1.367(b)–3 regimes. The regulations, however, reserve with respect to the treatment of U.S. persons that own foreign distributing corporation stock after a non pro rata distribution. The IRS and Treasury invite comments as to whether U.S. shareholders should have an all earnings and profits amount inclusion in connection with a non pro rata foreign divisive transaction in which they do not receive stock of the domestic controlled corporation.

5. *Foreign corporation distributes stock of a foreign corporation*

In foreign divisive transactions involving a foreign distributing corporation and a foreign controlled corporation, the foreign controlled corporation may succeed to earnings and profits of the foreign distributing corporation. Because such earnings and profits are allocated from one foreign corporation to another foreign corporation, the transaction raises issues similar to those in a foreign 381 transac-

tion. Accordingly, the proposed regulations adopt and apply the principles in proposed regulation §1.367(b)–7 to these transactions.

E. *Prop. Reg. §1.367(b)–9*

Proposed §1.367(b)–9 provides special rules applicable to foreign-to-foreign F reorganizations and foreign 381 transactions in which either the foreign target corporation or the foreign acquiring corporation is newly created. Proposed §1.367(b)–9 also applies to foreign divisive transactions that involve a foreign distributing and a foreign controlled corporation, either of which is newly created.

Under proposed §1.367(b)–9, a foreign surviving corporation succeeds to earnings and profits, deficits in earnings and profits, and foreign income taxes without regard to the proposed §1.367(b)–7 hovering deficit rules. See section 1.381(b)–1(a)(2) (providing an analogous rule with respect to domestic F reorganizations).

This rule prevents inappropriate tax consequences. For example, under the generally applicable hovering deficit rules, a foreign corporation with significant deficits in earnings and profits could combine with a newly created foreign corporation and thereafter distribute dividends (along with deemed paid foreign income taxes under section 902), despite the presence of a significant deficit that would have precluded a dividend distribution before the transaction. Proposed §1.367(b)–7 provides the Commissioner discretion to apply the principles of proposed §1.367(b)–9 to circumstances where a principal purpose of the foreign 381 transaction is to affirmatively use the hovering deficit rule in order to gain a tax benefit.

Proposed Effective Dates

These regulations are proposed to apply to section 367(b) exchanges that occur on or after 30 days after 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. 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 regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

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. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 13, 2001, beginning at 10 a.m., in room 7218 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 February 20, 2001. 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 Anne O'Connell Devereaux, Office of Associate Chief Counsel (International). 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 revising the entries for sections 1.367(b)–7, 1.367(b)–8, and 1.367(b)–9 to read in part as follows:

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

Section 1.367(b)–7 also issued under 26 U.S.C. 367(a) and (b), 26 U.S.C. 902, and 26 U.S.C. 904.

Section 1.367(b)–8 also issued under 26 U.S.C. 367(a) and (b), 26 U.S.C. 902, and 26 U.S.C. 904.

Section 1.367(b)–9 also issued under 26 U.S.C. 367(a) and (b), 26 U.S.C. 902, and 26 U.S.C. 904. * * *

Par. 2. Section 1.312–10 is amended by adding paragraph (d) to read as follows:

§1.312–10 Allocation of earnings in certain corporate separations.

* * * * *

(d) For additional rules involving foreign corporations, see §1.367(b)–8.

Par. 3. Section 1.367(b)–0 is amended by:

1. Revising the introductory text.

2. Revising the entry for §1.367(b)–2(j)(3) and adding entries for §1.367(b)–2(j)(4), (j)(5), and (l).

3. Adding entries for §1.367(b)–3(e) and (f).

4. Adding entries for §1.367(b)–5(c)(2)(i), (c)(2)(ii), and (e)(3).

5. Adding entries for §§1.367(b)–7 through 1.367(b)–9.

The revisions and additions read as follows:

§1.367(b)–0 Table of contents.

This section lists the paragraphs contained in §§1.367(b)–1 through 1.367(b)–9.

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§1.367(b)–2 Definitions and special rules.

* * * * *
(j) * * *
(3) Dividend described in section 243(e).
(4) Coordination with §1.367(b)–8(c)(2).
(5) Other rules.
* * * * *
(l) Additional definitions.
(1) Foreign income taxes.
(2) Post-1986 undistributed earnings.
(3) Post-1986 foreign income taxes.
(4) Pre-1987 accumulated profits.
(5) Pre-1987 foreign income taxes.
(6) Pre-1987 section 960 earnings and profits.
(7) Pre-1987 section 960 foreign income taxes.
(8) Earnings and profits.
(9) Look-through corporation.
(10) Non-look-through 10/50 corporation.
(11) Less-than-10%-U.S.-owned foreign corporation.
(12) Separate category.
(13) Statutory grouping of earnings and profits.

§1.367(b)–3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

* * * * *
(e) Net operating loss and capital loss carryovers.
(f) Carryover of earnings and profits.
* * * * *

§1.367(b)–5 Distributions of stock described in section 355.

* * * * *
(c) * * *
(2) * * *
(i) In general.
(ii) Exception.
* * * * *
(e) * * *
(3) Divisive D reorganization with a pre-existing controlled corporation.
* * * * *

§1.367(b)–7 Carryover of earnings and profits and foreign income taxes in certain foreign-to-foreign nonrecognition transactions.

(a) Scope.
(b) General rules.
(1) Non-previously taxed earnings and profits and related taxes.
(2) Previously taxed earnings and profits. [Reserved]
(c) Ordering rule for post-transaction distributions.
(1) If foreign surviving corporation is a look-through corporation.
(2) If foreign surviving corporation is a non-look-through 10/50 corporation.
(3) If foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation.
(d) Look-through pool.
(1) In general.
(i) Qualifying earnings and taxes.
(ii) Carryover rule.
(2) Hovering deficit.
(i) Offset rule.
(ii) Related taxes.
(3) Examples.
(e) Non-look-through pool.
(1) If foreign surviving corporation is a look-through corporation.
(i) Qualifying earnings and taxes.
(ii) Carryover rule.
(iii) Hovering deficit.
(A) Offset rule.
(B) Related taxes.
(iv) Examples.
(2) If foreign surviving corporation is a non-look-through 10/50 corporation.
(i) Qualifying earnings and taxes.
(ii) Carryover rule.
(iii) Hovering deficit.
(A) Offset rule.
(B) Related taxes.
(iv) Examples.
(f) Pre-pooling annual layers.
(1) If foreign surviving corporation is a look-through corporation or a non-look-through 10/50 corporation.
(i) Qualifying earnings and taxes.
(ii) Carryover rule.
(iii) Deficits.
(A) Aggregate positive earnings and profits.
(B) Aggregate deficit in earnings and profits.
(iv) Pre-1987 section 960 earnings and profits and foreign income taxes.
(v) Examples.
(2) If foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation. (i) Qualifying earnings and taxes.
(ii) Carryover rule.
(iii) Deficits.
(A) Aggregate positive earnings and profits.
(B) Aggregate deficit in earnings and profits.
(iv) Pre-1987 section 960 earnings and profits and foreign income taxes.
(v) Examples.
(g) Special rules.
(1) Treatment of deficit.
(2) Reconciling taxable years.
(3) Post-transaction change of status.
(4) Ordering rule for offsetting multiple hovering deficits.
(i) Rule.
(ii) Example.
(5) Pro rata rule for earnings during transaction year.
(6) Nonapplicability of hovering deficit rules to certain transactions.
(i) Rule.
(ii) Example.
(h) Effective date.

§1.367(b)–8 Allocation of earnings and profits and foreign income taxes in certain foreign corporate separations.

(a) Scope.
(b) General rules.
(1) Application of §1.312–10.
(i) In general.
(ii) Special rules for application of §1.312–10(b).
(A) Distributing corporation.
(B) Controlled corporation.
(iii) Net deficit in pre-transaction earnings.
(iv) Use of net bases.
(v) Gain recognized by distributing corporation.
(vi) Coordination with branch profits tax.
(2) Cross-section of earnings and profits.
(3) Foreign income taxes.
(4) Divisive D reorganization with a pre-existing controlled corporation.
(i) Calculation of earnings and profits of distributing corporation.
(ii) Calculation of earnings and profits of controlled corporation.
(c) Foreign divisive transactions involving a domestic distributing corporation and a foreign controlled corporation.
(1) Scope.
(2) Earnings and profits allocated to a foreign controlled corporation.
(3) Examples.
(d) Foreign divisive transactions involving a foreign distributing corporation and a domestic controlled corporation.
(1) Scope.
(2) Coordination with §1.367(b)–3.
(i) In general.
(ii) Determination of all earnings and profits amount.

(iii) Interaction with section 358 and §1.367(b)–2(e)(3)(ii).
(iv) Coordination with §1.367(b)–3(c).
(v) Special rule for U.S. persons that own foreign distributing corporation stock after a non pro rata distribution. [Reserved]
(3) Foreign income taxes.
(4) Previously taxed earnings and profits. [Reserved]
(5) Coordination with §1.367(b)–5.
(6) Examples.
(e) Foreign divisive transactions involving a foreign distributing corporation and a foreign controlled corporation.
(1) Scope.
(2) Earnings and profits of foreign controlled corporation.
(i) In general.
(ii) Special rule for pre-transaction earnings allocated to a newly created controlled corporation.
(3) Foreign income taxes.
(4) Previously taxed earnings and profits. [Reserved]
(5) Coordination with §1.367(b)–5.
(6) Examples.
(f) Effective date.

§1.367(b)–9 Special rule for F reorganizations and similar transactions.

(a) Scope.
(b) Hovering deficit rules inapplicable.
(c) Example.
(d) Effective date.

Par. 4. Section 1.367(b)–1 is amended by:

1. Removing the language "and" at the end of paragraph (c)(2)(iii).

2. Removing the period at the end of paragraph (c)(2)(iv)(B) and adding ";" in its place.

3. Adding paragraphs (c)(2)(v), (c)(2)(vi), and (c)(2)(vii).

4. Revising paragraphs (c)(3)(ii)(A), (c)(4)(iv), and (c)(4)(v).

The additions and revisions read as follows:

§1.367(b)–1 Other transfers.

* * * * *

(c) * * *

(2) * * *

(v) A foreign surviving corporation described in §1.367(b)–7(a);

(vi) A distributing corporation that is subject to the rules of §1.367(b)–8; and

(vii) A controlled corporation that is subject to the rules of §1.367(b)–8.

(3) * * *

(ii) * * *

(A) United States shareholders (as defined in §1.367(b)–3(b)(2)) of foreign corporations described in paragraph (c)(2)(i), (v), (vi), or (vii) of this section; and

* * * * *

(4) * * *

(iv) A statement that describes any amount (or amounts) required, under the section 367(b) regulations, to be taken into account as income or loss or as an adjustment (including an adjustment under §1.367(b)–7, 1.367(b)–8, or 1.367(b)–9) to basis, earnings and profits, or other tax attributes as a result of the exchange;

(v) Any information that is or would be required to be furnished with a Federal income tax return pursuant to regulations under section 332, 351, 354, 355, 356, 361, 368, or 381 (whether or not a Federal income tax return is required to be filed), if such information has not otherwise been provided by the person filing the section 367(b) notice;

* * * * *

Par. 5. Section 1.367(b)–2 is amended by:

1. Revising paragraph (j)(1)(i).

2. Redesignating paragraph (j)(3) as paragraph (j)(5).

3. Adding new paragraphs (j)(3) and (j)(4).

4. Adding paragraph (l).

The revision and addition read as follows:

§1.367(b)–2 Definitions and special rules.

* * * * *

(j) *Sections 985 through 989*—(1) *Change in functional currency of a qualified business unit*—(i) *Rule.* If, as a result of a section 367(b) exchange described in section 381(a) or 312(h), a qualified business unit (as defined in section 989(a)) (QBU) has a different functional currency determined under the rules of section 985(b) than it used prior to the transaction, then the QBU shall be deemed to have automatically changed its functional currency immediately prior to the transaction. A QBU that is deemed to change its functional currency pursuant to this paragraph (j) must make the adjustments described in §1.985–5.

* * * * *

(3) *Dividend described in section 243(e).* Dividend distributions by a foreign corporation out of earnings and profits accumulated by a domestic corporation that are eligible for the dividends received deduction under section 243(e) shall not exceed an amount equal to the U.S. dollar value of the earnings and profits at the time the earnings and profits were accumulated by such domestic corporation. See §1.367(b)–8(c)(3), *Example 1* and *Example 3.*

(4) *Coordination with §1.367(b)–8(c)(2).* Solely for purposes of Chapter 3 of subtitle A of the Internal Revenue Code, dividend distributions by a foreign corporation that are treated under §1.367(b)–8(c)(2) as U.S. source shall not exceed an amount equal to the U.S. dollar value of the earnings and profits at the time allocated to the foreign corporation. See §1.367(b)–8(c)(3), *Example 1.*

* * * * *

(l) *Additional definitions*—(1) *Foreign income taxes.* The term *foreign income taxes* has the meaning set forth in §1.902–1(a)(7).

(2) *Post-1986 undistributed earnings.* The term *post-1986 undistributed earnings* has the meaning set forth in §1.902–1(a)(9).

(3) *Post-1986 foreign income taxes.* The term *post-1986 foreign income taxes* has the meaning set forth in §1.902–1(a)(8).

(4) *Pre-1987 accumulated profits.* The term *pre-1987 accumulated profits* means the earnings and profits described in §1.902–1(a)(10)(i), computed in accordance with the rules of §1.902–1(a)(10)(ii).

(5) *Pre-1987 foreign income taxes.* The term *pre-1987 foreign income taxes* has the meaning set forth in §1.902–1(a)(10)(iii).

(6) *Pre-1987 section 960 earnings and profits.* The term *pre-1987 section 960 earnings and profits* means the earnings and profits of a foreign corporation accumulated in taxable years beginning before January 1, 1987, computed under §1.964–1(a) through (e), and translated into the functional currency (as determined under section 985) of the foreign corporation at the spot rate on the first day of the foreign corporation's taxable year

beginning after December 31, 1986. For further guidance, see Notice 88–70 (1988–2 C.B. 369, 370) (see also §601.601(d)(2) of this chapter). The term pre-1987 section 960 earnings and profits does not include earnings and profits that represent previously taxed earnings and profits for purposes of section 959.

(7) *Pre-1987 section 960 foreign income taxes.* The term *pre-1987 section 960 foreign income taxes* means the foreign income taxes related to pre-1987 section 960 earnings and profits, determined in accordance with the rules of §1.902–1(a)(10)(iii), except that the U.S. dollar amounts of pre-1987 section 960 foreign income taxes are determined by reference to the exchange rates in effect when the taxes were paid or accrued.

(8) *Earnings and profits.* The term *earnings and profits* means post-1986 undistributed earnings, pre-1987 accumulated profits, and pre-1987 section 960 earnings and profits.

(9) *Look-through corporation.* The term *look-through corporation* means a foreign corporation that is subject to the look-through rules of section 904(d)(3) or section 904(d)(4) (as in effect for taxable years beginning after December 31, 2002 (the day before the effective date of section 1105(b) of Public Law 105-34 (111 Stat. 788)) and regulations thereunder.

(10) *Non-look-through 10/50 corporation.* The term *non-look- through 10/50 corporation* means a noncontrolled section 902 corporation as defined in section 904(d)(2)(E) that is not a look-through corporation.

(11) *Less-than-10%-U.S.-owned foreign corporation.* The term *less-than-10%-U.S.-owned foreign corporation* means a foreign corporation that is neither a look-through corporation nor a non-look-through 10/50 corporation.

(12) *Separate category.* The term *separate category* has the meaning set forth in section 904(d)(1), and shall also include any other category of income to which section 904(a), (b), and (c) are applied separately under any other provision of the Internal Revenue Code (e.g., sections 56(g)(4)(C)(iii)(IV), 245(a)(10), 865(h), 901(j), and 904(g)(10)).

(13) *Statutory grouping of earnings and profits.* The term *statutory grouping of earnings and profits* means the earnings and profits from a specific source or activity that must be determined for purposes of applying a provision of the Internal Revenue Code. Compare §1.861–8(a)(4) (providing an analogous definition for statutory grouping of gross income).

Par. 6. Section 1.367(b)–3 is amended by adding paragraphs (e) and (f) to read as follows:

§1.367(b)–3 Repatriation of foreign corporate assets in certain nonrecognition transactions.

* * * * *

(e) *Net operating loss and capital loss carryovers.* A net operating loss or capital loss carryover of the foreign acquired corporation is described in section 381(c)(1) and (c)(3) and thus is eligible to carry over from the foreign acquired corporation to the domestic acquiring corporation only to the extent the underlying deductions or losses were allowable under chapter 1 of subtitle A of the Internal Revenue Code. Thus, only a net operating loss or capital loss carryover that is effectively connected with the conduct of a trade or business within the United States (or that is attributable to a permanent establishment, in the context of an applicable United States income tax treaty) is eligible to be carried over under section 381. For further guidance, see Rev. Rul. 72–421 (1972–2 C.B. 166) (see also §601.601(d)(2) of this chapter).

(f) *Carryover of earnings and profits.* Except to the extent otherwise specifically provided (see, e.g., Notice 89–79 (1989–2 C.B. 392) (see also §601.601–(d)(2) of this chapter)), earnings and profits of the foreign acquired corporation that are not included in income as a deemed dividend under the section 367(b) regulations (or deficit in earnings and profits) are eligible to carry over from the foreign acquired corporation to the domestic acquiring corporation under section 381(c)(2) or §1.367(b)–8(b)(1)(i) only to the extent such earnings and profits (or deficit in earnings and profits) are effectively connected with the conduct of a trade or business within the United States (or are attributable to a permanent establishment, in the context of an applicable United States income tax treaty). All other earnings and profits (or deficit in earnings and profits) of the foreign acquired corporation shall not carry over to the domestic acquiring corporation and, as a result, shall be eliminated.

Par. 7. Section 1.367(b)–5 is amended by:

1. Revising paragraphs (b)(1)(ii) and (c)(2).

2. Adding paragraph (e)(3).

The revisions and addition read as follows:

§1.367(b)–5 Distributions of stock described in section 355.

* * * * *

(b) * * *

(1) * * *

(ii) If the distributee is an individual or a tax-exempt entity as described in §1.337(d)–4(c)(2) then, solely for purposes of determining the gain recognized by the distributing corporation, the controlled corporation shall not be considered to be a corporation, and the distributing corporation shall recognize any gain (but not loss) realized on the distribution.

* * * * *

(c) * * *

(2) *Adjustment to basis in stock and income inclusion*—(i) *In general.* If the distributee's postdistribution amount (as defined in paragraph (e)(2) of this section) with respect to the distributing or controlled corporation is less than the distributee's predistribution amount (as defined in paragraph (e)(1) of this section) with respect to such corporation, then the distributee's basis in such stock immediately after the distribution (determined under the normal principles of section 358) shall be reduced by the amount of the difference. However, the distributee's basis in such stock shall not be reduced below zero, and to the extent the foregoing reduction would have reduced basis below zero, the distributee shall instead include such amount in income as a deemed dividend from such corporation. See, e.g., paragraph (g) *Example 1* of this section.

(ii) *Exception.* The basis reduction rule of paragraph (c)(2)(i) of this section shall apply only to the extent such reduction increases the distributee's section 1248 amount (as defined in §1.367(b)–2(c)(1)) with respect to the distributing or controlled corporation; otherwise such basis reduction shall be replaced by the income inclusion rule of paragraph (c)(2)(i) of this section. See, e.g., §1.367(b)–8(d)(6) *Example 2.*

* * * * *

(e) * * *

(3) *Divisive D reorganization with a preexisting controlled corporation.* In the case of a transaction described in §1.367(b)–8(b)(4), the predistribution amount with respect to a distributing or controlled corporation shall be computed after the allocation of the distributing corporation's earnings and profits described in §1.367(b)–8(b)(4)(i)(A) and (b)(4)(ii)(A) (without regard to the parenthetical phrase in §1.367(b)–8(b)(4)(ii)(A)), but before the reduction in the distributing corporation's earnings and profits described in §1.367(b)–8(b)(4)(i)(B). See, e.g., §1.367(b)–8(d)(6) *Example 3* and §1.367(b)–8(e)(7) *Example 3.*

* * * * *

Par. 8. In §1.367(b)–6, paragraph (a)(1) is revised to read as follows:

§1.367(b)–6 Effective dates and coordination rules.

(a) *Effective date*—(1) *In general.* Sections 1.367(b)–1 through 1.367(b)–5, and this section, apply to section 367(b) exchanges that occur on or after the date that is 30 days after the date these regulations are published as final regulations in the **Federal Register**. For guidance with respect to section 367(b) exchanges that occur prior to the date 30 days after these regulations are published as final regulations in the **Federal Register,** see §§1.367(b)–1 through 1.367(b)–6 in effect prior to the date 30 days after these regulations are published in the **Federal Register** (see 26 CFR part 1 revised as of April 1, 2000).

Par. 9. Section 1.367(b)–7 is added to read as follows:

§1.367(b)–7 Carryover of earnings and profits and foreign income taxes in certain foreign-to-foreign nonrecognition transactions.

(a) *Scope.* This section applies to an acquisition by a foreign corporation (foreign acquiring corporation) of the assets of another foreign corporation (foreign target corporation) in a transaction described in section 381 (foreign 381 transaction). This section describes the manner and extent to which earnings and profits and foreign income taxes of the foreign acquiring corporation and the foreign target corporation carry over to the surviving foreign corporation (foreign surviving corporation). See §1.367(b)–9 for special rules governing reorganizations described in section 368(a)(1)(F) and foreign 381 transactions in which either the foreign target corporation or the foreign acquiring corporation is newly created.

(b) *General rules*—(1) *Non-previously taxed earnings and profits and related taxes.* Earnings and profits and related foreign income taxes of the foreign acquiring corporation and the foreign target corporation (pre-transaction earnings and pre- transaction taxes, respectively) shall carry over to the foreign surviving corporation in the manner described in paragraphs (d), (e), (f), and (g) of this section. Dividend distributions by the foreign surviving corporation (post-transaction distributions) shall be out of earnings and profits and shall reduce related foreign income taxes in the manner described in paragraph (c) of this section.

(2) *Previously taxed earnings and profits.* [Reserved]

(c) *Ordering rule for post-transaction distributions.* Dividend distributions out of a foreign surviving corporation's earnings and profits shall be ordered in accordance with the rules of paragraph (c)(1), (2), or (3) of this section, depending on whether the foreign surviving corporation is a look-through corporation, a non-look-through 10/50 corporation, or a less-than-10%-U.S.-owned foreign corporation.

(1) *If foreign surviving corporation is a look-through corporation.* In the case of a foreign surviving corporation that is a look-through corporation, post-transaction distributions shall be first out of the look-through pool (as described in paragraph (d) of this section), second out of the non-look-through pool (as described in paragraph (e)(1) of this section), and third out of the pre-pooling annual layers (as described in paragraph (f)(1) of this section) under an annual last-in, first-out (LIFO) method.

(2) *If foreign surviving corporation is a non-look-through 10/50 corporation.* In the case of a foreign surviving corporation that is a non-look-through 10/50 corporation, post-transaction distributions shall be first out of the non-look-through pool (as described in paragraph (e)(2) of this section), and second out of the pre-pooling annual layers (as described in paragraph (f)(1) of this section) under the LIFO method.

(3) *If foreign surviving corporation is a less-than-10%- U.S.-owned foreign corporation.* In the case of a foreign surviving corporation that is a less-than-10%-U.S.-owned corporation, post-transaction distributions shall be out of the pre-pooling annual layers (as described in paragraph (f)(2) of this section) under the LIFO method.

(d) *Look-through pool.* If the foreign surviving corporation is a look-through corporation, then the look-through pool shall be determined under the rules of this paragraph (d).

(1) *In general*—(i) *Qualifying earnings and taxes.* The look-through pool shall consist of the post-1986 undistributed earnings and related post-1986 foreign income taxes of the foreign acquiring corporation and the foreign target corporation that were subject to the look-through provisions of section 904(d)(3) or section 904(d)(4) (as in effect for taxable years beginning after December 31, 2002 (the day before the effective date of section 1105(b) of Public Law 105-34 (111 Stat. 788)) and regulations thereunder.

(ii) *Carryover rule.* Subject to paragraph (d)(2) of this section, the amounts described in paragraph (d)(1)(i) of this section attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation and shall be combined on a separate category-by-separate category basis.

(2) *Hovering deficit.* The rules of this paragraph (d)(2) apply when the foreign acquiring corporation or the foreign target corporation has a deficit in one or more separate categories of post-1986 undistributed earnings described in paragraph (d)(1)(i) of this section immediately prior to the foreign 381 transaction. In the event both the foreign acquiring corporation and the foreign target corporation have a deficit in the same separate category of earnings and profits, such deficits and their related foreign income taxes shall be combined for purposes of applying this paragraph (d)(2). See also paragraphs (g)(1) and (4) of this section (describing other rules applicable to a deficit described in this paragraph (d)(2)).

(i) *Offset rule.* A deficit in a separate category of earnings and profits described in this paragraph (d)(2) shall offset only earnings and profits accumulated by the foreign surviving corporation after the foreign 381

transaction (post-transaction earnings) in the same separate category of earnings and profits.

(ii) *Related taxes.* Foreign income taxes that are related to a deficit in a separate category of earnings and profits described in this paragraph (d)(2) shall be added to the foreign surviving corporation's post-1986 foreign income taxes related to that separate category of earnings and profits only after post- transaction earnings in the same separate category have been offset by and exceed the entire amount of the deficit.

(3) *Examples.* The following examples illustrate the rules of this paragraph (d). The examples presume the following facts: Foreign corporations A and B were both incorporated after December 31, 1986, always have been controlled foreign corporations, and always have had calendar taxable years. None of the shareholders of foreign corporations A and B are required to include any amount in income under §1.367(b)-4 as a result of the foreign 381 transaction. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a "u" functional currency. Finally, unless otherwise stated, any earnings and profits described in section 904(d)(1)(D) and 904(d)(1)(E) (shipping income and 10/50 dividends, respectively) qualified for the high tax exception from subpart F income under section 954(b)(4), and all United States shareholders elected to exclude such earnings and profits from subpart F income under section 954(b)(4) and §1.954-1(d)(5). The examples are as follows:

Example 1—(i) *Facts.* (A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A

Separate Category:	*E&P*	*Foreign Taxes*
10/50 dividends from FC1, a noncontrolled section 902 corporation	100u	$40
General	300u	$60
	400u	$100

Foreign Corporation B

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	200u	$40
10/50 dividends from FC2, a noncontrolled section 902 corporation	50u	$20
General	300u	$70
	550u	$130

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a controlled foreign corporation (CFC).

(ii) *Result.* Under the rules described in paragraph (d)(1) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	200u	$40
General	600u	$130
10/50 dividends from FC1	100u	$40
10/50 dividends from FC2	50u	$20
	950u	$230

(iii) *Post-transaction distribution.* (A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 475u to its shareholders. Under the rules described in §1.902–1(d)(1) and paragraph (c)(1) of this section, the distribution is out of separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	100u	$20
General	300u	$65
10/50 dividends from FC1	50u	$20
10/50 dividends from FC2	25u	$10
	475u	$115

(B) The foreign income taxes available to foreign surviving corporation shareholders upon the distribution are subject to the generally applicable rules and limitations, such as those of sections 902 and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	100u	$20
General	300u	$65
10/50 dividends from FC1	50u	$20
10/50 dividends from FC2	25u	$10
	475u	$115

Example 2—(i) *Facts.* (A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	(100u)	$ 5
10/50 dividends	400u	$160
General	(200u)	$ 25
	100u	$190

Foreign Corporation B

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	100u	$20
General	300u	$60
	400u	$80

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraphs (d)(1) and (2) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
Separate Category:	*Positive E&P*	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Shipping	100u	(100u)	$ 20	$ 5
10/50 dividends	400u	0u	$160	$ 0
General	300u	(200u)	$ 60	$25
	800u	(300u)	$240	$30

(iii) *Post-transaction distribution*—(A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 400u to its shareholders. Under the rules described in section 904(d)(3) and paragraph (c)(1) of this section, the distribution is out of separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	50u	$ 10
10/50 dividends	200u	$ 80
General	150u	$ 30
	400u	$120

(B) The foreign income taxes available to foreign surviving corporation shareholders upon the distribution are subject to the generally applicable rules and limitations, such as those of sections 902 and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
Separate Category:	*Positive E&P*	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Shipping	50u	(100u)	$ 10	$ 5
10/50 dividends	200u	0u	$ 80	$ 0
General	150u	(200u)	$ 30	$25
	400u	(300u)	$120	$30

(iv) *Post-transaction earnings.* (A) In its taxable year ending on December 31, 2003, foreign surviving corporation accumulates earnings and profits and pays related foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
Shipping	105u	$20
General	100u	$20
	205u	$40

(B) None of foreign surviving corporation's earnings and profits for its 2003 taxable year qualify as subpart F income as defined in section 952(a). Under the rules described in paragraphs (d)(2)(i) and (ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts on December 31, 2003:

	Earnings & Profits:		*Foreign Taxes:*	
Separate Category:	*Positive E&P*	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Shipping	55u	0u	$ 35	$ 0
10/50 dividends	200u	0u	$ 80	$ 0
General	150u	(100u)	$ 50	$25
	405u	(100u)	$165	$25

Example 3—(i) *Facts.* The facts are the same as *Example 2* (i), (ii), (iii), and (iv)(A), except that the 105u in the section 904(d)(1)(D) shipping separate category accumulated by foreign surviving corporation during 2003 qualify as subpart F income, all of which is included in income under section 951(a) by United States shareholders (as defined in section 951(b)).

(ii) *Result.* (A) Under the rule described in paragraph (g)(1) of this section, the 100u hovering deficit in the shipping separate category does not reduce foreign surviving corporation's current earnings and profits for purposes of determining subpart F income. Thus, foreign surviving corporation's United States shareholders include their pro rata shares of the 105u in taxable income for the year and are eligible for a deemed paid foreign tax credit under section 960, computed by reference to their pro rata shares of $20.32 (105u subpart F inclusion ÷ (105u + 50u accumulated earnings and profits in the shipping category = 155u) = 0.68%, x $30 foreign income taxes in the shipping category = $20.32).

(B) Immediately after the subpart F inclusion and section 960 deemed paid taxes (and taking into account the taxable year 2003 earnings and profits and related taxes in the general category), foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
Separate Category:	*Positive E&P*	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Shipping	50u	(100u)	$ 9.68	$ 5
10/50 dividends	200u	0u	$ 80.00	$ 0
General	150u	(100u)	$ 50.00	$25
	400u	(200u)	$139.68	$30

(C) The 105u included as subpart F income constitutes previously taxed earnings and profits under section 959.

(e) *Non-look-through pool*—(1) *If foreign surviving corporation is a look-through corporation.* If the foreign surviving corporation is a look-through corporation, then the non-look-through pool shall be determined under the rules of this paragraph (e)(1).

(i) *Qualifying earnings and taxes.* The non-look-through pool shall consist of the post-1986 undistributed earnings and related post-1986 foreign income taxes that were accumulated (or treated as accumulated) by the foreign target corporation or the foreign acquiring corporation while it was a non-look-through 10/50 corporation.

(ii) *Carryover rule.* Subject to paragraph (e)(1)(iii) of this section, the amounts described in pararaph (e)(1)(i) of this section attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation but shall not be combined. Thus, post-transaction distributions by the foreign surviving corporation out of the non-look-through pool shall be made from the separate amounts attributable to the foreign acquiring corporation and the foreign target corporation on a pro rata basis, and shall reduce a pro rata portion of any related foreign income taxes.

(iii) *Hovering deficit.* The rules of this paragraph (e)(1)(iii) apply when the for-

eign acquiring corporation or the foreign target corporation (or both) has a deficit in the post-1986 undistributed earnings described in paragraph (e)(1)(i) of this section immediately prior to the foreign 381 transaction. In the event that this paragraph (e)(1)(iii) applies to a deficit of both the foreign acquiring corporation and the foreign target corporation, the deficits shall not be combined and the rules of this paragraph (e)(1)(iii) shall be applied separately to each of such deficits on a pro rata basis. See also paragraphs (g)(1) and (g)(4) of this section (describing other rules applicable to a deficit described in this paragraph (e)(1)(iii)).

(A) *Offset rule.* A deficit described in this paragraph (e)(i)(iii) shall offset only post-transaction earnings. The deficit shall offset a pro rata portion of post-transaction earnings accumulated in each separate category of earnings and profits by the foreign surviving corporation.

