# Internal Revenue cumulative bulletin 2001-2 July-December

Department of the Treasury
**Internal Revenue Service**

Cumulative
Bulletin
2001-2

Rev. Ruls.
2001-30 to
2001-66

Rev. Procs.
2001-39 to
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Treasury
Decisions
8947 to
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# In This Issue

# The IRS Mission

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

# Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of the Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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 Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases.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

The Cumulative Bulletin (C.B.) is composed of reprints of the weekly Internal Revenue Bulletins (I.R.B.s) issued during the year, bound together to form the C.B. Volume 1 contains I.R.B. issues 1 through 26 and Volume 2 contains I.R.B. issues 27 through 53. Public laws relating to taxes are published in Volume 3 of the C.B. If needed, additional volumes are published and labeled consecutively.

The C.B. also includes the following items.

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

# Definition of Terms

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

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

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

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

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

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

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

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

# Abbreviations

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

*A—Individual.*
*Acq.—Acquiescence.*
*B—Individual.*
*BE—Beneficiary.*
*BK—Bank.*
*B.T.A.—Board of Tax Appeals.*
*C—Individual.*
*C.B.—Cumulative Bulletin.*
*CFR—Code of Federal Regulations.*
*CI—City.*
*COOP—Cooperative.*
*Ct.D.—Court Decision.*
*CY—County.*
*D—Decedent.*
*DC—Dummy Corporation.*
*DE—Donee.*
*Del. Order—Delegation Order.*
*DISC—Domestic International Sales Corporation.*
*DR—Donor.*
*E—Estate.*
*EE—Employee.*
*E.O.—Executive Order.*
*ER—Employer.*
*ERISA—Employee Retirement Income Security Act.*
*EX—Executor.*
*F—Fiduciary.*
*FC—Foreign Country.*
*FICA—Federal Insurance 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.—Intemal Revenue Bulletin.*
*LE—Lessee.*
*LP—Limited Partner.*
*LR—Lessor.*
*M—Minor.*
*Nonacq.—Nonacquiescence.*
*O—Organization.*
*P—Parent Corporation.*
*PHC—Personal Holding Company.*
*PO—Possession of the U.S.*
*PR—Partner.*
*PRS—Partnership.*
*PTE—Prohibited Transaction Exemption.*
*Pub. L.—Public Law.*
*REIT—Real Estate Investment Trust.*
*Rev. Proc—Revenue Procedure.*
*Rev. Rul.—Revenue Ruling.*
*S—Subsidiary.*
*S.P.R.—Statements of Procedural Rules.*
*Stat.—Statutes at Large.*
*T—Target Corporation.*
*T.C.—Tax Court.*
*T.D.—Treasury Decision.*
*TFE—Transferee.*
*TFR—Transferor.*
*T.I.R.—Technical Information Release.*
*TP—Taxpayer.*
*TR—Trust.*
*TT—Trustee.*
*U.S.C.—United States Code.*
*X—Corporation.*
*Y—Corporation.*
*Z—Corporation.*

