Internal Revenue
bulletin

Bulletin No. 2004-42
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 9158, page 665.
REG–169135–03, page 697.

Final, temporary, and proposed regulations under sections 338 and 1060 of the Code will affect the treatment of certain nuclear decommissioning funds in the allocation of purchase price in deemed and actual asset acquisitions. The rule will not apply to nuclear decommissioning funds qualifying under section 468A. The new treatment is elective on the part of taxpayers.

REG–101282–04, page 698.

Proposed regulations under section 269B of the Code generally treat a stapled foreign corporation as a domestic corporation for U.S. federal income tax purposes, unless the stapled foreign corporation and the corresponding domestic stapled corporation are foreign-owned. Under the regulations, while a stapled foreign corporation is not an includible corporation under section 1504(b) for most purposes, it may be an includible corporation for purposes of regulations sections 1.904(i)–1 and 1.861–11T(d)(6). They also provide that a conversion of a domestic corporation to a foreign corporation (or vice versa) as a result of section 269B is treated as an F reorganization; limit the application of treaty benefits to stapled foreign corporations; provide special collection procedures for tax liabilities of stapled foreign corporations; address issues involving multiple classes of stock in determining whether a foreign corporation is a stapled foreign corporation; and provide the Commissioner with authority to disregard certain stapled stock structures involving related parties. A public hearing is scheduled for December 15, 2004.

Rev. Proc. 2004–59, page 678.

This procedure describes the section 1441 Voluntary Compliance Program (VCP) which is available to certain withholding agents with respect to the withholding, payment, and reporting of certain taxes due on payments to foreign persons.

ESTATE TAX

REG–145988–03, page 693.

Proposed regulations relate to the predeceased parent rule, which provides an exception to the general rules of section 2651 of the Code for determining the generation assignment of a transferee of property for generation-skipping transfer (GST) purposes. The proposed regulations also provide rules regarding a transferee assigned to more than one generation. A public hearing is scheduled for December 14, 2004.

EMPLOYMENT TAX

Rev. Rul. 2004–98, page 664.

Parking reimbursements. This ruling holds that certain amounts paid to an employee as "reimbursements" for a parking expense that the employee supposedly "paid" through a salary reduction are wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the collection of income tax at source on wages (federal income tax withholding).

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

TAX CONVENTIONS

Announcement 2004–81, page 675.

This announcement provides the rates for various types of income under a new income tax treaty with Sri Lanka. The treaty is generally effective January 1, 2004. The tables in this announcement can be used, depending on the effective dates to supplement Tables 1 and 2 of Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities (For Withholding in 2004)* and Publication 901, *U.S. Tax Treaties*.

ADMINISTRATIVE

T.D. 9156, page 669.

Final regulations under section 6091 of the Code relate to the filing of hand-carried returns and other documents, remove references to IRS titles and organizational units that have been superseded, and replace them with updated references to offices and officers that are sufficiently flexible to take into account any future changes to structure or operations of the IRS.

REG–101282–04, page 698.

Proposed regulations under section 269B of the Code generally treat a stapled foreign corporation as a domestic corporation for U.S. federal income tax purposes, unless the stapled foreign corporation and the corresponding domestic stapled corporation are foreign-owned. Under the regulations, while a stapled foreign corporation is not an includible corporation under section 1504(b) for most purposes, it may be an includible corporation for purposes of regulations sections 1.904(i)–1 and 1.861–11T(d)(6). They also provide that a conversion of a domestic corporation to a foreign corporation (or vice versa) as a result of section 269B is treated as an F reorganization; limit the application of treaty benefits to stapled foreign corporations; provide special collection procedures for tax liabilities of stapled foreign corporations; address issues involving multiple classes of stock in determining whether a foreign corporation is a stapled foreign corporation; and provide the Commissioner with authority to disregard certain stapled stock structures involving related parties. A public hearing is scheduled for December 15, 2004.

Notice 2004–66, page 677.

The Service is suspending certain income limitation requirements under section 42 of the Code for certain low-income housing credit properties in Florida as a result of the devastation caused by Hurricane Charley and Hurricane Frances.

Rev. Proc. 2004–60, page 682.

***Per diem* allowances.** This procedure provides rules for deeming substantiated the amount of certain reimbursed traveling expenses of an employee as well as optional rules for determining the amount of deductible meals and incidental expenses while traveling away from home. Rev. Proc. 2003–80 superseded.

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 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 Bulletin is divided into four parts as follows:

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

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

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

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

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

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

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62–2: Reimbursements and other expense allowance arrangements.

Rules are set forth under which a reimbursement or other expense allowance arrangement for the cost of lodging, meal, and incidental expenses, or for meal and incidental expenses, incurred by an employee while traveling away from home will satisfy the requirements of § 62(c) of the Code as to substantiation of the amount of the expenses. See Rev. Proc. 2004-60, page 682.

Section 132.—Certain Fringe Benefits

26 CFR 1.132–9(b): Qualified transportation fringes.

Parking reimbursements. This ruling holds that certain amounts paid to an employee as "reimbursements" for a parking expense that the employee supposedly "paid" through a salary reduction are wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the collection of income tax at source on wages (federal income tax withholding).

Rev. Rul. 2004–98

ISSUE(S)

Whether, under the facts described below, the exclusion from gross income under § 132(a)(5) applies to payments from an employer to employees characterized as "reimbursements" by the employer.

FACTS

Employer X decides to provide parking for its employees. The parking will be on or near X's business premises.

Before X implements the arrangement for parking, as described below, X pays Employee A monthly wages of $1,500. After withholding for employee FICA tax of $114.75 and withholding for federal income tax of $83.80, A's net pay is $1,301.45.

Monthly wages	$1,500.00
FICA tax withholding	(114.75)
Federal income tax withholding	(83.80)
Net monthly payment	$1,301.45

X implements a payroll arrangement under which the amount of its employees' cash compensation is reduced in return for X providing parking. In addition, X makes "reimbursement" payments to employees with respect to parking expenses in amounts that cause employees' net after-tax pay from X to be the same amount as it would have been if there was no compensation reduction. X takes the position that both the compensation reduction amounts and the "reimbursement" payments are excluded from gross income of employees and are not subject to Federal Insurance Contributions Act (FICA) tax, Federal Unemployment Tax Act (FUTA) tax, or federal income tax withholding.

X can make the compensation reduction used to pay for parking under X's payroll arrangement mandatory or elective. For example, X could unilaterally reduce all employees' salaries and provide parking to all employees. Alternatively, X could offer employees the choice, as permitted under section 132(f)(4), between cash compensation and parking, and provide parking to the employees electing to reduce their cash compensation.

After X implements the arrangement, Employee A's monthly wages of $1,500 are reduced by $100 in exchange for the parking. From the remaining $1,400, X withholds employee FICA tax of $105 and federal income tax of $73.30. X then pays A an additional $79.75 as a purported reimbursement of parking expenses, with the result that A's net pay remains at $1,301.45.

Monthly wages	$1,400.00
FICA tax withholding	(105.00)
Federal income tax withholding	(73.30)
Subtotal	$1,221.70
Additional payment	79.75
Net monthly payment	$1,301.45

LAW AND ANALYSIS

Section 132(a)(5) provides that any employer-provided fringe benefit that qualifies as a "qualified transportation fringe" is excluded from gross income. Section 132(f)(1) provides that the term "qualified transportation fringe" means (1) transportation between home and work in a commuter highway vehicle, (2) any transit pass, and (3) qualified parking. Under § 132(f)(5)(C), the term "qualified parking" means parking provided by an employer to an employee on or near the employer's business premises.

Section 132(f)(4) provides that no amount shall be included in the gross income of an employee solely because the employee may choose between any qualified transportation fringe and compensation that would otherwise be includible in the gross income of such employee.

Section 132(f)(3) provides that a qualified transportation fringe includes a cash reimbursement by an employer to an employee for qualified parking expenses. Section 1.132–9(b) Q/A–16(a) of the regulations provides that a reimbursement must be made under a *bona fide* reimbursement arrangement within the meaning of § 1.132–9(b) Q/A–16(c) in order to be excluded from gross income. Section 1.132–9(b) Q&A–16(c) provides that employers that make cash reimbursements must establish a *bona fide* reimbursement arrangement to establish that their employees have, in fact, incurred expenses for qualified parking. The employer must implement reasonable procedures to ensure that an amount equal to the reimbursement was incurred by the employee for qualified parking.

Sections 3121(a) and 3306(b) define the term "wages" for FICA and FUTA purposes, respectively, as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specified exceptions. Section 3401(a) contains a similar definition for purposes of federal income tax withholding. Sections 3121(a)(20), 3306(b)(16), and 3401(a)(19) provide for purposes of FICA, FUTA, and federal income tax with-

holding, respectively, that the definition of "wages" does not include any benefit provided to or on behalf of an employee if, at the time such benefit is provided, it is reasonable to believe that the employee will be able to exclude such benefit from income under § 132.

X's position with respect to the transaction described in this ruling is meritless. An employee may exclude from gross income employer reimbursements for qualified parking expenses, but only if those expenses were actually incurred by the employee. If an employee is given a choice between cash compensation or an employer-provided benefit under a statutory exception to the constructive receipt rules, such as § 132(f)(4), or if an employer unilaterally reduces an employee's cash compensation for the purpose of providing a non-taxable benefit, the benefit is treated as provided directly by the employer rather than purchased by the employee with the amount of the compensation reduction. Otherwise, the value of the benefit would not be excluded from the employee's gross income. The cost of providing the parking is incurred by Employer X, not Employee A, and the value of the benefit is excludable from A's gross income under § 132(a)(5) because the parking is on or near X's business premises, and the parking benefit is provided by X. Although the § 132(a)(5) exclusion applies to the qualified parking benefits provided by X, there is no expense incurred by Employee A for X to reimburse, and therefore the "reimbursement" payments that X makes to A are not excluded from gross income under § 132(a)(5). The conclusion would be the same whether the compensation reduction was mandatory or elective. The conclusion would also be the same if the employer originally provided free parking to employees and then upon implementing the payroll arrangement purported to impose a charge on employees for parking. *See also*, Rev. Rul. 2002–3, 2002–1 C.B. 316, which holds that a purported reimbursement of health insurance premiums paid by the employer, and not by employees, is not excludable from the gross income of employees under §§ 106(a) and 105(b).

Because the "reimbursement" payments were not reimbursements of expenses incurred by A for parking, it was unreasonable for X to believe at the time the "reimbursements" were paid to A that A would be able to exclude the payments from gross income under § 132(a)(5). Thus, the "reimbursement" payments are not excluded from wages for FICA, FUTA, or federal income tax withholding purposes under §§ 3121(a)(20), 3306(b)(16), or 3401(a)(19), respectively.

HOLDING

The exclusion from gross income under § 132(a)(5) does not apply to the payments characterized by the employer as "reimbursements." Employee A has not incurred an expense for parking for which there can be a reimbursement. Accordingly, amounts that Employer X pays to Employee A purportedly as reimbursements are included in Employee A's gross income and are wages subject to employment taxes under §§ 3121(a), 3306(b), and 3401(a). This is the outcome whether or not the amounts of Employer X's payments are calculated to provide Employee A with the same net pay A received prior to the implementation of the payroll arrangement.

In addition, this ruling applies to arrangements with respect to benefits other than parking where: (1) an employee's salary (and gross income) is reduced in return for a non-taxable benefit, and (2) the employer "reimburses" the employee for some or all of the cost of the non-taxable benefit and excludes the reimbursement from the employee's salary (and gross income) even though that cost was paid by the employer and not the employee.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stephen D. Suetterlein of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue ruling, contact Mr. Suetterlein at (202) 622–6040 (not a toll-free call).

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 for meal and incidental expenses, incurred while traveling away from home that most nearly represents current costs. See Rev. Proc. 2004-60, page 682.

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. 2004-60, page 682.

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 for 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 expenses paid or incurred while traveling away from home. See Rev. Proc. 2004-60, page 682.

Section 338.—Certain Stock Purchases Treated as Asset Acquisitions

26 CFR 1.338–6: Allocation of ADSP and AGUB among target assets.

T.D. 9158

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Treatment of Certain Nuclear Decommissioning Funds for Purposes of Allocating Purchase Price in Certain

Deemed and Actual Asset Acquisitions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the allocation of purchase price in certain deemed and actual asset acquisitions under sections 338 and 1060. These regulations affect sellers and purchasers of nuclear power plants or of the stock of corporations that own nuclear power plants. The text of the temporary regulations also serves as the text of the proposed regulations (REG–169135–03) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on September 15, 2004.

FOR FURTHER INFORMATION CONTACT: Richard Starke at (202) 622–7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Sections 338 and 1060 and the regulations thereunder provide a methodology by which the purchase or sales price in certain actual and deemed asset acquisitions is computed and allocated among the assets acquired or treated as acquired. The purchase price generally includes liabilities of the seller that are assumed by the purchaser. Those liabilities, however, must be treated as having been incurred by the purchaser. In order to be treated as having been incurred by the purchaser, in addition to other requirements, economic performance must have occurred with respect to the liability.

Sections 338 and 1060 and the regulations promulgated thereunder employ a residual method of allocation under which assets are divided into seven classes and the consideration is allocated to each of the first six classes in turn, up to the fair market value of the assets in the class. The residual amount is allocated to assets in the last class. Accordingly, under the residual method of §1.338–6, the purchase or sales price is first allocated to Class I assets (cash and general deposit accounts other than certain certificates of deposit), then Class II assets (actively traded personal property, certificates of deposit, foreign currency, US government securities, and publicly traded stock), then Class III assets (assets that the taxpayer marks to market at least annually and certain debt instruments), then Class IV assets (inventory), then Class V assets (assets that are not assets of another class), then Class VI assets (section 197 intangibles, except goodwill and going concern value), and then Class VII assets (goodwill and going concern value). The ordering of the nonresidual classes generally reflects a policy of allocating basis first to those assets that are susceptible to more accurate valuation or the cost of which is recovered most rapidly. See Notice of Proposed Rulemaking REG–107069–97, 1999–2 C.B. 346, 350, 354 [64 FR 43462, 43465, 43469; August 10, 1999].

In connection with the sale of a nuclear power station, the assets sold by the seller and purchased by the purchaser may include the plant, equipment, operating assets, and one or more funds holding assets that have been set aside for the purpose of satisfying the owner's responsibility to decommission the nuclear power station after the conclusion of its useful life (the decommissioning liability), and the purchaser may have agreed to satisfy the decommissioning liability. One or more of the funds may be funds described in section 468A (qualified funds). Contributions to qualified funds are limited by statute and regulations but give rise to a deduction in the year of contribution. The qualified fund, not the contributor, is treated as the owner of the assets of the fund and is taxed on the income earned on the fund's assets. The assets of qualified funds are not treated as sold or purchased in an actual or deemed sale of the assets of a corporation that owns a nuclear power plant. One or more of the funds, however, may be funds that are not described in section 468A (nonqualified funds). Contributions to nonqualified funds do not give rise to a deduction in the year of contribution. In addition, the assets of a nonqualified fund continue to be treated as assets of the contributor.

Because the decommissioning liability will not satisfy the economic performance test until decommissioning occurs, as of the purchase date, it is not included in the purchase price that the purchaser allocates to the acquired assets. As a result, as of the purchase date, the purchase price to be allocated by the purchaser among the acquired assets may be significantly less than the fair market value of those assets. This situation will generally persist until economic performance with respect to the decommissioning liability is satisfied through decommissioning.

Under the residual method, the purchase price is allocated to the nonqualified fund's assets, which are typically Class II assets, before it is allocated to the plant, equipment, and other operating assets, which are typically Class V assets. Because the purchase price does not reflect the decommissioning liability and is first allocated to the assets of the nonqualified fund, the purchase price allocated to the plant, equipment, and other operating assets may be less than their fair market value. To the extent the purchase price allocated to the plant, equipment, and other operating assets is less than their fair market value, the purchaser will not recover a tax benefit (*i.e.*, a depreciation deduction) for the decommissioning liability until economic performance occurs on decommissioning. This result is appropriate given Congress's decision in enacting section 468A not to allow a plant operator a deduction prior to decommissioning for funds set aside in excess of those amounts set aside in qualified funds, and Congress's decision in enacting section 461(h) not to allow a deduction for costs that do not satisfy the economic performance test.

A number of commentators have argued that economic performance occurs with respect to such decommissioning liabilities at the time of the purchase. These commentators have based their positions on section 461(h)(2)(A)(ii) and §1.461–4(d)(5).

The IRS and Treasury Department do not believe that this position is consistent with the rule and policies of section 461(h)(2). Under section 461(h)(2)(A)(ii), if a liability arises out of the providing of property to the taxpayer by another person, economic performance occurs as such person provides such property. Decommissioning liabilities are the same type of lia-

bilities to both the seller and the purchaser and are fixed by the same circumstances, specifically acquiring a power plant and the license to operate it. The economic performance rules look at the nature of the liability and look to what the taxpayer is required to "perform" in order to satisfy the liability. To the purchaser, merely acquiring the power plant does not satisfy the decommissioning liabilities. Instead, the purchaser cannot be considered to satisfy the liabilities until it performs those services required to decommission the plant. See section 461(h)(2)(B) (providing that where the liability of the taxpayer requires the taxpayer to provide property or services, economic performance occurs as the taxpayer provides such property or service). Therefore, section 461(h)(2)(A)(ii) does not apply to treat economic performance as satisfied at the time of purchase.