(B) *Related taxes.* Foreign income taxes that are related to a deficit described in this paragraph (e)(1)(iii) shall be added to the foreign surviving corporation's post-1986 foreign income taxes (in the applicable segregated portion of the non-look-through pool) only after post-transaction earnings have been offset by and exceed the entire amount of the deficit.

(iv) *Examples.* The following examples illustrate the rules of this paragraph (e)(1). The examples presume the following facts: Foreign corporation A was a non-look-through 10/50 corporation from its incorporation on January 1, 1995 until December 31, 1997; foreign corporation A became a CFC on January 1, 1998 and has been a CFC since that time. Foreign corporation B has been a non-look-through 10/50 corporation since its incorporation on January 1, 1993. Both foreign corporation A and foreign corporation B always have had calendar taxable years. None of the shareholders of foreign corporation A are required to include any amount in income under §1.367(b)-4 as a result of the foreign 381 transaction. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a "u" functional currency. Finally, any earnings and profits described in section 904(d)(1)(E) (10/50 dividends) qualified for the high tax exception from subpart F income under section 954(b)(4), and all United States shareholders elected to exclude such earnings and profits from subpart F income under section 954(b)(4) and §1.954–1(d)(5). The examples are as follows:

Example 1—(i) *Facts.* (A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
Separate Category:		
10/50 dividends	100u	$ 40
General	300u	$ 60
E&P Accumulated as Non-Look-Through 10/50 Corporation:	400u	$100
	800u	$200

Foreign Corporation B	*E&P*	*Foreign Taxes*
E&P Accumulated as Non-Look- Through 10/50 Corporation:	200u	$ 40

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraphs (d)(1), (e)(1)(i), and (e)(1)(ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
Look-Through Pool Separate Category:		
10/50 dividends	100u	$ 40
General	300u	$ 60
Two Side-by-Side Non-Look-Through Pool Amounts:		
Non-look-through pool amount #1 (from Corp A)	400u	$100
Non-look-through pool amount #2 (from Corp B)	200u	$ 40
	1,000u	$240

(iii) *Post-transaction distribution.* (A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 700u to its shareholders. Under the rules described in paragraphs (c)(1) and (e)(1)(ii) of this section, the distribution is first out of the look-through pool, then out of the non-look-through pool, as follows:

Look-Through Pool Separate Category:	*E&P*	*Foreign Taxes*
10/50 dividends	100u	$ 40
General	300u	$ 60
Non-Look-Through Pool Amounts:		
Non-look-through pool amount #1	200u	$ 50
Non-look-through pool amount #2	100u	$ 20
	700u	$170

(B) The foreign income taxes available to foreign surviving corporation shareholders upon the distribution are subject to the generally applicable rules and limitations, such as those of sections 902 and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

Two Side-by-Side Non-Look-Through Pool Amounts:	*E&P*	*Foreign Taxes*
Non-look-through pool amount #1	200u	$50
Non-look-through pool amount #2	100u	$20
	300u	$70

Example 2—(i) *Facts*—(A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
Look-through Pool Separate Category:		
10/50 dividends	100u	$ 40
General	300u	$ 60
E&P Accumulated as Non-Look-Through 10/50 Corporation:	400u	$100
	800u	$200

Foreign Corporation B	*E&P*	*Foreign Taxes*
E&P Accumulated as Non-Look-Through 10/50 Corporation:	(200u)	$ 5

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraphs (d)(1), (e)(1)(i), (e)(1)(ii), and (e)(1)(iii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Look-through Pool Separate Category:				
10/50 dividends	100u		$ 40	
General	300u		$ 60	
Two Side-by-Side Non-Look-Through Pool Amounts:				
Non-look-through pool amount #1	400u		$100	
Non-look-through pool amount #2		(200u)		$5
	800u	(200u)	$200	$5

(iii) *Post-transaction distribution.* (A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 600u to its shareholders. Under the rules described in paragraphs (c)(1) and (e)(1)(ii) of this section, the distribution is first out of the look-through pool, then out of the non-look-through pool, as follows:

Look-Through Pool Separate Category:	*E&P*	*Foreign Taxes*
10/50 dividends	100u	$ 40
General	300u	$ 60
Non-Look-Through Pool Amount:		
Non-look-through pool amount #1	200u	$ 50
	600u	$150

(B) The foreign income taxes available to foreign surviving corporation shareholders upon the distribution are subject to the generally applicable rules and limitations, such as those of sections 902 and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Two Side-by-Side Non-Look-Through Pool Amounts:				
Non-look-through pool amount #1	200u		$50	
Non-look-through pool amount #2		(200u)		$5
	200u	(200u)	$50	$5

(iv) *Post-transaction earnings.* (A) In the taxable year ending on December 31, 2003, foreign surviving corporation accumulates earnings and profits and pays related foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
10/50 dividends	150u	$ 60
General	300u	$ 60
	450u	$120

(B) None of the earnings and profits qualify as subpart F income as defined in section 952(a). Under the rules described in paragraph (e)(1)(iii)(A) of this section, the 200u deficit in non-look-through pool amount #2 offsets a pro rata portion of the foreign surviving corporation's post-transaction earnings in each separate category. Thus, the 200u deficit offsets 66.66u of section 904(d)(1)(E) 10/50 dividends separate category earnings (33.33% of 200u) and offsets 133.34u of section 904(d)(1)(I) general separate category earnings (66.67% of 200u). Accordingly, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts as of December 31, 2002:

Look-Through Pool Separate Category:	*E&P*	*Foreign Taxes*
10/50 dividends	83.34u	$ 60
General	166.66u	$ 60
Two Side-by-Side Non-Look-Through Pool Amounts:		
Non-look-through pool amount #1	200u	$ 50
Non-look-through pool amount #2		$ 5
	450u	$175

(C) Under paragraph (e)(1)(iii)(B) of this section, the $5 of foreign income taxes associated with the non-look-through pool amount #2 hovering deficit are added to foreign surviving corporation's available foreign income taxes because post-transaction earnings have been offset by and exceed the deficit in the non-look-through pool. However, the $5 of foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped.

(2) *If foreign surviving corporation is a non-look-through 10/50 corporation.* If the foreign surviving corporation is a non-look-through 10/50 corporation, then the non-look-through pool shall be determined under the rules of this paragraph (e)(2).

(i) *Qualifying earnings and taxes.* The non-look-through pool shall consist of the post-1986 undistributed earnings and related post-1986 foreign income taxes of the foreign acquiring corporation and the foreign target corporation.

(ii) *Carryover rule.* Subject to paragraph (e)(2)(iii) of this section, the amounts described in paragraph (e)(2)(i) of this section attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation and shall be

combined as a single separate category of earnings and profits under section 904(d)(1)(E).

(iii) *Hovering deficit.* The rules of this paragraph (e)(2)(iii) apply when the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate deficit in its post-1986 undistributed earnings described in paragraph (e)(2)(i) of this section immediately prior to the foreign 381 transaction. In the event that both the foreign acquiring corporation and the foreign target corporation have an aggregate deficit in post-1986 undistributed earnings, such deficits and their related foreign income taxes shall be combined for purposes of applying this paragraph (e)(2)(iii). See also paragraphs (g)(1) and (4) of this section (describing other rules applicable to a deficit described in this paragraph (e)(2)(iii)).

(A) *Offset rule.* A deficit described in this paragraph (e)(2)(iii) shall offset only post-transaction earnings accumulated by the foreign surviving corporation.

(B) *Related taxes.* Foreign income taxes that are related to a deficit described in this paragraph (e)(2)(iii) shall be added to the foreign surviving corporation's post-1986 foreign income taxes only after post-transaction earnings have been offset by and exceed the entire amount of the deficit.

(iv) *Examples.* The following examples illustrate the rules of this paragraph (e)(2). The examples presume the following facts: Both foreign corporation A and foreign corporation B always have had calendar taxable years. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a "u" functional currency. Finally, any earnings and profits described in section 904(d)(1)(E) (10/50 dividends) qualified for the high tax exception from subpart F income under section 954(b)(4), and all United States shareholders elected to exclude such earnings and profits from subpart F income under section 954(b)(4) and §1.954-1(d)(5). The examples are as follows:

Example 1—(i) *Facts.* (A) Foreign corporations A and B are and always have been non-look-through 10/50 corporations since they were incorporated in 1995. On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
E&P accumulated as non- look-through 10/50 corporation	400u	$100
Foreign Corporation B	*E&P*	*Foreign Taxes*
E&P accumulated as non-look-through 10/50 corporation	200u	$ 40

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a non-look-through 10/50 corporation.

(ii) *Result.* Under the rules described in paragraphs (e)(2)(i) and (ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
Non-Look-Through Pool	600u	$140

Example 2—(i) *Facts*—(A) Foreign corporation A is and always has been a CFC since it was incorporated in 1995. Foreign corporation B is and always has been a non-look-through 10/50 corporation since it was incorporated in 1995. Immediately before the foreign 381 transaction (but after application of the rules of §1.367(b)-4 to foreign corporation A and its shareholders), foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
Separate Category:		
Passive	(200u)	$ 10
10/50 dividends	100u	$ 40
General	300u	$ 60
	200u	$110
Foreign Corporation B	*E&P*	*Foreign Taxes*
E&P accumulated as non-look-through 10/50 corporation	200u	$ 30

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a non-look-through 10/50 corporation.

(ii) *Result.* Because neither foreign corporation A nor foreign corporation B has an aggregate deficit in post-1986 undistributed earnings, the rules described in paragraphs (e)(2)(i) and (ii) of this section apply, but the rules described in paragraph (e)(2)(iii) do not. Accordingly, foreign corporation A's net positive earnings and profits of 200u (300u + 100u + (200u)) and its aggregate foreign income taxes of $110 ($10 + $40 + $60) are combined with the earnings and profits and foreign income taxes of foreign corporation B, so that foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
Non-Look-Through Pool	400u	$140

Example 3—(i) *Facts.* (A) Foreign corporation A is and always has been a CFC since it was incorporated in 1995. Foreign corporation B is and always has been a non-look-through 10/50 corporation since it was incorporated in 1995. On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
Separate Category:		
Passive	(200u)	$ 10
10/50 dividends	100u	$ 40
General	(300u)	$ 60
	(400u)	$110
Foreign Corporation B	*E&P*	*Foreign Taxes*
E&P accumulated as non-look-through 10/50 corporation	200u	$ 30

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a non-look-through 10/50 corporation. (Assume that none of the shareholders of foreign corporation A are required to include an amount in income under §1.367(b)–4 with regard to this transaction.)

(ii) *Result.* Because foreign corporation A has an aggregate deficit in post-1986 undistributed earnings, the rules of paragraph (e)(2)(iii) of this section apply. Accordingly, foreign corporation A's 400u aggregate deficit in earnings and profits ((200u) + 100u + (300u)) carries over as a hovering deficit to foreign surviving corporation, so that foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Non-Look-Through Pool	200u	(400u)	$30	$110

(iii) *Post-transaction earnings.* (A) In the taxable year ending on December 31, 2002, foreign surviving corporation accumulates earnings and profits and pays related foreign income taxes as follows:

	E&P	*Foreign Taxes*
E&P accumulated as non-look-through 10/50 corporation	500u	$100

(B) Under the rule described in paragraph (e)(2)(iii)(A) of this section, the hovering deficit of 400u in the non-look-through pool offsets 400u of post-transaction earnings. Under the rules of paragraph (e)(2)(iii)(B) of this section, the foreign income taxes related to the hovering deficit are added to foreign surviving corporation's available foreign income taxes because post-transaction earnings have been offset by and exceed the deficit in the non-look-through pool. Accordingly, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts as of December 31, 2002:

	E&P	*Foreign Taxes*
Non-Look-Through Pool	300u	$240

(f) *Pre-pooling annual layers*—(1) *If foreign surviving corporation is a look-through corporation or a non-look-through 10/50 corporation.* If the foreign surviving corporation is a look-through corporation or a non-look-through 10/50 corporation, the pre-pooling annual layers shall be determined under the rules of this paragraph (f)(1).

(i) *Qualifying earnings and taxes.* The pre-pooling annual layers shall consist of the pre-1987 accumulated profits and the pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation.

(ii) *Carryover rule.* Subject to paragraph (f)(1)(iii) of this section, the amounts described in paragraph (f)(1)(i) of this section attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation but shall not be combined. Thus, when the foreign acquiring corporation and the foreign target corporation have pre-1987 accumulated profits in the same year and a distribution is made therefrom, the rules of §1.902–1(b)(2)(ii) and (b)(3) shall apply separately to reduce pre-1987 accumulated profits and pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Rev. Rul. 68–351 (1968–2 C.B. 307); Rev. Rul. 70–373 (1970–2 C.B. 152) (see also §601.601(d)(2) of this chapter); see also paragraph (g)(2) of this section (governing the reconciliation of taxable years).

(iii) *Deficits.* The rules of this paragraph (f)(1)(iii) apply when the foreign acquiring corporation or the foreign target corporation (or both) has a deficit in one or more years that comprise its pre-1987 accumulated profits immediately prior to the foreign 381 transaction (see also paragraphs (g)(1) and (g)(4) of this section, describing other rules applicable to a deficit described in this paragraph (f)(1)(iii)).

(A) *Aggregate positive earnings and profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in one or more individual years, then the rules otherwise applicable to such deficits shall apply separately to the pre-1987 accumulated profits and related foreign income taxes of such corporation. For further guidance, see Rev. Rul. 74–550 (1974–2 C.B. 209) (see also §601.601(d)(2) of this chapter); *Champion Int'l Corp. v. Commissioner*, 81 T.C. 424 (1983), acq. in result, 1987–2 C.B. 1; Rev. Rul. 87–72 (1987–2 C.B. 170) (see also §601.601(d)(2) of this chapter). As a result, no amount in excess of the aggregate positive amount of pre-1987 accumulated profits shall be distributed from the pre-transaction earnings of the foreign acquiring corporation or the foreign target corporation.

(B) *Aggregate deficit in earnings and profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate deficit in pre-1987 accumulated profits, then the rules under §1.902–2(b) shall apply to such deficit (and related foreign income taxes) immediately prior to the transaction, except that the aggregate deficit that is carried forward into the look-through pool (in the case of a foreign surviving corporation that is a look-through corporation) or non-look-through pool (in the case of a foreign surviving corporation that is a non-look-through 10/50 corporation) shall be available to offset only post-transaction earnings accumulated by the foreign surviving corporation.

(iv) *Pre-1987 section 960 earnings and profits and foreign income taxes.* The pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation but shall not be combined. The rules otherwise applicable to such amounts shall apply separately to the pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Notice 88–70 (1988–2 C.B. 369) (see also §601.601(d)(2) of this chapter).

(v) *Examples.* The following examples illustrate the rules of this paragraph (f)(1). The examples presume the following facts: foreign corporation A was incorporated in 1998 and was a less-than-10%-U.S.-owned foreign corporation through December 31, 1999. Foreign corporation A became a non-look-through 10/50 corporation on January 1, 2000 and, as a result, began to maintain a pool of post-1986 undistributed earnings on that date. Foreign corporation B was incorporated in 1998 and always has been owned by foreign shareholders (and thus never has met the requirements of section 902(c)(3)(B)). Both foreign corporation A and foreign corporation B always have had calendar taxable years. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a "u" functional currency. The examples are as follows:

Example 1—(i) *Facts.* (A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
E&P accumulated as non-look-through 10/50 corporation	1,000u	$350
1999	400u	160u
1998	100u	5u
	1,500u	

Foreign Corporation B	*E&P*	*Foreign Taxes*
2001	100u	20u
2000	150u	30u
1999	0u	50u
1998	50u	5u
	300u	105u

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a non-look-through 10/50 corporation.

(ii) *Result.* Under the rules described in paragraphs (e)(2)(i), (e)(2)(ii), (f)(1)(i), and (f)(1)(ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
Non-look-through pool	1,000u	$350
2001	100u	20u
2000	150u	30u
Two Side-by-Side Layers of 1999 E&P:		
1999 layer #1 (from Corp A)	400u	160u
1999 layer #2 (from Corp B)	0u	50u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1 (from Corp A)	100u	5u
1998 layer #2 (from Corp B)	50u	5u
	1,800u	

(iii) *Post-transaction distribution.* (A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 1,700u to its shareholders. Under the rules of paragraph (c)(2) of this section, the distribution is first out of the non-look-through pool, and then out of the pre-pooling annual layers under the LIFO method, as follows:

Distribution	*E&P*	*Foreign Taxes*
Non-look-through pool	1,000u	$350
2001	100u	20u
2000	150u	30u
Two Side-by-Side Layers of 1999 E&P:		
1999 layer #1	400u	160u
1999 layer #2	0u	0u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1	33.33u	1.67u
(100u in layer ÷ 150u aggregate 1998 earnings = 66.67% x 50u distribution)		
1998 layer #2	16.67u	1.67u
(50u in layer ÷ 150u aggregate 1998 earnings = 33.33% x 50u distribution)		
	1,700u	

(B) The foreign income taxes available to foreign surviving corporation shareholders upon the distribution are subject to the generally applicable rules and limitations, such as those of sections 902 and 904(d).

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
1999 layer #2	0.00u	50.00u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1	66.67u	3.33u
1998 layer #2	33.33u	3.33u
	100.00u	56.66u

(iv) *Post-transaction earnings.* For the taxable year ending on December 31, 2003, foreign surviving corporation accumulates 500u of current earnings and profits and pays $70 in foreign income taxes. As of the close of the 2003 taxable year, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
E&P accumulated as non-look-through 10/50 corporation	500.00u	$70.00
1999	0.00u	50.00u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1	66.67u	3.33u
1998 layer #2	33.33u	3.33u
	600u	

Example 2—(i) *Facts.* (A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
E&P accumulated as non-look-though 10/50 corporation	1,000u	$350
1999	100u	20u
1998	(50u)	5u
	1,050u	

Foreign Corporation B	*E&P*	*Foreign Taxes*
2001	100u	20u
2000	(50u)	5u
1999	0u	50u
1998	100u	10u
	150u	85u

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a non-look-through 10/50 corporation.

(ii) *Result.* Because foreign corporations A and B have aggregate positive amounts of pre-1987 accumulated profits with a deficit in one or more individual years, the rules of paragraph (f)(1)(iii)(A) of this section apply. Accordingly, after the foreign 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Deficit E&P*	*Foreign Taxes Available*	*Foreign Taxes Associated with Deficit E&P*
Non-Look-Through 10/50 Pool	1,000u		$350	
2001	100u		20u	
2000		(50u)		5u
Two Side-by-Side Layers of 1999 E&P:				
1999 layer #1 (from foreign corporation A)	100u		20u	
1999 layer #2 (from foreign corporation B)	0u		50u	
Two Side-by-Side Layers of 1998 E&P:				
1998 layer #1 (from foreign corporation A)		(50u)		5u
1998 layer #2 (from foreign corporation B)	100u		10u	
	1,300u	(100u)		10u

(iii) *Post-transaction distribution*—(A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 1,175u to its shareholders. Under the rules described in paragraphs (c)(2) and (f)(1)(iii)(A) of this section, the distribution is first out of the non-look-through pool, and then out of the pre-pooling annual layers, as follows:

Distribution	*E&P*	*Foreign Taxes*
Non-Look-Through 10/50 Amount	1,000u	$350
2001	100u	20u
2000	0u	0u
Two Side-by-Side Layers of 1999 E&P:		
1999 layer #1	50u	20u
1999 layer #2	0u	0u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1	0u	0u
1998 layer #2	25u	5u
	1,175u	

(B) Under the rules described in paragraph (f)(1)(iii)(A) of this section, the rules otherwise applicable when a foreign corporation has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in one or more individual years, apply separately to the pre-1987 accumulated profits and related foreign income taxes of foreign corporation A and foreign corporation B. As a result, distributions out of the pre-pooling annual layers of foreign corporation A and foreign corporation B can not exceed the aggregate positive amount of pre-1987 accumulated profits of each corporation. Accordingly, only 50u can be distributed from foreign corporation A's pre-pooling annual layers and is out of its 1999 layer #1. Under *Champion Int'l Corp. v. Commissioner*, 81 T.C. 424 (1983), the full 20u of taxes related to 1999 layer #1 is reduced or deemed paid ($20 x (50 ÷ 50)). Under Rev. Rul. 74–550 (1974–2 C.B. 209) (see also §601.601(d)(2) of this chapter), 100u is distributed from foreign corporation B's 2001 annual layer. Foreign corporation B's deficit in 2000 is then rolled back to offset its 1998 annual layer to reduce earnings in that layer to 50u, 25u of which is distributed (and reduces one-half of that year's foreign income taxes).

(C) The foreign income taxes available to foreign surviving corporation shareholders upon the distribution are subject to the generally applicable rules and limitations, such as those of sections 902 and 904(d).

(D) Immediately after the distribution foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
2000	0u	5u
1999 layer #2	0u	50u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1	0u	5u
1998 layer #2	25u	5u
	25u	65u

(E) Under the rules described in paragraph (f)(1)(iii)(A) of this section, the 5u, 50u, and 5u of foreign income taxes related to foreign surviving corporation's 2000 layer, 1999 layer #2, and 1998 layer #1, respectively, remain in those layers. These foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped.

Example 3—(i) *Facts.* (A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
E&P accumulated as non-look-through 10/50 corporation	1,000u	$350
1999	150u	20u
1998	100u	5u
	1,250u	

Foreign Corporation B	*E&P*	*Foreign Taxes*
2001	100u	20u
2000	(250u)	5u
1999	0u	50u
1998	100u	10u
	(50u)	85u

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a non-look-through 10/50 corporation.

(ii) *Result.* (A) Because foreign corporation B has an aggregate deficit in pre-1987 accumulated profits, the rules of paragraph (f)(1)(iii)(B) of this section apply. Accordingly, §1.902–2(b) applies immediately prior to the foreign 381 transaction, except that foreign corporation B's aggregate deficit in pre-1987 accumulated profits is carried forward into the post-1986 undistributed earnings pool and is available to offset only post-transaction earnings accumulated by foreign surviving corporation. Accordingly, after the foreign 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Non-Look-Through 10/50 Pool	1,000u	(50u)	$350	$0
2001	0u		20u	
2000	0u		5u	
Two Side-by-Side Layers of 1999 E&P:				
1999 layer #1 (from Corp A)	150u		20u	
1999 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 1998 E&P:				
1998 layer #1 (from Corp A)	100u		5u	
1998 layer #2 (from Corp B)	0u			
	1,250u	(50u)	10u	$0

(B) Under paragraph (f)(1)(iii)(B) of this section, the 20u, 5u, 50u, and 10u of foreign income taxes associated with foreign corporation B's earnings and profits for 2001, 2000, 1999 layer #2, and 1998 layer #2, respectively, remain in those layers. These foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped.

(2) *If foreign surviving corporation is a less-than-10%- U.S.-owned foreign corporation.* If the foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation, then the pre-pooling annual layers shall be determined under the rules of this paragraph (f)(2).

(i) *Qualifying earnings and taxes.* The pre-pooling annual layers shall consist of the pre-1987 accumulated profits and the pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation. If the foreign acquiring corporation or the foreign target corporation (or both) has post-1986 undistributed earnings or a deficit in post-1986 undistributed earnings, then those earnings or deficits and any related post-1986 foreign income taxes shall be recharacterized as pre-1987 accumulated profits or deficits and pre-1987 foreign income taxes of the foreign acquiring corporation or the foreign target corporation accumulated immediately prior to the foreign 381 transaction.

(ii) *Carryover rule. Sub*ject to paragraph (f)(2)(iii) of this section, the amounts described in paragraph (f)(2)(i) of this section attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation but shall not be combined. Thus, when the foreign acquiring corporation and the foreign target corporation have pre-1987 accumulated profits in the same year and a distribution is made therefrom, the principles of §1.902–1(b)(2)(ii) and (3) shall apply separately to reduce pre-1987 accumulated profits and pre-1987 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Rev. Rul. 68–351 (1968–2 C.B. 307); Rev. Rul. 70–373 (1970–2 C.B. 152) (see also §601.601(d)(2) of this chapter); see also paragraph (g)(2) of this section (governing the reconciliation of taxable years).

(iii) *Deficits.* The rules of this paragraph (f)(2)(iii) apply when the foreign acquiring corporation or the foreign target corporation (or both) has a deficit in one or more years that comprise its pre-1987 accumulated profits immediately prior to the foreign 381 transaction (and after application of the last sentence of paragraph (f)(2)(i) of this section). See also paragraphs (g)(1) and (4) of this section (describing other rules applicable to a deficit described in this paragraph (f)(2)(iii)).

(A) *Aggregate positive earnings and profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in one or more individual years, then the rules otherwise applicable to such deficits shall apply separately to the pre-1987 accumulated profits and related foreign income taxes of such corporation. For further guidance, see Rev. Rul. 74–550 (1974–2 C.B. 209) (see also §601.601(d)(2) of this chapter); *Champion Int'l Corp. v. Commissioner*, 81 T.C. 424 (1983), acq. in result, 1987–2 C.B. 1; Rev. Rul. 87–72 (1987–2 C.B. 170) (see also §601.601(d)(2) of this chapter). As a result, no amount in excess of the aggregate positive amount of pre-1987 accumulated profits shall be distributed from the pre-transaction earnings of the foreign acquiring corporation or the foreign target corporation.

(B) *Aggregate deficit in earnings and profits.* If the foreign acquiring corporation or the foreign target corporation (or both) has an aggregate deficit in pre-1987 accumulated profits, then the rules otherwise applicable to such deficits shall apply separately to the pre-transaction earnings and profits and related taxes of the applicable corporation. See, e.g., sections 316(a) and 381(c)(2)(B). Thus, any aggregate net deficit shall be available to offset only post-transaction earnings accumulated by the foreign surviving corporation.

(iv) *Pre-1987 section 960 earnings and profits and foreign income taxes.* The pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation but shall not be combined. The rules otherwise applicable to such amounts shall apply separately to the pre-1987 section 960 earnings and profits and pre-1987 section 960 foreign income taxes of the foreign acquiring corporation and the foreign target corporation on a pro rata basis. For further guidance, see Notice 88–70 (1988–2 C.B. 369) (see also §601.601(d)(2) of this chapter).

(v) *Examples.* The following examples illustrate the rules of this paragraph (f)(2). The examples presume the following facts: Both foreign corporation A and foreign corporation B always have had calendar taxable years. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a "u" functional currency. The examples are as follows:

Example 1—(i) *Facts.* (A) Foreign corporations A and B both were incorporated in 1998. Nine percent of the voting stock of foreign corporation A is owned by domestic corporate shareholder C. Nine percent of the voting stock of foreign corporation B is owned by domestic corporate shareholder D. Shareholders C and D are unrelated. The remaining 91% of the voting stock of each foreign corporation is owned by unrelated foreign shareholders. Thus, neither corporation meets the requirements of section 902(c)(3)(B). On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
2001	500u	350u
2000	400u	300u
1999	400u	160u
1998	100u	5u
	1,400u	815u

Foreign Corporation B	*E&P*	*Foreign Taxes*
2001	100u	20u
2000	300u	60u
1999	0u	50u
1998	50u	5u
	450u	135u

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation that does not meet the requirements of section 902(c)(3)(B).

(ii) *Result.* Under the rules described in paragraphs (f)(2)(i) and (ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	Foreign Taxes
Two Side-by-Side Layers of 2001 E&P:		
2001 layer #1 (from Corp A)	500u	350u
2001 layer #2 (from Corp B)	100u	20u
Two Side-by-Side Layers of 2000 E&P:		
2000 layer #1 (from Corp A)	400u	300u
2000 layer #2 (from Corp B)	300u	60u
Two Side-by-Side Layers of 1999 E&P:		
1999 layer #1 (from Corp A)	400u	160u
1999 layer #2 (from Corp B)	0u	50u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1 (from Corp A)	100u	5u
1998 layer #2 (from Corp B)	50u	5u
	1,850u	950u

(iii) *Post-transaction distribution.* (A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 600u to its shareholders. Under the rules of paragraph (c)(3) of this section, the distribution is out of pre-pooling annual layers under the LIFO method as follows:

	E&P	Foreign Taxes
Two Side-by-Side Layers of 2001 E&P:		
2001 layer #1 (from Corp A)	500u	350u
2001 layer #2 (from Corp B)	100u	20u
	600u	370u

(B) Foreign surviving corporation's foreign income tax accounts are reduced to reflect the distribution of earnings and profits, see §1.902-1(a)(10)(iii), notwithstanding that no shareholders are eligible to claim deemed paid foreign income taxes under section 902.

(C) Immediately after the distribution, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	Foreign Taxes
Two Side-by-Side Layers of 2000 E&P:		
2000 layer #1 (from Corp A)	400u	300u
2000 layer #2 (from Corp B)	300u	60u
Two Side-by-Side Layers of 1999 E&P:		
1999 layer #1 (from Corp A)	400u	160u
1999 layer #2 (from Corp B)	0u	50u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1 (from Corp A)	100u	5u
1998 layer #2 (from Corp B)	50u	5u
	1,250u	580u

Example 2—(i) *Facts.* (A) The facts are the same as in *Example 1* (i)(A), except that foreign corporation A met the requirements of section 902(c)(3)(B) on January 1, 2000, when U.S. corporate shareholder C acquired an additional 1% of voting stock for a total ownership interest of 10%; foreign corporation A thereby became a non-look-through 10/50 corporation. On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	E&P	Foreign Taxes
E&P Accumulated as Non-Look-Through 10/50 Corporation	900u	$650
1999	400u	160u
1998	100u	5u
	1,400u	

Foreign Corporation B	E&P	Foreign Taxes
2001	100u	20u
2000	300u	60u
1999	0u	50u
1998	50u	5u
	450u	135u

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation that does not meet the requirements of section 902(c)(3)(B).

(ii) *Result.* Under the rules described in paragraphs (f)(2)(i) and (ii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	Foreign Taxes
Two Side-by-Side Layers of 2001 E&P:		
2001 layer #1 (from Corp A's pool)	900u	$650
2001 layer #2 (from Corp B's layer)	100u	20u
2000 (from Corp B):	300u	60u
Two Side-by-Side Layers of 1999 E&P:		
1999 layer #1 (from Corp A)	400u	160u
1999 layer #2 (from Corp B)	0u	50u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1 (from Corp A)	100u	5u
1998 layer #2 (from Corp B)	50u	5u
	1,850u	

(iii) *Subsequent ownership change.* On January 1, 2007, USS (a domestic corporation) acquires 100% of the stock of foreign surviving corporation. Under the rules of paragraph (g)(3) of this section, foreign surviving corporation begins to pool its earnings and profits under section 902(c)(3) as of January 1, 2007. Foreign surviving corporation's earnings and profits and foreign income taxes accrued before January 1, 2007 retain their character as pre-1987 accumulated profits and pre-1987 foreign income taxes.

Example 3—(i) *Facts.* (A) The facts are the same as in *Example 2* (i)(A), except that on December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	E&P	Foreign Taxes
E&P Accumulated as Non-Look-Through 10/50 Corporation	1,000u	$500
1999	(200u)	10u
1998	400u	5u
	1,200u	

Foreign Corporation B	E&P	Foreign Taxes
2001	300u	20u
2000	(100u)	60u
1999	0u	50u
1998	50u	5u
	250u	135u

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation that does not meet the requirements of section 902(c)(3)(B).