# Numerical Finding List

## Finding List of Current Actions on Previously Published Items

### Announcements:

**2000–48**
Modified by
Notice 2001–43, *72*

**2001–77**
Modified by
Ann. 2001–122, *604*

**2001–117**
Modified by
Ann. 2001–124, *630*

### Notices:

**88–129**
Amplified and modified by
Notice 2001–82, *619*

**90–60**
Amplified and modified by
Notice 2001–82, *619*

**98–52**
Modified by
Notice 2001–56, *277*

**99–41**
Modified and superseded by
Notice 2001–62, *307*

**2000–15**
Supplemented and superseded by
Notice 2001–51, *190*

**2001–4**
Modified by
Notice 2001–43, *72*

**2001–9**
Modified by
Notice 2001–46, *122*

**2001–42**
Modified by
Notice 2001–57, *279*

**2001–61**
Supplemented by
Notice 2001–68, *504*

**2001–70**
Clarified and supplemented by
Notice 2001–74, *551*

### Proposed Regulations:

**LR–97–79**
Withdrawn by
REG–100548–01, *67*

**LR–107–84**
Withdrawn by
REG–100548–01, *67*

**REG–106186–98**
Withdrawn by
Ann. 2001–121, *584*

### Proposed Regulations—Continued

**REG–110311–98**
Supplemented by
T.D. 8961, *194*

**REG–106917–99**
Corrected by
Ann. 2001–86, *207*

**REG–103735–00**
Supplemented by
T.D. 8961, *194*

**REG–103736–00**
Supplemented by
T.D. 8961, *194*

**REG–130477–00**
Supplemented by
Ann. 2001–82, *123*

**REG–130481–00**
Supplemented by
Ann. 2001–82, *123*

### Revenue Procedures:

**83–78**
Revoked by
Rev. Proc. 2001–49, *300*

**84–84**
Revoked by
Rev. Proc. 2001–49, *300*

**90–58**
Obsoleted by
Rev. Proc. 2001–58, *579*

**91-52**
Obsoleted by
Rev. Proc. 2001–58, *579*

**93–27**
Clarified by
Rev. Proc. 2001–43, *191*

**97–13**
Modified by
Rev. Proc. 2001–39, *38*

**97–19**
Modified by
Notice 2001–62, *307*

**98–44**
Superseded by
Rev. Proc. 2001–40, *130*

**99–27**
Superseded by
Rev. Proc. 2001–42, *212*

**99–49**
Modified and amplified by
Notice 2001–76, *613*
Rev. Proc. 2001–46, *263*
Rev. Rul. 2001–60, *587*

**2000–19**
Superseded by
Rev. Proc. 2001–45, *227*

### Revenue Procedures—Continued

**2000–20**
Modified by
Notice 2001–42, *70*
Rev. Proc. 2001–55, *552*

**2000–27**
Modified by
Rev. Proc. 2001–55, *552*

**2000–28**
Superseded by
Rev. Proc. 2001–50, *437*

**2000–39**
Corrected by
Ann. 2001–73, *40*
Superseded by
Rev. Proc. 2001–47, *332*

**2000–48**
Superseded by
Rev. Proc. 2001–54, *530*

**2001–2**
Modified by
Rev. Proc. 2001–41, *173*

**2001–3**
Modified by
Rev. Proc. 2001–51, *369*

**2001–6**
Modified by
Notice 2001–42, *70*
Rev. Proc. 2001–55, *552*

### Revenue Rulings:

**55–290**
Modified and superseded by
Rev. Rul. 2001–60, *587*

**57–589**
Obsoleted by
REG–106917–99, *4*

**65–316**
Obsoleted by
REG–106917–99, *4*

**67–274**
Amplified by
Rev. Rul. 2001–46, *321*

**68–125**
Obsoleted by
REG–106917–99, *4*

**69–563**
Obsoleted by
REG–106917–99, *4*

**70–379**
Obsoleted by
Rev. Rul. 2001–39, *125*

**74–326**
Obsoleted by
REG–106917–99, *4*

**78–127**
Modified by
Rev. Rul. 2001–40, *276*

### Revenue Rulings—Continued

**78–179**
Obsoleted by
REG–106917–99, *4*

**89–42**
Modified and superseded by
Rev. Rul. 2001–48, *324*

**90–95**
Distinguished by
Rev. Rul. 2001–46, *321*

**92–19**
Supplemented by
Rev. Rul. 2001–38, *124*

**95–6**
Superseded for certain distributions by
Rev. Rul. 2001–62, *632*

**97–31**
Modified and superseded by
Rev. Rul. 2001–48, *324*

**98–1**
Modified by
Rev. Rul. 2001–51, *427*
Rev. Rul. 2001–62, *632*

**99–49**
Modified and amplified by
Rev. Rul. 2001–60, *587*

**2000–55**
Supplemented and superseded by
Rev. Rul. 2001–65, *639*

**2000–56**
Supplemented and superseded by
Rev. Rul. 2001–64, *640*

### Treasury Decisions:

**8948**
Corrected by
Ann. 2001–90, *208*

# Code Sections Affected by Current Actions

# Cumulative List of Actions on Decisions

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

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

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

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

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

The Commissioner ACQUIESCES in the following decisions:

**Exxon v. Commissioner,**[1]
113 T.C. 338 (1999)
(Dkt. Nos. 23331–95, 16692–97)

**Therese Hahn v. Commissioner,**[2]
110 T.C. 140 (1998)
T.C. Dkt. No. 17210–96

**Robert L. Beck v. Commissioner,**[3]
T.C. Memo. 2001–198 (filed July 30, 2001)
Dkt. Nos. 14577–98 and 14578–98

The Commissioner does NOT ACQUIESCE in the following decisions:

**Mesa Oil, Inc. v. United States,**[4]
86 A.F.T.R.2d (RIA) 7312
(D. Colo. 2000)

**North Dakota State University v. United States,**[5]
84 F. Supp. 2d 1043 (D.N.D. 1999),
*aff'd.* 255 F.3d 599 (8th Cir. 2001)

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[1] Acquiescence in result only relating to whether the U.K. Petroleum Revenue Tax (PRT) is a creditable income tax under section 901.

[2] Acquiescence relating to whether I.R.C. section 2040(b)(1) applies to joint interest created before January 1, 1977, where the deceased joint tenant died after December 31, 1981.

[3] Acquiescence relating to whether the Tax Court has jurisdiction to review the Service's determination that a spouse is not entitled to equitable relief under I.R.C. section 66(c).

[4] Nonacquiescence relating to whether a verbatim recording of a Collection Due Process (CDP) hearing is required under I.R.C. sections 6320 ad 6330 to create a judicially reviewable administrative record.

[5] Nonacquiescence relating to whether early retirement payments that the taxpayer made to tenured faculty members are wages subject to Federal Insurance Contributions Act ("FICA") taxes.

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

## Section 3221.—Rate of Tax

### Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., Section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning July 1, 2001, shall be at the rate of 26 cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning July 1, 2001, 38.6 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 61.4 percent of the taxes collected under such Sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated May 24, 2001.
By Authority of the Board.

Beatrice Ezerski,
*Secretary to the Board*.

(Filed by the Office of the Federal Register on May 31, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 1, 2001, 66 F.R. 29848)

# Part II. Treaties and Tax Legislation

## Subpart A.—Tax Conventions and Other Related Items

## French Social Security Agreement

## Notice 2001–41

The following is a copy of the News Release issued by the Director, International (U.S. Competent Authority) on May 31, 2001 (IR–2001–54).

U.S. AND FRANCE AGREE ON TAXATION OF FRENCH SOCIAL SECURITY

Washington — The Competent Authorities of the United States and France reached a mutual agreement on the tax treatment of contributions to, and distributions from, the French social security regime (Basic Plan and Complementary Plans). The agreement clarifies the application of Article 18 of the Convention between the Government of the United States of America and the Government of the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital (the "Treaty"), signed on August 31, 1994, and entered into force on December 30, 1995.