With respect to the application of §1.461–4(d)(5), that regulation provides that if, in connection with the sale or exchange of a trade or business by a taxpayer, the purchaser expressly assumes a liability arising out of the trade or business that the taxpayer (the seller) but for the economic performance requirement would have been entitled to incur as of the date of the sale, economic performance with respect to that liability occurs as the amount of the liability is properly included in the amount realized on the transaction by the taxpayer (the seller). The IRS and Treasury Department believe the "taxpayer" described in §1.461–4(d)(5) is the seller, and the acceleration of economic performance is for the "taxpayer." Section 1.461–4(d)(5) does not address the treatment of the purchaser. This interpretation is consistent with the discussion of the preamble to that regulation. (T.D. 8408, 1992–1 C.B. 157, 160 [57 FR 12412–3, 12415–6; April 10, 1992].

Nonetheless, the IRS and Treasury Department recognize the special circumstances related to the purchase and sale of nuclear power plants and transfer of nonqualified funds. The Nuclear Regulatory Commission requires, as one of several decommissioning alternatives available to nuclear power plant operators, that funds be established and maintained to fund decommissioning and related administrative expenditures and that the use of such set aside funds be primarily restricted to such uses. Thus, although the assets in nonqualified funds are relatively liquid, they are ones to which the purchaser's access is significantly limited.

To mitigate the tax effect of these decommissioning liabilities' not satisfying the statutory requirements for economic performance as to the purchaser, these temporary regulations add §1.338–6T. That regulation provides that, for purposes of allocating purchase or sales price among the acquisition date assets of a target, a taxpayer may elect to treat a nonqualified fund as if such fund were an entity classified as a corporation the stock of which were among the acquisition date assets of the target and a Class V asset. In these cases, for allocation purposes, the hypothetical corporation will be treated as bearing the responsibility for decommissioning to the extent assets of the fund are expected to be used for that purpose. A section 338(h)(10) election will be treated as made for the hypothetical corporation (regardless of whether the requirements for a section 338(h)(10) election are otherwise satisfied).

The election provided for in these temporary regulations converts the assets of the nonqualified fund from primarily Class I and Class II assets to the assets of a corporation the stock of which is a Class V asset and allows the present cost of the decommissioning liability funded by the nonqualified fund, which otherwise cannot be taken into account for income tax purposes, to be netted against the fund assets for the sole purpose of valuing the stock of the hypothetical subsidiary corporation. Therefore, if this election were made, it would be expected that the assets of the nonqualified fund would be allocated a much smaller amount of the initial purchase price than if no such election had been made, and the disposition of fund assets would result in gain. A larger amount of the initial purchase price, however, would be available for allocation to the plant and other operating assets.

This election is available for applicable asset acquisitions and qualified stock purchases on or after September 15, 2004. The purchaser may make this election regardless of whether the seller or sellers also make the election. However, in the case of a deemed asset acquisition under section 338, if the target corporation is an S corporation, all of the S corporation shareholders, including those that do not sell their stock, must consent to the election for the election to be effective as to any S corporation shareholder. In the case of a deemed asset acquisition under section 338, the election is made by taking a position on an original or amended tax return for the taxable year of the qualified stock purchase that is consistent with having made the election. Such tax return, however, must be filed no later than the later of 30 days after the date on which the section 338 election is due or the day the original tax return for the taxable year of the qualified stock purchase is due (with extensions). The election is irrevocable. If the transaction is an applicable asset acquisition within the meaning of section 1060, the election is made by taking a position on the timely filed original return for the year of the applicable asset acquisition.

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. These temporary regulations provide elective relief to certain purchasers of stock and assets by providing an alternative method for allocating basis among acquired assets. It is necessary to provide this relief immediately to remove an impediment to such transactions. Accordingly, good cause is found for dispensing with prior notice and comment pursuant to 5 U.S.C. 553(b) and for dispensing with a delayed effective date pursuant to 5 U.S.C. 553(d). For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), see the notice of proposed rulemaking on this subject in this issue of the Bulletin. The IRS and the Treasury Department request comments from small entities that believe they might be adversely affected by these regulations. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for the Advocacy of the Small Business Administration for comment on their impact.

Drafting Information

The principal author of these regulations is Richard Starke, Office of the Associate Chief Counsel (Corporate).

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Adoption of Amendments to the Regulations

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 1.338–6T also issued under 26 U.S.C. 337(d), 338, and 1502. * * *

Par. 2. Section 1.338–0 is amended by adding an entry in the list of captions for paragraph (c)(5) of §1.338–6 and §1.338–6T to read as follows:

§1.338–0 Outline of topics.

* * * * *

§1.338–6 Allocation of ADSP and AGUB among target assets.

* * * * *

(c) * * *

(5) Allocation to certain nuclear decommissioning funds. [Reserved]

* * * * *

§1.338–6T Allocation of ADSP and AGUB among target assets (temporary).

(a) through (c)(4) [Reserved].

(c)(5) Allocation to certain nuclear decommissioning funds.

(d) [Reserved].

Par. 3. Section 1.338–6 is amended by adding paragraph (c)(5) to read as follows:

§1.338–6 Allocation of ADSP and AGUB among target assets.

* * * * *

(c) * * *

(5) *Allocation to certain nuclear decommissioning funds*. [Reserved]. For further guidance, see §1.338–6T.

* * * * *

Par. 4. Section 1.338–6T is added to read as follows:

§1.338–6T Allocation of ADSP and AGUB among target assets (temporary).

(a) through (c)(4) [Reserved]. For further guidance, see §1.338–6(a) through (c)(4).

(5) *Allocation to certain nuclear decommissioning funds*—(i) *General rule*. For purposes of allocating ADSP or AGUB among the acquisition date assets of a target (and for no other purpose), a taxpayer may elect to treat a nonqualified nuclear decommissioning fund (as defined in paragraph (c)(5)(ii) of this section) of the target as if—

(A) Such fund were an entity classified as a corporation;

(B) The stock of the corporation were among the acquisition date assets of the target and a Class V asset;

(C) The corporation owned the assets of the fund;

(D) The corporation bore the responsibility for decommissioning one or more nuclear power plants to the extent assets of the fund are expected to be used for that purpose; and

(E) A section 338(h)(10) election were made for the corporation (regardless of whether the requirements for a section 338(h)(10) election are otherwise satisfied).

(ii) *Definition of nonqualified nuclear decommissioning fund*. A nonqualified nuclear decommissioning fund means a trust, escrow account, Government fund or other type of agreement—

(A) That is established in writing by the owner or licensee of a nuclear generating unit for the exclusive purpose of funding the decommissioning of one or more nuclear power plants;

(B) That is described to the Nuclear Regulatory Commission in a report described in 10 CFR 50.75(b) as providing assurance that funds will be available for decommissioning;

(C) That is not a Nuclear Decommissioning Reserve Fund, as described in section 468A;

(D) That is maintained at all times in the United States; and

(E) The assets of which are to be used only as permitted by 10 CFR 50.82(a)(8).

(iii) *Availability of election*. P may make the election described in this paragraph (c)(5) regardless of whether the selling consolidated group (or the selling affiliate or the S corporation shareholders) also makes the election. In addition, the selling consolidated group (or the selling affiliate or the S corporation shareholders) may make the election regardless of whether P also makes the election. If T is an S corporation, all of the S corporation shareholders, including those that do not sell their stock, must consent to the election for the election to be effective as to any S corporation shareholder.

(iv) *Time and manner of making election*. The election described in this paragraph (c)(5) is made by taking a position on an original or amended tax return for the taxable year of the qualified stock purchase that is consistent with having made the election. Such tax return must be filed no later than the later of 30 days after the date on which the section 338 election is due or the day the original tax return for the taxable year of the qualified stock purchase is due (with extensions).

(v) *Irrevocability of election*. An election made pursuant to this paragraph (c)(5) is irrevocable.

(vi) *Effective date*. This paragraph (c)(5) applies to qualified stock purchases occurring on or after September 15, 2004.

(d) [Reserved]. For further guidance, see §1.338–6(d).

Par. 5. Section 1.1060–1 is amended by revising the Outline of Topics in paragraph (a)(3) to add an entry to reflect the addition of paragraph (e)(1)(ii)(C); by adding a sentence to the end of paragraph (c)(3); and by adding paragraph (e)(1)(ii)(C) to read as follows:

§1.1060–1 Special allocation rules for certain asset acquisitions.

(a) * * *

(3) * * *

* * * * *

(e) Reporting requirements.

(1) Applicable asset acquisitions.

(ii) Time and manner of reporting.

(C) Election described in §1.338–6T(c)(5).

* * * * *

(c) * * *

(3) * * * For further guidance, see §1.1060–1T.

(e) * * *

(1) * * *

(ii) * * *

(C) *Allocation to certain nuclear decommissioning funds*. [Reserved]. For further guidance, see §1.338–6T.

* * * * *

Par. 6. Section 1.1060–1T is added to read as follows:

§1.1060–1T Special allocation rules for certain asset acquisitions (temporary).

(a) through (c)(2) [Reserved]. For further guidance, see §1.1060–1(a) through (c)(2).

(c)(3) *Certain costs*. The seller and purchaser each adjusts the amount allocated to an individual asset to take into account the specific identifiable costs incurred in transferring that asset in connection with the applicable asset acquisition (*e.g.*, real estate transfer costs or security interest perfection costs). Costs so allocated increase, or decrease, as appropriate, the total consideration that is allocated under the residual method. No adjustment is made to the amount allocated to an individual asset for general costs associated with the applicable asset acquisition as a whole or with groups of assets included therein (*e.g.*, non-specific appraisal fees or accounting fees). These latter amounts are taken into account only indirectly through their effect on the total consideration to be allocated. If an election described in §1.338–6T(c)(5) is made with respect to an applicable asset acquisition, any allocation of costs pursuant to this paragraph (c)(3) shall be made as if such election had not been made. The preceding sentence applies to applicable asset acquisitions occurring on or after September 15, 2004.

(c)(4) through (e)(1)(ii)(B) [Reserved]. For further guidance, see §1.1060–1(c)(4) through (e)(1)(ii)(B).

(e)(1)(ii)(C) *Election described in §1.338–6T(c)(5)—(1) Availability*. The election described in §1.338–6T(c)(5) is available in respect of an applicable asset acquisition provided that the requirements of that section are satisfied. Such election may be made by the seller, regardless of whether the purchaser also makes the election, and may be made by the purchaser, regardless of whether the seller also makes the election.

(*2*) *Time and manner of making election*. The election described in §1.338–6T(c)(5) is made by taking a position on a timely filed original tax return for the taxable year of the applicable asset acquisition that is consistent with having made the election.

(*3*) *Irrevocability of election*. The election described in §1.338–6T(c)(5) is irrevocable.

(*4*) *Effective date*. This paragraph (e)(1)(ii)(C) applies to applicable asset acquisitions occurring on or after September 15, 2004.

(e)(2) [Reserved]. For further guidance, see §1.1060–1(e)(2).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved September 8, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 15, 2004, 8:45 a.m., and published in the issue of the Federal Register for September 16, 2004, 69 F.R. 55740)

Section 1060.—Special Allocation Rules for Certain Asset Acquisitions

Regulations relate to the allocation of purchase price in certain deemed and actual asset acquisitions under sections 338 and 1060. See T.D. 9158, page 665. See REG-169135-03, page 697.

Section 6091.—Place for Filing Returns or Other Documents

26 CFR 1.6091–2: Place for filing income tax returns.

T.D. 9156

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 20, 25, 31, 40, 41, 44, 53, 55, 156, and 301

Place for Filing

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that update obsolete references in the existing regulations under section 6091 of the Internal Revenue Code (Code) regarding the place for filing hand-carried returns and other documents. These final regulations reflect changes in the organizational structure of the IRS but do not make substantive changes to taxpayers' current ability to hand carry returns to a local IRS office.

DATES: These final regulations are effective September 16, 2004.

FOR FURTHER INFORMATION CONTACT: Emly B. Berndt of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice, (202) 622–4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains final regulations that amend 26 CFR parts 1, 20, 25, 31, 40, 41, 44, 53, 55, 156, and 301 with respect to the place for filing returns and other documents under section 6091 of the Code. These final regulations reflect the changes in the IRS organizational structure following the Internal Revenue Service Restructuring and Reform Act of 1998 (112 Stat. 685). These final regulations specify where the IRS now accepts hand-carried returns in a manner consistent with the instructions in Notice 2003–19, 2003–1 C.B. 703, and do not make any substantive changes to a taxpayer's ability to hand carry returns to a local IRS office.

These final regulations remove the examples under §1.6091–4(a)(4), which are obsolete due to various amendments to the Code, and add an example in their place that illustrates the application of the rules in §1.6091–4(a)(2) and (3) to a current provision of the Code. These final regulations also include one citation correction in §1.6091–1(b). In certain cases, these final regulations cross reference regulations that contain references to obsolete IRS offices or titles. Taxpayers in those cases should continue to follow any updated instructions in other published guidance. See, *e.g.*, Notice 2003–19.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these final regulations

for two reasons. First, these final regulations reflect changes in the organizational structure of the IRS and are rules concerning agency organization, procedure, or practice that are exempted from the notice and comment requirement of 5 U.S.C. 553. Second, for good cause, Treasury and the IRS have determined that notice and public procedure are impracticable, unnecessary, and contrary to the public interest because these final regulations do not make substantive changes to taxpayers' current ability to hand carry returns to a local IRS office. Instead, these final regulations replace obsolete references to IRS organizations and titles with updated references that are sufficiently flexible to take into account future changes to IRS structure or operations. In addition, these final regulations reflect existing instructions given to taxpayers with respect to the hand-carrying of returns. Because no notice of proposed rulemaking is required, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Code, these final regulations were submitted four weeks prior to filing with the **Office of the Federal Register** 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 Ann M. Kramer and Emly B. Berndt of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, 25, 31, 40, 41, 44, 53, 55, 156, and 301 are 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 * * *

§1.6091–1(b) [Amended]

Par. 2. Section 1.6091–1 is amended as follows:

1. Paragraph (b)(1) is amended by removing the reference "1.6031–1" and adding "1.6031(a)–1" in its place.

2. Paragraph (b)(5) is amended by removing the language "paragraph (d) of §1.6035–1 and paragraph (d) of §1.6035–2" and adding "§1.6035–1" in its place.

3. Paragraph (b)(8) is amended by removing the language "paragraph (d) of §1.6042–1 and".

4. Paragraph (b)(11) is amended by removing the language "paragraph (b) of §1.6044–1, and" and the parenthetical "(relating to returns for calendar years after 1962)".

5. Paragraph (b)(12) is amended by removing the language "(e)" and adding "(j)(2)" in its place.

Par. 3. Section 1.6091–2 is amended as follows:

1. The introductory text is amended by removing the parenthetical "(relating to income tax returns required to be filed with the Director of International Operations)" and adding the parenthetical "(relating to certain international income tax returns)" in its place.

2. Paragraph (a)(1) is revised.

3. Paragraph (b) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

4. Paragraph (d)(1) is revised.

5. Paragraph (d)(2), first sentence, is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director)" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

6. Paragraph (e)(1) is amended by removing the language "internal revenue district referred to in paragraph (a) of this section" and adding "legal residence or principal place of business of the person required to make the return" in its place.

7. Paragraph (e)(2) is amended by removing the language "internal revenue district referred to in paragraph (b) of this section" and adding "principal place of business or principal office or agency of the corporation" in its place.

8. Paragraph (f)(1) is amended by removing the language "the district director" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office" in its place.

9. Paragraph (f)(2) is amended by removing the language "the district director" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office" in its place.

10. Paragraph (g) is amended by removing the language "the district director" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office" in its place.

The revisions read as follows:

§1.6091–2 Place for filing income tax returns.

(a) *Individuals, estates, and trusts*. (1) Except as provided in paragraph (c) of this section, income tax returns of individuals, estates, and trusts shall be filed with any person assigned the responsibility to receive returns at the local Internal Revenue Service office that serves the legal residence or principal place of business of the person required to make the return.

* * * * *

(d) * * *

(1) *Persons other than corporations*. Returns of persons other than corporations which are filed by hand carrying shall be filed with any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office as provided in paragraph (a) of this section.

* * * * *

Par. 4. Section 1.6091–3 is amended by revising the section heading and introductory text to read as follows:

§1.6091–3 Filing certain international income tax returns.

The following income tax returns shall be filed as directed in the applicable forms and instructions:

* * * * *

Par. 5. Section 1.6091–4 is amended as follows:

1. Paragraph heading for (a) is amended by removing the language "district other than required district" and adding "office other than required office" in its place.

2. Paragraph (a)(1) is amended by removing the language "internal revenue district" and adding "Internal Revenue Service office" in its place.

3. Paragraph (a)(2), first sentence is amended by removing the language "a director of".

4. Paragraph (a)(2), first sentence is amended by removing the language "the director" and adding "that service center" in its place.