(ii) *Result.* Because foreign corporations A and B have aggregate positive amounts of pre-1987 earnings and profits with a deficit in one or more individual years, the rules of paragraph (f)(2)(iii)(A) of this section apply. Accordingly, after the foreign 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Deficit E&P*	*Foreign Taxes Available*	*Foreign Taxes Associated with Deficit E&P*
Two Side-by-Side Layers of 2001 E&P:				
2001 layer #1 (from Corp A's non-look-through 10/50 pool)	1,000u		$500	
2001 layer #2 (from Corp B's layer)	300u		20u	
2000 (from Corp B)		(100u)		60u
Two Side-by-Side Layers of 1999 E&P:				
1999 layer #1 (from Corp A)		(200u)		10u
1999 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 1998 E&P:				
1998 layer #1 (from Corp A)	400u		5u	
1998 layer #2 (from Corp B)	50u		5u	
	1,750u	(300u)		70u

(iii) *Post-transaction distribution.* (A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 1,300u to its shareholders. Under the rules described in paragraphs (c)(3) and (f)(2)(iii)(A) of this section, the distribution is out of the pre-pooling annual layers, as follows:

	E&P	*Foreign Taxes Paid*
Two Side-by-Side Layers of 2001 E&P:		
2001 layer #1	1,000u	$500
2001 layer #2	250u	20u
1998 E&P:		
1998 layer #1	50u	1.25u (25% of 5u taxes)
	1,300u	

(B) Under the rules described in paragraph (f)(2)(iii)(A) of this section, the rules otherwise applicable when a foreign corporation has an aggregate positive (or zero) amount of pre-1987 accumulated profits, but a deficit in one or more individual years, apply separately to the pre-1987 accumulated profits and related foreign income taxes of foreign corporation A and foreign corporation B. As a result, distributions out of the pre-pooling annual layers of foreign corporation A and foreign corporation B cannot exceed the aggregate positive amount of pre-1987 accumulated profits of each corporation. Accordingly, only 1,200u and 250u can be distributed out of foreign corporation A's and foreign corporation B's pre-pooling annual layers, respectively. Thus, 1,250u of the distribution is out of 1,000u of foreign corporation A's 2001 layer #1 and 250u of foreign corporation B's 2001 layer #2. Under the principles of §1.902–1(b)(3) and *Champion Int'l Corp. v. Commissioner*, 81 T.C. 424 (1983), all of the taxes in each of those respective layers are reduced. Applying Rev. Rul. 74–550 (1974–2 C.B. 209) (see also §601.601(d)(2) of this chapter), the remaining 50u is distributed from foreign corporation A's 1998 layer #1 (after rolling back the 200u deficit in 1999 layer #1 to reduce earnings in 1998 layer #1 to 200u (400u – 200u)). Thus, after the distribution, 150u remains in the 1998 layer #1 along with 3.75u of foreign income taxes (5u x (150u ÷ 200u)).

(C) Foreign surviving corporation's foreign income tax accounts are reduced to reflect the distribution of earnings and profits, see §1.902–1(a)(10)(iii), notwithstanding that no shareholders are eligible to claim a credit for deemed paid foreign income taxes under section 902.

(D) Immediately after the distribution foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	E&P	*Foreign Taxes*
2000	0u	60u
Two Side-by-Side Layers of 1999 E&P:		
1999 layer #1	0u	10u
1999 layer #2	0u	50u
Two Side-by-Side Layers of 1998 E&P:		
1998 layer #1	150u	3.75u
1998 layer #2	0u	5u
	150u	128.75u

(E) Under the rules described in paragraph (f)(2)(iii)(A) of this section, the 60u, 10u, 50u, and 5u of foreign income taxes related to foreign surviving corporation's 2000 layer, 1999 layer #1, 1999 layer #2, and 1998 layer #2, respectively, remain in those layers. These foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped.

Example 4—(i) *Facts.* (A) The facts are the same as in *Example 2* (i)(A), except that on December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A E&P Accumulated as Non-Look- Through 10/50 Corporation:	*E&P*	*Foreign Taxes*
	(1,000u)	$20
1999	(200u)	10u
1998	400u	5u
	(800u)	

Foreign Corporation B	*E&P*	*Foreign Taxes*
2001	100u	20u
2000	300u	60u
1999	0u	50u
1998	50u	5u
	450u	135u

(B) On January 1, 2002, foreign corporation A acquires the assets of foreign corporation B in a reorganization described in section 368(a)(1)(C). Im-

mediately following the foreign 381 transaction, foreign surviving corporation is a less-than-10%-U.S.-owned foreign corporation.

(ii) *Result.* Because foreign corporation A has an aggregate deficit in pre-1987 earnings and profits, the rules of paragraph (f)(2)(iii)(B) of this section apply and the rules otherwise applicable apply separately to the pre-1987 accumulated profits that carry over to foreign surviving corporation from foreign corporation A. Accordingly, after the foreign 381 transaction, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Deficit E&P*	*Foreign Taxes Available*	*Foreign Taxes Associated with Deficit E&P*
Two Side-by-Side Layers of 2001 E&P:				
2001 layer #1 (from Corp A)		(1,000u)		$20
2001 layer #2 (from Corp B)	100u		20u	
2000	300u		60u	
Two Side-by-Side Layers of 1999 E&P:				
1999 layer #1 (from Corp A)		(200u)		10u
1999 layer #2 (from Corp B)	0u		50u	
Two Side-by-Side Layers of 1998 E&P:				
1998 layer #1 (from Corp A)	400u		5u	
1998 layer #2 (from Corp B)	50u		5u	
	850u	(1,200u)	140u	

(iii) *Post-transaction distribution.* (A) During 2002, foreign surviving corporation does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, foreign surviving corporation distributes 200u to its shareholders. Under the rules described in paragraph (f)(2)(iii)(B) of this section, no distribution can be made out of the pre-1987 accumulated profits of foreign corporation A (and the 800u aggregate deficit is available to offset only post-transaction earnings accumulated by foreign surviving corporation). Thus, the distribution is out of pre-pooling annual layers as follows:

	E&P	*Foreign Taxes Paid*
2001 layer #2	100u	20u
2000	100u	20u
	200u	40u

(B) Foreign surviving corporation's foreign income tax accounts are reduced to reflect the distribution of earnings and profits, see §1.902-1(a)(10)(iii), notwithstanding that no shareholders are eligible to claim deemed paid foreign income taxes under section 902.

(g) *Special rules*—(1) *Treatment of deficit.* Any deficit described in paragraph (d)(2), (e)(1)(iii), (e)(2)(iii), (f)(1)(iii), or (f)(2)(iii) of this section shall not be taken into account in determining current or accumulated earnings and profits of a foreign surviving corporation, including for purposes of calculating—

(A) The earnings and profits limitation of section 952(c)(1)(A) and (c)(1)(C); and

(B) the amount of the foreign surviving corporation's subpart F income as defined in section 952(a).

(2) *Reconciling taxable years.* If a foreign acquiring corporation and a foreign target corporation had taxable years ending on different dates, then the pro rata distribution rules of paragraphs (f)(1)(ii) and (f)(2)(ii) of this section shall apply with respect to the taxable years that end within the same calendar year.

(3) *Post-transaction change of status.* If a foreign surviving corporation that is subject to the rules of paragraph (c)(2) of this section subsequently becomes a look-through corporation, or if a foreign surviving corporation that is subject to the rules of paragraph (c)(3) of this section subsequently becomes a non-look-through 10/50 corporation or a look-through corporation, by reason, for example, of a reorganization, liquidation, or change of ownership, then post-1986 undistributed earnings and post-1986 foreign income taxes that have lost their look-through or pooling character by reason of this section shall not have such look-through or pooling character restored. See, e.g., paragraph (f)(2)(v) *Example 2* of this section.

(4) *Ordering rule for offsetting multiple hovering deficits* —(i) *Rule.* A foreign surviving corporation shall apply the deficit rules of paragraphs (d)(2), (e)(1)(iii), (e)(2)(iii), (f)(1)(iii), and (f)(2)(iii) of this section in that order (in the event that more than one of such rules applies to the foreign surviving corporation).

(ii) *Example.* The following example illustrates the rules of this paragraph (g)(4). The examples presume the following facts: Foreign corporation A was a non-look-through 10/50 corporation from its incorporation on January 1, 1995 until December 31, 1997; foreign corporation A became a CFC on January 1, 1998 and has been a CFC since that time. Foreign corporation B has been a non-look-through 10/50 corporation since its incorporation on January 1, 1993. Foreign corporations A and B always have had calendar taxable years. Foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a "u" functional cur-

rency. Finally, any earnings and profits described in section 904(d)(1)(E) (10/50 dividends) qualified for the high tax exception from subpart F income under section 954(b)(4), and all shareholders elected to exclude such earnings and profits from subpart F income under section 954(b)(4) and §1.954–1(d)(5). The example is as follows:

Example—(i) *Facts.* (A) On December 31, 2001, foreign corporations A and B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A	*E&P*	*Foreign Taxes*
Separate Category:		
10/50 dividends from FC1, a noncontrolled section 902 corporation	100u	$60
General	(300u)	$25
E&P Accumulated as Non-Look-Through 10/50 Corporation	300u	$100
	100u	$185

Foreign Corporation B	*E&P*	*Foreign Taxes*
E&P Accumulated as Non-Look-Through 10/50 Corporation	(200u)	$50

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). Immediately following the foreign 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result.* Under the rules described in paragraphs (d)(1), (d)(2), (e)(1)(i), (e)(1)(ii), and (e)(1)(iii) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts:

	Earnings & Profits:		*Foreign Taxes:*	
	Positive E&P	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Look-Through Pool:				
10/50 dividends	100u		$60	
General		(300u)		$25
Two Side-by-Side Non-Look-Through Pool Amounts:				
Non-look-through pool amount #1 (from Corp A)	300u		$100	
Non-look-through pool amount #2 (from Corp B)		(200u)		$50
	400u	(500u)	$160	75

(iii) *Post-transaction earnings.* (A) In the taxable year ending on December 31, 2002, foreign surviving corporation accumulates earnings and profits and pays related foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
10/50 dividends from FC1	150u	$ 40
General	400u	$ 60
	550u	$100

(B) None of the earnings and profits qualify as subpart F income as defined in section 952(a). Under the rules of paragraph (g)(4)(i) of this section, the rules of paragraph (d)(2) of this section apply before the rules of paragraph (e)(1)(iii) of this section. Accordingly, post-transaction earnings in a separate category are first offset by a hovering deficit in the same separate category in the look-through pool. Thus, foreign surviving corporation's 300u deficit in the section 904(d)(1)(I) general separate category offsets 300u of post-transaction general separate category earnings. After application of paragraph (d)(2) of this section, foreign surviving corporation has the following post-transaction earnings available for further offset by a hovering deficit: 150u in the section 904(d)(1)(E) 10/50 dividends separate category and 100u in the general separate category. Under paragraph (e)(1)(iii) of this section, a deficit in the non-look-through pool offsets a pro rata portion of post-transaction earnings in each separate category. Thus, foreign surviving corporation's 200u deficit in non-look-through pool amount #2 offsets the remaining post-transaction earnings on a pro rata basis (200u x (150u ÷ 250u) = 120u against 10/50 dividends separate category earnings and 200u x (100u ÷ 250u) = 80u against general separate category earnings). Accordingly, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts at the end of 2002:

	E&P	*Foreign Taxes*
Look-Through Pool Separate Category:		
10/50 dividends	130u	$100
General	20u	$85
Two Side-by-Side Non-Look-Through Pool Amounts:		
Non-look-through pool amount #1	300u	$100
Non-look-through pool amount #2	0u	$ 50
	450u	$335

(C) Under paragraph (d)(2)(ii) of this section, the $25 of foreign income taxes related to the 300u hovering deficit in the section 904(d)(1)(I) general separate category is added to foreign surviving corporation's post-1986 foreign income taxes in that separate category (because post-transaction earnings in the general separate category have been offset by and exceed the deficit in that category). Under paragraph (e)(1)(iii)(B) of this section, the $50 of foreign income taxes related to the 200u hovering deficit in non-look-through pool amount #2 is added to foreign surviving corporation's post-1986 foreign income taxes for non-look-through pool amount #2 (because post-transaction earnings have been offset by and exceed the deficit in the non-look-through pool). However, the $50 of foreign income taxes generally will not be reduced or deemed paid unless a foreign tax refund restores a positive balance to the associated earnings pursuant to section 905(c), and thus will be trapped.

(5) *Pro rata rule for earnings during transaction year.* For purposes of offsetting post-transaction earnings of a foreign surviving corporation under the rules described in paragraphs (d)(2), (e)(1)(iii), (e)(2)(iii), (f)(1)(iii), and (f)(2)(iii), the earnings and profits for the taxable year of the foreign surviving corporation in which the transaction occurs shall be deemed to have been accumulated after such transaction in an amount which bears the same ratio to the undistributed earnings and profits of the foreign surviving corporation for such taxable year (computed without regard to any earnings and profits carried over) as the number of days in the taxable year after the date of

transaction bears to the total number of days in the taxable year. See, e.g., §1.381(c)(2)–1(a)(7) *Example 2* (illustrating application of this rule with respect to domestic corporations).

(6) *Nonapplicability of hovering deficit rules to certain transactions*—(i) *Rule.* If a principal purpose of a foreign 381 transaction is to gain a tax benefit from affirmative use of the hovering deficit rule described in paragraph (d)(2), (e)(1)(iii), (e)(2)(iii), (f)(1)(iii), or (f)(2)(iii) of this section, then the Commissioner may exercise discretion to apply the principles of §1.367(b)–9 to such transaction.

(ii) *Example.* The following example illustrates the rules of this paragraph (h)(6). The example is as follows:

Example—(i) *Facts.* (A) Foreign corporations A and B are and always have been wholly owned subsidiaries of USP, a domestic corporation. Both foreign corporations A and B were incorporated in 1990, and both always have been CFCs using a calendar taxable year. Both foreign corporations A and B (and all of their respective qualified business units as defined in section 989) maintain a "u" functional currency and 1u = US$1 at all times. Any earnings and profits described in section 904(d)(1)(E) (10/50 dividends) qualified for the high tax exception from subpart F income under section 954(b)(4), and USP elected to exclude such earnings and profits from subpart F income under section 954(b)(4) and §1.954–1(d)(5). On December 31, 2001, foreign corporation A and foreign corporation B have the following earnings and profits and foreign income taxes accounts:

Foreign Corporation A		
Separate Category:	*E&P*	*Foreign Taxes*
Passive	(1,000u)	$ 5
General	200u	$200
	(800u)	$205

Foreign Corporation B		
Separate Category:	*E&P*	*Foreign Taxes*
10/50 dividends	5u	$ 3

(B) On January 1, 2002, foreign corporation B acquires the assets of foreign corporation A in a reorganization described in section 368(a)(1)(C). A principal purpose of the foreign 381 transaction is to gain a tax benefit from affirmative use of the hovering deficit rule described in paragraph (d)(2) of this section. Immediately following the foreign 381 transaction, foreign surviving corporation is a CFC.

(ii) *Result under general rules.* (A) If the rules of paragraphs (d)(1) and (2) of this section were to apply, foreign surviving corporation would have the following earnings and profits and foreign income taxes accounts immediately after the foreign 381 transaction:

	Earnings & Profits:		*Foreign Taxes:*	
Separate Category:	*Positive E&P*	*Hovering Deficit*	*Foreign Taxes Available*	*Foreign Taxes Associated with Hovering Deficit*
Passive		(1,000u)		$5
10/50 dividends	5u		$ 3	
General	200u		$200	
	205u	(1,000u)	$203	$5

(B) Accordingly, if the hovering deficit rules of paragraph (d)(2) of this section were to apply, foreign surviving corporation would be able to pay to USP a dividend of $205 that would carry deemed paid foreign income taxes of $203 under section 902.

(iii) *Result under this paragraph (g)(6).* Because a principal purpose of the foreign 381 transaction was to gain a tax benefit from affirmative use of the hovering deficit rule described in paragraph (d)(2) of this section, the Commissioner may exercise discretion to apply the principles of §1.367(b)–9 to the transaction. Under the principles of §1.367(b)–9, the earnings and profits and foreign income taxes accounts of foreign corporation A and foreign corporation B are combined under paragraph (d)(1) of this section without reference to the hovering deficit rule of paragraph (d)(2) of this section. Accordingly, foreign surviving corporation would have the following earnings and profits and foreign income taxes accounts immediately after the transaction:

Separate Category:	*E&P*	*Foreign Taxes*
Passive	(1,000u)	$ 5
10/50 dividends	5u	$ 3
General	200u	$200
	(795u)	$208

(h) *Effective date.* This section shall apply to section 367(b) exchanges that occur on or after the date 30 days after these regulations are published as final regulations in the **Federal Register**.

Par. 10. Section 1.367(b)–8 is added to read as follows:

§1.367(b)–8 Allocation of earnings and profits and foreign income taxes in certain foreign corporate separations.

(a) *Scope.* This section applies to distributions to which section 355 (or so much of section 356 as relates to section 355) applies, whether or not in connection with a section 368(a)(1)(D) reorganization (D reorganization), in which the distributing corporation or the controlled corporation (or both) is a foreign corporation (foreign divisive transaction). For purposes of this section, the terms distributing corporation and controlled corporation have the same meaning as used in section 355 and the regulations thereunder. Paragraph (b) of this section provides general rules governing the allocation and reduction of a distributing corporation's earnings and profits and foreign income taxes (pre-transaction earnings and pre-transaction taxes, respectively) in foreign divisive transactions. Paragraphs (c), (d), and (e) of this section describe special rules for the application of paragraph (b) of this section to specific situations, depending upon whether the distributing corporation or the controlled corporation (or both the distributing and the controlled corporation) is a foreign corporation.

(b) *General rules*—(1) *Application of §1.312–10*—(i) *In general.* Pre-transaction earnings of a distributing corporation shall be allocated between the distributing corporation and the controlled corporation in accordance with the rules of §1.312-10(a) and shall be reduced in accordance with the rules of §1.312-10(b), except to the extent otherwise provided in this section.

(ii) *Special rules for application of §1.312–10(b)*—(A) *Distributing corporation.* The pre-transaction earnings of a distributing corporation shall be reduced without taking into account §1.312–10(b)(2).

(B) *Controlled corporation.* Section 1.312–10(b) shall not apply to increase or replace the earnings and profits of a controlled corporation by the amount of any decrease in the pre-transaction earnings of a distributing corporation.

(iii) *Net deficit in pre-transaction earnings.* Nothing in this section shall permit any portion of the pre-transaction earnings of a distributing corporation that has

a net deficit in pre-transaction earnings to be allocated or reduced under paragraph (b)(1)(i) of this section. See §1.312–10(c). Compare paragraph (b)(2) of this section (requiring an allocation or reduction of a pro rata portion of deficits in statutory groupings of earnings and profits when a distributing corporation has a net positive amount of pre-transaction earnings).

(iv) *Use of net bases.* All allocations and reductions described in paragraph (b)(1)(i) of this section shall be determined in accordance with the net bases in assets. Net basis shall have the same meaning as under §1.312–10(a).

(v) *Gain recognized by distributing corporation.* The pre- transaction earnings that are subject to allocation or reduction under paragraph (b)(1)(i) of this section shall include any increase in earnings and profits from gain recognized or income included by the distributing corporation as a result of the foreign divisive transaction. See, for example, section 367(a) and (e), section 1248(f), and §1.367(b)–5(b).

(vi) *Coordination with branch profits tax.* An allocation or reduction in a distributing corporation's pre-transaction earnings under paragraph (b)(1)(i) of this section shall not be out of or reduce effectively connected earnings and profits or non-previously taxed accumulated effectively connected earnings and profits, as defined in section 884. See also §1.884–2T(d)(5)(iii) (providing that such earnings and profits are not subject to reduction under §1.312–10(b)).

(2) *Cross-section of earnings and profits.* Except to the extent provided in paragraphs (b)(1)(iii), (b)(1)(vi), (d)(2)(ii), (d)(4), and (e)(4) of this section and other than any portion attributable to an inclusion under §1.367(b)–5 or paragraph (d)(2)(i) of this section, an allocation or reduction of pre-transaction earnings described in paragraph (b)(1)(i) of this section shall decrease, on a pro rata basis, the statutory groupings of earnings and profits (or deficits in statutory groupings of earnings and profits) of the distributing corporation. Thus, for example, a pro rata portion of a foreign distributing corporation's separate categories, post-1986 undistributed earnings, and annual layers of pre-1987 accumulated profits and pre-1987 section 960 earnings and profits shall be allocated or reduced.

(3) *Foreign income taxes.* Pre-transaction taxes of a distributing corporation shall be ratably allocated or reduced only to the extent described in paragraphs (d)(3) and (e)(3) of this section. Thus, a distributing corporation's excess foreign taxes described in section 904(c) shall not be allocated or reduced under this section.

(4) *Divisive D reorganization with a preexisting controlled corporation.* In the case of a foreign divisive transaction that includes a D reorganization with a controlled corporation that is not newly created (a preexisting controlled corporation), paragraph (b)(1)(i) of this section shall apply in the following manner:

(i) *Calculation of earnings and profits of distributing corporation.* The pre-transaction earnings of a distributing corporation shall be reduced by the sum of—

(A) The amount of the reduction in the pre-transaction earnings of the distributing corporation as described in §1.312–10(a) (as determined under this section); and

(B) The amount of the reduction in the pre-transaction earnings of the distributing corporation as described in §1.312–10(b) (as determined under this section).

(ii) *Calculation of earnings and profits of controlled corporation.* The amount of earnings and profits of the controlled corporation immediately after the foreign divisive transaction shall equal the sum of—

(A) The amount described in paragraph (b)(4)(i)(A) of this section (except to the extent such amounts are included in income as a deemed dividend pursuant to the foreign divisive transaction or are subject to the rule of §1.367(b)–3(f)); and

(B) The amount of earnings and profits of the controlled corporation immediately before the foreign divisive transaction.

(c) *Foreign divisive transactions involving a domestic distributing corporation and a foreign controlled corporation—* (1) *Scope.* The rules of this paragraph (c) apply to a foreign divisive transaction involving a domestic distributing corporation and a foreign controlled corporation.

(2) *Earnings and profits allocated to a foreign controlled corporation.* Pre-transaction earnings of a domestic distributing corporation that are allocated to a foreign controlled corporation under the rules described in paragraph (b)(1)(i) of this section shall not be included in the foreign controlled corporation's post-1986 undistributed earnings, pre-1987 accumulated profits, or pre-1987 section 960 earnings and profits. In addition, if a distribution by the domestic distributing corporation out of pre-transaction earnings immediately before the foreign divisive transaction would have been treated as a U.S. source dividend under section 861(a)(2)(A) that would not be exempt from tax under section 871(i)(2)(B) or 881(d), a distribution out of such earnings and profits by the foreign controlled corporation shall be treated as a U.S. source dividend under section 904(g) and for purposes of Chapter 3 of subtitle A of the Internal Revenue Code. See *Georday Enterprises v. Commissioner*, 126 F.2d 384 (4th Cir. 1942). See also sections 243(e) and 861(a)(2)(C) and §1.367(b)–2(j) for other rules that may apply.

(3) *Examples.* The following examples illustrate the application of the rules of this section to transactions described in paragraph (c)(1) of this section. The examples presume the following facts: USD is a domestic corporation engaged in manufacturing and shipping activities through Business A and Business B, respectively. FC is a foreign corporation that is wholly owned by USD. USD and FC use calendar taxable years. FC (and all of its qualified business units as defined in section 989) maintains a "u" functional currency and, except as otherwise specified, 1u = US$1 at all times. The examples are as follows:

Example 1—(i) *Facts.* The stock of USD is owned in equal parts by three shareholders, USP (a domestic corporation), USI (a United States citizen), and FP (a foreign corporation). USD owns assets with total net bases of $260 (including $100 attributable to the Business B shipping assets, which have a $160 fair market value). USD has $500 of earnings and profits (that it accumulated). The entire $500 would have been treated as a U.S. source dividend under section 861(a)(2)(A) that would not be exempt from tax under sections 871(i)(2)(B) or 881(d) if distributed by USD immediately before the foreign divisive transaction. On January 1, 2002, USD incorporates FC and transfers to FC the Business B shipping assets. USD then distributes the FC stock pro rata to USP, USI, and FP. The transaction meets the requirements of sections 368(a)(1)(D) and 355.

(ii) *Result*—(A) *Gain Recognition.* Under section 367(a)(5), USD recognizes gain equal to the difference between the fair market value and USD's adjusted basis in the Business B shipping assets ($160 - $100 = $60).

(B) *Calculation of USD's earnings and profits.* Under paragraph (b)(1)(v) of this section, USD's pre-transaction earnings include any gain recognized or income included as a result of the foreign divisive transaction. As described in this *Example 1* (ii)(A), USD recognizes $60 of gain as a result of the foreign divisive transaction. Accordingly, USD has $560 of pre-transaction earnings ($500 + $60). Under paragraph (b)(1)(i) of this section, USD's pre-transaction earnings are reduced by an amount equal to its pre-transaction earnings times the net bases of the assets transferred to FC divided by the net bases of the assets held by USD immediately before the foreign divisive transaction ($560 x ($160 ÷ $320) = $280). Following this reduction, USD has $280 of earnings and profits ($560 - $280).

(C) *Calculation of FC's earnings and profits.* Under paragraph (b)(1)(ii) of this section, the $280 reduction in USD's pre-transaction earnings is allocated to FC. Under §1.367(b)-2(j)(1), the $280 is translated into "u" at the spot rate on January 1, 2002, to 280u. Under paragraph (c)(2) of this section, the 280u is not included as part of FC's post-1986 undistributed earnings, pre-1987 accumulated profits, or section 960 earnings and profits.

(iii) *Post-transaction distribution.* During 2002, FC does not accumulate any earnings and profits or pay or accrue any foreign income taxes. On December 31, 2002, at a time when US$1 = 0.5u, FC distributes 180u (or $360) to its shareholders. Thus, FP, USP, and USI each receive a $120 dividend. See section 989(b)(1). Under paragraph (c)(2) of this section and §1.367(b)-2(j)(4), $93.33 of the distribution to FP is subject to withholding under Chapter 3 of subtitle A of the Internal Revenue Code ($280 ÷ 3 = $93.33). Under section 243(e) and §1.367(b)-2(j)(3), $93.33 of the distribution to USP is eligible for the dividends received deduction. See also section 861(a)(2)(C). Under paragraph (c)(2) of this section, the remaining $26.67 distribution to USP is treated as U.S. source under section 904(g) (and is not eligible for the dividends received deduction under section 243(e)). Under paragraph (c)(2) of this section, the $120 dividend distribution to USI is treated as U.S. source under section 904(g).

Example 2—(i) *Facts.* The stock of USD is owned by the following unrelated persons: 20 percent by USP (a domestic corporation), 20 percent by USI (a United States citizen), and 60 percent by FP (a foreign corporation). FC is a preexisting controlled corporation that was incorporated in 1995 and USD always has owned all of the FC stock. USD owns assets with total net bases of $320 (including $160 attributable to the FC stock), and USD has $500 of earnings and profits. FC has 150u of earnings and profits in the section 904(d)(1)(D) shipping separate category and has $60 of related foreign income taxes. FC's earnings and profits qualified for the high tax exception from subpart F income under section 954(b)(4), and USD elected to exclude the earnings and profits from subpart F income under section 954(b)(4) and §1.954-1(d)(5). On January 1, 2002, USD distributes the stock of FC to its shareholders in a transaction that meets the requirements of section 355. FC is not a controlled foreign corporation after the foreign divisive transaction. On the date of the foreign divisive transaction, the FC stock has a $460 fair market value.

(ii) *Result*—(A) *Gain Recognition.* Under §1.367(b)-5(b)(1)(ii), USD recognizes gain equal to the difference between the fair market value and USD's adjusted basis in the FC stock distributed to USI. Under §1.367(e)-1(b)(1), USD recognizes gain equal to the difference between the fair market value and USD's adjusted basis in the FC stock distributed to FP. As a result of the transfers to USI and FP, USD recognizes gain of $240 (4/5 x ($460 - $160)), $120 of which is included in USD's income as a dividend under section 1248(a) and (f)(1) (4/5 x 150u, translated at the spot rate under section 989(b)(2)). Under section 1248(a) and (f)(1), USD includes as a dividend the difference between the fair market value and its adjusted basis in the FC stock distributed to USP to the extent of FC's earnings and profits attributable to the distributed stock. For further guidance, see also Notice 87-64 (1987-2 C.B. 375) (see also §601.601(d)(2) of this chapter). As a result of this transfer, USD includes a $30 dividend under section 1248(a) and (f)(1) (1/5 x 150u). USD qualifies for a section 902 deemed paid foreign tax credit with respect to its $150 of section 1248 dividends.

(B) *Calculation of USD's earnings and profits.* Under paragraph (b)(1)(v) of this section, USD's pre-transaction earnings include any gain recognized or income included as a result of the foreign divisive transaction. As described in this *Example 2* (ii)(A), USD recognizes and includes a total of $270 of gain and dividend income as a result of the foreign divisive transaction. Accordingly, USD has $770 of pre-transaction earnings ($500 + $270). Under paragraphs (b)(1)(i) and (b)(1)(ii)(A) of this section, USD's pre-transaction earnings are reduced by the amount of the reduction that would have been required if USD had transferred the stock of FC to a new corporation in a D reorganization. Thus, USD's pre-transaction earnings are reduced by an amount equal to its pre-transaction earnings times its net basis in the FC stock divided by the net bases of the assets held by USD immediately before the foreign divisive transaction ($770 x ($430 ÷ $590) = $561.19). Following this reduction, USD has $208.81 of earnings and profits ($770 - $561.19).

(C) *Calculation of FC's earnings and profits.* Under paragraph (b)(1)(ii)(B) of this section, FC's earnings and profits are not increased (or replaced) as a result of the foreign divisive transaction.

Example 3—(i) *Facts.* USP, a domestic corporation, owns all of the stock of USD. FC is a preexisting controlled corporation and USD has owned all of the FC stock since FC was incorporated in 1995. USD owns assets with total net bases of $320 (including $100 attributable to the FC stock and $160 attributable to the Business B shipping assets). USD has $500 of pre-transaction earnings. FC has 150u of earnings and profits in the section 904(d)(1)(D) shipping separate category and has $60 of related foreign income taxes. FC's earnings and profits qualified for the high tax exception from subpart F income under section 954(b)(4), and USD elected to exclude the earnings and profits from subpart F income under section 954(b)(4) and §1.954-1(d)(5). On January 1, 2002, USD transfers to FC the Business B shipping assets. USD then distributes the FC stock to USP. The transaction meets the requirements of sections 368(a)(1)(D) and 355. USD's transfer of the Business B shipping assets to FC falls within the active trade or business exception to section 367(a)(1) described in §1.367(a)-2T. Immediately after the foreign divisive transaction, the FC stock has a $460 fair market value. USP and USD meet and comply with the requirements of section 367(a)(5) and 1248(f)(2) (and any regulations thereunder). (Sections 1.367(b)-5(b)(1)(ii) and 1.367(e)-1(b)(1) do not apply with respect to the foreign divisive transaction because the distributee, USP, is a domestic corporation.)

(ii) *Result*—(A) *Calculation of USD's earnings and profits.* Under paragraph (b)(4)(i) of this section, USD's pre- transaction earnings are reduced by the sum of the amounts described in paragraphs (b)(4)(i)(A) and (b)(4)(i)(B) of this section. Under paragraph (b)(4)(i)(A) of this section, USD's pre-transaction earnings are reduced by an amount equal to USD's pre-transaction earnings times the net bases of the assets transferred to FC divided by the total net bases of the assets held by USD immediately before the foreign divisive transaction ($500 x ($160 ÷ $320) = $250). Under paragraph (b)(4)(i)(B) of this section, USD's pre-transaction earnings are reduced by an amount equal to USD's pre-transaction earnings times USD's net basis in the stock of FC (immediately before USD's transfer of the shipping assets) divided by the total net bases of the assets held by USD immediately before the foreign divisive transaction ($500 x ($100 ÷ $320) = $156.25). The sum of the amounts described in paragraphs (b)(4)(i)(A) and (B) of this section is $406.25 ($250 + $156.25). Following the reduction described in paragraph (b)(4)(i) of this section, USD has $93.75 of earnings and profits ($500 - $406.25).

(B) *Calculation of FC's earnings and profits.* Under paragraphs (b)(4)(ii) of this section, the earnings and profits of FC immediately after the foreign divisive transaction are increased by the amount of the reduction in USD's pre-transaction earnings described in paragraph (b)(4)(i)(A) of this section ($250). Under §1.367(b)-2(j)(1), this $250 is translated into "u" at the spot rate on January 1, 2002, to 250u. Under paragraph (c)(2) of this section, the 250u is not included as part of FC's post-1986 undistributed earnings. FC has 400u in earnings and profits (250u + 150u) immediately after the foreign divisive transaction.

(iii) *Post-transaction distribution.* FC does not accumulate any earnings and profits or pay or accrue any foreign income taxes during 2002. On December 31, 2002, FC distributes 100u as a dividend to USP, which has remained its sole shareholder. Under section 989(b)(1), the 100u distribution is translated into US$ at the spot rate on December 31, 2002, to $100. Proportionate parts of the $100 dividend are attributable to the pre-transaction earnings of FC ($37.50 = $100 x (150 ÷ 400)) and USD ($62.50 = $100 x (250 ÷ 400)). See sections 243(e) and 245. Thus, under sections 243(e) and §1.367(b)-2(j)(3), $62.50 of the distribution is eligible for the dividends received deduction. See also section 861(a)(2)(C). The remaining $37.50 of the distribution (and $15 of related foreign income taxes) is subject to the generally applicable rules concerning dividends paid by foreign corporations.