BACKGROUND

Subparagraph (a) of Article 18(1) of the Treaty provides that, except as provided in subparagraph (b), distributions from private pension and other retirement arrangements derived and beneficially owned by a resident of a Contracting State in consideration of past employment shall be taxable only in that State. Subparagraph (b) provides that pensions and other payments made under the social security legislation of a Contracting State to a resident of the other Contracting State shall be taxable only in the first-mentioned State.

Article 18(2) of the Treaty applies when determining the taxable income of an individual who renders personal services and who is a resident of a Contracting State, but not a national of that State. Contributions paid by, or on behalf of, such individual to a pension or other retirement arrangement that is established, maintained, and recognized for tax purposes in the other Contracting State shall be treated in the same way for tax purposes in the first-mentioned State as a contribution paid to a pension or other retirement arrangement that is established, maintained, and recognized for tax purposes in that first-mentioned State. However, the competent authority of the first-mentioned State must agree that the pension or other retirement arrangement generally corresponds to a pension or other retirement arrangement recognized for tax purposes by that State.

Questions have arisen concerning the treatment of contributions to, and distributions from, the French social security regime (Basic Plan and Complementary Plans) by, and to, individuals residing in the United States.

The United States and France have agreed that until the applicable language in the Treaty is amended or terminated, the Treaty will be applied as follows.

TREATMENT OF CONTRIBUTIONS

For purposes of Article 18(2), the French social security regime does not generally correspond to a pension or other retirement arrangement that is recognized for tax purposes by the United States. Accordingly, both mandatory and voluntary contributions to the French social security regime (Basic Plan and Complementary Plans) by individuals who are resident in the United States are not deductible or excludible for purposes of determining the individuals' taxable income in the United States.

TREATMENT OF DISTRIBUTIONS

Under Article 18(1)(b), distributions from the French social security regime (Basic Plan and Complementary Plans) to individuals who are residents of the United States are taxable only by France and not by the United States, regardless of whether contributions to the Plans were made on a voluntary or mandatory basis.

WAIVER OF DISCLOSURE REQUIREMENT

Section 6114(a) of the Internal Revenue Code requires that taxpayers taking the position that a U.S. treaty overrules a general U.S. tax principle of law must disclose such position on a return of tax or, if no return of tax is required to be filed, as the Internal Revenue Service may prescribe. However, pursuant to Treas. Reg. Sec. 301.6114–1(c)(1)(iii), the reporting requirement is waived with regard to taxpayers taking the position that a U.S. treaty reduces or modifies the taxation of income derived from public or private pensions or social security. Accordingly, taxpayers claiming exemption for French social security benefits pursuant to Article 18(1)(b) of the Treaty are not required to disclose this position on their income tax return for the year in which the distributions are received.

EFFECTIVE DATE

The mutual agreement is applicable to tax years beginning on or after January 1, 1996. Pursuant to Article 26(1) of the Treaty, an individual who paid U.S. income tax on distributions from the French social security regime (Basic Plan and Complementary Plans) for one or more tax years beginning on or after January 1, 1996, may request a refund of such tax within three years of the date of this news release provided such individual was a resident of the United States during each year for which a refund is requested. Individuals who took the position for purposes of determining their taxable income in the United States that mandatory or voluntary contributions to the French social security regime (Basic Plan and Complementary Plans) were deductible or excludible, should file amended returns for all tax years beginning on or after January 1, 1996, for which the statute of limitations on assessment and collection has not expired as of the date of this news release (generally calendar years 1998, 1999, and 2000).

CONTACT INFORMATION

For further information or assistance regarding the U.S. income tax treatment of social security pensions received from France, please contact David Kosterlitz, IRS Large & Mid-size Business, International, Tax Treaty, ((202) 874-1550 (not a toll-free number)). For information or assistance regarding the French tax treatment of social security pensions received from France, please contact Christiane Marechal, Fiscal Attache, French Embassy, ((202) 944-6390 (not a toll-free number)). In France, please contact Centre des Impots des Non-Residents, 9, Rue d'Uzes, 75094, Paris Cedex 02.

# Part III. Administrative, Procedural, and Miscellanous

## Weighted Average Interest Rate Update

## Notice 2001-39

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of section 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103-465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for May 2001 is 5.78 percent.

The following rates were determined for the plan years beginning in the month shown below.

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---|---|---|---|---|
| June | 2001 | 5.82 | 5.24 to 6.11 | 5.24 to 6.40 |

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283-9702 (not a toll-free number).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking and Notice of Public Hearing

## Changes in Accounting Periods

## REG–106917–99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under sections 441, 442, 706, 898, and 1378 of the Internal Revenue Code of 1986 that relate to certain adoptions, changes, and retentions of annual accounting periods. The proposed regulations are necessary to update, clarify, and reorganize the rules and procedures for adopting, changing, and retaining a taxpayer's annual accounting period. The proposed regulations primarily affect taxpayers that want to adopt an annual accounting period under section 441 or that must receive approval from the Commissioner to adopt, change, or retain their annual accounting periods under section 442. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written and electronic comments and requests to speak (with outlines of oral comments) at a public hearing scheduled for October 2, 2001, must be received by September 11, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–106917–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–106917–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.ustreas.gov/tax_regs/regslist.html*. The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Roy A. Hirschhorn and Martin Scully, Jr. (202) 622-4960; concerning submissions of comments and the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collections of information should be received by August 13, 2001. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

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

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

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

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

The collection of information can be found in §§1.441–2(b)(1), 1.442–1(b)(1) and (b)(4) and (d), and 1.1378–1 of these regulations. Section 1.441–2(b)(1) requires certain taxpayers to file statements on their federal income tax returns to notify the Commissioner of the taxpayers' election to adopt a 52-53-week taxable year. Section 1.442–1(b)(4) provides that certain taxpayers must establish books and records that clearly reflect income for the short period involved when changing their taxable year from their taxable year to a proposed fiscal taxable year. Section 1.442–1(d) requires a newly married husband or wife to file a statement with their short period return when changing to the other spouse's taxable year. This collection of information is mandatory. The likely respondents are businesses or other profit entities and individuals.