5. Paragraph (a)(2), first sentence is amended by removing the language "with him" and adding "there" in its place.

6. Paragraph (a)(2), second sentence is amended by removing the language "director of a".

7. Paragraph (a)(3)(i) is amended by removing the language "the director of".

8. Paragraph (a)(3)(i) is amended by removing the language "district director" and adding "members of the office" in its place.

9. Paragraph (a)(3)(ii) is amended by removing the language "director of a".

10. Paragraph (a)(3)(iii) is amended by removing the language "director of a".

11. Paragraph (a)(4) is revised.

12. Paragraph (b) is amended by removing the language "district" and adding "Internal Revenue Service office" in its place.

The revision reads as follows:

§1.6091–4 Exceptional cases.

(a) * * *

(4) The application of paragraphs (a)(2) and (3) of this section may be illustrated by the following example:

Example. The Commissioner has authorized the Internal Revenue Service Center, Philadelphia, Pennsylvania (for all purposes except venue), to receive Form 1120. Except for that authorization, A, a corporation with its principal place of business in Greensboro, North Carolina, is required to file its Form 1120 for Year X with the Internal Revenue Service Center, Atlanta, Georgia. In addition, A may file an election to defer development expenditures paid or incurred in Year X. Under §1.616–2(e)(2) and applicable published guidance (in this case Notice 2003–19, 2003–1 C.B. 703) that statement of election must be filed with the service center that serves A's principal place of business where A filed its income tax return. A may make that election on its income tax return or by filing it separately. Under paragraph (a)(2) of this section, A may send its Form 1120 to either the Internal Revenue Service Center, Philadelphia, Pennsylvania, or to the Internal Revenue Service Center, Atlanta, Georgia. If A files its statement of election separately from its income tax return for Year X, then the statement of election is not a proper attachment to A's income tax return and A should send the statement of election to the Internal Revenue Service Center, Atlanta, Georgia (with which A must, without regard to paragraph (a)(2) of this section, file its income tax return), no later than the time prescribed for filing Form 1120 for Year X (including extensions).

* * * * *

PART 20—ESTATE TAXES

Par. 6. The authority citation for part 20 continues to read, in part, as follows:

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

§20.6091–1 [Amended]

Par. 7. Section 20.6091–1 is amended as follows:

1. Paragraph (a)(1) is amended by removing the language "district" and adding "location" in its place.

2. Paragraph (a)(2) is amended by removing the language "The district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within an internal revenue district of such director) in whose district" and adding "Any person assigned the responsibility to receive returns in the local Internal Revenue Service office serving the location in which" in its place.

3. Paragraph (b) is amended by removing the language "the Director of International Operations, Washington, DC, depending upon the place" and adding "as" in its place.

§20.6091–2 [Amended]

Par. 8. Section 20.6091–2 is amended by removing the language "internal revenue district" and adding "local Internal Revenue Service office" in its place.

PART 25—GIFT TAXES

Par. 9. The authority citation for part 25 continues to read, in part, as follows:

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

§25.6091–1 [Amended]

Par. 10. Section 25.6091–1 is amended as follows:

1. Paragraph (a), first sentence is amended by removing the language "the district director for the district in which the legal residence or principal place of business of the donor is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves the legal residence or principal place of business of the donor" in its place.

2. Paragraph (a), second sentence is amended by removing the language "located in an internal revenue district, the gift tax return shall be filed with the district director for the internal revenue district in which the donor's principal place of business is located" and adding "served by a local Internal Revenue Service office, the gift tax return shall be filed with any person assigned the responsibility to receive returns in that office" in its place.

3. Paragraph (b), second sentence is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director)" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

4. Paragraph (c) is amended by removing the language "which is located in an internal revenue district" and adding "in the United States" in its place.

5. Paragraph (c) is further amended by removing the language "the Director of International Operations, Washington, D.C., depending upon the place" and adding "as" in its place.

§25.6091–2 [Amended]

Par. 11. Section 25.6091–2 is amended by removing the language "internal revenue district" and adding "local Internal Revenue Service office" in its place.

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

Par. 12. The authority citation for part 31 continues to read, in part, as follows:

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

Par. 13. Section 31.6091–1 is amended as follows:

1. Paragraph (a), first sentence is amended by removing the language "The" and adding "Except as provided in paragraph (c) of this section, the" in its place.

2. Paragraph (a) is further amended by removing from the first sentence the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place, and removing the last sentence.

3. Paragraph (b) is amended by removing the language "the district director for the district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

4. Paragraph (c) is revised.

5. Paragraph (e)(1) is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director)" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

6. Paragraph (e)(2) is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director)" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

7. Paragraph (e)(3)(i) is amended by removing the language "in any internal revenue district" and adding "served by a local Internal Revenue Service office" in its place.

8. The heading for paragraph (f) is amended by removing the language "*district other than required district*" and adding "*office other than required office*" in its place.

9. Paragraph (f) is amended by removing the language "internal revenue district" and adding "local Internal Revenue Service office" in its place.

10. Paragraph (g) is amended by removing the language "internal revenue district" and adding "local Internal Revenue Service office" in its place.

The revision reads as follows:

§31.6091–1 Place for filing returns.

* * * * *

(c) *Returns of taxpayers outside the United States.* The return of a person (other than a corporation) outside the United States having no legal residence or principal place of business in the United States, or the return of a corporation having no principal place of business or principal office or agency in the United States, shall be filed with the Internal Revenue Service, Philadelphia, Pennsylvania 19255, or as otherwise directed in the applicable forms and instructions.

* * * * *

PART 40—EXCISE TAX PROCEDURAL REGULATIONS

Par. 14. The authority citation for part 40 continues to read, in part, as follows:

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

§40.6091–1 [Amended]

Par. 15. Section 40.6091–1 is amended as follows:

1. Paragraph (b)(1) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office that serves" in its place.

2. Paragraph (b)(2) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office that serves" in its place.

3. Paragraph (c) is amended by removing the language "instructions of the district director requiring that filing" and adding "forms and instructions, or other published guidance" in its place.

PART 41—EXCISE TAX ON USE OF CERTAIN HIGHWAY MOTOR VEHICLES

Par. 16. The authority citation for part 41 continues to read as follows:

Authority: 26 U.S.C. 7805.

§41.6091–1 [Amended]

Par. 17. Section 41.6091–1 is amended as follows:

1. Paragraph (b)(1) is amended by removing the language "the Commissioner in the internal revenue district in which is located" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office that serves" in its place.

2. Paragraph (b)(2) is amended by removing the language "the Commissioner in the internal revenue district in which is located" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office that serves" in its place.

PART 44—EXCISE TAXES AND GAMBLING

Par. 18. The authority citation for part 44 continues to read, in part, as follows:

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

§44.6091–1 [Amended]

Par. 19. Section 44.6091–1 is amended as follows:

1. Paragraph (a), first sentence is amended by removing the language "A" and adding "Except as provided in paragraph (b) of this section, a" in its place.

2. Paragraph (a), first sentence is further amended by removing the language "the district director of internal revenue for the district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

3. Paragraph (a) is amended by removing the second sentence.

4. Paragraph (b) is amended by removing the language "any internal revenue district" and adding "the United States" in its place.

5. Paragraph (b) is further amended by removing the language "Director, International Operations Division, Internal Revenue Service, Washington, DC 20225" and adding "Internal Revenue Service Center, Cincinnati, Ohio 45999, or as otherwise directed in the applicable forms and instructions" in its place.

6. Paragraph (d) is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director)" and adding "any per-

son assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

PART 53—FOUNDATION AND SIMILAR EXCISE TAXES

Par. 20. The authority citation for part 53 continues to read as follows:

Authority: 26 U.S.C. 7805.

§53.6091–1 [Amended]

Par. 21. Section 53.6091–1 is amended as follows:

1. Paragraph (a) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

2. Paragraph (b) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

3. Paragraph (c), second sentence is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director)" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

4. Paragraph (d) is amended by removing the language "the district director" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office" in its place.

§53.6091–2 [Amended]

Par. 22. Section 53.6091–2 is amended by removing the language "internal revenue district" and adding "local Internal Revenue Service office" in its place.

PART 55—EXCISE TAXES AND INVESTMENTS

Par. 23. The authority citation for part 55 continues to read, in part, as follows:

Authority: Secs. 6001, 6011, 6071, 6091, and 7805 * * *

§55.6091–1 [Amended]

Par. 24. Section 55.6091–1 is amended as follows:

1. Paragraph (a) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office serving" in its place.

2. Paragraph (b), second sentence is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within an internal revenue district of such director)" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

§55.6091–2 [Amended]

Par. 25. Section 55.6091–2 is amended by removing the language "internal revenue district" and adding "local Internal Revenue Service office" in its place.

PART 156—EXCISE TAX ON GREENMAIL

Par. 26. The authority citation for part 156 continues to read, in part, as follows:

Authority: Secs. 6001, 6011, 6061, 6071, 6091, 6161, and 7805 * * *

Par. 27. Section 156.6091–1 is amended as follows:

1. Paragraph (a) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

2. Paragraph (b) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

3. Paragraph (c) is amended by removing the language "the district director for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive returns in the local Internal Revenue Service office that serves" in its place.

4. Paragraph (d) is revised.

5. Paragraph (e), second sentence is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within an internal revenue district of such director)" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

The revision reads as follows:

§156.6091–1 Place for filing chapter 54 (Greenmail) tax returns.

* * * * *

(d) *Returns of taxpayers outside the United States*. The return of a person (other than a partnership or a corporation) outside the United States having no legal residence or principal place of business or agency in the United States, or the return of a partnership or a corporation having no principal place of business or principal office or agency in the United States, shall be filed with the Internal Revenue Service, Philadelphia, PA 19255, or as otherwise directed in the applicable forms and instructions.

* * * * *

§156.6091–2 [Amended]

Par. 28. Section 156.6091–2 is amended by removing the language "with any internal revenue district" and adding "in any local Internal Revenue Service office" in its place.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 29. The authority citation for part 301 continues to read, in part, as follows:

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

§301.6091–1 [Amended]

Par. 30. Section 301.6091–1 is amended as follows:

1. Paragraph (b)(1), first sentence is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director) for the internal revenue district in which is located"

and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office that serves" in its place.

2. Paragraph (b)(1), first sentence is further amended by removing the language "internal revenue district in which was" and adding "local Internal Revenue Service office serving" in its place.

3. Paragraph (b)(1), last sentence is amended by removing the language "(i) with the Office of International Operations, by hand carrying to such Office, or (ii) with the office of the assistant regional commissioner (alcohol and tobacco tax) by hand carrying to such office" and adding in its place the language "with an office of the Alcohol and Tobacco Tax and Trade Bureau, by hand carrying as specified in regulations of the Alcohol and Tobacco Tax and Trade Bureau, see, 27 CFR chapter I, subchapter F".

4. Paragraph (b)(2) is amended by removing the language "the district director (or with any person assigned the administrative supervision of an area, zone or local office constituting a permanent post of duty within the internal revenue district of such director) for the internal revenue district in which is located" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office that serves" in its place.

5. Paragraph (b)(2), last sentence is amended by removing the language "(i) with the Office of International Operations, by hand carrying to such Office, or (ii) with the office of the assistant regional commissioner (alcohol and tobacco tax) by hand carrying to such office" and adding in its place the language "with an office of the Alcohol and Tobacco Tax and Trade Bureau, by hand carrying as specified in regulations of the Alcohol and Tobacco Tax and Trade Bureau, see, 27 CFR chapter I, subchapter F".

6. Paragraph (c) is amended by removing the language "district director" and adding "any person assigned the responsibility to receive hand-carried returns in the local Internal Revenue Service office" in its place.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved July 13, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

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Part II. Treaties and Tax Legislation
Subpart A.—Tax Conventions and Other Related Items

Supplemental Tables of Income Tax Rates Under New Income Tax Convention With Sri Lanka

Announcement 2004–81

The United States recently exchanged instruments of ratification for a new income tax treaty with Sri Lanka.

Effective dates. The provisions relating to withholding tax at source are effective for amounts paid or credited on or after September 1, 2004. For all other taxes, the treaty is effective for tax periods beginning on or after January 1, 2004.

Tables 1 and 2. The following tables can be used to supplement Tables 1 and 2 in Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities (For Withholding in 2004)* and Publication 901, *U.S. Tax Treaties*. The footnotes in Publication 901 that relate to the column headings in these tables generally apply to these new entries.

Table 1. **Tax Rates on Income Other Than Personal Service Income**

Income code number	1	2	3	6	7	9	10	11	12	13	14	21
Country/Code												
Sri Lanka CE	10 a,b	10 a,b,c	10 a,b	15 a,d	15 a,d	0 a,g	10 a	10 a	10 a,e	30	0 f,h	30

Income Codes

1 Interest paid by U.S. obligors — General
2 Interest on real property mortgages
3 Interest paid to controlling foreign corporations
6 Dividends paid by U.S. corporations — General
7 Dividends qualifying for direct dividend rate
9 Capital gains
10 Industrial royalties
11 Copyright royalties — Motion pictures and Television
12 Copyright royalties — Other
13 Real property income and Natural resources royalties
14 Pensions and annuities
21 Social security payment

Footnotes

a The 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 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.
b The rate is 15% for contingent interest that does not qualify as portfolio interest. Generally, this is interest based on receipts, sales, income, or changes in the value of property.
c The reduced rate does not apply to an excess inclusion for a residual interest in a real estate mortgage investment conduit (REMIC).
d The rate applies to dividends paid by a real estate investment trust (REIT) only if the beneficial owner of the dividends is (a) an individual holding less 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.
e The rate is 5% for the rental of tangible personal property.
f Exemption does not apply to U.S. Government (federal, state, or local) pensions and annuities; a 30% rate applies to these pensions and annuities.
g The exemption does not apply to a sale of a U.S. company's stock representing ownership of 50% or more.
h Does not apply to annuities.

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

Country	Code	Category of personal services Purpose	Maximum presence in U.S.	Required Employer or Payer	Maximum Amount of Compensation	Article No.
Sri Lanka	16	Independent personal services [2,3]	183 days	Any contractor	No limit	15
	20	Public entertainment[3]	183 days	Any contractor	$6,000 p.a. [4]	18
	17	Dependent personal services [1,2]	183 days	Any foreign resident	No limit	16
	20	Public entertainment[1]	183 days	Any foreign resident	$6,000 p.a. [4]	18
	19	Studying and training: Remittances or allowances [5]	No limit	Any foreign resident	No limit	21(1)
		Compensation while gaining experience[6]	1 year	Sri Lankan resident[7]	$6,000	21(2)

Footnotes

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

2 Fees paid to a resident of Sri Lanka for services performed in the United States as a director of a U.S. corporation are subject to U.S. tax.

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

4 Does not apply if the gross receipts (including reimbursements) exceed this amount during the year. Income is fully exempt if visit is wholly or substantially supported by public funds of the United States or Sri Lanka or their political subdivisions or local authorities.

5 Applies only to a full-time student or trainee.

6 Applies only if the training or experience is received from a person other than the alien's employer.

7 Applies also to a participant in a program sponsored by the U.S. government or an international organization.

Part III. Administrative, Procedural, and Miscellaneous

Relief From Certain Low-Income Housing Credit Requirements Due to Hurricane Charley and Hurricane Frances

Notice 2004–66

The Internal Revenue Service is suspending certain income limitation requirements under § 42 of the Internal Revenue Code for certain low-income housing credit properties in Florida as a result of the devastation caused by Hurricane Charley and Hurricane Frances. This relief is being granted pursuant to the Service's authority under § 42(n) and § 1.42–13(a) of the Income Tax Regulations.

BACKGROUND

On August 13, 2004, and September 4, 2004, respectively, the President declared major disasters for the State of Florida as a result of Hurricane Charley and Hurricane Frances. These declarations were made under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, Title 42 U.S.C. 5121–5206 (2000 & Supp. I 2001). Subsequently, the Federal Emergency Management Agency (FEMA) designated counties for Individual Assistance.

The State of Florida has requested that the Service allow owners of low-income housing credit projects to provide temporary housing in vacant units to individuals displaced (displaced individuals) because their homes were destroyed or damaged as a result of the devastation caused by Hurricane Charley and Hurricane Frances. The State of Florida has further requested that the temporary housing of the displaced individuals in low-income units without regard to income not cause the owners to lose low-income housing credits.

SUSPENSION OF INCOME LIMITATION

Because of the widespread damage to housing caused by the hurricanes, the Service has determined that it is appropriate to temporarily suspend certain income limitation requirements under § 42 for qualified low-income housing projects in the State of Florida that are beyond the first year of the credit period under § 42(f)(1). The suspension will apply to low-income housing projects, approved by the Florida Housing Finance Corporation, in which vacant units are rented to individuals displaced by Hurricane Charley or Hurricane Frances. The Florida Housing Finance Corporation will determine the appropriate period of temporary housing for each project, not to extend beyond September 30, 2005.

