receive timely and adequate notice. If an interested party who is a present employee is in a unit of employees covered by a collective-bargaining agreement between employee representatives and one or more employers, notice shall also be given to the collective-bargaining representative of such interested party by any method that satisfies this paragraph. Whether the notice is provided in a manner that satisfies this paragraph will be determined on the basis of all the facts and circumstances. Because the facts and circumstances will differ depending on the interested party, it is possible that more than one method of delivery must be used in order to ensure timely and adequate notice to all interested parties.

(2) If the notice to interested parties is delivered using an electronic medium under a system that satisfies the requirements of Q&A–5 of § 1.402(f)–1, the notice will be deemed to be provided in a manner that satisfies the requirements of paragraph (c)(1) of this section.

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

Example 1. (i) Employer A is amending Plan C and applying for a determination letter. Plan C is not maintained pursuant to one or more collective-bargaining agreements and is not being terminated. As part of the determination letter application process, Employer A provides the notice required under this section to interested parties. For present employees, Employer A provides the notice by posting the notice at those locations within the principal places of employment of the interested parties which are customarily used for employer notices to employees with regard to labor-management relations matters.

(ii) In this *Example 1,* Employer A satisfies the notice to interested parties requirement described in this section.

Example 2. (i) Employer B is amending Plan D and applying for a determination letter. As part of the determination letter application process, Employer B provides the notice required under this section to interested parties.

(ii) Employer B has multiple worksites. Employer B's employees located at worksites 1 through 4 have access to computers at their workplace. However, Employer B's employees located at worksite 5 do not have access to computers.

(iii) For present employees with access to computers (worksites 1 through 4), Employer B provides the notice by posting the notice on Employer B's web site (Internet or intranet). Employer B customarily posts employer notices to employees at worksites 1 through 4 with regard to labor-management relations matters on its web site. For present employees without access to computers (worksite 5), Employer B provides the notice by posting the notice at worksite 5 in a location that is customarily used for employer notices to employees with regard to labor-management relations matters.

(iv) Employer B also sends the notice by e-mail to each collective-bargaining representative of interested parties who are present employees of Employer B covered by a collective-bargaining agreement between employee representatives and Employer B, using the e-mail address previously provided to Employer B by such collective-bargaining representative.

(v) In this *Example 2,* Employer B satisfies the notice to interested parties requirement described in this section.

Example 3. (i) Employer C is terminating Plan E and applying for a determination letter as to whether the plan termination affects the continuing qualification of Plan E. As part of the determination letter application process, Employer C provides the notice required under this section to interested parties.

(ii) All of Employer C's employees have access to computers. Each employee has an e-mail address where he or she can receive messages from Employer C. Employer C has set up kiosks for employees' use. The kiosks are located within the principal places of employment of the employees and are customarily used for employer notices to employees with regard to labor-management relations matters.

(iii) For present employees, Employer C provides the notice by sending the notice by e-mail.

(iv) Employer C also sends the notice by e-mail to each collective-bargaining representative of interested parties who are present employees of Employer C covered by a collective-bargaining agreement between employee representatives and Employer C, using the e-mail address previously provided to Employer C by such collective-bargaining representative.

(v) In addition, Employer C sends the notice by e-mail to each interested party who is a former employee or beneficiary, using the e-mail address previously provided to Employer C by such interested party. For any former employee or beneficiary who did not provide an e-mail address, Employer C sends the notice by regular mail to the last known address of such former employee or beneficiary.

(vi) In this *Example 3,* Employer C satisfies the notice to interested parties requirement described in this section.

(e) *Effective date.* (1) The provisions of this section shall apply to applications referred to in paragraph (a) of § 1.7476–1 made on or after the date the regulations are published in the **Federal Register** as final regulations.

PART 601—STATEMENT OF PROCEDURAL RULES

Paragraph 1. The authority citation for part 601 continues to read, in part, as follows:

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

Par. 2. Section 601.201 is amended as follows:

1. In paragraph (o)(3)(xv), the first sentence is replaced by two new sentences.

2. In paragraph (o)(3)(xvi), introductory text is revised.

The revisions read as follows:

§ 601.201 Rulings and determination letters.

* * * * *

(o) * * * (3) * * *

(xv) When the notice referred to in paragraph (o)(3)(xiv) of this section is given in the manner set forth in § 1.7476–2(c), the following time limitations for providing the notice apply. When the notice is given other than by mailing, it should be given not less than 7 days nor more than 21 days prior to the date that the application for a determination is made. * * *

(xvi) The notice referred to in paragraph (o)(3)(xiv) of this section shall be given in the manner prescribed in § 1.7476–2 and shall contain the following information:

* * * * *

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

[FR Doc. 01–131 Filed 1–16–01; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

[REG–110374–00]

RIN 1545–AY21

Interest-free adjustments with respect to underpayments of employment taxes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed amendment to the regulations relating to interest-free adjustments with respect to underpayments of employment taxes. The proposed amendment reflects changes to the law made by the Taxpayer Relief Act of 1997. The proposed amendment affects employers that are the subject of IRS examinations involving determinations by the IRS that workers are employees for purposes of subtitle C or that the employers are not entitled to relief from employment taxes under section 530 of the Revenue Act of 1978 (section 530).