The estimated average annual burden per respondent and/or recordkeeper required by §§1.442–1(b)(1) and 1.1378–1 are reflected in the burdens of Forms 1128 and 2553.

Further, the estimated average burden per respondent and/or recordkeeper required by §§1.441–2(b)(1), 1.442–1(b)(4) and 1.442–1(d) is as follows:

Estimated total reporting/recordkeeping burden: 3,500 hours.

Estimated average burden per respondent/recordkeeper: 21 minutes.

Estimated number of respondents/recordkeepers: 10,000.

Estimated annual frequency of responses: On occasion.

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

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

### Background and Explanation of Provisions

A. *Overview*

This document contains proposed amendments to regulations under section 441 (period for computing taxable income), and sections 442, 706, 898, and

1378 (regarding the requirement to obtain the approval of the Commissioner to adopt, change, or retain an annual accounting period).

B. *Section 441: Period for computing taxable income*

1. *Background*. Section 441 provides that taxable income must be computed on the basis of the taxpayer's taxable year and generally defines the term "taxable year." The current temporary regulations under section 441 are primarily the product of two separate Treasury Decisions, T.D. 8167, 52 FR 485241 (published with a cross reference to a notice of proposed rulemaking) and T.D. 8123, 52 FR 3615 (1988). Prior to the issuance of T.D. 8167 and T.D. 8123 (the temporary regulations), the regulations under section 441 contained provisions relating mostly to the period for computing taxable income and the election of a 52-53-week taxable year. The temporary regulations retain these provisions, but also add new provisions to implement section 806 of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2362), 1986–3 C.B. (Vol. 1) 1, 279, (the 1986 Act). Enacted with the principal intent of eliminating the deferral period between certain entities and their owners, the 1986 Act generally required partnerships, S corporations, and personal service corporations (PSCs) to conform their taxable years to the taxable years of their partners, shareholders, or employee-owners, respectively. H.R. Conf. Rep. No. 99–841, 99th Cong., 2d Sess., II–318, 1986–3 (Vol. 4) C.B. 319.

In addition to general implementation provisions, the temporary regulations include transition and anti-abuse provisions specific to taxpayers in existence at the time the 1986 Act became effective. For example, §1.441–3T provides rules intended to prevent taxpayers from circumventing the effective date of the provisions of the 1986 Act by adopting or changing to (or from) a 52-53-week taxable year during the period beginning after September 29, 1986, and ending before January 5, 1987.

Generally, this document reproposes the temporary regulations under section 441. However, this document also reorganizes, clarifies, modifies, and updates the temporary regulations. Many of the provisions contained in the temporary regulations remain essentially the same, including the general rules for adopting a taxable year, the provisions relating to electing a 52-53-week taxable year, and the rules for PSCs. However**,** provisions that are now obsolete have been removed, and new rules and definitions have been added, as described in more detail below. In addition, new cross-references to section 442 and the proposed regulations thereunder are included to guide taxpayers, where appropriate, to the rules and procedures for obtaining approval to adopt, change, or retain their annual accounting periods.

2. *General Rules and Definitions*. Most of the substantive provisions in §1.441–1T of the temporary regulations have been retained, including the general rules for the period for computing tax, numerous definitions, and the requirement that partnerships, S corporations, electing S corporations, and PSCs generally must demonstrate a business purpose and obtain the Commissioner's approval to adopt or retain a taxable year other than their required taxable year. However, §1.441–1T has been reorganized, obsolete transition rules have been removed, and some rules have been clarified. For example, the proposed regulations now define the term required taxable year, identify entities that have such a year (with appropriate cross-references), and clarify the applicable exceptions.

In addition, the proposed regulations clarify the meaning of the requirement to keep books for taxpayers using a fiscal year. The temporary regulations provide that a fiscal year will be recognized only if the books of the taxpayer are kept in accordance with that fiscal year. The proposed regulations conform the book keeping requirement for taxpayers using a fiscal year to that of §1.446–1(a)(4), which allows for a reconciliation between the taxpayer's books and return. However, as a term and condition of obtaining approval to adopt, change to, or retain an annual accounting period under section 442, certain taxpayers nevertheless may be required to compute income and keep their books (including financial statements and reports to creditors) on the basis of the requested annual accounting period. *See, e.g.*, Rev. Proc. 2000–11 (2000–3 I.R.B. 309).

The proposed regulations also provide that a taxable year is adopted by filing the first federal income tax return using that taxable year. Accordingly, filing an application for an employer identification number, filing an extension, or making estimated tax payments, indicating a particular taxable year do not constitute an adoption of that year. Consequently, Rev. Rul. 57–589 (1957–2 C.B. 298), and Rev. Rul. 69–563 (1969–2 C.B. 104), holding that the filing of an extension and estimated tax payments establishes a taxable year, are proposed to be superseded. The IRS will continue to follow the decision in *E.G. Wilson*, 267 F.Supp. 89 (East. Dist. MO, 1967), with respect to the classification of an amended return as a "first return."