During the temporary housing period established by the Florida Housing Finance Corporation, the status of a vacant unit (that is, market rate or low-income for purposes of § 42) that becomes temporarily occupied by a displaced individual remains the same as the unit's status before the displaced individual moves in. Displaced individuals temporarily occupying vacant units will not be treated as low-income tenants under § 42(i)(3)(A)(ii) (a low-income unit that was vacant before the effective date of this notice will continue to be treated as a vacant low-income unit even if it houses a displaced individual and a market rate unit that was vacant before the effective date of this notice will continue to be treated as a vacant market rate unit even if it houses a displaced individual). Thus, the fact that a vacant unit becomes occupied by a displaced individual will not affect the building's applicable fraction under § 42(c)(1)(B) for purposes of determining the building's qualified basis, nor will it affect the 20–50 test or 40–60 test of § 42(g)(1). If the income of occupants in low-income units exceeds 140 percent of the applicable income limitation, the temporary occupancy of a unit by a displaced individual will not cause application of the available unit rule under § 42(g)(2)(D)(ii). In addition, the project owner is not responsible during the temporary housing period to make attempts to rent to low-income individuals the low-income units housing displaced individuals. All other rules and requirements of § 42 will continue to apply.

At the end of the temporary housing period established by the Florida Housing Finance Corporation, the applicable income limitations contained in § 42(g)(1), the available unit rule under § 42(g)(2)(D)(ii), and the requirement to make reasonable attempts to rent vacant units to low-income individuals resume. The suspension of income limitations is subject to the requirements listed below.

REQUIREMENTS FOR SUSPENSION OF INCOME LIMITATIONS

To qualify for the suspension of income limitations, the project owner must meet all of the following requirements:

(1) Major Disaster Area

The displaced individual must have resided in a Florida county designated for Individual Assistance by FEMA as a result of Hurricane Charley or Hurricane Frances.

(2) Approval of Florida Housing Finance Corporation

The project owner must obtain approval from the Florida Housing Finance Corporation to obtain the relief described in this notice. The Florida Housing Finance Corporation will determine the appropriate period of temporary housing for each project, not to extend beyond September 30, 2005.

(3) Certifications and Recordkeeping

To comply with the requirements of § 1.42–5, project owners are required to maintain and certify certain information concerning each displaced individual, specifically: name, address, social security number, and a statement signed under penalties of perjury by the displaced individual that, because of damage to the individual's home in a Florida county designated for Individual Assistance by FEMA as a result of Hurricane Charley or Hurricane Frances, the individual requires temporary housing. The owner must also certify the date the individual began temporary occupancy and the date the project will discontinue providing temporary housing as established by the Florida Housing Finance Corporation. The certifications and recordkeeping for displaced individuals must be maintained as part of the annual compliance monitoring process with the Florida Housing Finance Corporation.

(4) Rent Restrictions

Rent for the low-income units housing displaced individuals must not exceed the existing rent-restricted rates for the low-income units established under § 42(g)(2).

(5) Protection of Existing Tenants

Existing tenants in occupied low-income units cannot be evicted or have their tenancy terminated as a result of efforts to provide temporary housing for displaced individuals.

EFFECTIVE DATE

This notice is effective August 13, 2004 (the date of the President's major disaster declaration as a result of Hurricane Charley).

PAPERWORK REDUCTION ACT

The collection of information contained in this notice 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 1545–1907.

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 notice is in the section titled "REQUIREMENTS FOR SUSPENSION OF INCOME LIMITATIONS," under "*(3) Certifications and Recordkeeping*." This information is required to enable the Service and the Florida Housing Finance Corporation to verify that the individuals obtaining temporary housing in approved low-income housing projects are displaced from their homes in a Florida county designated for Individual Assistance by FEMA as a result of Hurricane Charley and Hurricane Frances. This information will be used in the Florida Housing Finance Corporation's compliance monitoring process. The collection of information is required to obtain a benefit. The likely respondents are individuals, businesses, and nonprofit institutions.

The estimated total annual recordkeeping burden is 750 hours.

The estimated annual burden per recordkeeper is approximately 15 minutes. The estimated number of recordkeepers is 3,000.

Books or records relating to a collection of information must be retained as long as their contents may become material to the administration of the 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 notice is Jack Malgeri of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Malgeri at (202) 622–3040 (not a toll-free call).

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26 CFR 1.1441–7: Offer to resolve issues arising from certain tax, withholding, and reporting obligations of U.S. withholding agents with respect to payments to foreign persons.

Rev. Proc. 2004–59

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SECTION 1 GENERAL

.01 Background. This revenue procedure describes the Section 1441 Voluntary Compliance Program (the "Section 1441 VCP"), which is available to certain withholding agents with respect to the withholding, payment, and reporting of certain taxes due on payments to foreign persons. "Payments" includes both actual and deemed payments.

In Treasury Decision 8734, 1997–2 C.B. 109 [62 F.R. 53387], the Treasury Department and the Internal Revenue Service (the "IRS") issued comprehensive regulations (the "final regulations") under chapter 3 (sections 1441–1464) and subpart G of Subchapter A of chapter 61 (sections 6041–6050S) of the Internal Revenue Code. The final regulations were amended by T.D. 8804, 1999–1 C.B. 793 [63 F.R. 72183], T.D. 8856, 2000–1 C.B. 298 [64 F.R. 73408], T.D. 8881, 2000–1 C.B. 1158 [65 F.R. 32152], and T.D. 9023, 2002–2 C.B. 955 [67 F.R. 70310]. The final regulations generally were effective January 1, 2001. In addition, in Notice 2001–4, 2001–1 C.B. 267, Notice 2001–11, 2001–1 C.B. 464, and Notice 2001–43, 2001–2 C.B. 72, the IRS and Treasury provided clarification and guidance regarding certain aspects of the final regulations.

Financial institutions have commented that they have expended significant effort to implement the final regulations. This effort has involved ongoing documentation of account holders and major systems and procedural changes. As part of this effort, financial institutions have been identifying tax deficiencies and failures in their systems and have come forward to the IRS to disclose and resolve issues arising from the effort to implement the final regulations. To provide consistent treatment with respect to withholding agents, this revenue procedure formalizes a program for disclosure and resolution of these implementation issues.

The IRS is initiating the Section 1441 VCP as a temporary program. See section 6 of this revenue procedure for the effective date and sunset date of the program. See section 2 of this revenue procedure for the withholding agents that are eligible to participate in the program. See section 3 of this revenue procedure for the tax, withholding, and reporting obligations covered by the Section 1441 VCP.

.02 Applicable law. The objective of the Section 1441 VCP is to enhance voluntary compliance among certain withholding agents making payments of U.S.-source dividends, interest, rents, royalties, and other fixed or determinable, annual or periodical income ("FDAP income") to foreign persons. Generally, FDAP income received by a foreign person from sources within the United States is subject to tax under section 871(a) or 881(a) of the Internal Revenue Code (the "Code"). The tax is imposed on the gross amount of income, generally at a 30-percent rate. Section 1441 of the Code requires any person who pays to a foreign person income subject to tax under section 871(a) or 881(a) to deduct and withhold the 30-percent tax from the gross amount paid. The rate of tax, and therefore the withholding obligation, may be reduced or eliminated under other provisions of the Code or under an applicable income tax treaty. A withholding agent is required to determine the status of the persons to whom it makes payments by obtaining documentation from them and may withhold at a reduced rate on payments to foreign persons only if the foreign person has furnished the required documentation. See § 1.1441–1 *et seq.* of the Income Tax Regulations. See also IRS Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*.

.03 Summary of the Section 1441 VCP. The Section 1441 VCP applies only to tax and reporting obligations that relate to Forms 1042 and 1042-S. It does not apply to tax and reporting obligations that relate to Forms 945 and 1099 except to the extent that correction of a failure to document U.S. persons or misclassification of U.S. and foreign persons requires filing or correction of those forms. The Section 1441 VCP does not provide substantive determinations about a payment (such as the amount, timing, character, or source of such a payment) concerning whether or to what extent it was an amount subject to withholding. A withholding agent that requests consideration under the Section 1441 VCP agrees to (1) identify those areas in which it is not in compliance with tax, withholding, and reporting obligations on payments to foreign persons; (2) pay any tax, interest, and penalties (all as determined by the IRS) due to satisfy its outstanding tax, withholding, and reporting obligations; and (3) institute corrective procedures that will ensure compliance in the future with the withholding agent's tax, withholding, and reporting obligations. The IRS will not impose penalties for identified underpayments or deficiencies if such underpayments or deficiencies are due to reasonable cause. See section 5.02(3) of this revenue procedure. The IRS

will provide the withholding agent with a written acknowledgment, as described in section 5.06 of this revenue procedure, if the IRS finds the withholding agent's proposed procedures and policies relating to tax, withholding, and reporting obligations applicable to payments to foreign persons are acceptable.

.04 No effect on or applicability to other obligations. Subject to the limitations described below, the Section 1441 VCP applies to tax, withholding, and reporting obligations under sections 1441, 1442, 1443, and 1461 and related tax, withholding, and reporting obligations under sections 3406 and 6041 through 6050N that arise from adjustments under sections 1441, 1442, 1443, and 1461. The Section 1441 VCP does not apply to and does not affect any other tax or reporting obligation. In addition, the Section 1441 VCP does not apply to and does not affect any other obligations of the taxpayer or the IRS that are not within the scope of this revenue procedure.

SECTION 2 ELIGIBLE WITHHOLDING AGENTS

.01 Eligible withholding agents. Except as provided in section 2.02, a withholding agent is eligible for the Section 1441 VCP (an "eligible withholding agent") if it is a withholding agent, as defined in § 1.1441–7(a)(1) of the Income Tax Regulations, that is not a "qualified intermediary," a "withholding foreign partnership," a "withholding foreign trust," or an "eligible organization" as defined in section 2.01 of Rev. Proc. 2001–20, 2001–1 C.B. 738.

.02 Withholding agents currently under examination. A withholding agent is not eligible for the Section 1441 VCP if the withholding agent is under examination with respect to Form 1042 on the date of the publication of this revenue procedure, or if it comes under examination prior to submitting the information required by section 4 of this revenue procedure. For this purpose, an examination is treated as commencing on the date the withholding agent receives notification from the IRS of an impending examination or of an impending referral for examination. This program also is not available to any withholding agent that has a case pending in Appeals or in litigation on issues involving tax, withholding, or reporting obligations described in section 3 of this revenue procedure.

SECTION 3 TAX, WITHHOLDING, AND REPORTING OBLIGATIONS SUBJECT TO THE SECTION 1441 VCP

.01 Disclosures and representations of withholding agent. The Section 1441 VCP allows a withholding agent to come forward voluntarily to disclose withholding deficiencies and reporting errors. The Section 1441 VCP does not provide substantive determinations about a payment (such as the amount, timing, character, or source of such a payment) concerning whether or to what extent it was an amount subject to withholding. The Section 1441 VCP will proceed based on the withholding agent's disclosures and representations regarding, for example, the amount, timing, character, and source of payments, and the U.S. or foreign status of a beneficial owner. The issuance of an acknowledgment letter, as described in section 5.06 of this revenue procedure, is not a determination of the validity of those disclosures and representations, which remain subject to subsequent examination.

.02 Failures subject to the Section 1441 VCP. The failures for which an eligible withholding agent may make a submission under the Section 1441 VCP are:

(1) Failure to withhold or pay the correct amount of tax on dividends, interest, or other income that would properly be taken into account on Form 1042 and that is paid to foreign persons (sections 1441, 1442, and 1443);

(2) Failure to withhold or pay the correct amount of backup withholding tax as the result of failure to document U.S. persons or misclassification of U.S. and foreign persons (section 3406); and

(3) Failure to correctly report information under section 1461 or, in the case of failures described in (2) above, sections 6041–6050N.

SECTION 4 SUBMISSION PROCEDURES

.01 In general. In general, a withholding agent submits a request under the Section 1441 VCP through a letter to the IRS at the address in section 4.08 of this revenue procedure. The submission must contain the information and documentation described in sections 4.02 and 4.03 of this revenue procedure. The IRS will not accept anonymous submissions under the Section 1441 VCP.

.02 Required information. The request for consideration under the Section 1441 VCP must contain the following information:

(1) The name, address, and taxpayer identification number of the withholding agent.

(2) A description of the current procedures that the withholding agent uses to determine tax, withholding, and reporting obligations regarding payments to foreign persons.

(3) A description of the failures in the withholding agent's tax, withholding, and reporting procedures for payments to foreign persons, how and why the failures occurred, and the years affected by such failures.

(4) The number of persons affected by such failures and how the number was determined.

(5) A calculation of the total amount of taxes the withholding agent failed to withhold, pay, and/or report, not including interest and penalties, for tax periods open for assessment or collection under the provisions of section 6501 of the Code. This calculation should take into account properly substantiated adjustments under section 1463 of the Code. The withholding agent must agree to report and remit all of its additional tax, interest, and penalties (all as determined by the IRS), at the completion of the IRS review. See section 5 of this revenue procedure. (However, regarding the reasonable-cause exception to penalties, see section 5.02(3) of this revenue procedure.) In certain cases involving large liabilities or underpayments, the IRS will consider the withholding agent's proposal for payment of the liability or underpayment in more than one installment, or will consider the withholding agent's posting of a cash bond under the procedures outlined in Rev. Proc. 84–58, 1984–2 C.B. 501. See section 5.02(4) of this revenue procedure.

(6) A detailed description of the corrective procedures the withholding agent has implemented or will implement to ensure that payments to foreign persons will be subject to the correct amount of withholding and that withheld amounts will be paid

over and reported to the IRS on the proper forms in a timely manner.

(7) A statement signed by the withholding agent or its authorized representative acknowledging and agreeing that the withholding agent's participation in the section 1441 VCP will not constitute an audit of the withholding agent.

.03 Required documents. The submission must be accompanied by the following documentation:

(1) A statement that the withholding agent is an eligible withholding agent.

(2) Copies of workpapers or schedules that clearly explain the withholding agent's calculation of its correct tax liability regarding payments to foreign persons (see section 4.02(5) of this revenue procedure). The workpapers or schedules should also show to which specific tax returns and tax periods the liability relates.

(3) Copies of the original Forms 1042 and 945, if any, as filed that relate to the above calculations.

.04 Signatures. The submission must be signed by the withholding agent or the withholding agent's authorized representative.

.05 Power of attorney requirements. To sign the submission or to appear before the IRS in connection with the submission, a representative must comply with the requirements of section 9 of Rev. Proc. 2004–1, 2004–1 I.R.B. 1.

.06 Penalty of perjury statement. The following declaration must accompany a Section 1441 VCP submission and any factual information submitted after the original submission or any change in the submission at a later time: "Under penalties of perjury, I declare that I have examined this submission, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the Section 1441 VCP request are true, correct, and complete." The declaration must be signed by the withholding agent, not the withholding agent's representative (described in section 4.05 above).

.07 Marked letter and marked envelope. The letter which transmits the submission to the IRS must be marked "Section 1441 VCP" in the upper right-hand corner of the letter, and the envelope containing the submission must be marked "Section 1441 VCP" in the lower left-hand corner of the envelope.

.08 Mailing address. The submission must be mailed to the address shown below. The IRS may issue an announcement later which contains other addresses for the mailing of Section 1441 VCP submissions.

Internal Revenue Service
290 Broadway
LMSB 12th Floor
New York, NY 10007
ATTN: Section 1441 VCP Coordinator

SECTION 5 PROCESSING OF SECTION 1441 VCP REQUESTS

.01 Inadequate or incomplete submission or request for additional information. If the submission fails to comply with the provisions of this revenue procedure, or if the IRS requires additional information, the IRS representative assigned to the case will contact the withholding agent or its authorized representative and explain what is needed to complete the submission. The withholding agent will have 90 business days from the date of this contact to provide the requested information. Any request for an extension of the 90-day time period must be made prior to expiration of the period and must be approved by the Section 1441 VCP Coordinator or his or her designated representative. If the requested information is not received within 90 business days (plus any extension, if granted), the matter will be closed, and the IRS may consider the case for examination.

.02 Determining tax liability. Once the IRS accepts the submission under the Section 1441 VCP, the IRS will analyze the withholding agent's calculation of its tax liability regarding payments to foreign persons and will analyze the accompanying workpapers, schedules, and returns that support such calculation. The IRS generally will apply the following approach to determine a withholding agent's liability for tax, interest, and penalties:

(1) The IRS will normally allow reduced rates of withholding in the computation of any adjustments to taxes and withholding of taxes on payments to foreign persons if the withholding agent has properly documented the foreign persons and if the documentation relates to the time of payment.

(2) Interest on the withholding agent's underpayments will be due from the last date prescribed for payment of the taxes (determined without regard to the Section 1441 VCP or any extension of time for payment) to the date on which payment is received.

(3) The IRS will not assert any penalties on the withholding agent's liability if the withholding agent's failure to withhold, pay, and report is due to reasonable cause.

(4) In certain cases involving large liabilities, the IRS will consider the withholding agent's proposal for payment of the liability in more than one installment. See Internal Revenue Manual (IRM) Handbook 4.20.4, Examination Collectibility Handbook. Applicants may also wish to avail themselves of the procedures for making a deposit in the nature of a cash bond as contained in Rev. Proc. 84–58, 1984–2 C.B. 501.