(d) *Foreign divisive transactions involving a foreign distributing corporation and a domestic controlled corporation*—(1) *Scope.* The rules of this paragraph (d) apply to a foreign divisive transaction involving a foreign distributing corporation and a domestic controlled corporation.

(2) *Coordination with §1.367(b)–3*—(i) *In general.* In the case of a foreign divisive transaction that includes a D reorganization, the rules of §1.367(b)–3 are applicable with respect to the pre-transaction earnings of a foreign distributing corporation that are allocable to a domestic controlled corporation under paragraph (b)(1)(i) of this section.

(ii) *Determination of all earnings and profits amount.* An all earnings and profits amount inclusion under paragraph (d)(2)(i) of this section shall be computed with respect to the pre-transaction earnings that are allocable to the domestic controlled corporation, without regard to the parenthetical phrase in paragraph (b)(4)(ii)(A) of this section.

(iii) *Interaction with section 358 and §1.367(b)– 2(e)(3)(ii).* The basis increase provided in §1.367(b)– 2(e)(3)(ii) shall apply to an all earnings and profits amount inclusion under paragraph (d)(2)(i) of this section, subject to the following rules—

(A) Section 358 shall apply to determine the distributee's basis in the foreign distributing and domestic controlled corporation without regard to the all earnings and profits amount inclusion;

(B) After application of the rule in paragraph (d)(2)(iii)(A) of this section, the basis increase provided in §1.367(b)–2(e)(3)(ii) shall be applied in a manner that attributes such basis increase solely to the exchanging shareholder's stock in the domestic controlled corporation; and

(C) the rule of paragraph (d)(2)(iii)(B) of this section shall apply prior to §1.367(b)–5(c)(4) and (d)(4).

(iv) *Coordination with §1.367(b)–3(c).* In applying the rule of §1.367(b)–3(c)(2), an exchanging shareholder described in §1.367(b)–3(c)(1) shall recognize gain with respect to the stock of the domestic controlled corporation after the foreign divisive transaction.

(v) *Special rule for U.S. persons that own foreign distributing corporation stock after a non pro rata distribution.*

[Reserved]

(3) *Foreign income taxes.* Pre-transaction taxes related to a foreign distributing corporation's pre-transaction earnings that are allocable or are reduced under the rules described in paragraph (b)(1)(i) of this section shall be ratably reduced. Pre-transaction taxes related to a foreign distributing corporation's pre-transaction earnings that are allocable to a domestic controlled corporation under the rules described in paragraph (b)(1)(i) of this section shall not carry over to the domestic controlled corporation. Nothing in this paragraph (d)(3) shall affect the deemed paid taxes that otherwise would accompany an inclusion under §1.367(b)–5 or paragraph (d)(2)(i) of this section.

(4) *Previously taxed earnings and profits.* [Reserved]

(5) *Coordination with §1.367(b)–5.* See also §1.367(b)–5(c) and (d) for other rules that may apply to a foreign divisive transaction described in paragraph (d)(1) of this section.

(6) *Examples.* The following examples illustrate the application of the rules of this section to transactions described in paragraph (d)(1) of this section. The examples presume the following facts: FD is a foreign corporation engaged in manufacturing and shipping activities through Business A and Business B, respectively. Any earnings and profits of FD described in section 904(d)(1)(D) (shipping income) qualified for the high tax exception from subpart F income under section 954(b)(4), and FD's United States shareholders elected to exclude the earnings and profits from subpart F income under section 954(b)(4) and §1.954–1(d)(5). USC is a domestic corporation that is wholly owned by FD. FD and USC use calendar taxable years. FD (and all of its qualified business units as defined in section 989) maintains a "u" functional currency, and 1u = US$1 at all times. The examples are as follows:

Example 1—(i) *Facts.* (A) USP, a domestic corporation, has owned all of the stock of FD since FD's incorporation in 1995. USP's adjusted basis in the FD stock is $100, and the FD stock has a fair market value of $800. FD owns assets with total net bases of 320u (including 160u attributable to the Business B shipping assets), and has the following pre-transaction earnings and pre-transaction taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	300u	$60
Shipping	200u	$80
	500u	$140

(B) On January 1, 2002, FD incorporates USC and transfers to USC the Business B shipping assets. FD then distributes the USC stock to USP. The transaction meets the requirements of sections 368(a)(1)(D) and 355. Immediately after the foreign divisive transaction, the FD stock and the USC stock each have a fair market value of $400.

(ii) *Results*—(A) *Calculation of FD's earnings and profits.* Under paragraph (b)(1)(i) of this section, FD's pre- transaction earnings are reduced by an amount equal to its pre-transaction earnings times the net bases of the assets transferred to USC divided by the net bases of the assets held by FD immediately before the foreign divisive transaction (500u x (160u ÷ 320u) = 250u). Following this reduction, FD has 250u of earnings and profits (500u - 250u).

(B) *All earnings and profits amount inclusion.* Under §1.367(b)–3 and paragraph (d)(2)(i) of this section, USP includes in income as an all earnings and profits amount the pre-transaction earnings of FD that are allocable to USC under paragraph (b)(1)(i) of this section. Thus, USP's all earnings and profits amount inclusion is $250. See also section 989(b)(1) and paragraph (d)(2)(ii) of this section. Under §1.367(b)–3(b)(3)(i) and §1.367(b)–2(e), USP includes the all earnings and profits amount as a deemed dividend received from FD immediately before the foreign divisive transaction. Because the requirements of section 902 are met, USP qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FD. Under §1.902–1(d)(1), the $250 deemed dividend is out of FD's separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
General	150u	$30
Shipping	100u	$40
	250u	$70

(C) *Calculation of USP's basis in USC and USC's earnings and profits.* Under paragraph (d)(2)(iii) of this section, the §1.367(b)–2(e)(3)(ii) basis increase applies with respect to USP's all earnings and profits amount inclusion from FD and is attributed solely to USP's basis in USC (after application of section 358). Accordingly, USP has a $300 basis in the USC stock ($50 section 358 basis, determined by reference to the relative values of USP's FD and USC stock: $100 pre-transaction basis x ($400 ÷ $800) + $250 §1.367(b)–2(e)(3)(ii) basis increase = $300). Because USP included in income as a deemed dividend under §1.367(b)–3 and paragraph (d)(2) of this section the pre-transaction earnings of FD that are allocable to USC under paragraph (b)(1)(i) of this section, such earnings and profits are not available to increase USC's earnings and profits. As a result, USC has zero earnings and profits immediately after the foreign divisive transaction.

(D) *Application of §1.367(b)–5(c).* The basis adjustment and income inclusion rules of §1.367(b)–5(c)(2) apply if USP's postdistribution amount with respect to FD stock is less than its predistribution amount with respect to FD stock. Under §1.367(b)–5(e)(1), USP's predistribution amount with respect to FD stock is USP's section 1248 amount attributable to such stock computed immediately before the distribution but after taking into account the allocation of earnings and profits as a result of the D reorganization. Thus, USP's predistribution amount with respect to FD stock is $250 (500u - 250u). See also section 989(b)(2). Under section 358, USP allocates its $100 basis in FD stock between FD stock and USC stock according to the stock blocks' relative values, yielding a $50 ($100 x ($400 ÷ $800)) basis in FD stock. See

also paragraph (d)(2)(iii) of this section. Under §1.367(b)-5(e)(2), USP's postdistribution amount with respect to FD stock is USP's section 1248 amount with respect to such stock, computed immediately after the distribution. Accordingly, USP's postdistribution amount with respect to FD stock is $250. Because USP's postdistribution amount with respect to FD stock is not less than its predistribution amount, USP is not required to make any basis adjustment or include any income under §1.367(b)-5(c).

(E) *FD's earnings and profits after the foreign divisive transaction.* Following the reduction described in this *Example 1* (ii)(A) and (B), FD has the following earnings and profits and foreign income taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	150u	$30
Shipping	100u	$40
	250u	$70

Example 2—(i) *Facts.* (A) USP, a domestic corporation, has owned all of the stock of FD since FD's incorporation in 1995. USP's adjusted basis in the FD stock is $400 and the FD stock has a fair market value of $800. USC is a preexisting controlled corporation. FD owns assets with net total bases of 320u (including 160u attributable to the USC stock), and has the following pre-transaction earnings and pre-transaction taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	300u	$60
Shipping	200u	$80
	500u	$140

(B) On January 1, 2002, FD distributes the USC stock to USP in a transaction that meets the requirements of section 355. Immediately after the foreign divisive transaction, the FD stock and the USC stock each have a $400 fair market value.

(ii) *Results*—(A) *Calculation of FD's earnings and profits.* Under paragraphs (b)(1)(i) and (b)(1)(ii)(A) of this section, FD's pre-transaction earnings are reduced by the amount of the reduction that would have been required if FD had transferred the stock of USC to a new corporation in a D reorganization. Thus, FD's pre-transaction earnings are reduced by an amount equal to its pre-transaction earnings times its net basis in the USC stock divided by the net bases of the assets held by FD immediately before the foreign divisive transaction (500u x (160u ÷ 320u) = 250u). Following this reduction, FD has 250u of earnings and profits (500u - 250u).

(B) *Calculation of USC's earnings and profits.* Under paragraph (b)(1)(ii)(B) of this section, USC's earnings and profits are not increased (or replaced) as a result of the foreign divisive transaction. As a result, USP is not required to include an amount in income under paragraph (d)(2)(i) of this section.

(C) *Application of §1.367(b)-5(c).* The basis adjustment and income inclusion rules of §1.367(b)-5(e)(2) apply if USP's postdistribution amount with respect to FD stock is less than its predistribution amount with respect to FD stock. Under §1.367(b)-5(e)(1), USP's predistribution amount with respect to FD stock is USP's section 1248 amount attributable to such stock computed immediately before the distribution. Thus, USP's predistribution amount with respect to FD stock is $400 (the predistribution amount is limited to USP's built-in gain in FD stock immediately before the distribution ($800 - $400)). See also section 989(b)(2). Under section 358, USP allocates its $400 basis in FD stock between FD stock and USC stock according to the stock blocks' relative values, yielding a $200 ($400 x ($400 ÷ $800)) basis in each block. Under §1.367(b)-5(e)(2), USP's postdistribution amount with respect to FD stock is USP's section 1248 amount with respect to such stock, computed immediately after the distribution. Accordingly, USP's postdistribution amount with respect to FD stock is $200 (the postdistribution amount is limited to USP's built-in gain in FD stock immediately after the distribution ($400 - $200)). Because USP's postdistribution amount with respect to FD stock is $200 less than its predistribution amount with respect to such stock ($400 - $200), §1.367(b)-5(c)(2)(i) and (ii) require USP to reduce its basis in FD stock by the $200 difference, but only to the extent such reduction increases USP's section 1248 amount with respect to the FD stock. As a result, USP reduces its basis in the FD stock from $200 to $150 and includes $150 in income as a deemed dividend from FD. Because the requirements of section 902 are met, USP qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FD. Under §1.902-1(d)(1), the $150 deemed dividend is out of FD's separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
General	90u	$18
Shipping	60u	$24
	150u	$42

(D) *Basis adjustment.* Under §1.367(b)-5(c)(3), USP does not increase its basis in FD stock as a result of USP's $150 deemed dividend from FD. Under §1.367(b)-5(c)(4), USP increases its basis in the USC stock by the amount by which it decreased its basis in the FD stock, as well as by the amount of its deemed dividend inclusion. The §1.367(b)-5(c)(4) basis increase applies in full because USP's basis in the USC stock is not increased above the fair market value of such stock. Thus, USP increases its basis in USC stock to $400 ($200 + $50 + $150).

(E) *Reduction in FD's statutory groupings of earnings and profits.* Under paragraph (b)(2) of this section, the reduction in FD's pre-transaction earnings that is not attributable to USP's inclusion under §1.367(b)-5 decreases FD's statutory groupings of earnings and profits on a pro rata basis. Under paragraph (d)(3) of this section, FD's pre-transaction taxes also are ratably reduced. As described in this *Example 2* (ii)(A), the reduction in FD's pre-transaction earnings is 250u. As described in this *Example 2* (ii)(C), 150u of the 250u reduction is attributable to an inclusion under §1.367(b)-5. As a result, under paragraphs (b)(2) and (d)(3) of this section the remaining 100u reduction in FD's pre-transaction earnings is out of the following separate categories of earnings and profits and foreign income taxes:

Separate Category:	*E&P*	*Foreign Taxes*
General	60u	$12
Shipping	40u	$16
	100u	$28

(F) *FD's earnings and profits after the foreign divisive transaction.* After the reductions described in this *Example 2* (ii)(C) and (E), FD has the following earnings and profits and foreign income taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	150u	$30
Shipping	100u	$40
	250u	$70

Example 3—(i) *Facts.* (A) USP, a domestic corporation, has owned all of the stock of FD since FD's incorporation in 1995. USP's adjusted basis in the FD stock is $400 and the FD stock has a fair market value of $800. USC is a preexisting controlled corporation. FD owns assets with total net bases of 320u (including 160u attributable to the USC stock and 80u attributable to the Business B shipping assets), and has the following pre-transaction earnings and pre-transaction taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	300u	$ 60
Shipping	200u	$ 80
	500u	$140

(B) On January 1, 2002, FD transfers to USC the Business B shipping assets. FD then distributes the USC stock to USP. The transaction meets the requirements of sections 368(a)(1)(D) and 355. Immediately after the foreign divisive transaction, the FD stock has a $200 fair market value and the USC stock has a $600 fair market value.

(ii) *Results*—(A) *Calculation of FD's earnings and profits.* Under paragraph (b)(4)(i) of this section, FD's pre-transaction earnings are reduced by the sum of the amounts described in paragraphs (b)(4)(i)(A) and (B) of this section. Under paragraph (b)(4)(i)(A) of this section, FD's pre-transaction earnings are reduced by an amount equal to FD's pre-transaction earnings times the net bases of the Business B shipping assets transferred to USC divided by the total net bases of the assets held by FD immediately before the foreign divisive transaction (500u x (80u ÷ 320u) = 125u). Under paragraph (b)(4)(i)(B) of this section, FD's pre-transaction earnings are reduced by an amount equal to FD's pre-transaction earnings times FD's net basis in the stock of USC divided by the total net bases of the assets held by FD immediately before the foreign divisive transaction (500u x (160u ÷ 320u) = 250u). The sum of the amounts described in paragraphs (b)(4)(i)(A) and (B) of this section is 375u (125u + 250u).

(B) *All earnings and profits amount inclusion.* Under §1.367(b)-3 and paragraph (d)(2)(i) of this section, USP is required to include in income as an all earnings and profits amount the pre-transaction earnings of FD that are allocable to USC under paragraph (b)(1)(i) of this section. Under paragraph (b)(4)(ii)(A) of this section, the 125u of pre-transaction earnings described in paragraph (b)(4)(i)(A) are allocable to USC. Thus, the all earnings and profits amount is $125. See also section 989(b)(1) and paragraph (d)(2)(ii) of this section. Under §§1.367(b)-3(b)(3)(i) and 1.367(b)-2(e), USP includes the all earnings and profits amount as a deemed dividend received from FD immediately before the foreign divisive transaction. Because the requirements of section 902 are met, USP qualifies for a deemed paid for-

eign tax credit with respect to the deemed dividend that it receives from FD. Under §1.902–1(d)(1), the $125 deemed dividend is out of FD's separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
General	75u	$15
Shipping	50u	$20
	125u	$35

(C) *Calculation of USP's basis in USC and USC's earnings and profits.* Under paragraph (d)(2)(iii) of this section, the §1.367(b)–2(e)(3)(ii) basis increase applies with respect to USP's all earnings and profits amount inclusion and is attributed solely to USP's basis in USC (after application of section 358). Accordingly, USP has a $425 basis in the USC stock ($300 section 358 basis, determined by reference to the relative values of USP's FD and USC stock: $400 pre-transaction basis x ($600 ÷ $800) + $125 §1.367(b)–2(e)(3)(ii) basis increase = $425). Because USP included in income as a deemed dividend under §1.367(b)–3 and paragraph (d)(2) of this section the pre-transaction earnings of FD that are allocable to USC under paragraph (b)(1)(i) of this section, such earnings and profits are not available to increase USC's earnings and profits. As a result, USC's earnings and profits are not increased as a result of the foreign divisive transaction.

(D) *Application of §1.367(b)–5(c).* The basis adjustment and income inclusion rules of §1.367(b)–5(c)(2) apply if USP's postdistribution amount with respect to FD stock is less than its predistribution amount with respect to FD stock. Under §1.367(b)–5(e)(1) and (3), USP's predistribution amount with respect to FD stock is USP's section 1248 amount attributable to such stock computed immediately before the distribution, after the allocation of FD's pre-transaction earnings described in paragraphs (b)(4)(i)(A) and (ii)(A) of this section, but without regard to the reduction in FD's pre-transaction earnings described in paragraph (b)(4)(i)(B) of this section. Thus, USP's predistribution amount with respect to FD stock is $375 ($500 - $125). See also section 989(b)(2). Under section 358, USP allocates its $400 basis in FD stock between FD stock and USC stock according to the stock blocks' relative values, yielding a $100 ($400 x ($200 ÷ $800)) basis in FD stock. See also paragraph (d)(2)(iii) of this section. Under §1.367(b)–5(e)(2), USP's postdistribution amount with respect to FD stock is USP's section 1248 amount with respect to such stock, computed immediately after the distribution. Accordingly, USP's postdistribution amount with respect to FD stock is $100. (While FD has earnings and profits of 125u immediately after the foreign divisive transaction, USP's postdistribution amount is limited to its built-in gain in FD stock immediately after the distribution ($200 - $100).) Because USP's postdistribution amount with respect to FD stock is $275 less than its predistribution amount with respect to such stock ($375 - $100), §1.367(b)–5(c)(2)(i) and (ii) require USP to reduce its basis in FD stock, but only to the extent such reduction increases USP's section 1248 amount with respect to the FD stock. As a result, USP reduces its basis in the FD stock from $100 to $75 and includes $250 in income as a deemed dividend from FD. Because the requirements of section 902 are met, USP qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FD. Under §1.902–1(d)(1), the $250 deemed dividend is out of FD's separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
General	150u	$30
Shipping	100u	$20
	250u	$50

(E) *Basis adjustment.* Under §1.367(b)–5(c)(3), USP does not increase its basis in FD stock as a result of USP's $250 deemed dividend from FD. Under §1.367(b)–5(c)(4), USP increases its basis in the USC stock by the amount by which it decreased its basis in the FD stock, as well as by the amount of its deemed dividend inclusion, but only up to the fair market value of USP's USC stock. As described in this *Example 3* (ii)(C), USP has already increased its basis in the USC stock to $525. Because the fair market value of FD's USC stock is $600, USP's basis increase under §1.367(b)–5(c)(4) is limited to $75. See also paragraph (d)(2)(iii)(C) of this section. Thus, USP has a $600 basis in the USC stock immediately after the foreign divisive transaction.

(F) *Reduction in FD's statutory groupings of earnings and profits.* Under paragraph (b)(2) of this section, the reduction in FD's pre-transaction earnings that is not attributable to USP's inclusion under paragraph (d)(2)(i) of this section or §1.367(b)–5 decrease FD's statutory groupings of earnings and profits on a pro rata basis. Under paragraph (d)(3) of this section, FD's pre-transaction taxes are also ratably reduced. As described in this *Example 3* (ii)(A), the reduction in FD's pre- transaction earnings is 375u. As described in this *Example 3* (ii)(B) and (D), the entire 375u reduction was subject to inclusion as a deemed dividend by USP under paragraph (d)(2)(i) of this section or §1.367(b)–5. Thus, none of FD's pre-transaction earnings remain to be reduced under paragraph (b)(2) of this section.

(G) *FD's earnings and profits after the foreign divisive transaction.* After the reductions described in this *Example 3* (ii)(B) and (D), FD has the following earnings and profits and foreign income taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	75u	$15
Shipping	50u	$20
	125u	$35

(e) *Foreign divisive transactions involving a foreign distributing corporation and a foreign controlled corporation*—(1) *Scope.* The rules of this paragraph (e) apply to a foreign divisive transaction involving a foreign distributing corporation and a foreign controlled corporation.

(2) *Earnings and profits of foreign controlled corporation*—(i) *In general.* Except to the extent specified in paragraph (e)(2)(ii) of this section, pre-transaction earnings of a foreign distributing corporation that are allocated to a foreign controlled corporation under the rules described in paragraphs (b)(1)(i) and (4) of this section shall carry over to the foreign controlled corporation in accordance with the rules described in §1.367(b)–7.

(ii) *Special rule for pre-transaction earnings allocated to a newly created controlled corporation.* Section 1.367(b)–9 shall apply to pre-transaction earnings that are allocated from a foreign distributing corporation to a newly created foreign controlled corporation under the rules described in paragraph (b)(1)(i) of this section.

(3) *Foreign income taxes.* Pre-transaction taxes related to a foreign distributing corporation's pre-transaction earnings that are allocated or reduced under the rules described in paragraph (b)(1)(i) of this section shall be ratably reduced. Pre-transaction taxes related to a foreign distributing corporation's pre-transaction earnings that are allocated to a foreign controlled corporation under the rules described in paragraph (b)(1)(i) of this section shall carry over to the foreign controlled corporation in accordance with the rules of §1.367(b)–7. Section 1.367(b)–9 shall apply to pre-transaction taxes that are allocated from a foreign distributing corporation to a newly created foreign controlled corporation under the rules described in paragraph (b)(1)(i) of this section.

(4) *Previously taxed earnings and profits.* [Reserved]

(5) *Coordination with §1.367(b)–5.* See also §1.367(b)–5(c) and (d) for other rules that may apply to a foreign divisive transaction described in paragraph (e)(1) of this section.

(6) *Examples.* The following examples illustrate the application of the rules of this section to transactions described in paragraph (e)(1) of this section. The examples presume the following facts: FD is a foreign corporation engaged in manufacturing and shipping activities through Business A and Business B, respectively. FC is a foreign corporation that is wholly owned by FD. Any earnings and profits of FD or FC described in section 904(d)(1)(D) (shipping income) qualified for the high tax exception from subpart F income under section 954(b)(4), and FD's and FC's United States shareholders elected to exclude the earnings and profits from subpart F income under section 954(b)(4) and §1.954–1(d)(1). FD and FC have calendar taxable years. FD and FC (and all of their respective qualified

business units as defined in section 989) maintain a "u" functional currency, and 1u = US$1 at all times. The examples are as follows:

Example 1—(i) *Facts.* (A) USP, a domestic corporation, has owned all of the stock of FD since FD's incorporation in 1995. USP's adjusted basis in the FD stock is $400 and the FD stock has a fair market value of $800. FD owns assets with total net bases of 320u (including 160u attributable to the Business B shipping assets), and has the following pre-transaction earnings and pre-transaction taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	300u	$60
Shipping	200u	$80
	500u	$140

(B) On January 1, 2002, FD incorporates FC and transfers to FC the Business B shipping assets. FD then distributes the FC stock to USP. The transaction meets the requirements of sections 368(a)(1)(D) and 355. Immediately after the foreign divisive transaction, the FD stock and the FC stock each have a $400 fair market value.

(ii) *Result.* (A) *Calculation of FD's earnings and profits.* Under paragraph (b)(1)(i) of this section, FD's pre-transaction earnings are reduced by an amount equal to its pre-transaction earnings times the net bases of the assets transferred to FC divided by the net bases of the assets held by FD immediately before the foreign divisive transaction (500u x (160u ÷ 320u) = 250u). Following this reduction, FD has 250u of earnings and profits (500u - 250u).

(B) *Application of §1.367(b)-5(c).* The basis adjustment and income inclusion rules of §1.367(b)-5(c)(2) apply if USP's postdistribution amount with respect to FD or FC stock is less than its predistribution amount with respect to such stock. Under §1.367(b)-5(e)(1), USP's predistribution amount with respect to FD or FC stock is USP's section 1248 amount attributable to such stock computed immediately before the distribution but after taking into account the allocation of earnings and profits as a result of the D reorganization. Thus, USP's predistribution amounts with respect to FD and FC stock are both $200. See also section 989(b)(2) and §1.1248-1(d)(3). Under section 358, USP allocates its $400 basis in FD stock between FD stock and FC stock according to the stock blocks' relative values, yielding a $200 ($400 x ($400 ÷ $800)) basis in each block. Under §1.367(b)-5(e)(2), USP's postdistribution amount with respect to FD or FC stock is USP's section 1248 amount with respect to such stock, computed immediately after the distribution. Accordingly, USP's postdistribution amounts with respect to FD and FC stock are both $200. Because USP's postdistribution amounts with respect to FD and FC stock are not less than USP's respective predistribution amounts, USP is not required to make any basis adjustment or include any income under §1.367(b)-5(c).

(C) *Reduction in FD's statutory groupings of earnings and profits.* Under paragraph (b)(2) of this section, the 250u reduction in FD's pre-transaction earnings decreases FD's statutory groupings of earnings and profits on a pro rata basis. Under paragraph (e)(3) of this section, FD's pre-transaction taxes also are ratably reduced. Accordingly, FD's pre-transaction earnings and pre-transaction taxes are reduced by the following amounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	150u	$30
Shipping	100u	$40
	250u	$70

(D) *Calculation of FC's earnings and profits.* Under paragraph (e)(2) of this section, the pre-transaction earnings of FD that are allocated to FC under paragraph (b)(1)(i) of this section carry over to FC in accordance with the rules of §1.367(b)-7, subject to the rule of §1.367(b)-9. Under paragraph (e)(3) of this section, FD's pre-transaction taxes related to the pre-transaction earnings that are allocated to FC similarly carry over to FC in accordance with the rules of §1.367(b)-7, subject to the rule of §1.367(b)-9. As a result, under §1.367(b)-7(d), FC has the following earnings and profits and foreign income taxes accounts immediately after the foreign divisive transaction:

Separate Category:	*E&P*	*Foreign Taxes*
General	150u	$30
Shipping	100u	$40
	250u	$70

Example 2—(i) *Facts.* (A) USP, a domestic corporation, has owned all of the stock of FD since FD's incorporation in 1995. USP's adjusted basis in the FD stock is $300 and the FD stock has a fair market value of $1,500. FC is a preexisting controlled corporation and FD has always owned all of the FC stock. FD owns assets with total net bases of 320u (including 160u attributable to the FC stock). FD and FC have the following earnings and profits and foreign income taxes accounts:

FD:

Separate Category:	*E&P*	*Foreign Taxes*
General	400u	$ 50
Passive	(100u)	$ 6
Shipping	200u	$ 80
	500u	$136

FC:

Separate Category:	*E&P*	*Foreign Taxes*
General	600u	$100
Passive	(50u)	$ 6
Shipping	100u	$ 40
	650u	$146

(B) On January 1, 2002, FD distributes the FC stock to USP in a transaction that meets the requirements of section 355. Immediately after the foreign divisive transaction, the FD stock and the FC stock each have a $750 fair market value.

(ii) *Result*—(A) *Calculation of FD's earnings and profits.* Under paragraph (b)(1)(i) and (ii)(A) of this section, FD's pre-transaction earnings are reduced by the amount of the reduction that would have been required if FD had transferred the stock of FC to a new corporation in a D reorganization. Thus, FD's pre-transaction earnings are reduced by an amount equal to its pre-transaction earnings times its net basis in the FC stock divided by the net bases of the assets held by FD immediately before the foreign divisive transaction (500u x (160u ÷ 320u) = 250u). Following this reduction, FD has 250u of earnings and profits (500u - 250u).

(B) *Application of §1.367(b)-5(c).* The basis adjustment and income inclusion rules of §1.367(b)-5(c) apply if USP's postdistribution amount with respect to FD or FC stock is less than its predistribution amount with respect to such stock. Under §1.367(b)-5(e)(1), USP's predistribution amount with respect to FD or FC stock is USP's section 1248 amount attributable to such stock computed immediately before the distribution. Thus, USP's predistribution amounts with respect to FD and FC stock are $500 and $650, respectively. See also section 989(b)(2). Under section 358, USP allocates its $300 basis in FD stock between FD stock and FC stock according to the stock blocks' relative values, yielding a $150 ($300 x ($750 ÷ $1,500)) basis in each block. Under §1.367(b)-5(e)(2), USP's postdistribution amount with respect to FD or FC stock is USP's section 1248 amount with respect to such stock, computed immediately after the distribution. Accordingly, USP's postdistribution amount with respect to FD stock is $250 (500u - 250u), and its postdistribution amount with respect to FC stock is $600 (while FC has 650u of earnings and profits immediately after the foreign divisive transaction, USP's postdistribution amount is limited to its built-in gain in FC stock immediately after the distribution ($750 - $150)). USP's postdistribution amount with respect to both the FD and FC stock is less than its predistribution amount with respect to such stock. This difference is $50 with respect to FC ($650 - $600), and $250 with respect to FD ($500 - $250). Under §1.367(b)-5(c)(2)(i) and (ii), USP is required to reduce its basis in the FD and FC stock, but only to the extent such reductions increase USP's section 1248 amount with respect to the stock. Accordingly, USP reduces its basis in the FC stock by $50, and thereafter USP has a $100 basis in such stock ($150 - $100). Because a reduction in USP's basis in FD stock would not increase any of USP's section 1248 amount with respect to such stock, USP includes the entire $250 difference between its predistribution and postdistribution amounts with respect to the FD stock as a deemed dividend from FD. Because the requirements of section 902 are met, USP qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FD. Under §1.960-1(i)(4), the 100u deficit in the section 904(d)(1)(A) passive separate category is allocated proportionately against the other separate categories for purposes of computing the deemed paid credit on the distribution. Thus, there are 333.33u (400u - (100u x (400u ÷ 600u))) of available earnings in the section 904(d)(1)(I) general separate category (along with $50 of foreign income taxes) and 166.67u (200u - (100u x (200u ÷ 600u))) of available earnings in the section 904(d)(1)(D) shipping separate category (along with $80 of foreign income taxes). Under §1.902-1(d)(1), the $250 deemed dividend is out of FD's separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
General	166.67u	$25
Passive	0u	$ 0
Shipping	83.33u	$40
	250u	$65

(C) *Basis adjustments.* Under §1.367(b)-5(c)(3), USP does not increase its basis in FD stock as a result of USP's $250 deemed dividend from FD.

Under §1.367(b)–5(c)(4), USP increases its basis in the FD and FC stock by the amount of its basis decrease or deemed dividend inclusion with respect to the other corporation, but only to the extent such basis increase does not diminish USP's postdistribution amount with respect to that other corporation and only to the extent of the other corporation's fair market value. Under these rules, USP increases its basis in the FD stock by the full amount by which it decreased its basis in FC ($150 + $50 = $200). USP does not increase its basis in the FC stock as a result of its deemed dividend from FD because any increase in the FC stock basis would diminish USP's postdistribution amount with respect to such stock.

(D) *FD's earnings and profits after the foreign divisive transaction.* Because the entire $250 reduction in FD's pre- transaction earnings was subject to inclusion under §1.367(b)–5 (as described in this *Example 2* (ii)(B)), paragraph (b)(2) of this section does not apply. FD has the following earnings and profits and foreign income taxes accounts immediately after the foreign divisive transaction (see §1.960–1(i)(4)):

Separate Category:	*E&P*	*Foreign Taxes*
General	233.33u	$25
Passive	(100u)	$ 6
Shipping	116.67u	$40
	250u	$71

(E) *Calculation of FC's earnings and profits.* Under paragraph (b)(1)(ii)(B) of this section, FC's earnings and profits are not increased (or replaced) as a result of the foreign divisive transaction. FC's earnings and profits also are not reduced because USP was not required to include a deemed dividend out of FC under §1.367(b)–5.

Example 3—(i) *Facts.* (A) USP, a domestic corporation, has owned all of the stock of FD since FD's incorporation in 1995. USP's adjusted basis in the FD stock is $100 and the FD stock has a fair market value of $2,000. FC is a preexisting controlled corporation and FD has always owned all of the FC stock. FD owns assets with total net bases of 320u (including 100u attributable to the FC stock and 160u attributable to the Business B shipping assets). FD and FC have the following earnings and profits and foreign income taxes accounts:

FD:

Separate Category:	*E&P*	*Foreign Taxes*
General	300u	$ 50
10/50 dividends from FC1, a noncontrolled section 902 corporation	100u	$ 6
Shipping	200u	$ 80
	600u	$136

FC:

Separate Category:	*E&P*	*Foreign Taxes*
General	100u	$10
Passive	(50u)	$ 6
Shipping	100u	$40
	150u	$56

(B) On January 1, 2002, FD transfers to FC the Business B shipping assets. FD then distributes the FC stock to USP. The transaction meets the requirements of sections 368(a)(1)(D) and 355. Immediately after the foreign divisive transaction, the FD stock and the FC stock each have a $1,000 fair market value.