DATES: Written and electronic comments and requests for a public hearing must be received by April 17, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–110374–00), 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: Unit CC:M&SP:RU (REG–110374–00), 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/taxregs/reglist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Lynne Camillo of the Office of Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622–6040.

SUPPLEMENTARY INFORMATION:

Background

This document contains a proposed amendment to the Employment Tax Regulations (26 CFR part 31) under section 6205. Section 6205 allows employers that have paid less than the correct amount of employment taxes to make adjustments without interest, provided the error is reported and the taxes are paid by the last day for filing the return for the quarter in which the error was ascertained. However, no interest-free adjustments are permitted pursuant to section 6205 after receipt of notice and demand for payment thereof based upon an assessment. § 31.6205–1(a)(6).

The Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788), effective August 5, 1997, created new section 7436 of the Internal Revenue Code (Code), which provides the Tax Court with jurisdiction to review determinations by the IRS that workers are employees for purposes of subtitle C, or that the employer is not entitled to relief from employment taxes under section 530. Section 7436 resulted in a change in the way employment tax examinations involving worker classification and section 530 issues are conducted insofar as notice and demand for payment of an employment tax underpayment based upon an assessment cannot be made until after the taxpayer under examination receives notice of the IRS's determination and has been given an opportunity to file a petition in the Tax Court contesting such determination.

Explanation of Provisions

This document contains a proposed amendment to the regulations under section 6205. The proposed amendment clarifies the period for adjustments of employment tax underpayments without interest under section 6205 following the expansion of Tax Court review to certain employment tax determinations.

As a general rule, under section 6601, all taxpayers who fail to pay the full amount of a tax due under the Code must pay interest at the applicable rate on the unpaid amount from the last date prescribed for payment of the tax until the date the tax is paid. However, section 6205 allows employers that have paid less than the correct amount of certain employment taxes [1] with respect to any payment of wages or compensation to make adjustments to returns without interest pursuant to the regulations. The employment tax regulations under section 6205 generally allow employers to make adjustments to returns without interest until the last day for filing the return for the quarter in which the error was ascertained. An error is ascertained when the employer has sufficient knowledge of the error to be able to correct it. § 31.6205–1(a)(4). Section 31.6205–1(a)(6) provides that no interest-free adjustments can be made after receipt of a statement of notice and demand for payment based upon an assessment.

In Revenue Ruling 75–464 (1975–2 C.B. 474), the IRS further clarified the time for adjustments under section 6205. The ruling clarifies that employers can still make interest-free adjustments where the underpayment is discovered during an audit or examination (i.e., where the employer has not independently ascertained the underpayment). The ruling sets forth situations illustrating when an error is ascertained with respect to returns under audit by the IRS. Under the facts in the revenue ruling, an error is ascertained when the employer signs an ''Agreement to Adjustment and Collection of Additional Tax'', Form 2504, either at the examination level or the appeals level, when the taxpayer pays the full amount due so as to file a refund claim (if paid prior to notice and demand), or at the conclusion of internal IRS appeal rights if no agreement is reached. Under the factual situations in Revenue Ruling 75–464, the employment taxes can be paid free of interest at the time the employer signs Agreement Form 2504 or at the time it pays the tax preparatory to filing a claim to contest the liability in court, after having exhausted all appeal rights within the IRS, provided the payment is made before the taxpayer receives notice and demand for payment.

The Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788), created new section 7436 of the Code which provides the Tax Court with jurisdiction to review determinations by the IRS that workers are employees for purposes of subtitle C of the Code, or that the organization for which services are performed is not entitled to relief from employment taxes under section 530. Section 7436(a) requires that the determination involve an actual controversy and that it be made as part of an examination. Subsequent to enactment of section 7436 of the Code, the IRS created a standard notice, the ''Notice of Determination Concerning Worker Classification Under Section 7436'' (notice of determination) to serve as the ''determination'' that is a prerequisite to invoking the Tax Court's jurisdiction under section 7436. Notice 98–43 (1998–33 I.R.B. 13).