.03 Review of withholding agent's corrective procedures. The withholding agent must demonstrate to the satisfaction of the IRS that it has implemented (or that it has plans for implementing) the corrective procedures described in its submission under section 4.02(6). The IRS will review the corrective procedures to assure itself that these procedures are reasonably likely to bring the withholding agent into compliance on a prospective basis. The IRS will discuss with the withholding agent the effectiveness of its corrective procedures. The IRS reserves the right to require modifications to the corrective procedures or to require additional corrective procedures before it will issue an acknowledgment letter, as described in section 5.06 below. Where the IRS believes that the corrective procedures are not adequate to ensure compliance with the relevant tax, withholding, and reporting requirements, the IRS will not issue such an acknowledgment letter.

.04 Other tax liabilities or issues. If while considering the request the IRS discovers an unrelated tax liability that properly could have been the subject of the Section 1441 VCP submission but was not properly identified in the submission, that issue will remain outside the scope of the Section 1441 VCP.

.05 Verification. As part of the processing of the Section 1441 VCP submission, the IRS reserves the right to verify that corrections have been made to the withholding agent's tax, withholding, and reporting

procedures with respect to payments to foreign persons. Verification of such corrections does not constitute an examination of the books and records of the withholding agent. If the IRS determines that the withholding agent has not implemented or does not plan to implement the proper corrections and procedures, the case may be considered for examination. More generally, the IRS does not contemplate opening examinations on issues properly within the scope of a Section 1441 VCP submission but reserves the right to do so. If the IRS decides to examine the withholding agent, the examination will be commenced and completed as soon as possible.

.06 Acknowledgment letter. If, at the conclusion of its review, the IRS is satisfied that the withholding agent has instituted policies and procedures that ensure that the correct amounts of taxes on payments to foreign persons will be withheld, paid, and reported to the IRS on the proper forms in a timely manner, and has paid its outstanding liabilities as determined under section 5.02 of this revenue procedure (or has entered into an arrangement for such payment as described in section 5.02(4)), then the IRS will issue to the withholding agent an acknowledgment letter. The letter shall indicate that, based upon the IRS review, the withholding agent is at that time in substantial compliance with its tax, withholding, and reporting obligations with respect to payments to foreign persons. However, the Section 1441 VCP does not provide substantive determinations about a payment (such as the amount, timing, character, or source of such a payment) concerning whether or to what extent it was an amount subject to withholding, and an acknowledgment letter shall expressly state that the substantial-compliance acknowledgment does not apply to whether or to what extent payments are amounts subject to withholding. After the withholding agent has received an acknowledgment letter at the completion of the Section 1441 VCP process, and provided that the withholding agent in fact complies with the agreed upon withholding, payment, and reporting procedures, the information submitted by the withholding agent to the IRS under the Section 1441 VCP will not be used as the basis to initiate an examination of the withholding agent concerning issues within the scope of the acknowledgment letter for prior tax years that were the subject of the Section 1441 VCP submission.

.07 Failure to reach resolution. If resolution cannot be reached because sufficient information is not timely provided to the IRS or because agreement cannot be reached on corrective procedures, the IRS may consider the case for examination.

.08 Applicability of sections 6103 and 6110. The information received or generated by the IRS under the Section 1441 VCP is subject to the confidentiality requirements of section 6103 of the Code. The acknowledgment letter is not a written determination letter within the meaning of section 6110.

.09 Conferences. If the IRS declines to issue an acknowledgment letter because the parties cannot agree upon the amount of tax, interest, and penalties due, or upon the required corrective procedures, the withholding agent may request a conference. The IRS, in its discretion, may grant or deny the conference request. The conference may be held either in person or by telephone. If a conference request is granted, an IRS representative will contact the withholding agent.

SECTION 6 EFFECTIVE DATE AND SUNSET DATE

The Section 1441 VCP is effective on September 29, 2004. It will be available for submissions made on or before December 31, 2005.

SECTION 7 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 1545–1901.

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 contained in this revenue procedure are in section 4.02 and section 4.03(2). This information will enable the IRS to determine whether a withholding agent qualifies for the Section 1441 VCP. The collections of information are voluntary. The likely respondents are financial institutions and other businesses.

The estimated total annual reporting burden is 200,000 hours.

The estimated average annual burden per respondent is 400 hours. 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.

SECTION 8 CONTACT INFORMATION

For further information regarding the Section 1441 VCP contact the Section 1441 VCP Coordinator at (212) 298–2288 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also, Part I, §§ 62, 162, 267, 274; 1.62–2, 1.162–17, 1.267(a)–1, 1.274–5.)

Rev. Proc. 2004–60

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2003–80, 2003–45 I.R.B. 1037, 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 are 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 the expenses. In addition, this revenue procedure provides an optional method for employees and self-employed individuals who pay or incur meal costs to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. This revenue procedure also provides an optional method for use in computing the deductible costs of incidental expenses

paid or incurred while traveling away from home by employees and self-employed individuals who do not pay or incur meal costs and who are not reimbursed for the incidental expenses. 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 the 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 2004 and 2005, the deductible percentage for these expenses is 70 percent.

.03 Section 274(d) provides, in part, that no deduction is allowed under § 162 for any travel expense (including meals and lodging while away from home) unless the taxpayer complies with certain substantiation requirements. Section 274(d) 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 the regulations.

.04 Section 1.274–5(g), 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 these 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 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 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 do 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 the 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) will be treated as substantiation of the amount of the 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 is 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 the 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 within a reasonable period of time any portion of the 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 the travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g) or § 1.274–5(j), 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 has the discretion to 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 1.274–5(j)(3) grants the Commissioner the authority to establish a

method under which a taxpayer may elect to use a specified amount for incidental expenses paid or incurred while traveling away from home in lieu of substantiating the actual cost of incidental expenses.

.12 Sections 3.02(1)(a), 4.04(6), and 5.06 of this revenue procedure provide transition rules for the last 3 months of calendar year 2004.

.13 Section 5.02 of this revenue procedure contains revisions to the *per diem* rates for high-cost localities and for other localities for purposes of section 5.

.14 Sections 5.03 and 5.04 of this revenue procedure contain revisions to the list of high-cost localities for purposes of section 5.

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) *In general*. 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 2004 for expenses of all CONUS travel away from home that are paid or incurred during calendar year 2004 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, 2004, through December 31, 2004.

(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" has the same meaning as in the Federal Travel Regulations, 41 C.F.R. 300–3.1 (2004). Thus, based on the current definition of "incidental expenses" in the Federal Travel Regulations, "incidental expenses" means fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries; transportation between places of lodging or business and places where meals are taken, if suitable meals cannot be obtained at the temporary duty site; and the mailing cost associated with filing travel vouchers and payment of employer-sponsored charge card billings.

.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. The 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 (such as 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 (such as 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 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 that 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 that day (or partial day, see section 6.04 of this revenue procedure).

.02 *Meal and incidental expenses only per diem allowance*. If a payor pays a *per diem* allowance only for meal and incidental expenses in lieu of reimbursing actual meals 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 that day or the amount computed at the federal M&IE rate for the locality of travel for that day (or partial day). 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 (such as the number of hours worked, miles traveled, or pieces produced).

.03 *Optional method for meal and incidental expenses only deduction.* In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary meal and incidental expenses paid or incurred for travel away from home, employees and self-employed individuals who pay or incur meal expenses may use an amount computed at the federal M&IE rate for the locality of travel for each calendar day (or partial day) the employee or self-employed individual is away from home. This amount will be deemed substantiated for purposes of paragraphs (b)(2) 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 for that day (or partial day) in accordance with those regulations. See section 6.05(1) of this revenue procedure for rules related to the application of the limitation under § 274(n) to amounts determined under this section 4.03. See section 4.05 of this revenue procedure for a method for substantiating incidental expenses that may be used by employees or self-employed individuals who do not pay or incur meal expenses.

.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) *Transportation industry defined.* For purposes of this section 4.04, 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.

(3) *Rates.* A taxpayer described in section 4.04(1) of this revenue procedure may treat $41 as the federal M&IE rate for any CONUS locality of travel, and $46 as the federal M&IE rate for any OCONUS locality of travel. 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(6) of this revenue procedure for transition rules.

(4) *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 either at the federal M&IE rate(s) for the localities of travel, or at the special rate described in section 4.04(3), for the days (or partial days) the employee is away from home during the period.

(5) *Examples.*

(a) *Example 1.* Taxpayer, an employee in the transportation industry, travels away from home on business within CONUS on 17 days (including partial days) 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(3) 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 $697 (17 days at $41 per day).

(b) *Example 2.* Taxpayer, a truck driver employee in the transportation industry, is paid a "cents-per-mile" allowance that qualifies as an allowance paid under a flat rate or stated schedule as defined in section 3.03 of this revenue procedure. Taxpayer travels away from home on business for 10 days. Based on the number of miles driven by Taxpayer, Taxpayer's employer pays an allowance of $400 for the 10 days of business travel. Taxpayer actually drives for 8 days, and does not drive for the other 2 days Taxpayer is away from home. Taxpayer is paid under the periodic rule used for transportation industry employers and employees in accordance with section 4.04(4) of this revenue procedure. The amount deemed substantiated and excludable from Taxpayer's income is the full $400 because that amount does not exceed $410 (ten days away from home at $41 per day).

(6) *Transition rules.* Under the calendar-year convention provided in section 4.04(3), a taxpayer who used the federal M&IE rates during the first 9 months of calendar year 2004 to substantiate the amount of an individual's travel expenses under sections 4.02 or 4.03 of Rev. Proc. 2003–80 may not use, for that individual, the special transportation industry rates provided in this section 4.04 until January 1, 2005. Similarly, a taxpayer who used the special transportation industry rates during the first 9 months of calendar year 2004 to substantiate the amount of an individual's travel expenses may not use, for that individual, the federal M&IE rates until January 1, 2005.

.05 *Optional method for incidental expenses only deduction.* In lieu of using actual expenses in computing the amount allowable as a deduction for ordinary and necessary incidental expenses paid or incurred for travel away from home, employees and self-employed individuals who do not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may use, for each calendar day (or partial day) the employee or self-employed individual is away from home, an amount computed at the rate of $3 per day for any CONUS or OCONUS locality of travel.

This amount will be deemed substantiated for purposes of paragraphs (b)(2) 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 for that day (or partial day) in accordance with those regulations. See section 4.03 of this revenue procedure for a method that may be used by employees or self-employed individuals who pay or incur meal expenses. The method authorized by this section 4.05 may not be used by payors that use section 4.01, 4.02, or 5.01 of this revenue procedure, or by employees or self-employed individuals who use the method described in section 4.03 of this revenue procedure. See section 6.05(4) of this revenue procedure for rules related to the application of the limitation under § 274(n) to amounts determined under this section 4.05.

SECTION 5. HIGH-LOW SUBSTANTIATION METHOD

.01 *In general*. If a payor pays a *per diem* allowance in lieu of reimbursing actual 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 to the lesser of the *per diem* allowance for that day or the amount computed at the rate set forth in section 5.02 of this revenue procedure for the locality of travel for that day (or partial day, see section 6.04 of this revenue procedure). Except as provided in section 5.06 of this revenue procedure, this high-low substantiation method may be used in lieu of the *per diem* substantiation method provided in section 4.01 of this revenue procedure, but may not be used in lieu of the meals 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 $199 for travel to any "high-cost locality" specified in section 5.03 of this revenue procedure, or $127 for travel to any other locality within CONUS. The high or low rate, as appropriate, applies 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 $46 for a high-cost locality and $36 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*
Arizona	
Phoenix/Scottsdale (January 1-May 31)	Maricopa
California	
Monterey (February 1-November 30)	Monterey
Napa (May 1-October 31)	Napa
Palm Springs (January 1-May 31)	Riverside
San Diego	San Diego
San Francisco	San Francisco
Santa Barbara	Santa Barbara
Santa Monica	City limits of Santa Monica
South Lake Tahoe (December 1-August 31)	El Dorado

Key City	*County or other defined location*
Colorado	
Aspen	Pitkin
Crested Butte	City limits of Crested Butte
(December 1-March 31)	(Gunnison County)
Silverthorne/Breckenridge	Summit
Telluride	San Miguel
(December 1-September 30)	
Vail	Eagle
District of Columbia	
Washington D.C. (also the cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington, Loudoun, and Fairfax, in Virginia; and the counties of Montgomery and Prince George's in Maryland) (See also Maryland and Virginia)	
Delaware	
Lewes	Sussex
(July 1-August 31)	
Florida	
Daytona Beach	Volusia
(February 1-March 31)	
Fort Lauderdale	Broward
(October 1-May 31)	
Key West	Monroe
Miami	Miami-Dade
(October 1-May 31)	
Naples	Collier
(January 1-March 31)	
Palm Beach	Palm Beach (also the cities of Boca Raton, Delray Beach,
(October 1-May 31)	Jupiter, Palm Beach Gardens, Palm Beach Shores, Singer Island and West Palm Beach)
Illinois	
Chicago	Cook and Lake
Louisiana	
New Orleans	Orleans and St. Bernard
(September 1-April 30)	Parishes
Maryland	
(For the counties of Montgomery and Prince George's, see District of Columbia)	
Baltimore	Baltimore
Cambridge/St. Michaels	Dorchester and Talbot
(June 1-August 31)	
Ocean City	Worcester
(July 1-August 31)	
Massachusetts	
Boston	Suffolk
Cambridge	City limits of Cambridge

Key City	*County or other defined location*
Hyannis (July 1-August 31)	Barnstable
Martha's Vineyard (May 1-August 31)	Dukes
Nantucket	Nantucket
Michigan	
Mackinac Island	Mackinac
Nevada	
Las Vegas (September 1-May 31)	Clark
New Jersey	
Atlantic City (May 1-October 31)	Atlantic
Cape May (June 1-August 31)	Cape May (except Ocean City)
Ocean City (June 1-October 31)	City limits of Ocean City
Princeton/Trenton	Mercer
Tom's River (July 1-August 31)	Ocean
New Mexico	
Santa Fe (July 1-August 31)	Santa Fe
New York	
Brooklyn/The Bronx/Queens/Staten Island	Richmond and the boroughs of Brooklyn, The Bronx, and Queens
Carle Place/Garden City/Glen Cove/ Great Neck/Plainview/Rockville Centre/Syosset/Uniondale/Woodbury	Nassau
Lake Placid (July 1-August 31)	Essex
Manhattan	The borough of Manhattan
Riverhead/Ronkonkoma/Melville	Suffolk
Tarrytown	Westchester (except White Plains)
White Plains	City limits of White Plains
North Carolina	
Kill Devil (April 1-October 31)	Dare
Pennsylvania	
Hershey (May 1-August 31)	City limits of Hershey
Philadelphia	Philadelphia

Key City	*County or other defined location*
Rhode Island	
Jamestown/Middletown/Newport (May 1-October 31)	Newport
Providence	Providence
South Carolina	
Hilton Head (April 1-October 31)	Beaufort
Myrtle Beach (June 1-August 31)	Horry
Utah	
Park City (December 1-March 31)	Summit
Virginia	
(For the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, see District of Columbia)	
Virginia Beach (June 1-August 31)	Cities of Virginia Beach, Norfolk, Portsmouth, Chesapeake, and Suffolk
Washington	
Seattle (May 1-October 31)	King

.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. 2003–80 (changes listed by key cities).

(1) The following localities have been added to the list of high-cost localities: Cambridge/St. Michaels, Maryland; Crested Butte, Colorado; Daytona Beach, Florida; Fort Lauderdale, Florida; Hilton Head, South Carolina; Hyannis, Massachusetts; Jamestown/Middletown/Newport, Rhode Island; Kill Devil, North Carolina; Lake Placid, New York; Las Vegas, Nevada; Lewes, Delaware; Miami, Florida; Monterey, California; Myrtle Beach, South Carolina; Palm Beach, Florida; Phoenix/Scottsdale, Arizona; Providence, Rhode Island; San Diego, California; Santa Barbara, California; Santa Fe, New Mexico; South Lake Tahoe, California; Tarrytown, New York; Tom's River, New Jersey; and Virginia Beach, Virginia.

(2) The portion of the year for which the following are high-cost localities has been changed: Aspen, Colorado; Atlantic City, New Jersey; Cape May, New Jersey; Hershey, Pennsylvania; Key West, Florida; Martha's Vineyard, Massachusetts; Nantucket, Massachusetts; Napa, California; Naples, Florida; New Orleans, Louisiana; Ocean City, Maryland; Ocean City, New Jersey; Park City, Utah; Seattle, Washington; Telluride, Colorado; and Vail, Colorado.

(3) The following localities have been removed from the list of high-cost localities: Big Sky, Montana; Coeur d'Alene, Idaho; Edison, New Jersey; Kennebunk/Kittery/Sanford, Maine; King of Prussia/Ft. Washington/Bala Cynwyd, Pennsylvania; Newark, New Jersey; Piscataway/Belle Mead, New Jersey; Stateline, Nevada; Sun Valley, Idaho; Tahoe City, California; Traverse City, Michigan; and Wintergreen, Virginia.

(4) The boroughs of Brooklyn and Staten Island are no longer separately listed as high-cost localities and are now combined with the boroughs of The Bronx and Queens.