(ii) *Result*—(A) *Calculation of FD's earnings and profits.* Under paragraph (b)(4)(i) of this section, FD's pre-transaction earnings are reduced by the sum of the amounts described in paragraphs (b)(4)(i)(A) and (B) of this section. Under paragraph (b)(4)(i)(A) of this section, FD's pre-transaction earnings are reduced by an amount equal to FD's pre-transaction earnings times the net bases of the Business B shipping assets transferred to FC divided by the total net bases in the assets held by FD immediately before the foreign divisive transaction (600u x (160u ÷ 320u) = 300u). Under paragraph (b)(4)(i)(B) of this section, FD's pre-transaction earnings are reduced by an amount equal to FD's pre-transaction earnings times FD's net bases in the stock of FC divided by the total net bases of the assets held by FD immediately before the foreign divisive transaction (600u x (100u ÷ 320u) = 187.50u). The sum of the amounts described in paragraphs (b)(4)(i)(A) and (B) of this section is 487.50u.

(B) *Application of §1.367(b)–5(c).* The basis adjustment and income inclusion rules of §1.367(b)–5(c)(2) apply if USP's postdistribution amount with respect to FD or FC stock is less than its predistribution amount with respect to such stock. Under §1.367(b)–5(e)(1) and (3), USP's predistribution amount with respect to FD or FC stock is USP's section 1248 amount attributable to such stock computed immediately before the distribution, after the allocation of FD's pre-transaction earnings described in paragraphs (b)(4)(i)(A) and (ii)(A) of this section, but before the reduction in FD's pre-transaction earnings described in paragraph (b)(4)(i)(B) of this section. Thus, USP's predistribution amounts with respect to FD and FC stock are $300 (600u - 300u) and $450 (150u + 300u), respectively. See also section 989(b)(2). Under section 358, USP allocates its $100 basis in FD stock between FD stock and FC stock according to the stock blocks' relative values, yielding a $50 ($100 x ($1,000 ÷ $2,000)) basis in each block. Under §1.367(b)–5(e)(2), USP's postdistribution amount with respect to FD or FC stock is USP's section 1248 amount with respect to such stock, computed immediately after the distribution. Accordingly, USP's postdistribution amount with respect to FD stock is $112.50 (600u - 300u - 187.50u), and its postdistribution amount with respect to FC stock is $450 (150u + 300u). Because USP's postdistribution amount with respect to FC stock is not less than its predistribution amount with respect to such stock, the §1.367(b)–5(c)(2) basis adjustment and income inclusion rules do not apply with respect to the FC stock. Because USP's postdistribution amount with respect to FD stock is $187.50 less than its predistribution amount with respect to such stock ($300 - $112.50), §1.367(b)-5(c)(2)(i) and (ii) require USP to reduce its basis in FD stock, but only to the extent such reduction increases USP's section 1248 amount with respect to the FD stock. Because a reduction in USP's basis in the FD stock would not increase any of USP's section 1248 amount with respect to such stock, USP includes the entire $187.50 difference between its predistribution and postdistribution amounts with respect to the FD stock as a deemed dividend from FD. Because the requirements of section 902 are met, USP qualifies for a deemed paid foreign tax credit with respect to the deemed dividend that it receives from FD. Under §1.902–1(d)(1), the $187.50 deemed dividend is out of FD's separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
General	93.75u	$15.63
10/50 dividends from FC1	31.25u	$ 1.88
Shipping	62.50u	$25
	187.50u	$42.51

(C) *Basis adjustment.* Under §1.367(b)–5(c)(3), the basis increase provided in §1.367(b)–2(e)(3)(ii) does not apply with respect to USP's $187.50 deemed dividend from FD. Under §1.367(b)–5(c)(4), USP increases its basis in the FC stock by the amount of its deemed dividend inclusion from FD, but only to the extent such basis increase does not diminish USP's postdistribution amount with respect to FC stock and only up to the fair market value of the FC stock. Under these rules, USP increases its basis in the FC stock by the full amount of its deemed dividend from FD ($50 + $187.50 = $237.50).

(D) *Reduction in FD's statutory groupings of earnings and profits.* Under paragraph (b)(2) of this section, the reduction in FD's pre-transaction earnings that is not attributable to USP's inclusion under §1.367(b)–5 decreases FD's statutory groupings of earnings and profits on a pro rata basis. Under paragraph (e)(3) of this section, FD's pre-transaction taxes are also ratably reduced. As described in this *Example 3* (ii)(A), the reduction in FD's pre-transaction earnings is 487.50u. As described in this *Example 3* (ii)(B), 187.50u of the 487.50u reduction is attributable to a deemed dividend inclusion by USP under §1.367(b)–5. Thus, under paragraphs (b)(2) and (e)(3) of this section, the remaining 300u reduction in FD's pre-transaction earnings and related pre-transaction taxes is out of FD's separate categories and reduces foreign income taxes as follows:

Separate Category:	*E&P*	*Foreign Taxes*
General	150u	$25
10/50 dividends from FC1	50u	$ 3
Shipping	100u	$40
	300u	$68

(E) *Calculation of FC's earnings and profits.* Under paragraph (b)(4)(ii) of this section, FC's earnings and profits immediately after the foreign divisive transaction equal the sum of FC's earnings and profits immediately before the foreign divisive transaction, plus the amount of the reduction in FD's earnings and profits described in paragraph (b)(4)(i)(A) of this section, except to the extent such amount was included in income as a deemed dividend pursuant to the foreign divisive transaction. The reduction in FD's earnings and profits described in paragraph (b)(4)(i)(A) of this section is 300u, none of which was included in income by USP as a deemed dividend pursuant to the foreign divisive transaction. Under paragraphs (e)(2) and (3) of this section, the 300u of pre-transaction earnings and related pre-transaction taxes carry over to FC and combine with FC's earnings and profits and foreign income taxes accounts in accordance with the rules described in §1.367(b)–7. Under §1.367(b)–7(d), FC has the following earnings and profits and foreign income taxes accounts immediately after the foreign divisive transaction:

Separate Category:	*E&P*	*Hovering Deficit*	*Taxes*	*Taxes Associated with Hovering Deficit*
General	250u		$35	
10/50 dividends from FC1	50u		$ 3	
Passive		(50u)		$6
Shipping	200u		$80	
	500u	(50u)	$118	$6

(F) *FD's earnings and profits after the foreign divisive transaction.* Following the reductions described in this *Example 3* (ii)(B) and (D), FD has the following earnings and profits and foreign income taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
General	56.25u	$ 9.37
10/50 dividends from FC1	18.75u	$ 1.12
Shipping	37.50u	$15
	112.50u	$25.49

(f) *Effective date.* This section shall apply to section 367(b) exchanges that occur on or after the date 30 days after these regulations are published as final regulations in the **Federal Register**.

Par. 11. Section 1.367(b)–9 is added to read as follows:

§1.367(b)–9 Special rule for F reorganizations and similar transactions.

(a) *Scope.* This section applies to any foreign 381 transaction (as described in §1.367(b)–7(a)) described in section 368(a)(1)(F) or in which either the foreign target corporation or the foreign acquiring corporation is newly created. This section also applies to any foreign divisive transaction (as described in §1.367(b)–8(a)) that is described in §1.367(b)–8(e)(1) and that involves a newly created foreign distributing or foreign controlled corporation.

(b) *Hovering deficit rules inapplicable.* If a transaction is described in paragraph (a) of this section, a foreign surviving corporation or a newly created controlled corporation shall succeed to earnings and profits, deficits in earnings and profits, and foreign income taxes without regard to the hovering deficit rules of §1.367(b)–7(d)(2), (e)(1)(iii), (e)(2)(iii), (f)(1)(iii), and (f)(2)(iii). In the case of a foreign divisive transaction, nothing in this section shall affect the application of §1.367(b)–8(b)(iii).

(c) *Example.* The following example illustrates the rules of this section:

Example—(i) *Facts.* (A) Foreign corporation A is and always has been a wholly owned subsidiary of USP, a domestic corporation. Foreign corporation A was incorporated in 1990, and always has been a controlled foreign corporation using a calendar taxable year. Foreign corporation A (and all of its respective qualified business units as defined in section 989) maintains a "u" functional currency, and 1u = US$1 at all times. On December 31, 2001, foreign corporation A has the following earnings and profits and foreign income taxes accounts:

Separate Category:	*E&P*	*Foreign Taxes*
Passive	(1,000u)	$ 5
General	200u	$200
	(800u)	$205

(B) On January 1, 2002, foreign corporation A moves its place of incorporation from Country 1 to Country 2 in a reorganization described in section 368(a)(1)(F).

(ii) *Result.* Under §1.367(b)–7(d), as modified by paragraph (b) of this section, foreign surviving corporation has the following earnings and profits and foreign income taxes accounts immediately after the foreign 381 transaction:

Separate Category:	*E&P*	*Foreign Taxes*
Passive	(1,000u)	$ 5
General	200u	$200
	(800u)	$205

(d) *Effective date.* This section shall apply to section 367(b) exchanges that occur on or after the date 30 days after these regulations are published as final regulations in the **Federal Register**.

Par. 12. In §1.367(e)–1, paragraph (a) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.367(e)–1 Distributions described in section 367(e)(1).

(a) * * * See §1.367(b)–8(c)(3) for an example illustrating the interaction of §1.367(e)–1 with other sections of the Internal Revenue Code (such as sections 367(b) and 1248).

* * * * *

Par. 13. In §1.381(a)–1, paragraph (c) is revised to read as follows:

§1.381(a)–1 General rule relating to carryovers in certain corporate acquisitions.

* * * * *

(c) *Foreign corporations.* For additional rules involving foreign corporations see §§1.367(b)–7 and 1.367(b)–9.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 8, 2000, 4:19 p.m., and published in the issue of the Federal Register for November 15, 2000, 65 F.R. 69137)

Registration Still Underway for the International Taxation Institute

Announcement 2000–95

Registration is currently underway for the Thirteenth Annual Institute on Current Issues in International Taxation, to be held on December 7 and 8, 2000, at the J.W. Marriott Hotel in Washington, DC. The Internal Revenue Service and the George Washington University are jointly sponsoring the Institute, which is designed for professionals in international tax law. The program will offer a unique opportunity for top IRS and Treasury officials and tax experts, as well as leading private sector specialists, to present their perspectives on breaking issues in international taxation. For more information on topics and speakers, please refer to Internal Revenue Bulletin 2000–46, dated November 13, 2000, Announcement 2000–93. Those interested in attending or obtaining detailed information should contact the George Washington University, Conference Management Services, by telephone at (202) 973-1110 or by visiting their web site at http://www.gwu.edu/~cms/iti13.

Foreign Trusts That Have U.S. Beneficiaries; Correction

Announcement 2000–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains corrections to a notice of proposed rulemaking and notice of public hearing (REG–209038–89, 2000–34 I.R.B. 191) that was published in the **Federal Register** on Monday, August 7, 2000 (65 F.R. 48185) relating to transfers of property by U.S. persons to foreign trusts having one or more United States beneficiaries.

FOR FURTHER INFORMATION CONTACT: Willard W. Yates at (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The notice of proposed rulemaking and notice of public hearing that are the subject of this correction is under section 679 of the Internal Revenue Code.

Need for Correction

As published, the notice of proposed rulemaking and notice of public hearing contains errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking and notice of public hearing (REG–209038–89), that was the subject of FR Doc. 00–19897, is corrected as follows:

1. On page 48187, column 2, in the preamble under the paragraph heading "*Section 1.679–1 U.S. Transferor Treated as Owner of Foreign Trust*", first full paragraph from the top of the column, last line, the language "November 6, 2000 " is corrected to read "August 7, 2000".

2. On page 48188, column 1, in the preamble under the paragraph heading "*Section 1.679–2: Trusts Treated as Having a U.S. Beneficiary*", third full paragraph, last line, the language "November 6, 2000" is corrected to read "August 7, 2000".

3. On page 48188, column 3, in the preamble under the paragraph heading "*Section 1.679–3 Transfers*", fourth paragraph, last line, the language "November 6, 2000" is corrected to read "August 7, 2000".

4. On page 48189, column 2, in the preamble under the paragraph heading "*Section 1.679–4 Exceptions to General Rule*", second full paragraph, third line, the language "trusts after November 6, 2000. Special" is corrected to read "trusts after August 7, 2000. Special".

5. On page 48189, column 3, in the preamble under the paragraph heading "*Section 1.679–5 Pre-immigration Trusts*", third full paragraph, last line, the language "after November 6, 2000" is corrected to read "after August 7, 2000".

6. On page 48189, column 3, in the preamble under the paragraph heading "*Section 1.679–6 Outbound Migrations of Domestic Trusts*", last paragraph in the column, last line, the language "November 6, 2000" is corrected to read "August 7, 2000".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization and Strategic Planning).

(Filed by the Office of the Federal Register on November 8, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 9, 2000, 65 F.R. 67318)

New Code V for the 2001 Form W-2, Box 12

Announcement 2000–97

Purpose

The purpose of this announcement is to advise employers about an additional code for use on the 2001 Form W-2. This code will be used to identify the amount of compensation related to the exercise of an employer-provided nonstatutory stock option currently required to be included in an employee's wages in boxes 1, 3 (up to the social security wage base), and 5.

Nonstatutory Stock Options

A new code (**Code V—Income from the exercise of nonstatutory stock options**) for use in box 12 on the 2001 Form W-2 has been added to the 2001 Instructions for Forms W-2 and W-3.

When an employee (or former employee) exercises nonstatutory stock option(s), employers are currently required to report the excess of the fair market value of the stock received upon exercise of the option over the amount paid for that stock on Form W-2 in boxes 1, 3 (up to the social security wage base), and 5. The change requires that any compensation related to the exercise of the nonstatutory stock option(s) currently included in boxes 1, 3 (if applicable), and 5 must also be shown in box 12, using **Code V.**

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 2000. See Rev. Rul. 2000–54, page 566.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62–2: Reimbursements and other expense allowance arrangements.

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. 2000–48, page 570.

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. 2000–48, page 570.

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. 2000–48, page 570.

Section 197.—Amortization of Goodwill and Certain Other Intangibles

26 CFR 1.197–2: Amortization of goodwill and certain other intangibles.

T.D. 8907

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Application of the Anti-Churning Rules for Amortization of Intangibles in Partnerships

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the amortization of certain intangible property under section 197. Specifically, the regulations apply the anti-churning rules under section 197(f)(9) to partnership distributions resulting in basis adjustments under sections 732(b) and 734(b). This document also amends certain parts of the previously issued final regulations (TD 8865), including those parts that relate to the amount of a basis adjustment under sections 732(d) and 743(b) that is subject to the anti-churning rules under section 197(f)(9). The final regulations interpret the provisions of section 197(f)(9), reflecting changes to the law made by the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), and affect taxpayers who acquired intangible property after August 10, 1993, or made a retroactive election to apply OBRA '93 to intangibles acquired after July 25, 1991.

DATES: *Effective Date*: These regulations are effective November 20, 2000.

Applicability Date: These regulations apply to distributions or transfers occurring on or after November 20, 2000. However, a taxpayer may choose, on a transaction-by-transaction basis, to apply these regulations to property acquired (or partnership transactions occurring) after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and before November 20, 2000.

FOR FURTHER INFORMATION CONTACT: David J. Sotos or Robert G. Honigman at (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends §1.197–2 of the Income Tax Regulations (26 CFR Part 1) to provide additional rules regarding the application of section 197(f)(9) to partnership transactions under sections 732(b) and 734(b). This document also amends certain provisions of the final regulations under section 197 issued on January 25, 2000, (TD 8865, 2000–7 I.R.B. 589 [65 F.R. 3820]).

On January 16, 1997, the IRS published proposed regulations (REG–209709–94, 1997–1 C.B. 731) in the **Federal Register** (62 F.R. 2336) under sections 167(f) and 197, including the anti-churning rules in section 197(f)(9). In commenting on the proposed regulations, some practitioners noted that additional guidance was needed regarding how the special anti-churning rule of section 197(f)(9)(E) should apply to increases in the basis of partnership property under sections 732, 734, and 743. In response to these comments, the IRS published proposed regulations (REG–100163–00, 2000–7 I.R.B. 633) in the **Federal Register** (65 F.R. 3903) on January 25, 2000, providing rules for determining the portion of a basis adjustment under sections 732(b) and 734(b) that will be subject to the anti-churning rules. Final regulations (TD 8865, 65 F.R. 3820) (referred to herein as the "existing regulations") were issued at the same time as the proposed regulations. The existing regulations provide guidance regarding the application of the anti-churning rules to basis adjustments under sections 732(d) and 743(b) and to remedial allocations of deductions for amortization of section 197(f)(9) intangibles (i.e., goodwill and going concern value that was held or used at any time during the period beginning on July 25, 1991, and ending on August 10, 1993 (unless an election was made under §1.197–1T) and any other section 197 intangible that was held or used during such period and was not depreciable or amortizable under prior law).

The IRS received no requests to speak at a public hearing that was scheduled for May 24, 2000, and consequently the IRS canceled the hearing. Written comments were received in response to the notice of proposed rulemaking. The comments received and revisions made are discussed below.

Explanation of Provisions and Summary of Comments

A. *In General*

Section 197(f)(9)(E) provides that, in applying the anti-churning rules for basis adjustments under sections 732, 734, and 743, determinations are made at the partner level, and each partner is treated as having owned and used such partner's proportionate share of the partnership's assets. With respect to basis adjustments under sections 732(b) and 734(b), this rule requires taxpayers and the IRS to analyze transactions that actually involve a distribution of property from the partnership to a partner as deemed transactions involving transfers of property directly among the partners. In applying the anti-churning rules to basis adjustments under section 732(b), the distributee partner is deemed to acquire the distributed intangible directly from the continuing partners of the distributing partnership. Similarly, in applying the anti-churning rules to basis adjustments under section 734(b), the continuing partners are deemed to acquire interests in the intangible that remains in the partnership from the partner who received a distribution (giving rise to the section 734(b) basis adjustment) of property other than the intangible.

Consistent with this view of the transactions, §1.197–2(g)(3) of the existing regulations provides that the increase in the basis of a distributed section 197(f)(9) intangible under section 732(b) or the increase in the partnership's basis of an undistributed section 197(f)(9) intangible under section 734(b) is treated as a new intangible acquired as a result of the distribution. The rules for determining whether such basis adjustments are subject to the anti-churning rules under section 197(f)(9) operate by reference to the facts surrounding each partner's acquisition of its interest in the partnership, the relation of the distributee partner and the continuing partners, and the portion of the intangible that is allocable to such partners. Although the specific rules are not phrased in terms of analyzing a deemed transfer of a portion of an intangible between the distributee partner and the continuing partners, the effect of the rules is to analyze such a deemed transfer.

Under the proposed regulations, it first is necessary to determine whether the portion of an intangible that a partner is deemed to acquire as a result of the distribution was subject to the anti-churning rules immediately prior to the deemed transfer. Even if the intangible is a section 197(f)(9) intangible with respect to the partnership, for purposes of analyzing a deemed transfer, the partner's share of the intangible is treated as not being subject to the anti-churning rules if the intangible was held by the partnership at the time that the partner (or predecessor partner) acquired the partnership interest, and the partner (or predecessor partner) would have been able to amortize the intangible had the partner (or predecessor partner) directly acquired the intangible under the same circumstances that the partner (or predecessor partner) acquired the partnership interest. If a partner's share of the intangible is treated as not being subject to the anti-churning rules for this purpose, then the anti-churning rules would not apply to the portion of the basis adjustment that is attributable to the deemed transfer.

If the partner's share of the intangible was treated as being subject to the anti-churning rules immediately prior to the deemed transfer, it is necessary, as a further step, to determine whether the deemed transferor and transferee are related. If the partners are not related, the anti-churning rules would not apply to the basis adjustment that gives rise to the deemed transfer.

The proposed regulations also contain rules for measuring the portion of the intangible that is deemed to be transferred by the relevant partners in the deemed transactions together with certain additional rules designed to prevent circumvention of the anti-churning rules through the use of partnerships.

B. *Continuing Partner's Share of Basis Adjustment Under Section 734(b)*

The proposed regulations provide that, for purposes of analyzing basis adjustments under section 734(b), a continuing partner's share of a basis increase is equal to (1) the total basis increase allocable to the intangible; multiplied by (2) a fraction equal to (A) the unrealized appreciation from the intangible that would have been allocated to the continuing partner if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction; over (B) the total unrealized appreciation from the intangible that would have been realized by the partnership if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction.

One commentator stated that, under the proposed regulations, the fraction for determining a continuing partner's share of the basis adjustment under section 734(b) could lead to inappropriate results in some circumstances. For example, if a partner contributes to a partnership a section 197(f)(9) intangible which has a fair market value that exceeds its tax basis at the time of the contribution, and, at some later date, in an unrelated transaction, the contributing partner is redeemed from the partnership resulting in a section 734(b) adjustment to the intangible, the proposed regulations could determine that the entire adjustment under section 734(b) is allocable to the contributing partner (assuming that the basis adjustment does not exceed the section 704(c) gain attributable to the property), even though the contributing partner is no longer a partner in the partnership.

Treasury and the IRS agree that the fraction used in the proposed regulations can lead to inappropriate results. Furthermore, as discussed below, particularly in situations involving intangibles with built-in gain that are contributed to a partnership, an approach relying on a partner's share of appreciation in an intangible (whether measured before or after a distribution) to determine the partner's share of a basis increase under section 734(b) appears to be inconsistent with the purpose of section 197(f)(9)(E).

Positive basis adjustments under section 734(b) can be analyzed from two different perspectives: gain eliminated or deductions created. Under §1.755–1(c)(2)(i), positive section 734(b) basis adjustments are allocated first to appreciated properties within a class so as to eliminate the built-in gain (and hence section 704(c) gain) with respect to such properties. In analyzing gain on disposition of the asset, the basis adjustment inures first to the benefit of the contributing partner since it will reduce the section 704(c) gain recognized by the partner upon the disposition of the asset by the

partnership. However, in analyzing depreciation or amortization deductions attributable to the asset, the basis will inure first to the non-contributing partners to the extent that they were being denied such deductions as a result of the ceiling rule. In determining the portion of an intangible that a partner is deemed to receive from the distributee partner for purposes of applying the anti-churning rules, it seems that a rule focused on who would receive a deduction as a result of a section 734(b) basis adjustment, rather than who would avoid gain, is more appropriate.

A partner's proportionate share of partnership capital generally serves as a good proxy for estimating a partner's share of deductions. Accordingly, for purposes of determining a continuing partner's share of a section 734(b) basis adjustment, the fraction utilized in the final regulations compares a continuing partner's post-distribution capital account as determined under section 704(b) and §1.704–1(b)(2)(iv) to the aggregate of all of the continuing partners' post-distribution capital accounts (or if the partnership does not maintain capital accounts in accordance with §1.704–1(b)(2)(iv), the fraction is determined by reference to the partner's overall interest in the partnership under §1.704–1(b)(3)). Treasury and the IRS believe this change best reflects how deductions are likely to flow from the intangible asset in a typical partnership arrangement.

C. *Amortization of Section 197(f)(9) Intangible Where Some But Not All of the Basis Adjustment Under Section 734(b) is Amortizable*

The proposed regulations provide that taxpayers may use any reasonable method to determine amortization of a section 734(b) adjustment with respect to an intangible for book purposes, provided that the method does not permit any portion of the tax deduction for amortization attributable to the adjustment to be allocated to a partner who is subject to the anti-churning rules. Several commentators requested guidance as to what methods would be considered reasonable in situations where part, but not all, of a section 734(b) basis adjustment is attributable to an intangible that is subject to the anti-churning rules.

In response to the comments, the final regulations contain an example illustrating one method for determining book amortization that will be considered reasonable under the regulations.

D. *Adjustments Under Sections 743(b) and 732(d) Where the Transferor of the Partnership Interest is Related to the Transferee*

The existing regulations provide that the anti-churning rules apply with respect to positive basis adjustments under section 743(b) only if the person acquiring the partnership interest is related to the person transferring the partnership interest. One commentator pointed out that, even if the transferor partner is related to the transferee partner, there still may be situations where the section 743(b) adjustment should be amortizable by the transferee.

To illustrate the commentator's point, consider the following example: A partnership (PRS) with two partners, A and B, held an intangible subject to the anti-churning rules on August 10, 1993. The partnership has made a section 754 election. On June 1, 1995, A transfers his entire interest in PRS to C, an unrelated person. C has a positive section 743(b) basis adjustment with respect to the intangible that is not subject to the anti-churning rules. On April 30, 2000, C transfers his entire interest in PRS to D, a person related to C. C's section 743(b) basis adjustment disappears as a result of the transfer, and D obtains a new section 743(b) basis adjustment with respect to the intangible. According to the commentator, the ownership of the interest in PRS by C (a party unrelated to A) should permanently purge any taint with respect to a section 743(b) basis adjustment attributable to C's interest. The fact that D is related to C should not prevent D from amortizing the basis adjustment.

The commentator's suggestion is consistent with the aggregate approach in the regulations for adjustments under sections 732(b) and 734(b). Under §1.197–2(h)(12)(ii) and (iv) of these final regulations, if a partner acquires an interest in a partnership from an unrelated partner after August 10, 1993, and after the partnership has acquired the section 197(f)(9) intangible, the partner will be treated as holding a portion of the intangible that is not subject to the anti-churning rules for purposes of analyzing subsequent deemed transfers relating to basis adjustments under sections 732(b) and 734(b). The existing regulations are amended to include similar provisions for purposes of analyzing the application of the anti-churning rules with respect to basis adjustments under section 743(b).

The existing regulations pertaining to section 732(d) adjustments also are amended to coordinate those provisions with the change discussed above for section 743(b) adjustments. The amendment provides that the anti-churning rules do not apply to an increase in the basis of a section 197(f)(9) intangible under section 732(d) if, had an election been in effect under section 754 at the time of the transfer of the partnership interest, the distributee partner would have been able to amortize the basis adjustment made pursuant to section 743(b).

E. *Modification of Rule Where a Partner is or Becomes a User of a Partnership Intangible*

Section 1.197–2(h)(12)(vi) of the proposed regulations provides a rule to prevent avoidance of the anti-churning rules where a partner subject to the anti-churning rules becomes or remains a user of the intangible after the basis of the intangible is adjusted with respect to another partner under section 732, 734, or 743. One commentator noted that §1.197–2(h)(12)(vi) could apply if the partnership itself continues to use the intangible, at least where the deemed transferor of the intangible continues to own more than a 20 percent interest in the partnership, because the partner would be treated under the attribution rules as continuing to use the intangible by virtue of the partnership's use of the intangible. The commentator stated that such a result appears inconsistent with the policies underlying section 197(f)(9)(E), which ignore the existence of the partnership for purposes of anti-churning determinations with respect to basis adjustments under sections 732, 734, and 743. The commentator requested that the final regulations make clear that a partnership's continued use of an intangible would not invoke the rule of §1.197–2(h)(12)(vi).

Consistent with this comment, §1.197–2(h)(12)(vi) of these final regulations makes clear that the proscribed use must be by an anti-churning partner or re-

lated person other than the partnership. Attributed use of the intangible from the partnership to a partner will not cause this rule to apply.

F. *Clarification With Respect to Remedial Allocations*

Section 1.197–2(g)(4)(ii) of the existing regulations provides that "if a partner contributes a section 197 intangible to a partnership and the partnership adopts the remedial allocation method for making section 704(c) allocations of amortization deductions, the partnership generally may make remedial allocations of amortization deductions with respect to the contributed section 197 intangible in accordance with §1.704–3(d)." Comments have been received expressing concern that, because no similar affirmative rule is contained in the anti-churning section of the regulations, if a contributing partner owns a greater than 20 percent interest in the partnership (and thus is considered related to the partnership), the rule allowing remedial allocations will not be available. While Treasury and the IRS believe that it was clear under the existing regulations that remedial allocations of amortization deductions could be made where the contributing partner is related to the partnership (as opposed to the non-contributing partners), an affirmative rule has been added to the anti-churning rules at §1.197–2(h)(12)(vii)(B) in order to eliminate any doubt with respect to this issue.

In addition, the rule regarding the disallowance of remedials where a non-contributing partner is related to the contributing partner is amended in these final regulations to also cover situations where, as part of a series of related transactions that includes the contribution of the section 197(f)(9) intangible to the partnership, the contributing partner (or a related person) becomes or remains a direct user of the contributed intangible. Consistent with the analysis of remedials as being akin to a section 743(b) basis adjustment for the non-contributing partners, Treasury and the IRS believe that it is inappropriate for a non-contributing partner to obtain amortization deductions with respect to a portion of a contributed section 197(f)(9) intangible where the prior owner of the intangible becomes or remains a direct user of the intangible in connection with the contribution. See also section 197(f)(9)(A)(iii) and §1.197–2(h)(12)(vi).

G. *Rules for Determining When a Partnership Interest is Treated as Being Acquired From a Related Person for Purposes of Analyzing Basis Adjustments Under Sections 732(b) and 734(b)*

For purposes of analyzing deemed transfers resulting from basis adjustments under sections 732(b) and 734(b) in applying the anti-churning rules, the proposed regulations provide that if a partner contributed the distributed section 197(f)(9) intangible to the partnership, the partnership interest acquired by such partner is treated as not being described in §1.197–2(h)(12)(ii)(A)(2) and (3) (for section 732(b) adjustments) or 1.197–2(h)(12)(iv)(A)(2) and (3) (for section 734(b) adjustments) (i.e., the rules that allow a prior purchase of a partnership interest from an unrelated person to purge the partner's anti-churning taint in analyzing subsequent deemed transfers relating to basis adjustments). Accordingly, in order for a basis adjustment to a section 197(f)(9) intangible under section 732(b) or 734(b) to be amortizable, the deemed transfer (as a result of the basis adjustment) from the contributing partner must be to an unrelated partner.

Commentators indicated that this rule is unnecessary. According to the commentators, §§1.197–2(h)(12)(ii)(A)(2) and (3) and 1.197–2(h)(12)(iv)(A)(2) and (3), by their terms, cannot apply where the deemed transferor contributed the section 197(f)(9) intangible to the partnership. Treasury and the IRS agree with this comment. Accordingly, the final regulations omit the rule regarding a partner who contributes the distributed section 197(f)(9) intangible.

Special Analyses

It has been determined that the final regulations are not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 533(b) of the Administrative Procedures 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 final 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 authors of these regulations are David J. Sotos and Robert G. Honigman of Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and IRS 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 1.197–2 is amended by:

1. Revising paragraphs (h)(12)(ii), (h)(12)(iii), (h)(12)(iv), (h)(12)(v), and paragraph (h)(12)(vi)(A).

2. Removing ", and" at the end of paragraph (h)(12)(vi)(B)(*2*)(*ii*) and adding a period in its place.

3. Removing paragraph (h)(12)(vi)(B)(*3*).

4. Removing the first sentence of paragraph (h)(12)(vii)(B) and adding two new sentences in its place.

5. Removing the last two sentences of paragraph (iii) of *Example 27* in paragraph (k) and adding three sentences in their place.

6. Adding *Examples 28*, *29*, *30*, and *31* to paragraph (k).

7. Revising paragraphs (l)(1) and (l)(2).

The additions and revisions read as follows:

§1.197–2 Amortization of goodwill and certain other intangibles.

* * * * *

(h) * * *

(12) * * *

(ii) *Section 732(b) adjustments*—(A) *In general.* The anti-churning rules of this paragraph (h) apply to any increase in the adjusted basis of a section 197(f)(9) intangible under section 732(b) to the extent that the basis increase exceeds the total unrealized appreciation from the intangible allocable to—

(*1*) Partners other than the distributee partner or persons related to the distributee partner;

(*2*) The distributee partner and persons related to the distributee partner if the distributed intangible is a section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, to the extent that—

(*i*) The distributee partner and related persons acquired an interest or interests in the partnership after August 10, 1993;

(*ii*) Such interest or interests were held after August 10, 1993, by a person or persons other than either the distributee partner or persons who were related to the distributee partner; and

(*iii*) The acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner (or persons related to the distributee partner) subsequently acquired such interest or interests; and

(*3*) The distributee partner and persons related to the distributee partner if the distributed intangible is a section 197(f)(9) intangible acquired by the partnership after August 10, 1993, that is not amortizable with respect to the partnership, to the extent that—

(*i*) The distributee partner and persons related to the distributee partner acquired an interest or interests in the partnership after the partnership acquired the distributed intangible;

(*ii*) Such interest or interests were held after the partnership acquired the distributed intangible, by a person or persons other than either the distributee partner or persons who were related to the distributee partner; and

(*iii*) The acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner (or persons related to the distributee partner) subsequently acquired such interest or interests.