3. *52-53-week Taxable Years*. The proposed regulations retain most of the rules provided in §1.441–2T of the temporary regulations for taxpayers electing to use a 52-53-week taxable year or changing to or from a 52-53-week taxable year. However, the procedures for certain taxpayers to obtain approval (automatic or otherwise) to change to or from a 52-53-week taxable year have been removed and are now contained in administrative procedures published by the Commissioner. See Rev. Proc. 2000–11; and Notice 2001–35 (2001–23 I.R.B. 1314). In addition, although these administrative procedures continue to provide automatic approval for a change to a 52-53-week taxable year ending with reference to the same calendar month, the change will be effected with a Form 1128 (*Application to Adopt, Change or Retain a Tax Year*) rather than with a statement, consistent with most other changes.

The proposed regulations also expand the applicability of the rules for determining the inclusion of income and deductions from a pass-through entity where either the entity or its owner uses a 52-53-week taxable year. In addition to applying to partnerships, S corporations, and PSCs (as in the temporary regulations), the proposed regulations apply these inclusion rules to trusts, common trust funds, controlled foreign corporations, foreign personal holding companies, and passive foreign investment companies that are qualified electing funds.

4. *Transition Rules.* Section 1.441–3T of the temporary regulations provide transition rules for the 1986 Act that generally were effective from September 29, 1986, through

January 5, 1987. Moreover, the rules contained in §1.441–3T regarding 52-53-week taxable years and the definition of a PSC were superseded by similar rules promulgated under §§1.441–2T and 1.441–4T, respectively. Because these rules are now obsolete, this section has been removed from the proposed regulations.

5. *Personal Service Corporations*. The rules for PSCs contained in §1.441–4T of the temporary regulations generally have been retained in the proposed regulations. However, the proposed regulations reorganize and clarify the required taxable year of a PSC and the rules for adopting, changing to, and retaining a year other than the required taxable year. For example, the proposed regulations make clear that a PSC may have a year other than a required taxable year by making an election under section 444. In addition, the provision allowing a PSC to obtain automatic approval to change to its required taxable year has been removed and is now contained in Notice 2001–35 (2001–23 I.R.B. 1314). Similarly, the rules regarding establishing a business purpose and obtaining approval for the use of a fiscal year have been moved to §1.442–1(b) and Notice 2001–34 (2001–23 I.R.B. 1302).

Comments were received on the notice of proposed rulemaking that is cross-referenced by the temporary regulations under §1.441–4T. Most significantly, one commentator suggested that the testing period for determining whether a taxpayer is a PSC should be the three preceding taxable years, rather than the preceding taxable year, to prevent taxpayers from becoming a PSC due to temporary or aberrational conditions. The proposed regulations retain the one-year testing period provided in the temporary regulations. However, the IRS and Treasury Department will reconsider this testing period, as well as other comments received on the temporary regulations, to the extent similar comments are received on these proposed regulations now that taxpayers have significantly more experience with the provisions in the temporary regulations.

C. *Section 442: Changes of annual accounting period*

1. *Background*. Under section 442 and the current regulations, a taxpayer generally can change its annual accounting period only by obtaining the approval of the Commissioner. The current regulations set forth the general rules for obtaining such approval, including: (1) the manner and time for filing an application to change an annual accounting period; (2) the requirement that the taxpayer demonstrate a substantial business purpose for the change; and (3) the need for agreement between the taxpayer and the Commissioner to the terms, conditions, and adjustments that are necessary to effect the change. Under the current regulations, both tax and non-tax factors are considered in determining whether a taxpayer has established a substantial business purpose.

2. *Manner and Time for Filing*. The proposed regulations retain the general requirement to file a Form 1128 to request approval, but extend the time for filing the Form 1128. The current regulations require that the Form 1128 be filed on or before the 15th day of the second calendar month (generally 45 days) following the close of the short period. Under the proposed regulations, the Form 1128 must be filed by the 15th day of the third calendar month (generally 75 days) after the close of the taxable year in which the taxpayer wants the adoption, change, or retention to be effective (*i.e.*, the first effective year). However, taxpayers are encouraged to file their Forms 1128 as soon after the close of the first effective year as possible to allow the IRS adequate time to process the Form 1128 before the extended due date of the return for the first effective year. Because the IRS has found that Forms 1128 filed before the close of the short period often lack complete information and result in processing delays, the proposed regulation provides that the Form 1128 may not be filed prior to the close of the first effective year.

3. *Business Purpose, Terms, Conditions, and Adjustments*. Taxpayers have expressed concern with the substantial business purpose requirement set forth in the current regulations. In particular, taxpayers have complained that the Commissioner's interpretation of a substantial business purpose as demonstrated in the IRS's ruling practice has been unclear, inconsistent, and overly restrictive.

As a result, the IRS and Treasury Department published Notice 99–19 (1999–1 C.B. 919) soliciting comments on how the rules for obtaining approval of an adoption, change, or retention in annual accounting period could be clarified and simplified. In response, commentators urged the IRS and Treasury Department to expand the categories of taxpayers that would be granted automatic approval for an annual accounting period and to revise the substantial business purpose requirement to broaden the circumstances in which a taxpayer will be granted approval to change an annual accounting period.

The IRS and Treasury Department believe that the proposed regulations, in combination with automatic and prior approval revenue procedures, will clarify the rules governing accounting periods, expand the circumstances in which taxpayers will be granted approval (automatically and otherwise), and result in a more clear, uniform ruling practice.