.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. 2003–80 for an employee during the first 9 months of calendar year 2004 may not use the high-low substantiation method in section 5 of this revenue procedure for that employee until January 1, 2005. A payor who used the high-low substantiation method of section 5 of Rev. Proc. 2003–80 for an employee during the first 9 months of calendar year 2004 must

continue to use the high-low substantiation method for the remainder of calendar year 2004 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. 2003–80, 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, 2004, and before January 1, 2005, 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 (2004), 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 during each day of travel.

.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. The method described in section 6.04(1) of this revenue procedure must be used for purposes of determining the amount deemed substantiated under section 4.03 or 4.05 of this revenue procedure for partial days of travel away from home. For purposes of determining the amount deemed substantiated under section 4.01, 4.02, 4.04, or 5 of this revenue procedure for 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) The 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. The same ratio may be applied to prorate the allowance for incidental expenses described in section 4.05 of this revenue procedure; or

(2) The 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 two times the federal M&IE rate will be treated as being in accordance with reasonable business practice (even though only one and a half 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*. Except as provided in section 6.05(4), 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) If an amount for meal and incidental expenses is computed pursuant to section 4.03 of this revenue procedure, the taxpayer must treat that amount as an expense for food and beverages.

(2) If 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 each day (or partial day, see section 6.04 of this revenue procedure) as an expense for food and beverages.

(3) If 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) the employee is away from home as an expense for food and beverages. For purposes of the preceding sentence, if 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 each day (or partial day), the payor may treat an amount equal to 40 percent of the allowance as the federal M&IE rate for the locality of travel for each day (or partial day).

(4) If an amount for incidental expenses is computed under section 4.05 of this revenue procedure, none of the amount so computed is subject to limitation under § 274(n) on the deductibility of food and beverage expenses.

.06 *No double reimbursement or deduction*. If a payor pays a *per diem* allowance in lieu of reimbursing actual 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 those 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, "*Wage and Tax Statement*," 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 those 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 do not apply if 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 substantiates to the payor the elements of time, place, and business purpose of the travel for that day (or partial day) in accordance with paragraphs (b)(2) 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) of 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 the allowance that relates to days of travel not substantiated, even though the arrangement does not require the employee to return the portion of the 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 $31, 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 ($27) that exceeds the amount of the employee's expenses deemed substantiated under section 4.02 of this revenue procedure ($93) for the 3 substantiated days of travel. However, the $27 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, that 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 pays or incurs amounts for meal expenses and 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 on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67. See section 7.07 of this revenue procedure for the treatment of an employee who does not pay or incur amounts for meal expenses and does not receive a *per diem* allowance for incidental expenses.

.07 An employee who does not pay or incur amounts for meal expenses and does not receive a *per diem* allowance for incidental expenses may deduct an amount computed pursuant to section 4.05 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. See section 7.06 of this revenue procedure for the treatment of an employee who pays or incurs amounts for meal expenses and does not receive a *per diem* allowance for meal and incidental expenses.

.08 A self-employed individual who pays or incurs meal expenses for a calendar day (or partial day) of travel away from home 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 on meal and entertainment expenses provided in § 274(n).

.09 A self-employed individual who does not pay or incur meal expenses for a calendar day (or partial day) of travel away from home may deduct an amount computed pursuant to section 4.05 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.10 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. See § 1.62–2(k). Thus, these 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 payroll 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 § 1.62–2(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 § 1.62–2(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(4) 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(4) 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

Rev. Proc. 2003–80 is superseded (except to the extent specified in sections 3.02(1), 4.04(6), and 5.06 of this revenue procedure) for *per diem* allowances that are paid both (1) to an employee on or after October 1, 2004, and (2) with respect to lodging, meal, and incidental expenses or with respect to meal and incidental expenses paid or incurred for travel away from home on or after October 1, 2004. Rev. Proc. 2003–80 is also superseded (except to the extent specified in sections 3.02(1) and 4.04(6) of this revenue procedure) for purposes of computing the amount allowable as a deduction for meal and incidental expenses or for incidental expenses only paid or incurred by an employee or self-employed individual for travel away from home on or after October 1, 2004.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christian Wood of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Wood at (202) 622–4930 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Predeceased Parent Rule

REG–145988–03

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 predeceased parent rule, which provides an exception to the general rules of section 2651 of the Internal Revenue Code (Code) for determining the generation assignment of a transferee of property for generation-skipping transfer (GST) tax purposes. These proposed regulations also provide rules regarding a transferee assigned to more than one generation. The proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997 and generally apply to individuals, 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 December 2, 2004. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for December 14, 2004, at 10 a.m., must be received by November 23, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–145988–03), room 5203, 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 4 p.m. to CC:PA:LPD:PR (REG–145988–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at: *www.irs.gov/regs* or via the Federal eRulemaking portal at *www.regulations.gov* (IRS and REG–145988–03). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Lian A. Mito at (202) 622–7830; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, Guy R. Traynor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed regulations under sections 2651(e) and (f)(1) of the Internal Revenue Code (Code). Section 2651(e) was added to the Code by section 511(a) of the Taxpayer Relief Act of 1997 (Public Law 105–34; 111 Stat. 778; 1997–4 C.B. 1, vol. 1) (the 1997 Act) and expands the predeceased parent exception from GST tax previously contained in former section 2612(c)(2).

Under chapter 13 of the Code, a GST tax is imposed on all transfers, whether made directly or indirectly, to skip persons. Generally, a skip person is a person who is two or more generations below the generation of the transferor, or a trust if all of the interests are held by skip persons. The transferor is the individual who transferred property in a transaction subject to the gift or estate tax. Transfers that are subject to the GST tax are direct skips, taxable terminations, and taxable distributions. A direct skip is a transfer subject to gift or estate tax of an interest in property to a skip person. A taxable termination is the termination by death, lapse of time, release of power, or otherwise, of an interest in property held in a trust unless, immediately after the termination, a non-skip person has an interest in the property or at no time after the termination may a distribution be made from the trust to a skip person. A taxable distribution is any distribution (other than a direct skip or taxable termination) from a trust to a skip person.

For transfers before 1998, former section 2612(c)(2) provided an exception to the general rule that a transfer, either outright or in trust, to a grandchild of the transferor was a direct skip. Under former section 2612(c)(2), if a parent of the transferor's grandchild was a lineal descendant of the transferor and that parent was deceased at the time of the transfer, the grandchild was treated as the child of the transferor for purposes of determining whether a transfer was a direct skip. This rule also applied to a transfer made to a grandchild of the transferor's spouse or former spouse if a parent of the grandchild was a lineal descendant of the transferor's spouse or former spouse and that parent was deceased at the time of the transfer.

Former section 2612(c)(2) further provided that, if a transferor's grandchild was treated as the transferor's child, the lineal descendants of that grandchild also moved up one generation level. Furthermore, if any transfer of property to a trust would be a direct skip but for the application of the exception, any generation assignment determined under this exception also applied for purposes of applying chapter 13 of the Code to transfers from the portion of the trust attributable to the property. Therefore, a subsequent distribution of property from a trust to a grandchild treated as a child of the transferor was not treated as a taxable distribution.

Section 511(a) of the 1997 Act repealed former section 2612(c)(2) and replaced it with new subsection (e) of section 2651, which contains the rules for assigning individuals to generations for purposes of the GST tax. Section 2651(e) broadens the predeceased parent rule by expanding its application to: (1) transfers that would be taxable distributions or taxable terminations; and (2) transfers to collateral heirs (lineal descendants of the transferor's parents, or the parents of the transferor's spouse or former spouse), provided that the transferor (or the transferor's spouse or former spouse) has no living lineal descendants at the time of the transfer. Section 2651(e) applies to terminations, distributions, and transfers occurring after December 31, 1997.

Section 2651(e) applies if an individual is a descendant of a parent of the transferor (or the transferor's spouse or former spouse) and if the individual's parent, who also is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse), died prior to

the time the transferor is subject to estate or gift tax on the transfer from which an interest of that individual is established or derived. If these criteria are satisfied, then the individual is treated under section 2651(e) as if the individual is a member of the generation that is one generation below the lower of either the transferor's generation or the generation of the individual's youngest living lineal ancestor who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse). Section 2651(e) does not apply, however, to a transfer to an individual who is not a lineal descendant of the transferor (or the transferor's spouse or former spouse) if, at the time of the transfer, the transferor (or the transferor's spouse or former spouse, if applicable) has any living lineal descendant.

Explanation of Provisions

Predeceased Parent Rule

The proposed regulations provide rules and examples regarding the predeceased parent rule of section 2651(e). One issue addressed in these proposed regulations is the time when an interest is established or derived. The proposed regulations provide that, for purposes of section 2651(e), an individual's interest in property or a trust is established or derived at the time the transferor is subject to transfer tax under chapter 11 or 12 of the Code. If a transferor is subject to transfer tax under chapter 11 or 12 of the Code on the property transferred on more than one occasion, then the individual's interest will be considered established or derived on the earliest of those occasions.

However, the proposed regulations provide an exception to this general rule for remainder interests in trusts for which an election under section 2056(b)(7) (QTIP election) has been made to treat all or part of the trust as qualified terminable interest property (QTIP). Specifically, to the extent of the QTIP election, the remainder beneficiary's interest will be deemed to have been established or derived on the death of the transferor's spouse (the income beneficiary), rather than on the transferor's earlier death. Absent this exception, a remainder beneficiary of a QTIP trust would not benefit from the predeceased parent rule if the remainder beneficiary's parent is alive when the QTIP trust is established, but is deceased when the income beneficiary's interest terminates. Without this exception, the rule under section 2651(e) would be more restrictive than the previous rule under former section 2612(c)(2) which, by referring to the transfer from the transferor (*i.e.*, the surviving spouse, in the case of a QTIP trust), would have made the predeceased parent rule available to the remainder beneficiary. The rule under section 2651(e), however, does not apply to any trust for which the election under section 2652(a)(3) (reverse QTIP) is made. If a reverse QTIP election is made, the grantor remains the transferor of the trust for purposes of chapter 13 of the Code. In most cases in which the reverse QTIP election has been made for a trust, the transferor's GST exemption has been allocated to the trust. Thus, the trust will be exempt from GST tax.

Solely for purposes of section 2651(e), these proposed regulations limit the term *ancestor* to a lineal ancestor. No inference should be drawn with respect to the definition of *ancestor* for purposes of any other section of the Code.

Individuals Assigned to More Than One Generation

Under section 2651(f)(1), an individual who would be assigned to more than one generation is assigned to the youngest of those generations. This rule prevents the avoidance of the GST tax through adoption or marriage. Thus, for example, a transferor cannot avoid GST tax by adopting the transferor's adult grandchild. The Treasury Department and IRS believe, however, that it is reasonable to presume that tax avoidance is not a primary motive when a transferor adopts a descendant of a parent of the transferor (or the transferor's spouse or former spouse) who is a minor. Thus, under the proposed regulations, if an adoptive parent legally adopts an individual who is: (1) a descendant of a parent of the adoptive parent (or the adoptive parent's spouse or former spouse); and (2) under the age of 18 at the time of the adoption, then the adopted individual will be treated as a member of the generation that is one generation below the adoptive parent for purposes of determining whether a transfer from the adoptive parent (or the spouse or former spouse of the adoptive parent, or a lineal descendant of a grandparent of the adoptive parent) to the adopted individual is subject to GST tax.

In addition, the proposed regulations provide that if an individual's generation assignment is adjusted with regard to a transfer under either section 2651(e) or as a result of an adoption described above, a corresponding adjustment with respect to that transfer is made to the generation assignment of that individual's spouse or former spouse, that individual's descendants, and the spouse or former spouse of each of that individual's descendants.

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact.

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 to the IRS. The IRS and Treasury Department also 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 December 14, 2004, beginning at 10 a.m., in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. 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 30 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 December 2, 2004. 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 Lian A. Mito of the Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 26—GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1986

Paragraph 1. The authority citation for part 26 continues to read, in part, as follows:

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

Par. 2. In §26.2600–1, the table is amended by:

1. Removing the entries for §26.2612–1, paragraphs (a)(1) and (a)(2).
2. Adding entries for §§26.2651–1, 26.2651–2, and 26.2651–3.

The additions read as follows:

§26.2600–1 Table of contents.

* * * * *

§26.2612–1 Definitions.

(a) * * *

* * * * *

§26.2651–1 Generation assignment.

(a) Special rule for persons with a deceased parent.
(1) In general.
(2) Special rules.
(3) Established or derived.
(4) Special rule in the case of additional contributions to a trust.
(b) Limited application to collateral heirs.
(c) Examples.

§26.2651–2 Individual assigned to more than one generation.

(a) In general.
(b) Exception.
(c) Special rules.
(1) Corresponding generation adjustment.
(2) Continued application of generation assignment.

§26.2651–3 Effective dates.

(a) In general.
(b) Transition rule.

Par. 3. Section 26.2612–1 is amended by:

1. Removing the paragraph designation and heading for (a)(1).
2. Removing paragraph (a)(2).
3. Removing the second sentence of paragraph (f).
4. Removing *Examples 6* and *7* in paragraph (f).
5. Redesignating *Examples 8* through *15* as *Examples 6* through *13* in paragraph (f).
6. Revising the first sentence of newly designated *Example 7* in paragraph (f).
7. Revising the first sentence of newly designated *Example 11* in paragraph (f).

The revisions read as follows:

§26.2612–1 Definitions.

(a) * * *

* * * * *

(f) * * *

Example 7. Taxable termination resulting from distribution. The facts are the same as in *Example 6*, except twenty years after C's death the trustee exercises its discretionary power and distributes the entire principal to GGC. * * *

* * * * *

Example 11. Exercise of withdrawal right as taxable distribution. The facts are the same as in *Example 10*, except GC holds a continuing right to withdraw trust principal and after one year GC withdraws $10,000. * * *

* * * * *

Par. 4. Sections 26.2651–1, 26.2651–2, and 26.2651–3 are added to read as follows:

§26.2651–1 Generation assignment.

(a) *Special rule for persons with a deceased parent*—(1) *In general.* This paragraph (a) applies for purposes of determining whether a transfer to or for the benefit of an individual who is a descendant of a parent of the transferor (or the transferor's spouse or former spouse) is a generation-skipping transfer. If that individual's parent, who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse), is deceased at the time the transfer (from which an interest of such individual is established or derived) is subject to the tax imposed by chapter 11 or 12 of the Internal Revenue Code on the transferor, the individual is treated as if that individual were a member of the generation that is one generation below the lower of—

(i) The transferor's generation; or

(ii) The generation assignment of the individual's youngest living lineal ancestor who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse).

(2) *Special rules*—(i) *Corresponding generation adjustment.* If an individual's generation assignment is adjusted with respect to a transfer in accordance with paragraph (a)(1) of this section, a corresponding adjustment with respect to that transfer is made to the generation assignment of each—

(A) Spouse or former spouse of that individual;

(B) Descendant of that individual; and

(C) Spouse or former spouse of each descendant of that individual.

(ii) *Continued application of generation assignment*. If a transfer to a trust would be a generation-skipping transfer but for paragraph (a)(1) of this section, any generation assignment determined under this paragraph (a) continues to apply in determining whether any subsequent distribution from (or termination of an interest in) the portion of the trust attributable to that transfer is a generation-skipping transfer.

(iii) *Ninety-day rule*. For purposes of paragraph (a)(1) of this section, any individual who dies no later than 90 days after a transfer is treated as having predeceased the transferor.

(iv) *Local law*. Except as provided in paragraph (a)(2)(iii) of this section, a living descendant is not treated as having predeceased the transferor solely by reason of a provision of applicable local law; *e.g.*, an individual who disclaims is not treated as a predeceased parent solely because state law treats a disclaimant as having predeceased the transferor for purposes of determining the disposition of the disclaimed property.

(3) *Established or derived*. For purposes of section 2651(e) and paragraph (a)(1) of this section, an individual's interest is established or derived at the time the transferor who transferred the property that makes up the interest is subject to transfer tax imposed by either chapter 11 or 12 of the Internal Revenue Code on the property transferred. If the transferor will be subject to transfer tax imposed by either chapter 11 or 12 of the Internal Revenue Code on the property transferred on more than one occasion, then the relevant time for determining whether paragraph (a)(1) of this section applies is the earliest time at which the transferor is subject to the tax imposed by either chapter 11 or 12 of the Internal Revenue Code. However, for purposes of section 2651(e) and paragraph (a)(1) of this section, the interest of a remainder beneficiary in a trust for which an election under section 2056(b)(7) (QTIP election) has been made will be deemed to have been established or derived, to the extent of the QTIP election, on the death of the transferor's spouse (the income beneficiary). The preceding sentence does not apply to a trust for which the election under section 2652(a)(3) (reverse QTIP election) is made.

(4) *Special rule in the case of additional contributions to a trust*. If a transferor referred to in paragraph (a)(1) of this section contributes additional property to a trust that existed before the application of paragraph (a)(1), then the additional property is treated as being held in a separate trust for purposes of chapter 13 of the Internal Revenue Code. The provisions of §26.2654–1(a)(2) apply as if the portions of the single trust had had separate transferors. Other subsequent contributions are treated as contributions to the appropriate portion of the single trust.