(B) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(ii)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the relevant party made a valid retroactive election under §1.197–1T.

(C) *Intangible still subject to anti-churning rules.* Notwithstanding paragraph (h)(12)(ii) of this section, in applying the provisions of this paragraph (h) with respect to subsequent transfers, the distributed intangible remains subject to the provisions of this paragraph (h) in proportion to a fraction (determined at the time of the distribution), as follows—

(*1*) The numerator of which is equal to the sum of—

(*i*) The amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section; and

(*ii*) The total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply; and

(*2*) The denominator of which is the fair market value of such intangible.

(D) *Partner's allocable share of unrealized appreciation from the intangible.* The amount of unrealized appreciation from an intangible that is allocable to a partner is the amount of taxable gain that would have been allocated to that partner if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction.

(E) *Acquisition of partnership interest by contribution.* Solely for purposes of paragraphs (h)(12)(ii)(A)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each partner's respective proportionate interest in the partnership.

(iii) *Section 732(d) adjustments.* The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197(f)(9) intangible under section 732(d) if, had an election been in effect under section 754 at the time of the transfer of the partnership interest, the distributee partner would have been able to amortize the basis adjustment made pursuant to section 743(b).

(iv) *Section 734(b) adjustments*—(A) *In general.* The anti- churning rules of this paragraph (h) do not apply to a continuing partner's share of an increase in the basis of a section 197(f)(9) intangible held by a partnership under section 734(b) to the extent that the continuing partner is an eligible partner.

(B) *Eligible partner.* For purposes of this paragraph (h)(12)(iv), eligible partner means—

(*1*) A continuing partner that is not the distributee partner or a person related to the distributee partner;

(*2*) A continuing partner that is the distributee partner or a person related to the distributee partner, with respect to any section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, to the extent that—

(*i*) The distributee partner's interest in the partnership was acquired after August 10, 1993;

(*ii*) Such interest was held after August 10, 1993 by a person or persons who were not related to the distributee partner; and

(*iii*) The acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest; or

(*3*) A continuing partner that is the distributee partner or a person related to the distributee partner, with respect to any section 197(f)(9) intangible acquired by the partnership after August 10, 1993, that is not amortizable with respect to the partnership, to the extent that—

(*i*) The distributee partner's interest in the partnership was acquired after the partnership acquired the relevant intangible;

(*ii*) Such interest was held after the partnership acquired the relevant intangible by a person or persons who were not related to the distributee partner; and

(*iii*) The acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest.

(C) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(iv)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the distributee partner made a valid retroactive election under §1.197–1T.

(D) *Partner's share of basis increase*—(*1*) *In general.* Except as provided in paragraph (h)(12)(iv)(D)(*2*) of this section, for purposes of this paragraph

(h)(12)(iv), a continuing partner's share of a basis increase under section 734(b) is equal to—

(*i*) The total basis increase allocable to the intangible; multiplied by

(*ii*) A fraction the numerator of which is the amount of the continuing partner's post-distribution capital account (determined immediately after the distribution in accordance with the capital accounting rules of §1.704–1(b)(2)(iv)), and the denominator of which is the total amount of the post-distribution capital accounts (determined immediately after the distribution in accordance with the capital accounting rules of §1.704–1(b)(2)(iv)) of all continuing partners.

(2) *Exception where partnership does not maintain capital accounts.* If a partnership does not maintain capital accounts in accordance with §1.704–1(b)(2)(iv), then for purposes of this paragraph (h)(12)(iv), a continuing partner's share of a basis increase is equal to—

(*i*) The total basis increase allocable to the intangible; multiplied by

(*ii*) The partner's overall interest in the partnership as determined under §1.704–1(b)(3) immediately after the distribution.

(E) *Interests acquired by contribution—(1) Application of paragraphs (h)(12)(iv)(B)(2) and (3) of this section.* Solely for purposes of paragraphs (h)(12)(iv)(B)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership.

(2) *Special rule with respect to paragraph (h)(12)(iv)(B)(1) of this section.* Solely for purposes of paragraph (h)(12)(iv)(B)(*1*) of this section, if a distribution that gives rise to an increase in the basis under section 734(b) of a section 197(f)(9) intangible held by the partnership is undertaken as part of a series of related transactions that include a contribution of the intangible to the partnership by a continuing partner, the continuing partner is treated as related to the distributee partner in analyzing the basis adjustment with respect to the contributed section 197(f)(9) intangible.

(F) *Effect of section 734(b) adjustments on partners' capital accounts.* If one or more partners are subject to the anti-churning rules under this paragraph (h) with respect to a section 734(b) adjustment allocable to an intangible asset, taxpayers may use any reasonable method to determine amortization of the asset for book purposes, provided that the method used does not contravene the purposes of the anti-churning rules under section 197 and this paragraph (h). A method will be considered to contravene the purposes of the anti-churning rules if the effect of the book adjustments resulting from the method is such that any portion of the tax deduction for amortization attributable to the section 734 adjustment is allocated, directly or indirectly, to a partner who is subject to the anti-churning rules with respect to such adjustment.

(v) *Section 743(b) adjustments*—(A) *General Rule.* The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197 intangible under section 743(b) if the person acquiring the partnership interest is not related to the person transferring the partnership interest. In addition, the anti-churning rules of this paragraph (h) do not apply to an increase in the basis of a section 197 intangible under section 743(b) to the extent that—

(*1*) The partnership interest being transferred was acquired after August 10, 1993, provided—

(*i*) The section 197(f)(9) intangible was acquired by the partnership on or before August 10, 1993;

(*ii*) The partnership interest being transferred was held after August 10, 1993, by a person or persons (the post-1993 person or persons) other than the person transferring the partnership interest or persons who were related to the person transferring the partnership interest; and

(*iii*) The acquisition of such interest by the post-1993 person or persons was not part of a transaction or series of related transactions in which the person transferring the partnership interest or persons related to the person transferring the partnership interest acquired such interest; or

(*2*) The partnership interest being transferred was acquired after the partnership acquired the section 197(f)(9) intangible, provided—

(*i*) The section 197(f)(9) intangible was acquired by the partnership after August 10, 1993, and is not amortizable with respect to the partnership;

(*ii*) The partnership interest being transferred was held after the partnership acquired the section 197(f)(9) intangible by a person or persons (the post-contribution person or persons) other than the person transferring the partnership interest or persons who were related to the person transferring the partnership interest; and

(*iii*) The acquisition of such interest by the post-contribution person or persons was not part of a transaction or series of related transactions in which the person transferring the partnership interest or persons related to the person transferring the partnership interest acquired such interest.

(B) *Acquisition of partnership interest by contribution.* Solely for purposes of paragraph (h)(12)(v)(A)(*1*) and (*2*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership.

(C) *Effect of retroactive elections.* For purposes of paragraph (h)(12)(v)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the transferee partner made a valid retroactive election under §1.197–1T.

(vi) *Partner is or becomes a user of partnership intangible*—(A) *General rule.* If, as part of a series of related transactions that includes a transaction described in paragraph (h)(12)(ii), (iii), (iv), or (v) of this section, an anti-churning partner or related person (other than the partnership) becomes (or remains) a direct user of an intangible that is treated as transferred in the transaction (as a result of the partners being treated as having owned their proportionate share of partnership assets), the anti-churning rules of this paragraph (h) apply to the proportionate share of such intangible that is treated as transferred by such anti-churning partner, notwithstanding the application of paragraph (h)(12)(ii), (iii), (iv), or (v) of this section.

* * * * *

(vii)* * *

(B) *Allocations where the intangible is not amortizable by the contributor.* If a section 197(f)(9) intangible was not an amortizable section 197 intangible in the hands of the contributing partner, a noncontributing partner generally may receive remedial allocations of amortization under section 704(c) that are deductible for Federal income tax purposes. However, such a partner may not receive remedial allocations of amortization under section 704(c) if that partner is related to the partner that contributed the intangible or if, as part of a series of related transactions that includes the contribution of the section 197(f)(9) intangible to the partnership, the contributing partner or related person (other than the partnership) becomes (or remains) a direct user of the contributed intangible.* * *

* * * * *

(k) * * *

Example 27. * * *

(iii) * * * However, A is an anti-churning partner under paragraph (h)(12)(vi)(B)(2)(*i*) of this section. As a result of the license agreement, A remains a direct user of the section 197(f)(9) intangible after the transfer to C. Accordingly, paragraph (h)(12)(vi)(A) of this section will cause the anti-churning rules to apply to the entire basis adjustment under section 743(b).

Example 28. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest prior to the effective date. (i) In 1990, A, B, and C each contribute $150 cash to form general partnership ABC for the purpose of engaging in a consulting business and a software manufacturing business. The partners agree to share partnership profits and losses equally. In 2000, the partnership distributes the consulting business to A in liquidation of A's entire interest in ABC. The only asset of the consulting business is a nonamortizable intangible, which has a fair market value of $180 and a basis of $0. At the time of the distribution, the adjusted basis of A's interest in ABC is $150. A is not related to B or C. ABC does not have a section 754 election in effect.

(ii) Under section 732(b), A's adjusted basis in the intangible distributed by ABC is $150, a $150 increase over the basis of the intangible in ABC's hands. In determining whether the anti-churning rules apply to any portion of the basis increase, A is treated as having owned and used A's proportionate share of partnership property. Thus, A is treated as holding an interest in the intangible during the transition period. Because the intangible was not amortizable prior to the enactment of section 197, the section 732(b) increase in the basis of the intangible may be subject to the anti-churning provisions. Paragraph (h)(12)(ii) of this section provides that the anti-churning provisions apply to the extent that the section 732(b) adjustment exceeds the total unrealized appreciation from the intangible allocable to partners other than A or persons related to A, as well as certain other partners whose purchase of their interests meet certain criteria. Because B and C are not related to A, and A's acquisition of its partnership interest does not satisfy the necessary criteria, the section 732(b) basis increase is subject to the anti-churning provisions to the extent that it exceeds B and C's proportionate share of the unrealized appreciation from the intangible. B and C's proportionate share of the unrealized appreciation from the intangible is $120 (2/3 of $180). This is the amount of gain that would be allocated to B and C if the partnership sold the intangible immediately before the distribution for its fair market value of $180. Therefore, $120 of the section 732(b) basis increase is not subject to the anti-churning rules. The remaining $30 of the section 732(b) basis increase is subject to the anti-churning rules. Accordingly, A is treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $120 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $30.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-third of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 - $120 = $60), over the fair market value of the distributed intangible ($180).

Example 29. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest after the effective date. (i) The facts are the same as in *Example 28*, except that B and C form ABC in 1990. A does not acquire an interest in ABC until 1995. In 1995, A contributes $150 to ABC in exchange for a one-third interest in ABC. At the time of the distribution, the adjusted basis of A's interest in ABC is $150.

(ii) As in *Example 28*, the anti-churning rules do not apply to the increase in the basis of the intangible distributed to A under section 732(b) to the extent that it does not exceed the unrealized appreciation from the intangible allocable to B and C. Under paragraph (h)(12)(ii) of this section, the anti-churning provisions also do not apply to the section 732(b) basis increase to the extent of A's allocable share of the unrealized appreciation from the intangible because A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by the partnership before A acquired the ABC interest. Under paragraph (h)(12)(ii)(E) of this section, A is deemed to acquire the ABC partnership interest from an unrelated person because A acquired the ABC partnership interest in exchange for a contribution to the partnership of property other than the distributed intangible and, at the time of the contribution, no partner in the partnership was related to A. Consequently, the increase in the basis of the intangible under section 732(b) is not subject to the anti-churning rules to the extent of the total unrealized appreciation from the intangible allocable to A, B, and C. The total unrealized appreciation from the intangible allocable to A, B, and C is $180 (the gain the partnership would have recognized if it had sold the intangible for its fair market value immediately before the distribution). Because this amount exceeds the section 732(b) basis increase of $150, the entire section 732(b) basis increase is amortizable.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-sixth of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 - $150 = $30), over the fair market value of the distributed intangible ($180).

Example 30. Distribution of section 197(f)(9) intangible contributed to the partnership by a partner. (i) The facts are the same as in *Example 29*, except that C purchased the intangible used in the consulting business in 1988 for $60 and contributed the intangible to ABC in 1990. At that time, the intangible had a fair market value of $150 and an adjusted tax basis of $60. When ABC distributes the intangible to A in 2000, the intangible has a fair market value of $180 and a basis of $60.

(ii) As in *Examples 28* and *29*, the adjusted basis of the intangible in A's hands is $150 under section 732(b). However, the increase in the adjusted basis of the intangible under section 732(b) is only $90 ($150 adjusted basis after the distribution compared to $60 basis before the distribution). Pursuant to paragraph (g)(2)(ii)(B) of this section, A steps into the shoes of ABC with respect to the $60 of A's adjusted basis in the intangible that corresponds to ABC's basis in the intangible and this portion of the basis is nonamortizable. B and C are not related to A, A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by ABC before A acquired the ABC interest. Therefore, under paragraph (h)(12)(ii) of this section, the section 732(b) basis increase is amortizable to the extent of A, B, and C's allocable share of the unrealized appreciation from the intangible. The total unrealized appreciation from the intangible that is allocable to A, B, and C is $120. If ABC had sold the intangible immediately before the distribution to A for its fair market value of $180, it would have recognized gain of $120, which would have been allocated $10 to A, $10 to B, and $100 to C under section 704(c). Because A, B, and C's allocable share of the unrealized appreciation from the intangible exceeds the section 732(b) basis increase in the intangible, the entire $90 of basis increase is amortizable by A. Accordingly, after the distribution, A will be treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $90 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $60.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-half of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that

is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($60) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($120 - $90 = $30), over the fair market value of the distributed intangible ($180).

Example 31. Partnership distribution causing section 734(b) basis adjustment to section 197(f)(9) intangible. (i) On January 1, 2001, A, B, and C form a partnership (ABC) in which each partner shares equally in capital and income, gain, loss, and deductions. On that date, A contributes a section 197(f)(9) intangible with a zero basis and a value of $150, and B and C each contribute $150 cash. A and B are related, but neither A nor B is related to C. ABC does not adopt the remedial allocation method for making section 704(c) allocations of amortization expenses with respect to the intangible. On December 1, 2004, when the value of the intangible has increased to $600, ABC distributes $300 to B in complete redemption of B's interest in the partnership. ABC has an election under section 754 in effect for the taxable year that includes December 1, 2004. (Assume that, at the time of the distribution, the basis of A's partnership interest remains zero, and the basis of each of B's and C's partnership interest remains $150.)

(ii) Immediately prior to the distribution, the assets of the partnership are revalued pursuant to §1.704–1(b)(2)(iv)(*f*), so that the section 197(f)(9) intangible is reflected on the books of the partnership at a value of $600. B recognizes $150 of gain under section 731(a)(1) upon the distribution of $300 in redemption of B's partnership interest. As a result, the adjusted basis of the intangible held by ABC increases by $150 under section 734(b). A does not satisfy any of the tests set forth under paragraph (h)(12)(iv)(B) and thus is not an eligible partner. C is not related to B and thus is an eligible partner under paragraph (h)(12)(iv)(B)(*1*) of this section. The capital accounts of A and C are equal immediately after the distribution, so, pursuant to paragraph (h)(12)(iv)(D)(*1*) of this section, each partner's share of the basis increase is equal to $75. Because A is not an eligible partner, the anti-churning rules apply to A's share of the basis increase. The anti-churning rules do not apply to C's share of the basis increase.

(iii) For book purposes, ABC determines the amortization of the asset as follows: First, the intangible that is subject to adjustment under section 734(b) will be divided into three assets: the first, with a basis and value of $75 will be amortizable for both book and tax purposes; the second, with a basis and value of $75 will be amortizable for book, but not tax purposes; and a third asset with a basis of zero and a value of $450 will not be amortizable for book or tax purposes. Any subsequent revaluation of the intangible pursuant to §1.704–1(b)(2)(iv)(*f*) will be made solely with respect to the third asset (which is not amortizable for book purposes). The book and tax attributes from the first asset (i.e., book and tax amortization) will be specially allocated to C. The book and tax attributes from the second asset (i.e., book amortization and non-amortizable tax basis) will be specially allocated to A. Upon disposition of the intangible, each partner's share of gain or loss will be determined first by allocating among the partners an amount realized equal to the book value of the intangible attributable to such partner, with any remaining amount realized being allocated in accordance with the partnership agreement. Each partner then will compare its share of the amount realized with its remaining basis in the intangible to arrive at the gain or loss to be allocated to such partner. This is a reasonable method for amortizing the intangible for book purposes, and the results in allocating the income, gain, loss, and deductions attributable to the intangible do not contravene the purposes of the anti-churning rules under section 197 or paragraph (h) of this section.

(l) * * *(1) *In general.* This section applies to property acquired after January 25, 2000, except that paragraph (c)(13) of this section (exception from section 197 for separately acquired rights of fixed duration or amount) applies to property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T), and paragraphs (h)(12)(ii), (iii), (iv), (v), (vi)(A), and (vii)(B) of this section (anti-churning rules applicable to partnerships) apply to partnership transactions occurring on or after November 20, 2000.

(2) *Application to pre-effective date acquisitions.* A taxpayer may choose, on a transaction-by-transaction basis, to apply the provisions of this section and §1.167(a)–14 to property acquired (or partnership transactions occurring) after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and—

(i) On or before January 25, 2000; or

(ii) With respect to paragraphs (h)(12)(ii), (iii), (iv), (v), (vi)(A), and (vii)(B) of this section, before November 20, 2000.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue Service.

Approved November 9, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 17, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 20, 2000, 65 F.R. 69667)

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. 2000–48, page 570.

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. 2000–48, page 570.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

26 CFR 1.274–5: Substantiation requirements.

Rules are set forth for an optional method for substantiating the amount of ordinary and necessary business expenses of an employee for automobile expenses when a payor provides a mileage allowance for such expenses. Rules are also set forth for an optional method for employees and self-employed individuals to use in substantiating a trade or business deduction for automobile expenses. See Rev. Proc. 2000–48, page 570.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

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 2000. See Rev. Rul. 2000–54, page 566.

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 2000. See Rev. Rul. 2000–54, page 566.

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 2000. See Rev. Rul. 2000–54, 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 2000. See Rev. Rul. 2000–54, 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 2000. See Rev. Rul. 2000–54, 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 2000. See Rev. Rul. 2000–54, 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 2000. See Rev. Rul. 2000–54, 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 2000. See Rev. Rul. 2000–54, 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 2000. See Rev. Rul. 2000–54, 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 2000.

Rev. Rul. 2000-54

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2000 (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 2001 interest rate for purposes of sections 846 and 807.

REV. RUL. 2000–54 TABLE 1

Applicable Federal Rates (AFR) for December 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-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%
Mid-Term				
AFR	5.87%	5.79%	5.75%	5.72%
110% AFR	6.47%	6.37%	6.32%	6.29%
120% AFR	7.07%	6.95%	6.89%	6.85%
130% AFR	7.67%	7.53%	7.46%	7.41%
150% AFR	8.88%	8.69%	8.60%	8.54%
175% AFR	10.39%	10.13%	10.00%	9.92%
Long-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. 2000–54 TABLE 2

Adjusted AFR for December 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.30%	4.25%	4.23%	4.21%
Mid-term adjusted AFR	4.58%	4.53%	4.50%	4.49%
Long-term adjusted AFR	5.31%	5.24%	5.21%	5.18%

REV. RUL. 2000–54 TABLE 3

Rates Under Section 382 for December 2000

Adjusted federal long-term rate for the current month	5.31%
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.)	5.39%

REV. RUL. 2000–54 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for December 2000

Appropriate percentage for the 70% present value low-income housing credit	8.39%
Appropriate percentage for the 30% present value low-income housing credit	3.59%

REV. RUL. 2000–54 TABLE 5

Rate Under Section 7520 for December 2000

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. 2000–54 TABLE 6

Rate Under Sections 846 and 807

Applicable rate of interest for 2001 for purposes of sections 846 and 807	6.00%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2000. See Rev. Rul. 2000–54, page 566.

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 2000. See Rev. Rul. 2000–54, page 566.

Part III. Administrative, Procedural, and Miscellaneous

Stock Compensation Corporate Tax Shelter

Notice 2000–60

The Internal Revenue Service and the Treasury Department have become aware of certain types of transactions, as described below, that are being marketed to taxpayers for the avoidance of federal income taxes. The IRS and Treasury are issuing this notice to alert taxpayers and their representatives that the losses generated by such transactions are not properly allowable for federal income tax purposes and also to alert them of certain responsibilities that may arise from participation in such transactions.

FACTS

These transactions generally involve three parties: a domestic corporation (P) that is the common parent of a consolidated group, a domestic subsidiary (S), and a third party (X) that either is unrelated to P or is related but is not an includible corporation within the meaning of § 1504(b) of the Internal Revenue Code. P and X transfer cash to S in exchange for S's stock. After this exchange, P owns stock representing less than 80 percent of the voting power of S's stock, thus preventing S from being a member of P's consolidated group. X owns preferred stock of S. P's and X's basis in their S stock reflects the amount of cash they contributed to S. S uses the cash to purchase stock of P from P's shareholders. From time to time, S transfers P shares to P employees in satisfaction of P's stock-based employee compensation obligations (*e.g.*, upon the exercise by an employee of a non-statutory option to purchase P stock). In a few years, S will sell any remaining P stock, and then S will liquidate or P will sell its S stock.

Notwithstanding that P is the majority shareholder of S, P and S take the position that S's transfers of P stock to P's employees must be treated, under § 1.83–6(d) of the Income Tax Regulations, as deemed capital contributions by S to P followed by transfers by P to the P employees. P does not reduce its basis in its S stock as a result of S's deemed transfers to P. S increases its basis in its remaining P stock by the amount of the basis of the P shares S transferred in the deemed capital contributions to P. Under § 1032, P reports no gain or loss from the deemed transfers of P stock to P's employees. P takes deductions under § 83(h) in the amount that the P employees include in income under § 83(a) from their receipt of the P stock.

When S liquidates or P sells its S stock, P claims a capital loss under § 331 or § 1001 because S has already transferred most of its P stock to the P employees, which has substantially reduced the value of S without a corresponding downward adjustment in P's basis in its S stock. Because S claims to have shifted all of its basis in the P stock to S's shares of P stock remaining after the transfers to the P employees, S also reports a capital loss on the sale of its remaining P stock immediately before S's liquidation or sale.

ANALYSIS

When a corporation makes a payment that discharges a liability of its shareholder, the discharge of the liability is treated as a distribution to the shareholder with respect to the shareholder's stock. *See, e.g., Tennessee Securities Inc. v. Commissioner*, 674 F.2d 570, 573 (6th Cir. 1982), *citing Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929). To permit a controlled subsidiary to avoid distribution treatment for transfers made on behalf of a parent corporation merely by purchasing some shares of the parent corporation's stock would contravene the framework governing distributions under § 301. Moreover, to characterize such transfers as capital contributions made by the subsidiary in its capacity as a shareholder of the parent corporation would be inconsistent with the substance of these transactions. The characterization in § 1.83– 6(d) of a shareholder's transfer of property to a corporation's employees as a deemed capital contribution only applies when the transferor is acting in its capacity as a shareholder. That characterization is inapposite when the transferee is a controlling corporate shareholder of the transferor, and the transferor subsidiary has no plausible investment motive for making such transfers.

The transfers by S to the P employees are properly characterized as distributions by S to P with respect to P's S stock, subject to the rules of §§ 301 and 311, followed by compensatory transfers by P to P's employees. Distributions to the extent of earnings and profits result in dividend treatment under § 301(c)(1). To the extent that the amount of the distributions exceeds the earnings and profits of S, the distributions reduce P's basis in its S stock under § 301(c)(2), thus reducing or eliminating P's purported loss with respect to the S stock upon S's liquidation or sale. In addition, because the transfers of P stock by S to P are distributions and not capital contributions, S is not permitted to shift basis from the transferred P stock to S's remaining P stock and, therefore, S does not have a capital loss on the sale of its remaining P stock immediately before S's liquidation or sale.

Alternatively, the IRS may disregard the described steps and treat the transaction as a redemption by P. It is a well-established principle of tax law that when transactions lack a legitimate business purpose and are undertaken solely for tax avoidance purposes, their tax consequences will be determined based on substance and not form. *Gregory v. Helvering*, 293 U.S. 465 (1935). The transfer of cash from P to S, the purchase by S of P stock from P shareholders, the transfers by S of P stock to P's employees, and the ultimate liquidation or sale of S, all pursuant to the same arrangement, may be disregarded for tax purposes and, instead, be treated as a redemption by P of its stock followed by compensatory transfers of treasury stock by P to its employees. No deduction is permitted for amounts paid to redeem stock. *See* § 162(k).

It is also well-established that, to be allowable, a loss must be bona fide and must reflect actual economic consequences in order to be sustained. An artificial loss lacking economic substance is not allowable. *See* § 165(a); *ACM Partnership v. Commissioner*, 157 F.3d 231, 252 (3d Cir. 1998), *cert. denied*, 526 U.S. 1017 (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."); Treas. Reg. § 1.165-1(b) ("Only a bona

fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss."). This transaction is no more than a series of contrived steps that effect an artificial loss on P's disposition of S stock. Consequently, the arrangement described above, or any similar arrangement, does not produce an allowable loss.

The purported tax benefits from these transactions may also be subject to challenge for other reasons, including other provisions of the Code and the regulations, such as § 269.

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.

Transactions that are the same as or substantially similar to those described in this Notice 2000–60 are identified as "listed transactions" for the purposes of § 1.6011–4T(b)(2) of the Temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations. *See also* § 301.6112–1T, A–4. It should be noted that independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), such transactions may already be subject to the tax shelter registration and list maintenance requirements of §§ 6111 and 6112 under the regulations issued in February 2000 (§§ 301.6111–2T and 301.6112–1T, A-4), as well as the regulations issued in 1984 and amended in 1986 (§§ 301.6111–1T and 301.6112–1T, A-3). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under § 6707(a) and to the penalty under § 6708(a) if the requirements of § 6112 are not satisfied.

The principal author of this notice is Megan Fitzsimmons of the Office of the Associate Chief Counsel (Corporate). For further information regarding this notice, contact Ms. Fitzsimmons at 202-622-7790 (not a toll-free call).

Trusts Not Considered Individuals for Purposes of Section 935

Notice 2000–61

The Internal Revenue Service and the Treasury Department have become aware of certain types of transactions that are being marketed to taxpayers for the avoidance of federal income taxes. The promoters of these transactions claim that section 935 applies to a trust as part of a scheme in which the trust seeks effectively to avoid both U.S. and Guamanian tax liability. As explained below, section 935 applies to individuals only and not to trusts. These transactions may also be subject to challenge on other grounds. In addition, such transactions are hereby designated as "listed transactions" for purposes of sections 6011, 6111 and 6112.

Prior to 1973, U.S. citizens who were residents of Guam, and whose citizen status did not derive from birth or naturalization in Guam, were required to file both U.S. and Guamanian tax returns. H.R. Rep. No. 92–1479, 92d Cong., 2d Sess. 1 (1972); *see also* Section 31 of the Organic Act of Guam, 48 U.S.C. § 1421 *et seq.* In addition, most other individuals who derived income from both Guam and the United States had to file tax returns with both jurisdictions. *Id.*

Section 935 was enacted, effective for tax years beginning after 1972, to permit such individuals to file a single income tax return, in Guam, thus eliminating the administrative burdens associated with the filing of two income tax returns. It was recognized that the foreign tax credit generally eliminated the tax liability to one of the jurisdictions and, therefore, that section 935 generally would not affect the amount of tax ultimately due. *See* H.R. Rep. No. 92–1479, 92d Cong., 2d Sess. 1 (1972). Section 935 was repealed by P.L. 99–514, sec. 1272(d)(2) (1986), but the repeal takes effect only if (and for so long as) an implementing agreement under P.L. 99–514, section 1271, is in force between the United States and Guam. No such implementing agreement is in force, and thus section 935 remains in effect.

The single filing rule contained in section 935 applies solely to individuals who are resident in Guam, individuals who are citizens of Guam and are not otherwise citizens of the United States, individuals who are U.S. citizens or residents and have income derived from Guam, and individuals who file joint returns with any of these persons.

Nothing in the language of section 935, its legislative history, or the policy behind its enactment indicates that a trust is to be considered an individual for purposes of section 935. The fact that under section 641(b) the taxable income of a trust is generally determined in the same manner as the taxable income of an individual has no bearing on whether a trust is an individual for purposes of section 935. Section 935 does not relieve a trust from any obligation it may have to file an income tax return for the taxable year with the United States and to pay to the United States any tax due.

Transactions in which it is claimed that section 935 applies to a trust as part of a scheme in which the trust seeks effectively to avoid both U.S. and Guamanian tax liability may also be subject to challenge on other grounds.

The Service may impose penalties on participants in transactions subject to this Notice, or, as applicable, on persons who participate in the promotion or reporting of these transactions, including the accuracy-related penalty under section 6662, the return preparer penalty under section 6694, the promoter penalty under section 6700, and the aiding and abetting penalty under section 6701. Failure to file penalties under section 6651 on the trust may also be appropriate.

In addition, transactions subject to this Notice are hereby identified as "listed transactions" for the purposes of § 1.6011–4T(b)(2) of the Temporary Income Tax Regulations, to the extent applicable, and § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations. *See* also § 301.6112–1T, A-4. It should be noted that independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), such transactions may already be subject to the tax shelter registration and list maintenance requirements of sections 6111 and 6112 under the regulations issued in February 2000

(§§ 301.6111–2T and 301.6112–1T, A-4). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under section 6707(a) and to the penalty under section 6708(a) if the requirements of section 6112 are not satisfied.

The principal author of this notice is Karen A. Rennie-Quarrie of the Office of Associate Chief Counsel (International). For further information regarding this notice contact Ms. Rennie-Quarrie at (202) 622-3880 (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, Sections 62, 162, 170, 213, 217, 274, 1016; 1.62–2, 1.162–17, 1.170A–1, 1.213–1, 1.217–2, 1.274–5, 1.1016–3.)

Rev. Proc. 2000–48

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 99–38, 1999–43 I.R.B. 525, 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 § 1.274–5 of the 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)	34.5 cents per mile
(2) Charitable (section 7 below)	14 cents per mile
(3) Medical and Moving (section 7 below)	12 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.

SECTION 3. BACKGROUND

.01 Section 162(a) 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 1.274–5(j), in part, grants the Commissioner the authority to establish a method under which a taxpayer may use mileage rates to substantiate, for purposes of § 274(d), the amount of the ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home.

.04 Section 1.274–5(g), in part, grants the Commissioner the authority to prescribe rules relating to mileage allowances for ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling 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 § 1.274–5(c), and (2) satisfying the requirements of an adequate accounting to the employer of the amount of such expenses for purposes of § 1.274–5(f).

.05 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.

.06 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.

.07 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 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) 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.

.08 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 § 1.274–5(g), 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.

.09 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 34.5 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 personal property taxes may be deducted as separate items, but only to the extent allowable 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 1997, 1998, and 1999; 14 cents per mile for 2000; and 15 cents per mile for 2001, 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 12 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), 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. Interest relating to the purchase of the automobile and state and local personal property taxes are not deductible as charitable, medical, or moving expenses, but they may be deducted as separate items to the extent allowable 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 $27,100.

(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 em-

ployee 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 § 1.274–5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5(f), as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5(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 advance mileage allowance of $80 based on an anticipated 200 business miles at 40 cents per mile (at a time when the applicable business standard mileage rate is 34.5 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 ($32) even though the employee is not required to return the portion of the allowance ($6.60) that exceeds the amount of the employee's expenses deemed substantiated under section 9.01 of this revenue procedure ($41.40) for the 120 substantiated business miles. However, the $6.60 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* § 1.274–5(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 sub-

stantiates in accordance with section 9.02 of this revenue procedure. *See* § 1.274–5(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* § 1.274–5(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 40 cents per mile (when the business standard mileage rate is 34.5 cents per mile). The employer does not require the return of the portion of the allowance that exceeds the business standard mileage rate for the business miles substantiated (5.5 cents). In June, the employer advances an employee $200 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 $40 to the employer for the 100 business miles not traveled. The amount deemed substantiated for the 400 miles traveled is $138 and the employee is not required to return the remaining $22. 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 $22.