The proposed regulations continue to provide the general standards for obtaining approval for an adoption, change, or retention in annual accounting period: taxpayers must demonstrate the existence of a "business purpose" and must agree to the terms, conditions, and adjustments for the adoption, change, or retention. In modifying the "substantial business purpose" requirement to "business purpose," the IRS and Treasury Department intend merely to conform to the language of the business purpose requirement found in sections 441(i), 706, and 1378 and not to lower the current standard. In addition, the proposed regulations contain business purpose guidelines generally applicable to all taxpayers. For example, the proposed regulations provide the general rule that deferral of income will not be treated as a business purpose. They also explain that a taxpayer will have demonstrated a business purpose by applying to adopt, change to, or retain a year coinciding with its required taxable year, ownership taxable year, or natural business year.

The prior approval revenue procedure is intended to provide more detailed guidance about how a taxpayer's business purpose will be evaluated, and the terms, conditions, and adjustments that will apply to an adoption, change, or retention of annual accounting period. Notice 2001–34, issued concurrently with these proposed regulations, proposes a revenue procedure that, when finalized, will provide the rules and procedures applicable to taxpayers who must apply to the national office to obtain the Commissioner's prior approval for an adoption, change, or retention. Under the proposed revenue procedure, the IRS in its ruling practice would no longer weigh the merit of the taxpayer's stated business purpose against the amount of distortion of income or other tax consequences resulting from an adoption, change, or retention. Taxpayers wanting to adopt, change to, or retain a natural business year generally would be granted approval (provided they agree to general terms and conditions) under the proposed revenue procedure as under the current IRS ruling practice. Also consistent with the current IRS ruling practice, establishing a natural business year generally will be the only circumstance under which a partnership, S corporation, electing S corporation, or PSC will be granted approval. However, the IRS ruling practice for other taxpayers generally will be liberalized. These other taxpayers that do not establish a natural business year generally would be granted approval under the proposed revenue procedure if they agree to certain additional terms, conditions, and adjustments designed to neutralize the tax effects of substantial distortion of income resulting from the change. Under the IRS's current ruling practice, these other taxpayers generally would have been denied approval to change their annual accounting period if the change would have resulted in more than *de minimis* distortion of income.

4. *Automatic Approval*. Under the current regulations, automatic approval is granted to a C corporation that satisfies certain conditions through the filing of a statement with the District Director. Among the requirements for automatic approval are that the taxpayer not have changed its annual accounting period at any time within the preceding ten calendar years, and that a C corporation not elect S corporation status for the taxable year immediately following the short period. The rules for C corporations contained in the current regulations are inconsistent with, and generally more restrictive than, the automatic approval procedures in Rev. Proc. 2000–11. For example, under Rev. Proc. 2000–11, six years (rather than ten) is the required period of time between automatic changes and an S corporation election is allowed for the tax year following the short period. Consequently, the proposed regulations remove the automatic approval provision contained in the current regulations.

Further, the proposed regulations provide that the procedures to obtain automatic approval of the Commissioner for an adoption, change, or retention of annual accounting period generally are contained in administrative procedures. The IRS and Treasury Department believe that this structure will allow for the issuance of more detailed and useful guidance. *See*, for example, Rev. Proc. 2000–11 (2000–3 I.R.B. 309), which provides procedures for automatic approval for corporations; Notice 2001–35, proposing to update and supersede Rev. Proc. 87–32 (1987–2 C.B. 396), which provides procedures for automatic approval for partnerships, S corporations, electing S corporations, and PSCs; and Rev. Proc. 66–50 (1966–2 C.B. 1260), which provides automatic approval provisions for individuals. As part of the finalization of these proposed regulations and the proposed revenue procedures contained in Notices 2001–34 and 2001–35, the IRS and Treasury Department intend to update the procedures in Rev. Proc. 2000–11 to make conforming changes. For example, Rev. Proc. 2000–11 may be modified to reduce the time period between automatic changes from six to four years (as proposed in Notice 2001–34) and to provide audit protection for taxpayers making voluntary period changes (as proposed in both notices).

5. *Obsolete Provisions*. The rules relating to partners and partnerships contained in the current regulations are proposed to be removed because they have been superseded by the 1986 Act. Updated rules for partners and partnerships are provided in new proposed regulations under §1.706–1 contained in this notice of proposed rulemaking.

Similarly, the rules relating to certain foreign corporations contained in the current regulations are proposed to be removed because they have been superseded by section 898. Updated rules for these foreign corporations are contained in proposed regulations under section 898.

Finally, the proposed regulations would remove the following transitional provisions, which are now obsolete: §§5c.442–1, 5f.442–1, 1.442–2T, and 1.442–3T.

D. *Sections 706: Taxable Years of Partners and Partnerships*

1. *Partnership taxable year.*

The current regulations under §1.706–1 have not been updated to reflect changes made to section 706(b) by the 1986 Act. These proposed regulations modify the current regulations to reflect the required taxable year of a partnership consistent with the 1986 Act and §1.706–1T (regarding the taxable year that results in the least aggregate deferral of income). The proposed regulations also remove the procedural aspects of establishing a business purpose and requesting approval of the Commissioner to adopt or change a taxable year and instead refer to the procedures in §1.442–1 (including the administrative procedures prescribed thereunder).

These regulations also propose to remove §1.706–1T. This removal is not intended to effect a substantive change because the provisions of §1.706–1T generally are adopted by the proposed regulations. The IRS and Treasury recently expressed a commitment to the finalization of §1.706–1T, as well as other previously proposed regulations under section 706, LR–183–84 (1985–1 C.B. 653 [49 FR 47048]) and LR–53–88 (1988–1 C.B. 935 [53 FR 19715]). See 66 FR 3920, 3922. However, it is believed that adopting the substantive provisions of §1.706–1T in the current proposed regulations will promote clarity and efficiency.