Section 7436(d)(1) provides that the suspension of the limitations period for assessment in section 6503(a) applies in the same manner as if a notice of deficiency had been issued. Thus, pursuant to section 6503(a), the mailing of the notice of determination by certified or registered mail will suspend the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues. Generally, the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues is suspended for the 90-day period during which the taxpayer can begin a suit in Tax Court, plus an additional 60 days thereafter. Moreover, if the taxpayer does file a timely petition in the Tax Court, the statute of limitations for assessment of taxes attributable to the worker classification and section 530 issues is suspended under section 6503(a) during the Tax Court proceedings, and for sixty days after the Tax Court decision becomes final.

Current IRS guidance provides for interest-free adjustments under section 6205 prior to assessment and notice and demand. Because of the prohibition on assessment for cases pending in the Tax Court, this creates a potential for inconsistent application of interest depending upon whether an employer files a claim in the Tax Court or in

[1] Section 6205 applies to underpayments of taxes under the Federal Insurance Contributions Act (FICA), the Railroad Retirement Tax Act (RRTA), and income tax withholding. Section 6205 does not apply to underpayments of taxes under Federal Unemployment Tax Act (FUTA), as such underpayments are not subject to interest under section 6601(i).

another court of Federal jurisdiction. The legislative history of section 7436 shows no intent to create an advantage for taxpayers who choose to litigate their cases in Tax Court as opposed to another court of Federal jurisdiction. H.R. No. 105–148, 105th Cong., 1st Sess., at 639–640 (1997). Taxpayers who choose to petition the Tax Court under section 7436 still have the benefit of all of the inherent advantages of litigating in the Tax Court, including the ability to obtain judicial review without prior payment of the additional tax the IRS has determined to be due.

Judicial and administrative precedents provide that an error is ascertained for purposes of section 6205 (ending the period for interest-free adjustments) when the taxpayer has exhausted all internal appeal rights with the Service. *Eastern Investment Corp.* v. *United States,* 49 F. 3d 651 (10th Cir. 1995); Rev. Rul. 75–464 (1975–2 C.B. 474). In the context of refund litigation, where a taxpayer whose erroneous underpayment of employment taxes is discovered during an examination pays only the required divisible portion of employment tax prior to filing a claim for refund in order to satisfy the jurisdictional requirements for filing suit in district court, interest continues to accrue on the unpaid portion of employment tax from the date upon which the tax is assessed after the taxpayer has exhausted all appeal rights within the IRS until the date such tax is paid. *See Eastern Investment Corp., supra* (rejecting taxpayer's argument that the error could not have been ''ascertained'' until a decision was made by the court and the liability was no longer being contested). Moreover, in Tax Court deficiency proceedings that do not involve employment taxes, unless the taxpayer makes a deposit to stop the running of interest, interest continues to accrue on the deficiency during the course of the Tax Court proceeding. Rev. Rul. 56–501 (1956–2 C.B. 954).

In employment tax examinations that do not involve worker classification or section 530 issues, the taxpayer has exhausted all internal appeal rights by the time a notice and demand for payment thereof based upon an assessment is received. Similarly, in employment tax examinations involving worker classification or section 530 issues, the taxpayer has already had the benefit of all of the same internal appeal rights by the time a notice of determination is received.

These proposed regulations provide that, in employment tax examinations involving worker classification or section 530 issues, as in other types of employment tax examinations, the error is ascertained for purposes of section 6205 when the employer has exhausted all internal appeals within the IRS. The fact that notice and demand for payment based upon an assessment cannot be made in cases involving worker classification and section 530 issues until the suspension of the statute of limitations is lifted, following issuance of a notice of determination, does not result in an extension of the period during which interest-free adjustments can be made under section 6205. Accordingly, in order to clarify that the error is ascertained for purposes of section 6205 once a taxpayer has exhausted all internal appeal rights with the IRS, the existing regulations would be modified by prohibiting interest-free adjustments after receipt of the notice of determination.

However, if, prior to receipt of a notice of determination, a taxpayer makes a remittance which is equal to the amount of the proposed liability, the IRS considers the remittance a payment and assesses it. Rev. Proc. 84–58 (1984–2 C.B. 501). In such a situation, no notice of determination would be sent to the taxpayer. If a taxpayer wants to stop the running of interest and contest the adjustment in the Tax Court, the taxpayer may make a remittance, designating it in writing as a deposit in the nature of a cash bond. If the taxpayer makes such a deposit, the IRS does not consider the remittance a payment. Id. at § 4.02. The deposit stops the running of interest and, if the taxpayer does not waive the restrictions on assessment, the IRS will send the taxpayer a notice of determination, thus permitting the taxpayer the option of Tax Court review.

In order to provide a mechanism for taxpayers to make a remittance to stop the accrual of interest, yet still receive a notice of determination and retain the right to petition the Tax Court, these proposed regulations would further modify the existing regulations to provide that, prior to receipt of a notice of determination, the taxpayer may, in lieu of making a payment, make a cash bond deposit which would have the effect of stopping the accrual of any interest, but would not deprive the taxpayer of its right to receive a notice of determination and to petition the Tax Court under section 7436.