.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. 99–38, 1999–43 I.R.B. 525, is hereby superseded for mileage allowances that are paid both (1) to an employee on or after January 1, 2001, and (2) with respect to transportation expenses paid or incurred by the employee on or after January 1, 2001. Rev. Proc. 99–38 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, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Associate 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).

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 October 2000 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, 2000.

Rev. Rul. 2000–58

The following Department Store Inventory Price Indexes for October 2000 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, 2000.

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. 1999	Oct. 2000	Percent Change from Oct. 1999 to Oct. 2000[1]
1. Piece Goods	545.8	502.4	-8.0
2. Domestics and Draperies	625.6	608.5	-2.7
3. Women's and Children's Shoes	653.3	661.5	1.3
4. Men's Shoes	881.2	915.5	3.9
5. Infants' Wear	645.2	649.0	0.6
6. Women's Underwear	571.7	579.6	1.4
7. Women's Hosiery	328.9	346.2	5.3
8. Women's and Girls' Accessories	536.7	555.6	3.5
9. Women's Outerwear and Girls' Wear	416.9	414.1	-0.7
10. Men's Clothing	627.5	601.0	-4.2
11. Men's Furnishings	631.1	632.7	0.3
12. Boys' Clothing and Furnishings	508.8	494.4	-2.8
13. Jewelry	969.2	937.1	-3.3
14. Notions	771.7	792.8	2.7
15. Toilet Articles and Drugs	985.6	971.1	-1.5
16. Furniture and Bedding	692.3	704.3	1.7
17. Floor Coverings	603.3	627.7	4.0
18. Housewares	792.9	778.0	-1.9
19. Major Appliances	234.8	228.6	-2.6
20. Radio and Television	64.2	57.9	-9.8
21. Recreation and Education[2]	96.5	92.6	-4.0
22. Home Improvements[2]	128.8	128.9	0.1
23. Auto Accessories[2]	106.8	106.7	-0.1
Groups 1 - 15: Soft Goods	612.3	607.3	-0.8
Groups 16 - 20: Durable Goods	448.6	437.8	-2.4
Groups 21 - 23: Misc. Goods[2]	102.7	100.1	-2.5
Store Total[3]	550.9	543.6	-1.3

[1] Absence of a minus sign before the percentage change in this column signifies a 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 Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (202) 622-4970 (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, 2001, will be 9 percent for overpayments (8 percent in the case of a corporation), 9 percent for underpayments, and 11 percent for large corporate underpayments. The rate of interest paid on the portion of a coporate overpayment exceeding $10,000 is 6.5 percent.

Rev. Rul. 2000–57

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, 2001, 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 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 October 2000 is 6 percent. Accordingly, an overpayment rate of 9 percent (8 percent in the case of a corporation) and an underpayment rate of 9 percent are established for the calendar quarter beginning January 1, 2001. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 2001, is 6.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 2001, is 11 percent. These rates apply to amounts bearing interest during that calendar quarter.

The 9 percent rate also applies to estimated tax underpayments for the first calendar quarter in 2001 and for the first 15 days in April 2001.

Interest factors for daily compound interest for annual rates of 6.5 percent, 8 percent, 9 percent, and 11 percent are published in Tables 18, 21, 23, and 27 of Rev. Proc. 95–17, 1995–1 C.B. 556, 572, 575, 577, and 581.

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 Associate Chief Counsel (Procedure & Administration), Administrative Provisions & Judicial Practice Division. For further information regarding this revenue ruling, contact Mr. Bailey at (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

TABLE OF INTEREST RATES—Continued

PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
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

TABLE OF INTEREST RATES—Continued

FROM JAN. 1, 1987–Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
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
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31 2001	9%	23	577

TABLE OF INTEREST RATES

FROM JAN. 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%	9	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
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991–PRESENT

	RATE	1995–1 C.B. TABLE	PAGE
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
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995–PRESENT

		1995–1 C.B.	
	RATE	TABLE	PAGE
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
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572

Part IV. Items of General Interest

Foundations Status of Certain Organizations

Announcement 2000–98

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:

Abbeyfield Society of the USA, Brookfield, IL
Alabama Boychoir Foundation, Inc., Tuscaloosa, AL
Best Practices in Education, Inc., Portland, ME
Bunkie Community Development Corporation, Bunkie, LA
Calenergy Foundation, Inc., Omaha, NE
California Desert Protection League, Los Angeles, CA
Center for Natural Resources Development, Walnut Creek, CA
Central Coast Youth Foundation, Prunedale, CA
Centre for Science and Environment, Washington, DC
Christian Family Counseling & Nutrition Centre, Seaview, WA
Christie E. Cuddeback and Lucille M. Cuddeback Memorial Fund c/o Frank M. Banson, Jr. & Rob Ross Hendrickson, Co-Trustees, Baltimore, MD
Evelyn Graves Community Development Corporation, Philadelphia, PA
Iowa Construction Career Institute Inc., Des Moines, IA
Jesucristo Reina Evangelistic Association, Inc., Metuchen, NJ
Louisiana Center for Forensic Science, Inc., Bossier City, LA
Marble Hill Development Coporation, Baltimore, MD
Observer Educational Foundation, Inc., Sacramento, CA
Saginaw Partners in Networking, Saginaw, MI
Seneca Housing and Rural Preservation Corporation, Salamanca, NY
Shiloh Homes, Oakland, CA
Streets of Hope Foundation Inernational Inc., Glen Allen, VA
Town & Country Fire District, West Salem, OH
Turano Foundation, Chicago, IL
White Stone Ministries, Inc., Franklin, WI
Willamette Valley Sar Dogs, Inc., Albany, OR

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 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(j)(1)–1: Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

T.D. 8908

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Disclosure of Return Information to the Bureau of the Census

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to additions to, and deletions from, the list of items of information disclosed to the Bureau of the Census for use in certain statistical programs. These regulations reflect agreement between the IRS and the Bureau of the Census as to items of business tax information needed to more effectively meet the Bureau of the Census' program objectives with respect to existing economic programs.

DATES: *Effective Date*: These regulations are effective on November 30, 2000.

Applicability Date: For the date of applicability, see §301.6103(j)(1)-1(e).

FOR FURTHER INFORMATION CONTACT: Stuart Murray, (202) 622-4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On January 25, 1999, a temporary regulation (T.D. 8811, 1999–1 C.B. 680) relating to disclosure of return information to the Bureau of the Census was published in the **Federal Register** (64 F.R. 3631). A notice of proposed rulemaking (REG-121806-97, 1999–1 C.B. 707) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (64 F.R. 3669). No public hearing was requested or held. No written or electronic comments responding to the notice of proposed rulemaking were received. Accordingly, the proposed regulations are adopted as revised by this Treasury decision, and the corresponding temporary regulations are removed.

The regulations proposed by REG-121806-97 are adopted by this Treasury decision without revision and are discussed below.

Explanation of Provisions

Under section 6103(j)(1) of the Internal Revenue Code, upon written request from the Secretary of Commerce, the Secretary is to furnish to the Bureau of the Census (Bureau) tax return information that is prescribed by Treasury regulations for the purpose of, but only to the extent necessary in, structuring censuses and national economic accounts and conducting related statistical activities authorized by law. Section 301.6103(j)(1)-1 of the regulations provides an itemized description of the return information authorized to be disclosed for this purpose. Periodically, the disclosure regulations are amended to reflect the changing needs of the Bureau for data for its statutorily authorized statistical activities.

The amendments adopted by this Treasury decision authorize IRS personnel to disclose additional items of return information that have been requested by the Secretary of Commerce, and to delete certain items of return information that are enumerated in the regulations but that the Secretary of Commerce has indicated are no longer needed.

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 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.

Drafting Information

The principal author of these regulations is Jamie Bernstein of the Office of Associate Chief Counsel, Procedure & Administration (Disclosure & Privacy Law Division). 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 is amended in part by removing the entry for Section 301.6103(j)(1)-1T and adding an entry in numerical order to read as follows:

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

Section 301.6103(j)(1)-1 also issued under 26 U.S.C. 6103(j)(1);* * *

Par. 2. Section 301.6103(j)(1)-1 is amended by:

1. Revising paragraphs (b)(3) and (b)(6)(i)(A).

2. Adding paragraphs (b)(6)(iii) and (e).

The revisions and addition read as follows:

§301.6103(j)(1)-1 Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

* * * * *

(b) * * *

(3) Officers or employees of the Internal Revenue Service will disclose the following business related return information reflected on the return of a taxpayer to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of

title 13, United States Code, demographic and economic statistics programs, censuses, and surveys. The "return of a taxpayer" includes, but is not limited to, Form 941; Form 990 series; Form 1040 series and Schedules C and SE; Form 1065 and all attending schedules and Form 8825; Form 1120 series and all attending schedules and Form 8825; Form 851; Form 1096; and other business returns, schedules and forms that the Internal Revenue Service may issue—

(i) Taxpayer identity information (as defined in section 6103(b)(6)) including parent corporation, shareholder, partner, and employer identity information;

(ii) Gross income, profits, or receipts;

(iii) Returns and allowances;

(iv) Cost of labor, salaries, and wages;

(v) Total expenses or deductions;

(vi) Total assets;

(vii) Beginning- and end-of-year inventory;

(viii) Royalty income;

(ix) Interest income, including portfolio interest;

(x) Rental income, including gross rents;

(xi) Tax-exempt interest income;

(xii) Net gain from sales of business property;

(xiii) Other income;

(xiv) Total income;

(xv) Percentage of stock owned by each shareholder;

(xvi) Percentage of capital ownership of each partner;

(xvii) End-of-year code;

(xviii) Months actively operated;

(xix) Principal industrial activity code, including the business description;

(xx) Total number of documents and the total amount reported on the Form 1096 transmitting Forms 1099-MISC;

(xxi) Form 941 indicator and business address on Schedule C; and

(xxii) Consolidated return indicator.

* * * * *

(6)(i) * * *

(A) From the business master files of the Internal Revenue Service—

(1) Taxpayer identity information (as defined in section 6103(b)(6)), including parent corporation identity information;

(2) Document code;

(3) District office code;

(4) Consolidated return and final return indicators;

(5) Principal industrial activity code;

(6) Partial year indicator;

(7) Annual accounting period;

(8) Gross receipts less returns and allowances; and

(9) Total assets.

* * * * *

(iii) Information from an employment tax return disclosed pursuant to paragraphs (b)(2)(iii)(A), (B), (D), (I) and (J) of this section may be used by officers and employees of the Bureau of the Census for the purpose described in and subject to the limitations of this paragraph (b)(6).

* * * * *

(e) *Effective date.* This section is applicable to the Bureau of the Census on November 30, 2000.

§301.6103(j)(1) - 1T [Removed]

Par. 3. Section 301.6103(j)(1)-1T is removed.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved November 21, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 22, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 30, 2000, 65 F.R. 71256)

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 5 (Rev. 18)

Delegation of Authority

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Delegation of authority.

SUMMARY: The specific order of succession and designation to act as Commissioner of Internal Revenue Service. The text of the delegation order appears below.

FOR FURTHER INFORMATION CONTACT: Joann L. Buck, Chief of Staff, Room 3310, 1111 Constitution Avenue, NW., Washington, DC 20037, (202) 622-1320 (not a toll-free call).

EFFECTIVE DATE: October 2, 2000.

Order of Succession and Designation

To Act as Commissioner of Internal Revenue

Authority: To act as and to perform the functions of the Commissioner of Internal Revenue in the event of an enemy attack on the United States, the disability of the Commissioner, his/her absence from the main Treasury relocation Site, or if there is a vacancy in the office, thus insuring the continuity of the functions of the office.

Delegated to: The following officials in the specific sequence listed:

Deputy Commissioner
Assistant Deputy Commissioner (Operations)
Assistant Deputy Commissioner (Modernization)
Chief, Communications and Liaison
Commissioner, Small Business/Self-Employed Division
Commissioner, Wage and Investment Division
Commissioner, Tax Exempt/Government Entities Division
Commissioner, Large/Mid-Size Business Division
Deputy Commissioner, Small Business/Self-Employed Division
Deputy Commissioner, Wage and Investment Division
Deputy Commissioner, Tax Exempt/Government Entities Division
Deputy Commissioner, Large/Mid-Size Business Division
Chief, Agency-Wide Shared Services
Chief, Appeals
Chief, Criminal Investigation
Chief Information Officer

Redelegation: In the absence of these officials, the first available Compliance Director.

Sources of Authority: Treasury Order 150-10, Treasury Order 150-25.

This Order supersedes Delegation Order No. 5 (Rev. 17), effective October 15, 1999.

Dated October 4, 2000.

Charles O. Rossotti,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 6, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 7, 2000, 65 F.R. 66802)

Delegation Order No. 264

Delegation of Authority

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Delegation of authority.

SUMMARY: Authority to Offer and Accept Settlement Offers and to Execute Closing Agreements Made under the Targeted Jobs Tax Credit Initiative.

FOR FURTHER INFORMATION CONTACT: Robert Wheeler, Health and Welfare Branch, Office of Division Counsel/Associate Chief Counsel (Tax-Exempt and Government Entities), CC:TEGE:EB:HW, Room 5203, 1111 Constitution Avenue, NW., Washington, DC 20224, (202) 622-6060 (not a toll-free call).

EFFECTIVE DATE: September 15, 2000.

Authority To Offer and Accept Settlement Offers and To Execute Closing Agreements Made Under the Targeted Jobs Tax Credit Initiative

Authority: In cases under their jurisdiction, to accept or make settlement offers and to execute closing agreements to effect such settlement offers, regardless of liability sought to be compromised, made under Announcement 2000-58, subject to the prior written review and approval by the Retail Industry Technical Advisor (or his or her designee).

Delegated to: Examination Branch Chiefs in the District offices and Territory Managers in Large and Mid-Sized Business and Small Business/Self-Employed divisions.

Redelegation: This authority may not be redelegated.

Sources of Authority: Treasury Order Nos. 150-07, 150-09, and 150-10 and the authority contained in IRC 7121 to offer and accept written settlement offers and execute closing agreements, relating to federal tax matters that are the subject of Announcement 2000-58, Targeted Jobs Tax Credit Settlement Initiative, 2000-30 I.R.B. 135 (July 24, 2000).

Ratification: To the extent that authority previously exercised consistent with this Order may require ratification, it is hereby approved and ratified.

Dated October 5, 2000.

Stuart L. Brown,
Chief Counsel.

Dated October 16, 2000.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 6, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 7, 2000, 65 F.R. 66802)

Returns Relating to Payments of Qualified Tuition and Related Expenses, and to Payments of Interest on Education Loans

Notice 2000-62

PURPOSE

This notice announces that eligible educational institutions and certain persons who receive payments of student loan interest may continue to report the same information under § 6050S of the Internal Revenue Code for the year 2001 as required for the years 1998, 1999, and 2000.

BACKGROUND

Section 6050S requires eligible educational institutions ("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 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, 1999, and 2000 are described in Notice 97-73, 1997-2 C.B. 335 (as modified by Notice 98-46, 1998-36 I.R.B. 21; Notice 98-59, 1998-49 I.R.B. 16; and Notice 99-37, 1999-30 I.R.B. 124).

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, 1999, and 2000 are described in Notice 98-7, 1998–1 C.B. 339 (as modified by Notice 98-54, 1998-46 I.R.B. 25; and Notice 99-37).

The legislative history 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 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

On June 16, 2000, the Treasury Department and the Service issued proposed regulations under § 6050S. *See* 65 Federal Register 37728. The regulations propose reporting under § 6050S beyond that required in Notice 97-73 (as modified) and Notice 98-7 (as modified). The regulations are proposed to be applicable for information returns required to be filed, and statements required to be furnished, after December 31, 2001. The Treasury Department and the Service expect to finalize the proposed regulations in the year 2001.

The Service has received numerous comments on the proposed regulations under § 6050S. Several commentators indicated that the proposed applicability date does not provide sufficient lead time for institutions and payees to comply with the additional reporting requirements. In light of these comments, and consistent with the intent of Congress that final regulations provide sufficient time to implement additional reporting required under § 6050S, the Treasury Department and the Service have decided that institutions and payees should be allowed to satisfy the information reporting requirements for the year 2001 in the same manner as described in Notice 97-73 (as modified) and Notice 98-7 (as modified).

Accordingly, for the year 2001, 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 2001, 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 2001 must be filed with the Service by February 28, 2002, if filed on paper or by magnetic media, or by April 1, 2002, if filed electronically. In addition, for the year 2001, institutions and payees must furnish statements containing the same information as Forms 1098-T and Forms 1098-E that will be filed with the Service to the individuals named on the information returns on or before January 31, 2002.

Although such reporting is not required, the Treasury Department and the Service encourage institutions and payees that are able to do so to report the additional information described in the proposed regulations for the year 2001, in order to assist taxpayers in calculating any credit allowable under § 25A and any deduction allowable under § 221.

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 2001. 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 2001 if the institution or payee made a good faith effort to file information returns and furnish statements in accordance with either this notice or the proposed regulations.

EFFECT ON OTHER DOCUMENTS

Notice 97-73, Notice 98-7, Notice 98-46, Notice 98-54, Notice 98-59, and Notice 99-37 are modified.

DRAFTING INFORMATION

The principal author of this notice is Donna Welch of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this notice contact her at (202) 622-4910 (not a toll-free call).

Guidance Priority List for 2001; Comments Requested

Notice 2000-63

The Department of Treasury and Internal Revenue Service request public comment about items that should be included in the Guidance Priority List for 2001.

IRS and Treasury's Office of Tax Policy use the Guidance Priority List (GPL) each year to identify and prioritize the tax issues that should be addressed through regulations, rulings, and other published administrative guidance. Public input is invited as part of the process of formulating the GPL to ensure that the agency's resources focus on the guidance items that are most important to taxpayers and tax administration.

No particular format is required for comments submitted in response to this Notice. However, it will be helpful for

comments both to briefly describe the item that is recommended for inclusion on the GPL and to explain why there is a need for guidance. In addition, comments may present an analysis of how the issue should be resolved.

Please submit all comments by January 16, 2001. Written comments should be sent to:

Internal Revenue Service
Attn: CC:MSP:RU (Notice 2000-63)
Room 5228
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand delivered between the hours of 8 a.m. and 5 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:MSP:RU (Notice 2000-63)
Room 5228
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Alternatively, comments may be submitted electronically via e-mail to the following address:

Joel.S.Rutstein@m1.IRSCOUNSEL.TREAS.GOV

All comments will be available for public inspection and copying in their entirety.

For further information regarding this notice, contact Joel Rutstein of the Office of Special Counsel (Modernization and Strategic Planning) at (202) 622-8472 (not a toll-free call).

Balance Due and Refund Anticipation Loans Under Section 7216

Notice 2000-64

The Internal Revenue Service has received questions about the scope of section 7216 of the Internal Revenue Code, Treas. Reg. § 301.7216-3 and Rev. Proc. 2000-31, 2000-31 I.R.B. 146, in the context of loans associated with electronic filing, such as balance due and refund anticipation loans.

The IRS is reviewing both Treas. Reg. § 301.7216-3 and Rev. Proc. 2000-31. Until further guidance is issued, tax return preparers who follow the rules for electronic filing set forth in Rev. Proc. 2000-31 and all publications and notices governing the IRS *e-file* Program listed in section 5.01 of the Revenue Procedure, will be treated as in compliance with I.R.C. § 7216.

The IRS requests comments on whether and how Treas. Reg. § 301.7216-3 and/or Rev. Proc. 2000-31 could more clearly address the rules governing balance due and refund anticipation loans. Comments should be addressed to the IRS at 5000 Ellin Road, New Carrollton, MD 20706, Attn: Ms. Grace E. Davis, W:E:IEF:CMMB, Room C4-368.

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Rules Relating to General Definition of Dependent

REG-107279-00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that amend the definition of "authorized placement agency" for purposes of determining whether a child placed for legal adoption in a taxpayer's home is a dependent of the taxpayer. A taxpayer who has a child placed for legal adoption in his or her home by an authorized placement agency will be affected by these regulations.

DATES: Written or electronically generated comments and requests for a public hearing must be received by February 28, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-107279-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP (REG-107279-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue., NW., Washington, DC. Taxpayers may also 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 IRS will publish the time and date of any public hearing in the Federal Register.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Elizabeth Kaye, (202) 622-4910; concerning submissions of comments and requests for a public hearing, Guy Traynor, (202) 622-7180 (not toll-free calls);

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains proposed amendments to §1.152-2(c)(2) of the Income Tax Regulations (26 CFR part 1) relating to the general definition of a dependent.

On October 12, 1999, the IRS published final regulations under section 6109 regarding IRS adoption taxpayer identification numbers (T.D. 8839, 1999–41 I.R.B. 498 [64 F.R. 51241]). Those regulations provided, in part, that in order for an adoption taxpayer identification number (ATIN) to be assigned, a child must be placed for adoption by an "authorized placement agency" as defined in §1.152-2(c)(2). 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) uses an attorney or other intermediary to place the child with the adoptive parents. In other independent adoptions, no intermediary is necessary because the adoptive parents and the biological parent(s) know one another.

The proposed regulations amend the definition of "authorized placement agency" to provide that an 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.

These regulations are proposed to apply for taxable years beginning after December 31, 2000. Taxpayers may rely on these proposed regulations for guidance pending the issuance of the final regulations. If, and to the extent, future guidance is more restrictive than the guidance in the proposed regulations, the future guidance will be applied without retroactive effect.

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 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. 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 and electronic comments that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how it can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will 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 public hearing will be published in the Federal Register.

Drafting Information

The principal author of these proposed regulations is Elizabeth Kaye, 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.

* * * * *

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 1.152-2 is amended by revising paragraph (c)(2) to read as follows:

§ 1.152-2 Rules relating to general definition of dependent.

* * * * *

(c) * * *

(2) For any taxable year beginning after December 31, 2000, a child who is a member of an individual's household will be treated as a child of that individual by blood if the child was placed with the individual by an authorized placement agency for legal adoption pursuant to a formal application filed by the individual with the agency. For purposes of this paragraph (c)(2), an authorized placement agency is any agency that is authorized by a State, the District of Columbia, a possession of the United States, a foreign country, or a political subdivision of any of the foregoing to place children for adoption. An authorized placement agency also includes biological parents and other persons authorized by state law to place children for legal adoption.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on November 29, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 30, 2000, 65 F.R. 71277)

Deadline for Submission of M&P and Volume Submitter Specimen Plans

Announcement 2000-99

The Internal Revenue Service reminds sponsors of master and prototype (M&P) plans and practitioners who sponsor volume submitter specimen plans that the deadline for applying for GUST opinion and advisory letters for their plans is December 31, 2000. This deadline also applies to M&P sponsors and volume submitter practitioners who use mass submitter or lead specimen plans. This deadline does not require employers who have adopted or intend to adopt M&P or volume submitter specimen plans to take any action at this time.

Most employers must amend their tax-qualified retirement plans for new law changes (which are described using the acronym "GUST") by the end of the first plan year beginning in 2001 (2001 plan year). Thus, for calendar year plans, this deadline for making GUST plan amendments is December 31, 2001. However, employers who have, as of the end of the 2001 plan year, either adopted or certified their intent to adopt an M&P or volume submitter specimen plan may be allowed more time to make their GUST plan amendments. For these employers to be allowed the extra time, the sponsors of the M&P and volume submitter specimen plans must apply for GUST opinion or advisory letters by December 31, 2000.

Some sponsors and practitioners use an M&P "mass submitter plan" or a volume submitter "lead specimen plan" as their own M&P or volume submitter specimen plan. These sponsors and practitioners also must apply for GUST opinion or advisory letters by December 31, 2000, if they want to give their clients extra time to make GUST plan amendments. It does not matter that the mass submitter plan or lead specimen plan may not yet be approved.

Opinion letter applications for M&P sponsors who use mass submitter plans are filed by the mass submitter. Earlier this year, the IRS mailed each mass submitter of record a list of those M&P sponsors who previously adopted one of the mass submitter's plans. Mass submitters should use these lists to apply for opinion letters for these sponsors' plans by December 31, 2000. In other cases, the mass submitter must file Form 4461-B on behalf of the M&P sponsor by December 31, 2000.

Advisory letter applications for practitioners who use lead specimen plans must also be filed by December 31, 2000. Sponsors of lead specimen plans should refer to section 17.02 of Rev. Proc. 2000-20, 2000-6 I.R.B. 553, for the procedures governing these applications.

Employers who have not adopted an M&P or volume submitter specimen plan by the end of the 2001 plan year can nevertheless get extra time to make their GUST plan amendments. To get the extra time, these employers must sign a certification of intent to adopt an M&P or volume submitter specimen plan once the IRS has approved the plan for GUST. Both the employer and the M&P sponsor or volume submitter practitioner must sign the certification by the end of the 2001 plan year. Employers who do not timely adopt, or certify their intent to adopt, an M&P or volume submitter specimen plan generally must adopt individually designed GUST plan amendments by the end of the 2001 plan year.

More information about the GUST deadlines and filing procedures can be found in the following IRS procedures: Rev. Proc. 2000-20 (2000–6 I.R.B. 553), Rev. Proc. 2000-27 (2000-26 I.R.B. 1272), and Rev. Proc. 2000-6 (2000-1 I.R.B. 187).

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

Announcement 2000–100

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations that were published in the **Federal Register** on Tuesday, September 5, 2000 (65 F.R. 53587), relating to the definition of a qualified interest under section 2702 of the Internal Revenue Code.

DATES: This correction is effective September 5, 2000.

FOR FURTHER INFORMATION CONTACT: James F. Hogan (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject of these corrections are under section 2702 of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 8899, 2000–38 I.R.B. 288) 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. 8899), which were

the subject of FR Doc. 00-22544, is corrected as follows:

§25.2702-3 [Corrected]

1. On page 53589, column 1, §25.2702-3(b)(3), the paragraph heading "*Payment of annuity amount.*" is corrected to read "*Period for payment of annuity amount.*".

2. On page 53589, column 1, §25.2702-3(b)(4), first sentence, the language "An annuity amount payable based on the anniversary date of the creation of the trust must be paid by the anniversary date." is corrected to read "An annuity amount payable based on the anniversary date of the creation of the trust must be paid no later than 105 days after the anniversary date.".

3. On page 53589, column 2, §25.2702-3(c)(3), the paragraph heading "*Payment of unitrust amount.*" is corrected to read "*Period for payment of unitrust amount.*".

4. On page 53589, column 2, §25.2702-3(c)(4), first sentence, "A unitrust amount payable based on the anniversary date of the creation of the trust must be paid by the anniversary date." is corrected to read "A unitrust amount payable based on the anniversary date of the creation of the trust must be paid no later than 105 days after the anniversary date.".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization & Strategic Planning)

(Filed by the Office of the Federal Register on November 27, 2000, 8:45 a.m., and published in the issue of the Federal Register for November 28, 2000, 65 F.R. 70791)

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

Section 162.—Trade or Business Expenses

Under what circumstances may a taxpayer expense the costs of self-created computer software? See Rev. Proc. 2000–50, page 601.

Section 167.—Depreciation

How is the capitalized cost of computer software amortized? See Rev. Proc. 2000–50, page 601.

Section 197.—Amortization of Goodwill and Certain Other Intangibles

What is the proper tax treatment of the cost of computer software that is excluded from section 197? See Rev. Proc. 2000–50, page 601.

Section 446.—General Rule for Methods of Accounting

If a taxpayer changes to a method provided for in Rev. Proc. 2000–50, is this a change in method of accounting? See Rev. Proc. 2000–50, page 601.

Section 481.—Adjustments Required by Changes in Method of Accounting

Is a section 481(a) adjustment required for a change in the method of accounting under Rev. Proc. 2000–50 for the cost of computer software? See Rev. Proc. 2000–50, page 601.

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 instuments" 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 2001 calendar year. See Rev. Rul. 2000–55, page 595.

Section 894(a).—Income Affected by Treaty

26 CFR 1.894–1(a): Income affected by treaty. (Also sections 894(c); 1.894–1(d))

"Liable to Tax" treaty residence standard. Guidance is provided on the "liable to tax" standard for residence under U.S. income tax treaties.

Rev. Rul. 2000–59

This revenue ruling provides guidance on whether certain entities will be considered liable to tax under the laws of a foreign country for purposes of determining if such entities are residents within the meaning of the relevant Treaty. In order to obtain treaty benefits a person must be a resident of the applicable treaty jurisdiction and must meet all other applicable requirements for obtaining treaty benefits, including any applicable limitation on benefits provision and, in the case of an entity that is fiscally transparent under the laws of the United States or the entity's jurisdiction, the requirement that the entity derive the item of income for which treaty benefits are sought within the meaning of Treas. Reg. § 1.894–1(d).

FACTS

Situation 1

Entity A is a business organization in Country X, which has an income tax treaty in effect with the United States that is identical to the 1996 United States Model Income Tax Treaty (1996 U.S. Model). Under the laws of Country X, Entity A is an investment company taxable on income from all sources at the entity level by reason of being incorporated in Country X. Similar to other domestic corporations, distributions from a Country X investment company are generally treated as dividends and do not retain the character or source of the underlying income. However, net capital gains and, in some cases, tax exempt interest, retain their character when they are distributed to the investment company's interest holders. Further, a Country X investment company may deduct distributions of current income to its interest holders in computing taxable income. Entity A distributes its net income and capital gains on a current basis to its interest holders so that it will not actually bear a tax. Country X imposes a withholding tax on Entity A's dividend distributions to its foreign interest holders regardless of the source of Entity A's underlying income. If Entity A did not distribute such amounts, Entity A would be taxed by Country X on such amounts. Entity A receives dividend income from the United States.

Country X has not announced by public notice that investment companies such as Entity A are not residents of Country X, and there is no competent authority agreement providing that such entities are not residents of Country X. Further, the U.S. competent authority has not issued a public notice indicating that treaty benefits to such entities are being denied because, and to the extent that, Country X will not grant treaty benefits to similar U.S. entities.

Situation 2

Entity B is an investment company organized in Country Y, which has an income tax treaty in effect with the United States that is identical to the 1996 U.S. Model. Under the laws of Country Y, corporations organized in Country Y are generally taxable on income from all sources at the entity level by reason of being incorporated in Country Y. A specific provision in Country Y law, however, exempts the income of investment companies such as Entity B from taxation. Under Country Y law, the character and source of distributions from Entity B to all its interest holders are determined based on the distributions themselves rather than on the character and source of Entity B's underlying income. Further, Country Y imposes a withholding tax on distributions to its foreign interest holders regardless of the source of the underlying income. Entity B receives dividend income from the United States.

Country Y has not announced by public notice that investment companies such as Entity B are not residents of Country Y, and there is no competent authority agreement providing that such entities are not residents of Country Y. Further, the U.S. competent authority has not issued a public notice indicating that treaty benefits to such entities are being denied because, and to the extent that, Country Y will not grant treaty benefits to similar U.S. entities.

Situation 3

Entity C is a trust established and administered in Country Z, which has an in-

come tax treaty with the United States identical to the 1981 U.S. Model Income Tax treaty (1981 U.S. Model). The trust exclusively provides pension benefits. Entity C's trustee is a resident of Country Z. Under the laws of Country Z, because Entity C's trustee is a resident of Country Z, Entity C is treated as a resident trust taxable at the entity level. However, because Entity C is established and operated exclusively to provide pension benefits, a provision of Country Z law exempts Entity C from Country Z income tax. Entity C receives dividend income from the United States.

Country Z has not announced by public notice that entities such as Entity C are not residents of Country Z, and there is no competent authority agreement providing that such entities are not residents of Country Z. Further, the U.S. competent authority has not issued a public notice indicating that treaty benefits to such entities are being denied because, and to the extent that, Country Z will not grant treaty benefits to similar U.S. entities.

LAW AND ANALYSIS

Article 4 of the 1996 U.S. Model provides in relevant part:

1. Except as provided in this paragraph, for the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature.

a) The term "resident of a Contracting State" does not include any person who is liable to tax in that state in respect only of income from sources in that State or of profits attributable to a permanent establishment.

b) A legal person organized under the laws of a Contracting State and that is generally exempt from tax in that State and is established and maintained in that State either:

i) exclusively for a religious, charitable, educational, scientific, or other similar purpose; or

ii) to provide pension or other similar benefits to employees pursuant to a plan

is to be treated as a resident of the Contracting State where it is established.