2. *Inclusion rule for distributions, sales, and exchanges.*

Section 1.706–1(a)(2) of the current regulations provides that any gain or loss from a partnership distribution or from a sale or exchange of all or part of a partnership interest is includible in the partner's gross income for the taxable year in which the payment is made. Gain or loss from a distribution or a sale or exchange of a partnership interest generally is includible in gross income in the taxable year in which payment is made, but not always. For example, a partner who sells his partnership interest in exchange for an installment note may be able to defer inclusion of the gain from that sale under the installment method of accounting. Because the IRS and Treasury Department believe that other provisions of the Code and regulations provide adequate guidance on the time for including gain or loss from a partnership distribution or from a sale or exchange of a partnership interest, the inclusion rule in §1.706–1(a)(2) is proposed to be removed.

3. *Determination of interest in profits and capital.*

To apply any of the three required taxable year tests, a partnership must determine the partners' interests in partnership profits and capital. The proposed regulations elaborate on the meaning of a partner's interest in partnership profits and capital for purposes of these tests. With respect to profits interests, the regulations clarify that a partner's profits interest is the partner's share of the taxable income, rather than the book income, of the partnership. The regulations also clarify that the partners' profits interests are determined on an annual basis based on the manner in which the partnership expects to allocate its income for the year. If the partnership does not expect to have income in the current year, then the partnership determines the partner's profits interests based on the manner in which it expects to allocate its income in the first taxable year in which the partnership expects to have income.

Generally, a partner's interest in partnership capital is determined through reference to the assets of the partnership that the partner would be entitled to upon withdrawal from the partnership or upon the liquidation of the partnership. *See, e.g.*, §1.704–1(e)(v), Rev. Proc. 93–27 (1993 C.B. 343). As a practical matter, such a determination will require a valuation of the partnership's assets. Because the determination under section 706 must be made on an annual basis, the burden associated with actual valuations may make it difficult for partnerships to identify their taxable years quickly and easily. Therefore, for partnerships that maintain capital accounts in accordance with §1.704–1(b)(2)(iv), these proposed regulations provide that in making this determination, it will be reasonable for the partnership to assume that a partner's interest in partnership capital is the ratio of the partner's capital account to all partners' capital accounts. The IRS and Treasury Department are aware that this method will not always be as precise as an actual valuation, but believe that any imprecision is outweighed by the strong interest that partnerships have in being able to easily determine their taxable year.

This definition of a partner's interest in partnership profits and capital was designed to be compatible with the provisions of, and policies underlying, section 706(b). Many other sections of the Code also contain references to a partner's interest in partnership profits or capital. As those sections address concerns that differ substantially from the concerns addressed by section 706(b), this proposed regulation should not be read to create any implication as to the meaning of a partner's interest in partnership profits and capital for purposes of those sections.

E. *Section 1378: S Corporations*

The current regulations under §18.1378–1 describe the permitted year of an S corporation and provide procedural rules for an S corporation or electing S corporation to obtain approval to adopt, change, or retain its taxable year. However, the automatic change provision contained in these regulations is more restrictive than the automatic change proposed in Notice 2001–35. For this reason, and to be consistent with the policy decision to provide the procedural aspects of adopting, retaining, or changing a taxable year under §1.442–1 (including the administrative procedures prescribed thereunder), these regulations propose to modify §18.1378–1 to remove these procedural rules and instead refer to §1.442–1.

F. *Proposed Effective Date*

These regulations are proposed to be applicable for taxable years ending on or after the date these regulations are published in the **Federal Register** as final regulations.

**Effect on Other Documents**

Rev. Rul. 57–589 is obsolete.
Rev. Rul. 65–316 (1965–2 C.B. 149) is obsolete.
Rev. Rul. 68–125 (1968–1 C.B. 189) is obsolete.
Rev. Rul. 69–563 is obsolete.
Rev. Rul. 74–326 (1974–2 C.B. 142) is obsolete.
Rev. Rul. 78–179 (1978–1 C.B. 132) is obsolete.

**Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that few small entities are expected to adopt a 52-53-week taxable year, triggering the collection of information, and that for those who do, the burden imposed under §1.441–2(b)(1)(ii) will be minimal. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department specifically 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 October 2, 2001, at 10 a.m., in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit timely written or electronic comments and must submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by September 11, 2001.

A period of 10 minutes will be allocated to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

**Drafting Information**

The principal authors of these regulations are Roy A. Hirschhorn and Martin Scully, Jr. of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR parts 1, 5c, 5f, 18, and 301 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

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

| Affected Section | Remove | Add |
|---|---|---|
| 1.46–1(p)(2)(iv) | paragraph (b)(1) of §1.441–2 | §1.441–2 |
| 1.48–3(d)(1)(iii) | paragraph (b)(1) of §1.441–2 | §1.441–2 |
| 1.280H–1T(a), last sentence | §1.441–4T(d) | §1.441–3(c) |
| 1.443–1(b)(1)(ii) | and paragraph (c)(5) of §1.441–2 | and §1.441–2(b)(2)(ii) |
| 1.444–1T(a)(1), first sentence | §1.441–4T(d) | §1.441–3(c) |
| 1.444–2T(a), last sentence | §1.441–4T(d) | §1.441–3(c) |
| 1.448–1(h)(2)(ii)(B)(*1*) | §1.441–2T(b)(1) | §1.441–2(c) |
| 1.469–1(h)(4)(ii)(D) | §1.441–4T(f) | §1.441–3(e) |
| 1.469–1T(g)(2)(i) | §1.441–4T(d) | §1.441–3(c) |
| 1.1561–1(c)(2) | See paragraph (b)(1) of §1.441–2 | See §1.441–2 |
| 1.6654–2(a), concluding text | paragraph (b) of §1.441–2 | §1.441–2(c) |
| 1.6655–2(a)(4), first sentence | paragraph (b) of §1.441–2 | §1.441–2(c) |
| 301.7701(b)–6(a), third sentence | §1.441–1(e) | §1.441–1(b) |