Proposed Effective Date

These regulations are proposed to be applicable with respect to notices of determination issued on or after March 19, 2001. Interest will be computed under the rule in this regulation on any claims for refund of interest pending on January 12, 2001. No inference is intended that the rule set forth in these proposed regulations is not current law. 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 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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments that are submitted timely to the IRS. The IRS and Treasury Department specifically request comments on the clarity of the proposed regulations and how they 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 any 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 proposed regulations is Lynne Camillo, Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social Security, Unemployment compensation.

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 THE SOURCE

Paragraph 1. The authority for part 31 continues to read in part as follows:

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

Par. 2. In § 31.6205–1, paragraph (a)(6) is revised to read as follows:

§ 31.6205–1 Adjustments of underpayments.

(a) * * *

(6) No underpayment shall be reported pursuant to this section after the earlier of the following—

(i) Receipt from the Commissioner of notice and demand for payment thereof based upon an assessment; or

(ii) Receipt from the Commissioner of a Notice of Determination Concerning Worker Classification Under Section 7436 (Notice of Determination). (Prior to receipt of a Notice of Determination, the taxpayer may, in lieu of making a payment, make a cash bond deposit which would have the effect of stopping the accrual of any interest, but would not deprive the taxpayer of its right to receive a Notice of Determination and to petition the Tax Court under section 7436).

* * * * *

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

[FR Doc. 01–273 Filed 1–16–01; 8:45 am]

BILLING CODE 4830–01–U

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[REG–110659–00]

RIN 1545–AY16

Amendment, Check the Box Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance relating to elective changes in entity classification. The proposed regulations apply to subsidiary corporations that elect to change their classification for Federal tax purposes from a corporation to either a partnership or disregarded entity.

DATES: Written or electronic comments, or requests for a public hearing must be received by February 2, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–110659–00), room 5226, Internal Revenue Service, P.O. 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:M&SP:RU (REG–110659–00), 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.*

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David J. Sotos, (202) 622–3050; concerning submissions of comments, or to request a hearing, Sonya Cruse, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On November 29, 1999, Treasury and the IRS published final regulations (TD 8844) describing the transactions that are deemed to occur when an entity elects to change its classification for Federal tax purposes. Those regulations did not address certain requirements of section 332 as applied to the deemed liquidation incident to an association's election to be classified as a partnership or to be disregarded as an entity separate from its owner. This amendment to the final regulations addresses those requirements.

On January 20, 2000, Treasury and the IRS issued final regulations relating to qualified subchapter S subsidiaries. In order to permit the deemed transaction resulting from a QSub election to comply with the requirement of section 332 that a plan of liquidation have been adopted at the time of a liquidating distribution, the final regulations provide that a plan of liquidation is deemed adopted immediately before the deemed liquidation incident to the QSub election, unless a formal plan of liquidation that contemplates the filing of a QSub election is adopted on an earlier date. The preamble to the QSub regulations provided that Treasury and the IRS intend to amend the section 7701 regulations regarding elective changes in entity classification to provide a similar rule concerning the timing of the plan of liquidation.

Explanation of Provisions

A. In General

Section 301.7701–3(g)(1) describes how elective changes in the classification of an entity will be treated for tax purposes. Section 301.7701–3(g)(1)(ii) provides that an elective conversion of an association to a partnership is deemed to have the following form: the association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership. Section 301.7701–3(g)(1)(iii) provides that an elective conversion of an association to an entity that is disregarded as an entity separate from its owner is deemed to have the following form: the association distributes all of its assets and liabilities to its single owner in liquidation of the association.

Section 332 may be relevant to the deemed liquidation of an association if it has a corporate owner. Under section 332, no gain or loss is recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation if the requirements of section 332(b) are satisfied. Those requirements include the adoption of a plan of liquidation at a time when the corporation receiving the distribution owns stock of the liquidating corporation meeting the requirements of section 1504(a)(2) (i.e., 80 percent of vote and value). The elective changes from association to a partnership and to a disregarded entity result in a constructive liquidation of the association for Federal tax purposes. Formally adopting a plan of liquidation for the entity, however, is potentially incompatible with an elective change under § 301.7701–3, which allows the local law entity to remain in existence while liquidating only for Federal tax purposes. Accordingly, to provide tax treatment of an association's deemed liquidation that is compatible with the requirements of section 332, the proposed regulations state that, for purposes of satisfying the requirement of adoption of a plan of liquidation under section 332(b), a plan of liquidation is deemed adopted immediately before the deemed liquidation incident to an elective change in entity classification, unless a formal plan of liquidation that contemplates the filing of the elective change in entity classification is adopted on an earlier date.