The analogous portion of Article 4 of the 1981 U.S. Model provides:

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who under the laws of the State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that

(a) this term does not include any person who is liable to tax in that State in respect only of income from sources within that State or capital situated therein;

The phrase "liable to tax" as used in the above articles does not require actual taxation. Thus, the fact that a person is only nominally taxable does not preclude that person from meeting the applicable "liable to tax" standard of these residence articles. This is consistent with the position taken in the 1996 U.S. Model Technical Explanation to Article 4(1), which provides: "[c]ertain entities that are nominally subject to tax but that in practice rarely pay tax also would generally be treated as residents and therefore accorded treaty benefits. For example, RICs, REITs, and REMICs, are all residents of the United States for purposes of the treaty."

For purposes of these residence articles, whether a person will be liable to tax in, and thus a resident of, a jurisdiction depends on the facts and circumstances. However, in the context of a bilateral income tax treaty, a person will not be considered a resident of a contracting state if (1) the treaty partner has announced by public notice that such persons are not residents of that state; (2) there is a competent authority agreement or separate specific treaty provision providing that such persons are not residents of that state; or (3) the treaty partner would not treat similar U.S. persons as residents of the United States, and the Internal Revenue Service has issued a public notice indicating that treaty benefits to such entities are consequently being denied. Conversely, a person may be treated as a resident of a contracting state if there is a competent authority agreement or separate specific treaty provision providing that such persons are residents of that state. The Internal Revenue Service shall announce the terms of any relevant competent authority agreement or treaty partner's position.

Situation 1

Under the facts of Situation 1, notwithstanding that Entity A is only nominally taxable in Country X, Entity A is "liable to tax in [Country X] by reason of its place of incorporation," within the meaning of the U.S.- Country X treaty, because of the following factors. First, as a corporation incorporated in Country X, Entity A may be taxed by Country X on its worldwide income. Second, but for the deduction regime, Country X would have imposed a tax on Entity A as it would any corporation incorporated in Country X. Third, the character and source of certain distributions by Entity A are determined independent of the character and source of Entity A's income, and Country X imposes a withholding tax on such distributions by Entity A to its foreign interest holders regardless of the source of Entity A's underlying income.

Finally, Country X has not announced by public notice that persons such as Entity A are not residents of Country X; there is no competent authority agreement providing that such persons are not residents of Country X; and the U.S. competent authority has not issued a public notice indicating that treaty benefits to such persons are being denied because Country X will not grant treaty benefits to similar U.S. persons.

Accordingly, Entity A is liable to tax in Country X by reason of its place of incorporation within the meaning of Article 4 (1) of the U.S.-Country X treaty, and thus is a resident of Country X for purposes of the U.S.-Country X treaty. In order to obtain treaty benefits, however, Entity A must still meet all other applicable requirements for such benefits, including the applicable limitation on benefits provision and, if Entity A is viewed as fiscally transparent under the laws of either the United States or Country X, those provisions of Treas. Reg. § 1.894–1(d).

Situation 2

Under the facts of Situation 2, notwithstanding that Entity B is only nominally liable to tax in Country Y, Entity B is liable to tax by reason of its place of incorporation, within the meaning of the U.S.- Country Y treaty, because of the

following factors. First, as a corporation incorporated in Country Y, Entity B may be taxed by Country Y on its worldwide income. Second, but for the specific exemption in Country Y law, Country Y would have imposed a tax on Entity B as it would any corporation incorporated in Country Y. Third, the character and source of distributions by Entity B are determined independent of the character and source of the Entity B's underlying income, and Country Y imposes a withholding tax on distributions by Entity B to its foreign interest holders regardless of the source of Entity B's underlying income.

Finally, Country Y has not announced by public notice that persons such as Entity A are not residents of Country Y; there is no competent authority agreement providing that such persons are not residents of Country Y; and the U.S. competent authority has not issued a public notice indicating that treaty benefits to such persons are being denied because Country Y will not grant treaty benefits to similar U.S. persons.

Accordingly, Entity B is liable to tax in Country Y by reason of its place of incorporation within the meaning of Article 4 (1) of the U.S.-Country Y treaty, and thus B is a resident of Country Y for purposes of the U.S.-Country Y treaty. In order to obtain treaty benefits, however, Entity B must still meet all other applicable requirements for such benefits, including the applicable limitation on benefits provision and, if Entity B is viewed as fiscally transparent under the laws of either the United States or Country Y, those provisions of Treas. Reg. § 1.894–1(d).

Situation 3

Under the facts of Situation 3, notwithstanding that Entity C is only nominally taxable in Country Z, Entity C is liable to tax within the meaning of the U.S.-Country Z treaty because of the following. But for the exemption from tax for Country Z entities that provide pension benefits, Entity C would be taxable by Country Z at the entity level as a resident trust in Country Z. While the 1981 U.S. Model does not specifically provide that persons organized under the laws of a state that are generally exempt from tax and established and maintained exclusively to provide pension or other similar benefits are residents of that state (and the 1996 U.S. Model does so provide), the Treasury Department's Technical Explanation to the 1996 U.S. Model confirms that the specific provision in the 1996 U.S. Model merely clarifies the generally accepted practice that these entities are residents even though they may be entitled to a complete or partial exemption from tax.

Further, Country Z has not announced by public notice that persons such as Entity A are not residents of Country Z; there is no competent authority agreement providing that such persons are not residents of Country Z; and the U.S. competent authority has not issued a public notice indicating that treaty benefits to such persons are being denied because Country Z will not grant treaty benefits to similar U.S. persons.

Accordingly, Entity C is liable to tax in Country Z within the meaning of Article 4(1) of the Treaty, and thus is a resident of Country Z for purposes of the Treaty. In order to obtain treaty benefits, however, Entity C must still meet all other applicable requirements for such benefits, including the applicable limitation on benefits provision and, if Entity C is viewed as fiscally transparent under the laws of either the United States or Country Z, those provisions of Treas. Reg. § 1.894–1(d).

DRAFTING INFORMATION

The principal author of this revenue ruling is Shawn R. Pringle of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Elizabeth U. Karzon or Karen Rennie-Quarrie at (202) 622-3880 (not a toll-free call).

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 2001 calendar year. See Rev. Rul. 2000–55 on this page.

Section 1274A.—Special Rules for Certain Transactions Where Stated Principal Amount Does Not Exceed $2,800,000

(Also §§ 1274, 483; 1.1274A-1, 1.483–1)

Section 1274A inflation-adjusted numbers for 2001. This ruling provides the dollar amounts, increased by the 2001 inflation adjustment, for section 1274A of the Code. Rev. Rul. 99–50 supplemented and superseded.

Rev. Rul. 2000-55

This revenue ruling provides the dollar amounts, increased by the 2001 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 ac-

counted 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) 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.

Rev. Rul. 2000–55 Table 1

Inflation-Adjusted Amounts Under § 1274A

Calendar Year of Sale or Exchange	*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
2001	$4,085,900	$2,918,500

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. 99–50, 1999–50 I.R.B. 656 is supplemented and superseded.

DRAFTING INFORMATION

The principal 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 at (202) 622-3930 (not a toll-free call).

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. 8909

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: Temporary and final regulations.

SUMMARY: This document contains temporary and final regulations relating to the deposit of Federal employment taxes. The regulations change the *de minimis* deposit rule for quarterly and annual return

periods. The regulations affect taxpayers required to make deposits of Federal employment taxes. The text of the temporary regulations also serves as the text of the proposed regulations (REG–114423–00) set forth in the notice of proposed rulemaking on page 604.

DATES: *Effective date*: These regulations are effective Wednesday, December 6, 2000.

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

FOR FURTHER INFORMATION CONTACT: Brinton T. Warren, (202) 622-4940 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains amendments to 26 CFR part 31, Employment Taxes and Collection of Income Tax at the Source. Section 31.6302-1(f)(4) provides that if the total amount of accumulated employment taxes for a return period is less than $1,000 and the amount is fully deposited or remitted with a timely filed return for the quarter, the amount deposited or remitted will be deemed to be timely deposited.

The temporary regulations change the $1,000 threshold to $2,500. Thus, a taxpayer that has accumulated employment taxes of less than $2,500 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 *de minimis* threshold is being raised as part of the IRS and Treasury's continued efforts to reduce burden on the small business community. On June 16, 1998, temporary regulations (T.D. 8771, 1998–2 C.B. 72) that raised the *de minimis* threshold from $500 to $1,000 were published in the **Federal Register** (63 F.R. 32735). This increase of the threshold to $1,000 was made final on June 17, 1999, (T.D. 8822, 1999–2 C.B. 5) in regulations published in the **Federal Register** (64 F.R. 32408).

Having conducted further study, the IRS now seeks additional changes in deposit requirements to reduce taxpayer burden. The IRS and Treasury have determined that another increase in the *de minimis* threshold is a simple and straightforward step that will reduce burden on small businesses.

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, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of the regulations is Brinton T. Warren of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). 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 adding an entry in numerical order to read in part as follows:

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

Section 31.6302–1T also issued under 26 U.S.C. 6302(a) and (c). * * *

Par. 2. In §31.6302–1, a new sentence is added at the end of paragraph (f)(4) 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) * * * For guidance regarding *de minimis* amounts for quarterly or annual return periods beginning on or after January 1, 2001, see §31.6302–1T(f)(4).

* * * * *

Par. 3. Section 31.6302–1T is added to read as follows:

§31.6302–1T 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 (temporary).

(a) through (f)(3). [Reserved] For further guidance, see §31.6302–1(a) through (f)(3).

(f)(4) *De Minimis rule*. For quarterly and annual return periods beginning on or after January 1, 2001, if the total amount of accumulated employment taxes for the return period is less than $2,500 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.

(f)(5) through (n). [Reserved] For further guidance, see §31.6302–1(f)(5) through (n).

Charles O. Rossotti,
Commissioner of Internal Revenue.

Approved November 21, 2000.

Jonathan Talisman,
Assistant Secretary for Tax Policy.

(Filed by the Office of the Federal Register on December 5, 2000, 8:45 a.m., and published in the issue of the Federal Register for December 6, 2000, 65 F.R. 76152)

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

CPI adjustment for below-market loans for 2001. 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 published and adjusted for inflation for years

1987–2001. Rev. Rul. 99–49 supplemented and superseded.

Rev. Rul. 2000–56

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 1987-2001.

REV. RUL. 2000–56 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
2001	$144,111

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. 99–49, 1999–50 I.R.B. 667, 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 at (202) 622-3930 (not a toll-free call).

Part III. Administrative, Procedural, and Miscellaneous

Industry Issue Resolution Pilot Program

Notice 2000–65

1. INTRODUCTION OF A PILOT PROGRAM

This Notice announces the *Industry Issue Resolution Pilot Program.* The objective of the program is to provide guidance to resolve frequently disputed tax issues that are common to a significant number of large or mid-size business taxpayers. This effort is part of the IRS's strategy to resolve issues in a manner other than the traditional post-filing examination process. The Large and Mid-size Business Division (LMSB) of the IRS will undertake much of the operational responsibility for the projects in the program.

We invite taxpayers as well as industry associations and other groups representing taxpayers to suggest issues and possible options for resolution. Parties submitting suggestions may be asked to meet with government representatives and to provide additional information. After analysis and review, the IRS and Treasury intend to select issues to address in this pilot program. Taxpayers or groups may contact Richard Druk of LMSB's Pre-filing and Technical Guidance Office at (202) 283-8387 (not a toll-free number) to ask questions or to discuss this program.

The form of resulting guidance may vary depending on the issue. However, the most likely form of guidance will be a Revenue Procedure that permits taxpayers to adopt a recommended treatment of the issue on future returns. In many cases, this may require filing a request for a change in method of accounting. Examples of the types of Revenue Procedures that could be issued under this program include: Rev. Proc. 2000–38, 2000–40 I.R.B. 310, on the treatment of mutual fund distributor commissions; Rev. Proc. 99–26, 1999–24 I.R.B. 38, on employee benefits secured by letters of credit; Rev. Proc. 97–44, 1997–2 C.B. 496, on the LIFO conformity requirement for automobile dealers.

The principal focus of the program is to resolve issues arising in future years. However, depending on the circumstances, resolution also may be provided for certain issues for prior years.

Suggestions for issues for the pilot program should be forwarded as provided in section 3 of this Notice by February 28, 2001. LMSB, the IRS Office of Chief Counsel and the Treasury Office of Tax Policy will evaluate the suggestions with a view to selecting approximately five issues, drawn from diverse industries, for the pilot program. In reviewing potential issues for the program, the selection criteria will include the suitability of the issue for the program, the likelihood that timely guidance can be provided, and the availability of appropriate staffing and other resources. Projects selected for this program will be handled in a manner similar to items listed on the Treasury and IRS Guidance Priority List.

Parties whose topics are included in the pilot will be notified and may be asked to provide additional information and legal analysis of the issue. The issues selected for the pilot program will be announced publicly. After completing the pilot, the IRS and Treasury will evaluate the program and may then continue the program on a permanent basis.

We believe that the Industry Issue Resolution program offers significant and timely benefits for taxpayers as well as the IRS, and invites interested parties to participate.

2. ISSUES APPROPRIATE FOR THE PROGRAM

The objective of this program is to provide guidance to resolve frequently disputed tax issues that are common to a significant number of large or mid-size taxpayers. Therefore, issues most appropriate to the program generally will have the following characteristics:

- There is uncertainty about the appropriate tax treatment of a given factual situation.
- The uncertainty has resulted in frequent, often repetitive examinations of the same issue.
- The issue impacts a significant number of taxpayers within an industry group, many of which are larger businesses (those with gross assets in excess of $5 million).
- Factual determination is a major component of the issue.

For purposes of the pilot, the following issues would not be suitable:

- Issues unique to one or a small number of taxpayers.
- Issues under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division (e.g., employee plans).
- Issues regarding transactions that lack a *bona fide* business purpose or have as their principal purpose the reduction of federal taxes.
- Issues involving transfer pricing or international tax treaties.

3. REQUESTING CONSIDERATION UNDER THE PROGRAM

No particular format is required for submissions in response to this Notice. However, submissions should briefly describe the issue recommended for the pilot and explain why there is a need for guidance. Submissions may include an analysis of how the issue may be resolved. In addition, submissions should state the number of taxpayers estimated to be affected by the issue. All submissions will be available for public inspection and copying in their entirety. Therefore, comments should not include taxpayer-specific information of a confidential nature. Letters should include the name and telephone number of a person to contact should further clarification be needed.

The address to submit an issue for consideration under the pilot program is:

Internal Revenue Service
Att'n: Richard Druk
Large and Mid-size Business Division
LM:PFTG
Mint Building. 3rd Floor M-3-321
1111 Constitution Avenue NW
Washington, DC 20224

Alternatively, submissions may be faxed to 202-283-8427 or e-mailed to pftg2@irs.gov.

4. ADDITIONAL INFORMATION ABOUT THE PROGRAM

Project staffing. The IRS and Treasury intend to staff each project with a team

(the IIR team) that will analyze such information as may be appropriate and propose a resolution. This resolution will require the approval of those officials normally responsible for approving the type of guidance to be issued.

An IIR team will be composed of appropriate personnel from the IRS field, the IRS Office of Chief Counsel, Appeals, the LMSB Office of Pre-filing and Technical Guidance, and the Treasury Office of Tax Policy. A Technical Advisor (formally referred to as an Industry Specialist) also may be a team member. In some circumstances, the IRS may find it necessary to hire outside experts.

Communication with requesting taxpayer or group and other interested parties. As part of its efforts to formulate a recommendation for a resolution position, the IIR team may meet with the submitting taxpayer or group, and possibly with other interested parties. It is anticipated that the submitting party and other interested parties will be given the opportunity to present factual data and legal analysis. The IIR team may seek additional factual development or legal analysis from the submitting party or other sources.

Any solicitation of input from affected persons will be done within the requirements of the Federal Advisory Committee Act (FACA). The IRS does not intend to form advisory committees during this process. Input is welcome from interested parties, but they will not be invited to enter into negotiations or to participate in the decision-making process with respect to the proposed resolution of the issue.

Potential inspection of books and records. An IIR team may consider the inspection of an individual taxpayer's records desirable as part of the factual research necessary to develop its position. Although a team may request such inspection, any such inspection will be voluntary. Any inspection of a taxpayer's records under this program, whether at the initiative of the taxpayer or the team, will not preclude or impede (under section 7605(b) of the Internal Revenue Code or any IRS administrative provisions) a later examination or inspection of records with respect to any tax year, nor subject the IRS to any procedural restrictions (such as providing notice under section 7605(b)) that otherwise might apply before beginning such examination or inspection.

Disclosure of information provided by interested parties. Interested parties are encouraged to provide whatever information is necessary to permit the IRS and Treasury to reach an appropriate resolution of an issue. However, this information may be subject to disclosure under the Freedom of Information Act (FOIA).

5. COMMENTS

The IRS invites interested persons to comment and provide feedback on this program. Comments should be sent to the address provided in section 3 of this Notice.

6. FURTHER INFORMATION

For further information regarding this Notice, contact Richard Druk of the LMSB Pre-filing and Technical Guidance Office at (202) 283-8387 (not a toll-free number).

2001 Limitations Adjusted as Provided in Section 415(d), Etc.[1]

Notice 2000-66

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 qualified retirement plans, other deferred compensation plans, and fringe benefits are also affected by these adjustments.

Effective January 1, 2001, the limitation for the annual benefit under § 415(b)(1)(A) for a defined benefit plan is increased from $135,000 to $140,000. For participants who separated from service before January 1, 2001, the limitation for defined benefit plans under § 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 2000 by 1.0351. The limitation for defined contribution plans under § 415(c)(1)(A) is increased from $30,000 to $35,000.

[1]Based on News Release IR-2000-82, dated November 20, 2000.

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) remains unchanged at $10,500. This limitation affects elective deferrals to § 401(k) plans and to the federal government's Thrift Savings Plan, among other plans.

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 $755,000 to $780,000, while the dollar amount used to determine the lengthening of the 5-year distribution period is increased from $150,000 to $155,000.

The limitation used in the definition of a highly compensated employee under § 414(q)(1)(B) remains unchanged at $85,000.

The annual compensation limit under §§ 401(a)(17) and 404(l) remains unchanged at $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 $275,000 to $285,000.

The compensation amount under § 408(k)(2)(C) regarding simplified employee pension plans (SEPs) remains unchanged at $450. The compensation amount under § 408(k)(3)(C) for SEPs remains unchanged at $170,000.

The limitation under § 408(p)(2)(A) regarding simple retirement accounts is increased from $6,000 to $6,500.

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 is increased from $8,000 to $8,500.

The compensation amount under § 1.61–21(f)(5)(i) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes remains unchanged at

$75,000. The compensation amount under § 1.61–21(f)(5)(iii) is increased from $150,000 to $155,000.

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.

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26 CFR 601.201: Rulings and determination letters. (Also Part I, §§ 162, 167, 197, 446, 481; 1.162–11, 1.167(a)–14, 1.197–2, 1.446–1.)

REV. PROC. 2000–50

SECTION 1. PURPOSE

This revenue procedure provides guidelines on the treatment of the costs of computer software.

SECTION 2. DEFINITION

For the purpose of this revenue procedure, "computer software" is any program or routine (that is, any sequence of machine-readable code) that is designed to cause a computer to perform a desired function or set of functions, and the documentation required to describe and maintain that program or routine. It includes all forms and media in which the software is contained, whether written, magnetic, or otherwise. Computer programs of all classes, for example, operating systems, executive systems, monitors, compilers and translators, assembly routines, and utility programs as well as application programs, are included. Computer software also includes any incidental and ancillary rights that are necessary to effect the acquisition of the title to, the ownership of, or the right to use the computer software, and that are used only in connection with that specific computer software. Computer software does not include any data or information base described in § 1.197–2(b)(4) of the Income Tax Regulations (for example, data files, customer lists, or client files) unless the data base or item is in the public domain and is incidental to a computer program. Nor does it include any cost of procedures that are external to the computer's operation.

SECTION 3. BACKGROUND

.01 In the preamble to the final regulations issued January 25, 2000, under §§ 167(f) and 197 of the Internal Revenue Code (T.D. 8865, 2000–7 I.R.B. 589), the Internal Revenue Service advised taxpayers that they may not rely on the procedures in Rev. Proc. 69–21, 1969–2 C.B. 303, to the extent the procedures are inconsistent with § 167(f) or § 197, or the final regulations thereunder.

.02 Except as otherwise expressly provided, §§ 446(e) and 1.446–1(e) provide that a taxpayer must obtain the consent of the Commissioner of Internal Revenue before changing a method of accounting for federal income tax purposes. 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.

SECTION 4. SCOPE

This revenue procedure applies to all costs of computer software as defined in section 2 of this revenue procedure. This revenue procedure does not apply to any computer software that is subject to amortization as an "amortizable section 197 intangible" as defined in § 197(c) and the regulations thereunder, or to costs that a taxpayer has treated as a research and experimentation expenditure under § 174.

SECTION 5. COSTS OF DEVELOPING COMPUTER SOFTWARE

.01 The costs of developing computer software (whether or not the particular software is patented or copyrighted) in many respects so closely resemble the kind of research and experimental expenditures that fall within the purview of § 174 as to warrant similar accounting treatment. Accordingly, the Service will not disturb a taxpayer's treatment of costs paid or incurred in developing software for any particular project, either for the taxpayer's own use or to be held by the taxpayer for sale or lease to others, where:

(1) All of the costs properly attributable to the development of software by the taxpayer are consistently treated as current expenses and deducted in full in accordance with rules similar to those applicable under § 174(a); or

(2) All of the costs properly attributable to the development of software by the taxpayer are consistently treated as capital expenditures that are recoverable through deductions for ratable amortization, in accordance with rules similar to those provided by § 174(b) and the regulations thereunder, over a period of 60 months from the date of completion of the development or, in accordance with rules provided in § 167(f)(1) and the regulations thereunder, over 36 months from the date the software is placed in service.

SECTION 6. COSTS OF ACQUIRED COMPUTER SOFTWARE

.01 With respect to costs of acquired computer software, the Service will not disturb the taxpayer's treatment of:

(1) Costs that are included, without being separately stated, in the cost of the hardware (computer) if the costs are consistently treated as a part of the cost of the hardware that is capitalized and depreciated; or

(2) Costs that are separately stated if the costs are consistently treated as capital expenditures for an intangible asset the cost of which is to be recovered by amortization deductions ratably over a period of 36 months beginning with the month the software is placed in service, in accordance with the rules under § 167(f)(1). *See* § 1.167(a)–14(b)(1).

SECTION 7. LEASED OR LICENSED COMPUTER SOFTWARE

Where a taxpayer leases or licenses computer software for use in the taxpayer's trade or business, the Service will not disturb a deduction properly allowable under the provisions of § 1.162–11 as rental. However, an amount described in § 1.162–11 is not currently deductible if, without regard to § 1.162–11, the amount is properly chargeable to capital account. *See* § 1.197–2(a)(3).

SECTION 8. APPLICATION

.01 A change in a taxpayer's treatment of costs paid or incurred to develop, purchase, lease, or license computer software to a method described in section 5, 6, or 7 of this revenue procedure is a change in method of accounting to which §§ 446 and 481 apply. However, a change in useful life under the method described in section 5.01(2) or 6.01(2) of this revenue procedure is not a change in method of accounting. Section 1.446–1(e)(2)(ii)(*b*).

.02 A taxpayer that wants to change the taxpayer's method of accounting under this revenue procedure must follow the automatic change in method of accounting provisions in Rev. Proc. 99–49, 1999–2 C.B. 725 (or its successor), with the following modifications:

(1) In order to assist the Service in processing changes in method of accounting under this section and to ensure proper handling, section 6.02(3)(a) of Rev. Proc. 99–49 is modified to require that a Form 3115, Application for Change in Accounting Method, filed under this section include the statement: "Automatic Change Filed Under Section 8.01 of Rev. Proc. 2000–50." This statement must be legibly printed or typed at the top of any Form 3115 filed under this revenue procedure.

(2) If a taxpayer is changing to the method described in section 5.01(2) of this revenue procedure, the taxpayer must attach a statement to the Form 3115 stating whether the taxpayer is choosing the 60-month period from the date of completion of the development of the software, or the 36-month period from the placed-in-service date of the software.

.03 For taxable years ending on or after December 1, 2000, the Service will not disturb the taxpayer's treatment of costs of computer software that are handled in accordance with the practices described in this revenue procedure.

.04 For taxable years ending prior to December 1, 2000, the Service will not disturb the taxpayer's treatment of costs of computer software except to the extent that the taxpayer's treatment is markedly inconsistent with the practices described in this revenue procedure. For the purpose of applying the preceding sentence to costs described in section 5 of this revenue procedure, the absence of any formal election similar to that required by § 174 or the amortization of capitalized software costs over a period shorter than the 5-year period specified in § 174(b) (but not less than 36 months for costs paid or incurred after August 10, 1993, or, if a valid retroactive election has been made under § 1.197–1T, July 25, 1991) will not characterize the taxpayer's treatment of the costs as markedly inconsistent with the principles of this revenue procedure. In addition, the amortization of acquired software described in section 6 of this revenue procedure treated as an intangible asset over a period of 60 months or less, but in no case less than 36 months for costs paid or incurred after August 10, 1993 (or after July 25, 1991, if a valid retroactive election has been made under § 1.197–1T) will not characterize the taxpayer's treatment of these costs as markedly inconsistent with the principles of this revenue procedure.

SECTION 9. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 69–21, 1969–1 C.B. 303, is superseded.

.02 Rev. Proc. 97–50, 1997–2 C.B. 525, is modified by deleting all references to Rev. Proc. 69–21 and replacing them with references to this revenue procedure. Section 3 of Rev. Proc. 97–50 is modified by deleting references to section 3, section 4, and section 5 of Rev. Proc. 69–21, and replacing them with references to section 5, section 6, and section 7 of this revenue procedure.

.03 Rev. Proc. 99–49 is modified and amplified to include this accounting method change in the APPENDIX.

.04 Section 1.02 of the APPENDIX of Rev. Proc. 99–49 is modified by deleting all references to Rev. Proc. 69–21 and replacing them with references to this revenue procedure.

SECTION 10. EFFECTIVE DATE

This revenue procedure is effective for a Form 3115 filed on or after December 1, 2000, for taxable years ending on or after December 1, 2000. The Service will return any Form 3115 that is filed on or after December 1, 2000, for taxable years ending on or after December 1, 2000, if the Form 3115 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.

DRAFTING INFORMATION

The principal author of this revenue procedure is John Huffman of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Mr. Huffman at (202) 622-3110 (not a toll-free call).

Social Security Contribution and Benefit Base for 2001

Under authority contained in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (65 F.R. 63663, dated October 24, 2000) that the contribution and benefit base for remuneration paid in 2001, and self-employment income earned in taxable years beginning in 2001 is $80,400.

"Old-Law" Contribution and Benefit Base

General

The "old-law" contribution and benefit base for 2001 is $59,700. This is the base that would have been effective under the Act without the enactment of the 1977 amendments. We compute the base 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 2001 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 1999 to that for 1993. If the resulting amount 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 1999, $30,469.84, compared to that for 1993, $23,132.67, is 1.3171778. Multiplying the 1995 domestic employee coverage threshold amount of $1,000 by the ratio of 1.3171778 produces the amount of $1,317.18, which must then be rounded to $1,300. Accordingly, the domestic employee coverage threshold amount is $1,300 for 2001.

(Filed by the Office of the Federal Register on October 23, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 24, 2000, 65 F.R. 63663)

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Federal Employment Tax Deposits—*De Minimis* Rule

REG–114423–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: These proposed regulations affect taxpayers required to make deposits of Federal employment taxes. This document contains proposed regulations which change the *de minimis* deposit rule for quarterly and annual return periods.

In T.D. 8909 on page 596, the IRS is issuing temporary regulations relating to the deposit of Federal employment taxes. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronically generated comments and requests for a public hearing must be received by Tuesday, March 6, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–114423–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–114423–00), 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.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Brinton T. Warren, (202) 622-4940; concerning submissions of comments and requests for a public hearing, Treena Garrett of the Regulations Unit at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in T.D. 8909 amend the Employment Tax and Collection of Income Tax at Source Regulations (26 CFR part 31) relating to section 6302. The temporary regulations change the *de minimis* rule for the deposit of Federal employment taxes. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

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 their impact.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury 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 will be scheduled if requested in writing by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of the regulations is Brinton T. Warren of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX 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. 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) [The text of proposed §31.6302–1(f)(4) is the same as the text of §31.6302–1T(f)(4)].

* * * * *

Charles O. Rossotti,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 5, 2000, 8:45 a.m., and published in the issue of the Federal Register for December 6, 2000, 65 F.R. 76194)

Form 1065 Electronic Filing Waiver Request Procedures

Announcement 2000–101

Section 6011(e) of the Internal Revenue Code and section 301.6011–3(a) of the Regulations on Procedure and Administration require partnerships with more than 100 partners to file their partnership returns (Form 1065 series) on magnetic media. The regulations define "magnetic

media" to include electronic filing, if electronic filing is required by the Internal Revenue Service (Service).

Beginning with taxable years ending on or after December 31, 2000, the Service will require partnerships with more than 100 partners to file their partnership returns electronically. IRS Publication 1524 contains instructions for filing partnership returns electronically, and excludes certain partnerships from the electronic filing requirement. For Tax Year 2000, the IRS has excluded Partnerships with the following type of returns from the electronic filing requirement:

1) fiscal year filers
2) final year tax returns
3) short year returns
4) foreign address partnerships
5) delinquent and amended returns

For a detailed list of the exclusions, refer to Publication 1524.

Section 301.6011–3(b) of the regulations permits the Commissioner of Internal Revenue to waive the electronic filing requirement if the partnership demonstrates that a hardship would result if it were required to file its return electronically. The regulations require partnerships seeking a waiver to request one in the manner prescribed by the Service.

To request a waiver for the taxable year ending December 31, 2000, partnerships must file a written request containing the following information:

(1) A notation at the top of the request stating, in large letters, ***"Waiver Request: IRC Section 6011(e)(2)";***

(2) The name, federal tax identification number, and mailing address of the partnership;

(3) The taxable year for which the waiver is requested;

(4) A detailed statement which lists:

a) what steps the partnership has taken in an attempt to meet its requirement to file its return electronically,

b) why the steps were unsuccessful,

c) the hardship that would result, including any incremental cost to the partnership of complying with the electronic filing requirements. Incremental costs are those costs that are above and beyond the costs to file on paper.

(5) A statement as to what steps the partnership will take to assure its ability to electronically file its partnership return for the next tax year.

(6) A statement (signed by the Tax Matters Partner, as defined in section 6231(a)(7) of the Code) indicating:

"Under penalties of perjury, I declare that the information contained in this waiver request is true, correct and complete to the best of my knowledge and belief."

All requests for waiver must be filed with the Memphis Submission Processing Center during one of the following periods:

1) For returns due April 16, 2001 (Form 8736 not filed); January 2, 2001 to February 2, 2001,
2) For returns due July 16, 2001 (Form 8736 filed); February 3, 2001 to May 1, 2001,
3) For returns due October 15, 2001 (Form 8800 filed and approved); May 2, 2001 to August 1, 2001.

Requests from the partnership's tax advisor/preparer must be accompanied by a valid power of attorney. The address for the Memphis Submission Processing Center is:

Internal Revenue Service
P.O. Box 420
Memphis, TN 38101-0420

(Note: Do not attach the waiver request to the partnership's paper tax return. Also, do not file extension requests with the waiver.)

The Service will approve or deny waiver requests based on the facts and circumstances of each request. In determining whether to approve or deny a waiver request, the Service will consider the ability of the partnership to file its return electronically without incurring an undue economic hardship.

Within 30 days after receipt of the waiver request, the Service will send a letter to the partnership either approving or denying the request for waiver. Partnerships may not appeal a denial of a waiver request. However, partnerships may request a waiver of any penalty imposed by the Service for failing to file their partnership returns electronically. For further information regarding penalty waivers, see IRS Notice 746.

For questions concerning a request for waiver, contact the Memphis Submission Processing Center at 901-546-2690 (not a toll free call).

1999 AOD Footnotes; Correction Announcement 2000–102

This document contains corrections to the footnotes for the Actions on Court Decisions published in Internal Revenue Bulletin 1999–40 on the page following the Introduction and in 1999–2 C.B. xvi. The correct text for these footnotes is as follows:

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

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

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[1]This AOD reflects the Service's acquiescence as 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]This AOD reflects the Service's acquiescence as 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. § 6231, occurs as to only one spouse.

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The abbreviation and number in parenthesis following the index entry refer to the specific item; the number in italic type following the parenthesis refers to the page number on which the item appears.

Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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