(b) *Limited application to collateral heirs*. Paragraph (a) of this section does not apply in the case of a transfer to any individual who is not a lineal descendant of the transferor (or of the transferor's spouse or former spouse) if the transferor (or the transferor's spouse or former spouse) has any living lineal descendant at the time of the transfer.

(c) *Examples*. The following examples illustrate the provisions of this section:

Example 1. T establishes an irrevocable trust, Trust, providing that trust income is to be paid to T's grandchild, GC, for 5 years. At the end of the 5-year period or on GC's prior death, Trust is to terminate and the principal is to be distributed to GC if GC is living or to GC's children if GC has died. The transfer that occurred on the creation of the trust is subject to the tax imposed by chapter 12 of the Internal Revenue Code and, at the time of the transfer, T's child, C, who is a parent of GC, is deceased. GC is treated as a member of the generation that is one generation below T's generation. As a result, GC is not a skip person and Trust is not a skip person. Therefore, the transfer to Trust is not a direct skip. Similarly, distributions to GC during the term of Trust and at the termination of Trust will not be GSTs.

Example 2. On January 1, 2004, T transfers $100,000 to an *inter vivos* trust that provides T with an annuity payable for four years or until T's prior death. The annuity satisfies the definition of a qualified interest under section 2702(b). When the trust terminates, the corpus is to be paid to T's grandchild, GC. The transfer is subject to the tax imposed by chapter 12 of the Internal Revenue Code and, at the time of the transfer, T's child, C, who is a parent of GC, is living. C dies in 2006. In this case, C was alive at the time the transfer by T is subject to the tax imposed by chapter 12 of the Internal Revenue Code. Therefore, section 2651(e) and paragraph (a)(1) of this section do not apply. When the trust subsequently terminates, the distribution to GC is a taxable termination.

Example 3. T dies testate in 2002, survived by T's spouse, S, their children, C1 and C2, and C1's child, GC. Under the terms of T's will, a trust is established for the benefit of S and their descendants. Under the terms of the trust, all income is payable to S during S's lifetime and the trustee may distribute trust corpus for S's health, support and maintenance. At S's death, the corpus is to be distributed, outright, to C1 and C2. If either C1 or C2 has predeceased S, the deceased child's share of the corpus is to be distributed to that child's descendants, per stirpes. The executor of T's estate makes the election under section 2056(b)(7) to treat the trust property as qualified terminable interest property (QTIP) but does not make the election under section 2652(a)(3) (reverse QTIP election). In 2003, C1 dies survived by S and GC. In 2004, S dies, and the trust terminates. The full fair market value of the trust is includible in S's gross estate under section 2044 and S becomes the transferor of the trust under section 2652(a)(1)(A). Under the rule in paragraph (a)(3) of this section, GC's interest is considered established or derived at S's death, and because C1 is deceased at that time, GC is treated as a member of the generation that is one generation below the generation of the transferor, S. As a result, GC is not a skip person and the transfer to GC is not a direct skip.

Example 4. The facts are the same as in *Example 3*. However, the executor of T's estate makes the election under section 2652(a)(3) (reverse QTIP election) for the entire trust. Therefore, T remains the transferor because, for purposes of chapter 13 of the Internal Revenue Code, the election to be treated as qualified terminable interest property is treated as if it had not been made. In this case, the rule in paragraph (a)(3) of this section does not apply, so GC's interest is established or derived on T's death in 2002. Because C1 was living at the time of T's death, the predeceased parent rule under section 2651(e) does not apply, even though C1 was deceased at the time the transfer from S to GC is subject to the tax under chapter 11 of the Internal Revenue Code. When the trust terminates, the distribution to GC is a taxable termination that is subject to the GST tax to the extent the trust has an inclusion ratio greater than zero. See section 2642(a).

Example 5. T establishes an irrevocable trust providing that trust income is to be paid to T's grandniece, GN, for 5 years or until GN's prior death. At the end of the 5-year period or on GN's prior death, the trust is to terminate and the principal is to be distributed to GN if living, or if GN has died, to GN's descendants, per stirpes. S is a sibling of T and the parent of N. N is the parent of GN. At the time of the transfer, T has no living lineal descendant, S is living, N is deceased, and the transfer is subject to the gift tax imposed by chapter 12 of the Internal Revenue Code. GN is treated as a member of the generation that is one generation below T's generation because S, GN's youngest living lineal ancestor who is also a descendant of T's parent, is in T's generation. As a result, GN is not a skip person and the transfer to the trust is not a direct skip. In addition, distributions to GN during the term of the trust and at the termination of the trust will not be GSTs.

Example 6. On January 1, 2004, T transfers $50,000 to the great grandchild, GGC, of B, a brother of T. At the time of the transfer, B's grandchild, GC, who is a parent of GGC and a child of B's living child, C, is deceased. GGC will be treated as a member of the generation that is one generation below the lower of T's generation or the generation assignment of GGC's youngest living lineal ancestor who is also a descendant of the parent of the transferor. In this case, C is GGC's youngest living lineal ancestor who is also a descendant of the parent of

T. Because C's generation assignment is lower than T's generation, GGC will be treated as a member of the generation that is one generation below C's generation assignment (*i.e.*, GGC will be treated as a member of GC's generation). As a result, GGC remains a skip person and the transfer to GGC is a direct skip.

§26.2651–2 Individual assigned to more than 1 generation.

(a) *In general*. Except as provided in paragraphs (b) or (c) of this section, an individual who would be assigned to more than 1 generation is assigned to the youngest of the generations to which that individual would be assigned.

(b) *Exception*. An adopted individual will be treated as a member of the generation that is one generation below the adoptive parent for purposes of determining whether a transfer to the adopted individual from the adoptive parent (or the spouse or former spouse of the adoptive parent, or a lineal descendant of a grandparent of the adoptive parent) is subject to chapter 13 of the Internal Revenue Code. For purposes of this paragraph (b), an adopted individual is an individual who is—

(1) A descendant of a parent of the adoptive parent (or the spouse or former spouse of the adoptive parent); and

(2) Under the age of 18 at the time of the adoption.

(c) *Special rules*—(1) *Corresponding generation adjustment*. If an individual's generation assignment is adjusted with respect to a transfer in accordance with paragraph (b) of this section, a corresponding adjustment with respect to that transfer is made to the generation assignment of each—

(i) Spouse or former spouse of that individual;

(ii) Descendant of that individual; and

(iii) Spouse or former spouse of each descendant of that individual.

(2) *Continued application of generation assignment*. If a transfer to a trust would be a generation-skipping transfer but for paragraph (b) of this section, any generation assignment determined under paragraph (b) of this section continues to apply in determining whether any subsequent distribution from (or termination of an interest in) the portion of the trust attributable to that transfer is a generation-skipping transfer.

§26.2651–3 Effective dates.

(a) *In general*. The rules of §§ 26.2651–1 and 26.2651–2 are applicable for terminations, distributions, and transfers occurring on or after the date these regulations are issued as final regulations in the **Federal Register**.

(b) *Transition rule*. (1) The rule contained in the last two sentences of § 26.2651–1(a)(3) is applicable for terminations, distributions, and transfers occurring on or after the date these regulations are issued as final regulations in the **Federal Register**.

(2) Except as provided in paragraph (b)(1) of this section, in the case of transfers occurring after December 31, 1997, and before the date that this document is published in the **Federal Register** as a final regulation, taxpayers may rely on any reasonable interpretation of section 2651(e). For this purpose, these proposed regulations are treated as a reasonable interpretation of the statute.

Deborah M. Nolan,
Acting Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 2, 2004, 8:45 a.m., and published in the issue of the Federal Register for September 3, 2004, 69 F.R. 53862)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Treatment of Certain Nuclear Decommissioning Funds for Purposes of Allocating Purchase Price in Certain Deemed and Actual Asset Acquisitions

REG–169135–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9158) relating to the treatment of certain nuclear decommissioning funds in the allocation of purchase price in deemed and actual asset acquisitions under sections 338 and 1060. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments must be received by December 15, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–169135–03), room 5203, 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 4 p.m. to: CC:PA:LPD:PR (REG–169135–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*, or via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS — REG–169135–03).

FOR FURTHER INFORMATION CONTACT: Richard Starke at (202) 622–7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend 26 CFR 1 relating to sections 338 and 1060. The temporary regulations affect the treatment of certain nuclear decommissioning funds in the allocation of purchase price in deemed and actual asset acquisitions under sections 338 and 1060. The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

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 to the IRS. All comments will be available for public inspection and copying. A public hearing

will be scheduled if requested in writing by any person timely submitting 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**.

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 proposed regulations will not have a significant economic impact on a substantial number of small entities. Nevertheless, the IRS and Treasury Department request comments from small entities that believe they might be adversely affected by these regulations. This certification is based on the fact that the regulations provide relief to purchasers of nuclear power plants, which are generally not small businesses. Therefore, 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 the impact of these regulations.

Drafting Information

The principal author of these regulations is Richard Starke, Office of the Associate Chief Counsel (Corporate).

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Proposed Amendments to the Regulations

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

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

Par. 2. Section 1.338–6 is amended by adding paragraph (c)(5) to read as follows:

§1.338–6 Allocation of ADSP and AGUB among target assets.

[The text of this proposed section is the same as the text of §1.338–6T(c)(5) published elsewhere in this issue of the Bulletin].

Par. 3. Section 1.1060–1 is amended by revising paragraph (c)(3) to read as follows:

§1.1060–1 Special allocation rules for certain asset acquisitions.

[The text of this proposed section is the same as the text of §1.1060–1T(c)(3) and (e)(1)(ii)(C) published elsewhere in this issue of the Bulletin].

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 15, 2004, 8:45 a.m., and published in the issue of the Federal Register for September 16, 2004, 69 F.R. 55790)

Notice of Proposed Rulemaking and Notice of Public Hearing

Treatment of a Stapled Foreign Corporation Under Sections 269B and 367(b)

REG–101282–04

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains a notice of proposed rulemaking concerning the definition and tax treatment of a stapled foreign corporation, which generally is treated for tax purposes as a domestic corporation under section 269B of the Internal Revenue Code.

DATES: Written or electronic comments must be received by December 6, 2004. Outlines of topics to be discussed at the public hearing scheduled for December 15, 2004, at 10 a.m. must be received by December 6, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–101282–04), room 5203, 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 4 p.m. to CC:PA:LPD:PR (REG–101282–04), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–101282–04). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Richard L. Osborne, (202) 622–3977, or Bethany Ingwalson, (202) 622–3850; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Under section 269B(a)(1), if a domestic corporation and a foreign corporation are stapled entities, the foreign corporation will be treated as a domestic corporation for U.S. Federal tax purposes, unless otherwise provided in regulations. A domestic and a foreign corporation are stapled entities if more than 50 percent in value of the beneficial ownership in each corporation consists of stapled interests. Section 269B(c)(2). Interests are stapled if, by reason of form of ownership, restrictions on transfer, or other terms and conditions, in connection with the transfer of one of such interests, the other such interests are also transferred or required to be transferred. Section 269B(c)(3).

Section 269B(e) provides that a stapled foreign corporation will not be treated as a domestic corporation pursuant to section 269B(a)(1) if it is established to the satisfaction of the Secretary that the stapled corporations are foreign owned. A corporation is treated as foreign owned if U.S. persons own directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) less than 50 percent of the total combined voting power of all classes of stock entitled to vote and less than 50 percent of the total value of the stock of such corporation.

On August 28, 1989, the IRS and the Treasury Department issued Notice 89–94, 1989–2 C.B. 416, announcing the intention to adopt regulations under section

269B. The notice stated that regulations would provide that a stapled foreign corporation treated as a domestic corporation under section 269B(a)(1) was nevertheless to be treated as a foreign corporation for purposes of the definition of an includible corporation under section 1504(b). Notice 89–94 explained that, under these regulations, the stapled foreign corporation's losses would not offset the income of any member of the affiliated group unless a valid section 1504(d) election was in effect for the stapled foreign corporation.

Subsequent to the issuance of Notice 89–94, the IRS and Treasury Department became aware of instances in which taxpayers attempted to use section 269B and Notice 89–94 to manipulate the computation of their foreign tax credit limitation. These transactions typically involved stapling the interests of a domestic and foreign corporation, all or substantially all of the interests of which were held by the same person or related persons. On July 22, 2003, the IRS and Treasury Department issued Notice 2003–50, 2003–32 I.R.B. 295, to address these situations. Notice 2003–50 announced that regulations would be issued under section 269B providing that a stapled foreign corporation will be treated as a domestic corporation in determining whether it is an includible corporation for purposes of §§1.904(i)–1 and 1.861–11T(d)(6).

Explanation of Provisions

Includible Corporation

Consistent with Notice 89–94, this proposed regulation provides that a stapled foreign corporation, which is generally treated as a domestic corporation under section 269B, nevertheless will be treated as a foreign corporation for purposes of the definition of an includible corporation under section 1504(b). Thus, in the absence of a valid election under section 1504(d), an affiliated group cannot include the stapled foreign corporation in its consolidated tax return and therefore the affiliated group cannot use the stapled foreign corporation's losses to offset income of another member of the group. As announced in Notice 2003–50, however, the proposed regulation also treats a stapled foreign corporation as a domestic corporation in determining whether it is an includible corporation for purposes of §§1.904(i)–1 and 1.861–11T(d)(6).

Determination of Stapled Corporation Status in the Case of Multiple Classes of Stock

Section 269B(c)(2) provides that two or more entities are stapled entities if more than 50 percent in value of the beneficial ownership in each entity consists of stapled interests. This proposed regulation clarifies that this determination is made on an aggregate basis if there are multiple classes of stock. For example, if a class of stock in each corporation (representing more than 50 percent in value of such corporation) is stapled to a class of stock in the other corporation (representing less than 50 percent in value of such other corporation), the two corporations are considered stapled because, in the aggregate, more than 50 percent of the value of each corporation is stapled to the other corporation's stock.

Related Party Ownership Rule

In cases where stapled interests constituting more than 50 percent of the beneficial ownership in each stapled entity are held by the same or related persons, the IRS and Treasury Department believe that the formal transfer restrictions have little or no substantive consequence and may be intended to facilitate the affirmative use of section 269B for tax avoidance purposes. Accordingly, for purposes of determining whether a foreign corporation and a domestic corporation are stapled entities under section 269B, this proposed regulation permits the Commissioner to treat interests that otherwise would be stapled interests as not being stapled if the same person or related persons (within the meaning of section 267(b) or 707(b)) hold stapled interests constituting more than 50 percent of the beneficial ownership of both corporations, and a principal purpose of the stapling of those interests is the avoidance of U.S. income tax. No inference is intended as to whether current structures involving majority interests held by the same person or related persons are stapled interests within the meaning of section 269B. In such cases, the IRS will continue to apply principles of existing law to determine whether interests are stapled for purposes of section 269B. For example, under a substance-over-form analysis, restrictions on the transferability of ownership interests may be disregarded for tax purposes if the majority interests are held by the same person or related persons.

Inbound and Outbound Conversions

A corporation's status as either foreign or domestic may change under section 269B. For example, if a foreign corporation and a domestic corporation become stapled entities and are not foreign owned under section 269B(e), the foreign corporation will be treated as converting to a domestic corporation for U.S. tax purposes (inbound conversion). Similarly, if the stapled foreign corporation's interests cease to be stapled at some point in the future, the stapled foreign corporation no longer will be treated as a domestic corporation for U.S. tax purposes and, therefore, will be treated as converting to a foreign corporation (outbound conversion).

Section 1.367(b)–2(g) provides that an inbound conversion is treated as a reorganization described in section 368(a)(1)(F) (F reorganization). This proposed regulation includes this rule and revises §1.367(b)–2(g) to include a cross-reference to the relocated provision. Additionally, this proposed regulation provides that an outbound conversion also is treated as an F reorganization. Treatment of an inbound or outbound conversion as an F reorganization also applies in cases where the conversion results from a change in ownership of a stapled foreign corporation that changes its status as foreign owned under section 269B(e). In all such cases, this proposed regulation treats the conversion as an F reorganization, even though all of the technical requirements of an F reorganization may not be satisfied. See Staff of Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, H.R. Doc. 4170, 98th Cong., 456–57 (1984).

This proposed regulation references the section 367 regulations for purposes of determining the tax consequences under section 367 that result from an inbound or outbound conversion. Section 1.367(b)–2(f)(2) provides that an inbound F reorganization includes a transfer of assets by a foreign corporation to a domestic corporation. Section 1.367(a)–1T(f)

provides similar treatment in the case of an outbound conversion. Further, in both cases, the taxable year of the corporation ends as a result of the deemed conversion. See §§1.367(a)–1T(e) and 1.367(b)–2(f)(4).

U.S. Treaties

Section 269B(d) provides that a stapled foreign corporation treated as a domestic corporation under section 269B will not be exempt from U.S. tax liability by reason of any treaty obligation of the United States. In enacting section 269B(d), Congress was concerned that a stapled foreign corporation that is resident in a treaty country might claim an exclusion from U.S. taxation, for example, on the basis that its income is not attributable to a permanent establishment in the United States. See H.R. Rep. No. 98–432, 98th Cong., 1st Sess., 244–45. This would be contrary to the purpose of section 269B, which is to tax a stapled foreign corporation on its worldwide income as if it were a domestic corporation. Accordingly, this proposed regulation provides that a stapled foreign corporation treated as a domestic corporation under section 269B may not claim an exemption or reduction in tax rates provided under a treaty entered into by the United States.

Collection

Under section 269B(b), the Secretary may prescribe regulations providing that any U.S. income tax imposed on a stapled foreign corporation may, if not paid by such corporation, be collected from the domestic corporation whose ownership interests are stapled to the foreign corporation's ownership interests (stapled domestic corporation) or from the shareholders of the stapled foreign corporation. This proposed regulation provides that the Commissioner may collect the stapled foreign corporation's U.S. income tax liability from the stapled domestic corporation and, subject to certain limitations, from certain shareholders of such foreign corporation.

Any U.S. income tax assessed as a tax liability of the stapled foreign corporation will be deemed to be properly assessed as a tax liability of the stapled domestic corporation and the 10-percent shareholders of the stapled foreign corporation. For these purposes, a 10-percent shareholder of a stapled foreign corporation is defined as any person owning directly 10 percent or more of the total value or total combined voting power of all classes of stock in the stapled foreign corporation for any day of the foreign corporation's taxable year with respect to which the liability relates. The IRS and Treasury Department are concerned about 10-percent shareholders interposing entities in order to avoid collection under these rules. These proposed regulations contain a reserved section for rules regarding indirect ownership and request comments on how to address situations involving indirect ownership of the stapled foreign corporation.

The Commissioner may collect from the stapled domestic corporation any U.S. income tax properly assessed but not timely paid by the stapled foreign corporation, and, if the domestic corporation fails to timely pay such tax or any portion thereof, from one or more 10-percent shareholders of the stapled foreign corporation. The collection action may proceed against the domestic corporation only after the Commissioner has issued a notice and demand for payment of unpaid U.S. income tax to the stapled foreign corporation, and the stapled foreign corporation has failed to pay the tax due by the date specified in the notice. A collection action then may proceed against the 10-percent shareholders of the stapled foreign corporation if the Commissioner has issued a notice and demand for payment of the unpaid tax to the stapled domestic corporation, and the stapled domestic corporation has failed to pay such tax by the date specified.

This proposed regulation limits the amount of any U.S. income tax liability of the stapled foreign corporation that may be collected from any 10-percent shareholder of a stapled foreign corporation. The shareholder's share of the liability will be determined by assigning an equal portion of the total U.S. income tax liability of the stapled foreign corporation to each day in such corporation's taxable year, and then dividing that portion ratably among the shares outstanding for that day based on the relative values of such shares. The shareholder's share of the liability is the sum of the U.S. income tax liability allocated to the shares held by such shareholder for each day in the taxable year.

Proposed Effective Dates

Except as otherwise provided, the proposed regulations are applicable for taxable years that begin after the date on which final regulations are published in the **Federal Register**. Section 1.269B–1(d)(1) and (f) (except in the case of the collection of tax from a 10-percent shareholder that is a foreign person) applies beginning on July 18, 1984, for any foreign corporation that became stapled to a domestic corporation after June 30, 1983, and beginning on January 1, 1987, for any foreign corporation that was stapled to a domestic corporation as of June 30, 1983. Section 1.269B–1(d)(2) applies for taxable years beginning after July 22, 2003, except that in the case of a foreign corporation that becomes stapled to a domestic corporation on or after July 22, 2003, then paragraph (d)(2) applies to taxable years ending on or after July 22, 2003. Section 1.269B–1(e) applies beginning on July 18, 1984, except that §1.269B–1(e) does not apply, and the foreign corporation continues for all U.S. tax purposes to be a foreign entity, if the foreign corporation was stapled to a domestic corporation as of June 30, 1983, was entitled to benefits under an income tax treaty in existence as of that date, and has remained eligible to claim such treaty benefits. At such time as the stapled foreign corporation is no longer eligible to claim treaty benefits, the foreign corporation is deemed to convert to a domestic corporation for U.S. tax purposes.

Special Analyses

The IRS and the Treasury Department have 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 that because this 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 regulation will be submitted to the Chief Counsel for Advocacy of the

Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS specifically request comments on the clarity of the proposed regulations 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 December 15, 2004, at 10 a.m., in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. 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 more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by December 6, 2004. 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 Richard L. Osborne and Bethany Ingwalson, of the 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 parts 1 and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.269B(b)–1 also issued under 26 U.S.C. 269B(b).

Par. 2. Section 1.269B–1 is added to read as follows:

§1.269B–1 Stapled foreign corporations.

(a) *Treatment as a domestic corporation*—(1) *General rule*. Except as otherwise provided, if a foreign corporation is a stapled foreign corporation within the meaning of paragraph (b)(1) of this section, such foreign corporation will be treated as a domestic corporation for U.S. Federal income tax purposes. Accordingly, for example, the worldwide income of such corporation will be subject to the tax imposed by section 11. For application of the branch profits tax under section 884, and application of sections 871(a), 881, 1441, and 1442 to dividends and interest paid by a stapled foreign corporation, see §§1.884–1(h) and 1.884–4(d).

(2) *Foreign owned exception*. Paragraph (a)(1) of this section will not apply if a foreign corporation and a domestic corporation are stapled entities (as provided in paragraph (b) of this section) and such foreign and domestic corporations are foreign owned within the meaning of this paragraph (a)(2). A corporation will be treated as foreign owned if it is established to the satisfaction of the Commissioner that United States persons hold directly (or indirectly applying section 958(a)(2) and (3) and section 318(a)(4)) less than 50 percent of the total combined voting power of all classes of stock entitled to vote and less than 50 percent of the total value of the stock of such corporation. For the consequences of a stapled foreign corporation becoming or ceasing to be foreign owned, therefore converting its status as either a foreign or domestic corporation within the meaning of this paragraph (a)(2), see paragraph (c) of this section.

(b) *Definition of a stapled foreign corporation*—(1) *General rule*. A foreign corporation is a stapled foreign corporation if such foreign corporation and a domestic corporation are stapled entities. A foreign corporation and a domestic corporation are stapled entities if more than 50 percent of the aggregate value of each corporation's beneficial ownership consists of interests that are stapled. In the case of corporations with more than one class of stock, it is not necessary for a class of stock representing more than 50 percent of the beneficial ownership of the foreign corporation to be stapled to a class of stock representing more than 50 percent of the beneficial ownership of the domestic corporation, provided that more than 50 percent of the aggregate value of each corporation's beneficial ownership (taking into account all classes of stock) are in fact stapled. Interests are stapled if a transferor of one or more interests in one entity is required, by form of ownership, restrictions on transfer, or other terms or conditions, to transfer interests in the other entity. The determination of whether interests are stapled for this purpose is based on the relevant facts and circumstances, including, but not limited to, the corporations' by-laws, articles of incorporation or association, and stock certificates, shareholder agreements, agreements between the corporations, and voting trusts with respect to the corporations. For the consequences of a foreign corporation's change in status as a stapled foreign corporation (that is not foreign owned) under this paragraph (b)(1), see paragraph (c) of this section.

(2) *Related party ownership rule*. For purposes of determining whether a foreign corporation is a stapled foreign corporation, the Commissioner may, at his discretion, treat interests that otherwise would be stapled interests as not being stapled if the same person or related persons (within the meaning of section 267(b) or 707(b)) hold stapled interests constituting more than 50 percent of the beneficial ownership of both corporations, and a principal purpose of the stapling of those interests is the avoidance of U.S. income tax. A stapling of interests may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes when taken together.

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

Example. USCo, a domestic corporation, and FCo, a foreign corporation, are publicly traded companies, each having two classes of stock outstanding. USCo's class A shares, which constitute 75% of the value of all beneficial ownership in USCo, are stapled to FCo's class B shares, which constitute 25% of the value of all beneficial ownership in F Co. USCo's class B shares, which constitute 25% of the value of all beneficial ownership in USCo, are stapled to FCo class A shares, which constitute 75% of the value of all beneficial ownership in FCo. Because more than 50% of the aggregate value of the stock of each corporation is stapled to the stock of the other corporation, USCo and FCo are stapled entities within the meaning of section 269B(c)(2).

(c) *Changes in domestic or foreign status*. The deemed conversion of a foreign corporation to a domestic corporation under section 269B is treated as a reorganization under section 368(a)(1)(F). Similarly, the deemed conversion of a corporation that is treated as a domestic corporation under section 269B to a foreign corporation is treated as a reorganization under section 368(a)(1)(F). For the consequences of a deemed conversion, including the closing of a corporation's taxable year, see §§1.367(a)–1T(e), (f) and 1.367(b)–2(f).

(d) *Includible corporation*—(1) Except as provided in paragraph (d)(2) of this section, a stapled foreign corporation treated as a domestic corporation under section 269B nonetheless will be treated as a foreign corporation in determining whether it is an includible corporation within the meaning of section 1504(b). Thus, for example, a stapled foreign corporation shall not be eligible to join in the filing of a consolidated return under section 1501, and a dividend paid by such corporation shall not constitute a qualifying dividend under section 243(b), unless a valid section 1504(d) election is made with respect to such corporation.

(2) A stapled foreign corporation will be treated as a domestic corporation in determining whether it is an includible corporation under section 1504(b) for purposes of applying §§1.904(i)–1 and 1.861–11T(d)(6).

(e) *U.S. treaties*—(1) A stapled foreign corporation that is treated as a domestic corporation under section 269B may not claim an exemption from U.S. income tax or a reduction in U.S. tax rates by reason of any treaty entered into by the United States.

(2) The principles of this paragraph (e) are illustrated by the following example:

Example. FCo, a Country X corporation, is a stapled foreign corporation that is treated as a domestic corporation under section 269B. FCo qualifies as a resident of Country X pursuant to the income tax treaty between the United States and Country X. Under such treaty, the United States is permitted to tax business profits of a Country X resident only to the extent that the business profits are attributable to a permanent establishment of the Country X resident in the United States. While FCo earns income from sources within and without the United States, it does not have a permanent establishment in the United States within the meaning of the relevant treaty. Under paragraph (e)(1) of this section, however, FCo is subject to U.S. Federal income tax on its income as a domestic corporation without regard to the provisions of the U.S.- Country X treaty and therefore without regard to the fact that FCo has no permanent establishment in the United States.

(f) *Tax assessment and collection procedures*—(1) *In general*. (i) Any income tax imposed on a stapled foreign corporation by reason of its treatment as a domestic corporation under section 269B (whether such income tax is shown on the stapled foreign corporation's U.S. Federal income tax return or determined as a deficiency in income tax) shall be assessed as the income tax liability of such stapled foreign corporation.

(ii) Any income tax assessed as a liability of a stapled foreign corporation under paragraph (f)(1)(i) of this section shall be considered as having been properly assessed as an income tax liability of the stapled domestic corporation (as defined in paragraph (f)(4)(i) of this section) and all 10-percent shareholders of the stapled foreign corporation (as defined in paragraph (f)(4)(ii) of this section). The date of such deemed assessment shall be the date the income tax liability of the stapled foreign corporation was properly assessed. The Commissioner may collect such income tax from the stapled domestic corporation under the circumstances set forth in paragraph (f)(2) of this section and may collect such income tax from any 10-percent shareholders of the stapled foreign corporation under the circumstances set forth in paragraph (f)(3) of this section.

(2) *Collection from domestic stapled corporation*. If the stapled foreign corporation does not pay its income tax liability that was properly assessed, the unpaid balance of such income tax or any portion thereof may be collected from the stapled domestic corporation, provided that the following conditions are satisfied:

(i) The Commissioner has issued a notice and demand for payment of such income tax to the stapled foreign corporation in accordance with §301.6303–1;

(ii) The stapled foreign corporation has failed to pay the income tax by the date specified in such notice and demand;

(iii) The Commissioner has issued a notice and demand for payment of the unpaid portion of such income tax to the stapled domestic corporation in accordance with §301.6303–1.

(3) *Collection from 10-percent shareholders of the stapled foreign corporation*. The unpaid balance of the stapled foreign corporation's income tax liability may be collected from a 10-percent shareholder of the stapled foreign corporation, limited to each such shareholder's income tax liability as determined under paragraph (f)(4)(iv) of this section, provided the following conditions are satisfied:

(i) The Commissioner has issued a notice and demand to the stapled domestic corporation for the unpaid portion of the stapled foreign corporation's income tax liability, as provided in paragraph (f)(2)(iii) of this section;

(ii) The stapled domestic corporation has failed to pay the income tax by the date specified in such notice and demand;

(iii) The Commissioner has issued a notice and demand for payment of the unpaid portion of such income tax to such 10-percent shareholder of the stapled foreign corporation in accordance with §301.6303–1.

(4) *Special rules and definitions*. For purposes of this paragraph (f), the following rules and definitions apply:

(i) *Stapled domestic corporation*. A domestic corporation is a *stapled domestic corporation* with respect to a stapled foreign corporation if such domestic corporation and the stapled foreign corporation are stapled entities as described in paragraph (b)(1) of this section.

(ii) *10-percent shareholder*. A *10-percent shareholder* of a stapled foreign corporation is any person that owned directly 10 percent or more of the total value or total combined voting power of all classes of stock in the stapled foreign corporation for any day of the stapled foreign corporation's taxable year with respect to which the income tax liability relates.

(iii) *10-percent shareholder in the case of indirect ownership of stapled foreign corporation stock*. [Reserved].

(iv) *Determination of a 10-percent shareholder's income tax liability*. The

income tax liability of a 10-percent shareholder of a stapled foreign corporation, for the income tax of the stapled foreign corporation under section 269B and this section, is determined by assigning an equal portion of the total income tax liability of the stapled foreign corporation for the taxable year to each day in such corporation's taxable year, and then dividing that portion ratably among the shares outstanding for that day on the basis of the relative values of such shares. The liability of any 10-percent shareholder for this purpose is the sum of the income tax liability allocated to the shares held by such shareholder for each day in the taxable year.

(v) *Income tax*. The term *income tax* means any income tax liability imposed on a domestic corporation under title 26 of the United States Code, including additions to tax, additional amounts, penalties, and interest related to such income tax liability.

(g) *Effective dates*—(1) Except as provided in this paragraph (g), the provisions of this section are applicable for taxable years that begin after the date the final regulations are published in the **Federal Register**.

(2) Paragraphs (d)(1) and (f) of this section (except as applied to the collection of tax from any 10-percent shareholder of a stapled foreign corporation that is a foreign person) are applicable beginning on—

(i) July 18, 1984, for any foreign corporation that became stapled to a domestic corporation after June 30, 1983; and

(ii) January 1, 1987, for any foreign corporation that was stapled to a domestic corporation as of June 30, 1983.

(3) Paragraph (d)(2) of this section is applicable for taxable years beginning after July 22, 2003, except that in the case of a foreign corporation that becomes stapled to a domestic corporation on or after July 22, 2003, paragraph (d)(2) of this section applies for taxable years ending on or after July 22, 2003.

(4) Paragraph (e) of this section is applicable beginning on July 18, 1984, except as provided in paragraph (g)(5) of this section.

(5) In the case of a foreign corporation that was stapled to a domestic corporation as of June 30, 1983, which was entitled to claim benefits under an income tax treaty as of that date, and which remains eligible for such treaty benefits, paragraph (e) of this section will not apply to such foreign corporation and for all purposes of the Code such corporation will continue to be treated as a foreign entity. The prior sentence will continue to apply even if such treaty is subsequently modified by protocol, or superseded by a new treaty, so long as the stapled foreign corporation continues to be eligible to claim such treaty benefits. If the treaty benefits to which the stapled foreign corporation was entitled as of June 30, 1983, are terminated, then a deemed conversion of the foreign corporation to a domestic corporation shall occur pursuant to paragraph (c) of this section as of the date of such termination.

Par. 3. In §1.367(b)–2, paragraph (g) is revised to read as follows:

§1.367(b)–2 Definitions and special rules.

* * * * *

(g) *Stapled stock under section 269B*. For rules addressing the deemed conversion of a foreign corporation to a domestic corporation under section 269B, see §1.269B–1(c).

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par 4. The authority citation for part 301 continues to read, in part, as follows:

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

Section 301.269B–1 also issued under 26 U.S.C. 269B(b).

Par. 5. Section 301.269B–1 is added to read as follows:

§301.269B–1 Stapled foreign corporations.

In accordance with section 269B(a)(1), a stapled foreign corporation is subject to the same taxes that apply to a domestic corporation under Title 26 of the Internal Revenue Code. For provisions concerning taxes other than income for which the stapled foreign corporation is liable, apply the same rules as set forth in §1.269B–1(a) through (f)(1)(i), and (g), except that references to *income tax* shall be replaced with the term *tax*. In addition, for purposes of collecting those taxes solely from the stapled foreign corporation, the term *tax* means any tax liability imposed on a domestic corporation under Title 26, including additions to tax, additional amounts, penalties, and interest related to that tax liability.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 3, 2004, 8:45 a.m., and published in the issue of the Federal Register for September 7, 2004, 69 F.R. 54067)

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 laws 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 a 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 Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2004–1 through 2004–26 is in Internal Revenue Bulletin 2004–26, dated June 28, 2004.