Par. 3. Sections 1.441–0, 1.441–1, 1.441–2, 1.441–3, and 1.441–4 are added to read as follows:

*§1.441–0 Table of contents.*

This section lists the captions contained in §§1.441–1 through 1.441–4 as follows:

*§1.441–1 Period for computation of taxable income.*

(a) Computation of taxable income.
(1) In general.
(2) Length of taxable year.
(b) General rules and definitions.
(1) Taxable year.
(2) Required taxable year.
(i) In general.
(ii) Exceptions.
(A) 52-53-week taxable years.
(B) Partnerships, S corporations, and PSCs.
(C) Specified foreign corporations.
(3) Annual accounting period.
(4) Calendar year.
(5) Fiscal year.
(i) Definition.
(ii) Recognition.
(6) Grandfathered fiscal year.
(7) Books.
(c) Adoption of taxable year.
(1) In general.
(2) Approval required.
(i) Taxpayers with required taxable years.
(ii) Taxpayers without books.
(d) Retention of taxable year.
(e) Change of taxable year.
(f) Obtaining approval of the Commissioner or making a section 444 election.

*§1.441–2 Election of taxable year consisting of 52-53 weeks.*

(a) In general.
(1) Election.
(2) Eligible taxpayer
(3) Example.
(b) Procedures to elect a 52-53-week taxable year.
(1) Adoption of a 52-53-week taxable year.
(i) In general.
(ii) Filing requirement.

(2) Change to (or from) a 52-53-week taxable year.
(i) In general.
(ii) Special rules for short period required to effect the change.
(3) Examples.
(c) Application of effective dates.
(1) In general.
(2) Examples.
(3) Changes in tax rates.
(4) Examples.
(d) Computation of taxable income.
(e) Treatment of taxable years ending with reference to the same calendar month.
(1) Pass-through entities.
(2) Personal service corporations and employee-owners.
(3) Definitions.
(i) Pass-through entity.
(ii) Owner of a pass-through entity.
(4) Examples.
(5) Transition rule.

*§1.441–3 Taxable year of a personal service corporation.*

(a) Taxable year.
(1) Required taxable year.
(2) Exceptions.
(b) Adoption, change, or retention of taxable year.
(1) Adoption of taxable year.
(2) Change in taxable year.
(3) Retention of taxable year.
(4) Procedures for obtaining approval or making a section 444 election.
(5) Examples.
(c) Personal service corporation defined.
(1) In general.
(2) Testing period.
(i) In general.
(ii) New corporations.
(3) Examples.
(d) Performance of personal services.
(1) Activities described in section 448(d)(2)(A).
(2) Activities not described in section 448(d)(2)(A).
(e) Principal activity.
(1) General rule.
(2) Compensation cost.
(i) Amounts included.
(ii) Amounts excluded.
(3) Attribution of compensation cost to personal service activity.
(i) Employees involved only in the performance of personal services.
(ii) Employees involved only in activities that are not treated as the performance of personal services.
(iii) Other employees.
(A) Compensation cost attributable to personal service activity.
(B) Compensation cost not attributable to personal service activity.
(f) Services substantially performed by employee-owners.
(1) General rule.
(2) Compensation cost attributable to personal services.
(3) Examples.
(g) Employee-owner defined.
(1) General rule.
(2) Special rule for independent contractors who are owners.
(h) Special rules for affiliated groups filing consolidated returns.
(1) In general.
(2) Examples.

*§1.441–4 Effective date.*

*§1.441–1 Period for computation of taxable income.*

(a) *Computation of taxable income*—(1) *In general*. Taxable income must be computed and a return must be made for a period known as the "taxable year." For rules relating to methods of accounting, the taxable year for which items of gross income are included and deductions are taken, inventories, and adjustments, see parts II and III (section 446 and following), subchapter E, chapter 1 of the Internal Revenue Code, and the regulations thereunder.

(2) *Length of taxable year*. Except as otherwise provided in the Internal Revenue Code and the regulations thereunder (*e.g.*, §1.441–2 regarding 52-53-week taxable years), a taxable year may not cover a period of more than 12 calendar months.

(b) *General rules and definitions*. The general rules and definitions in this paragraph (b) apply for purposes of sections 441 and 442 and the regulations thereunder.

(1) *Taxable year*. *Taxable year* means—

(i) The period for which a return is made, if a return is made for a period of less than 12 months (short period). See section 443 and the regulations thereunder;

(ii) Except as provided in paragraph (b)(1)(i) of this section, the taxpayer's required taxable year (as defined in paragraph (b)(2) of this section), if applicable;

(iii) Except as provided in paragraphs (b)(1)(i) and (ii) of this section, the taxpayer's annual accounting period (as defined in paragraph (b)(3) of this section), if it is a calendar year or a fiscal year; or

(iv) Except as provided in paragraphs (b)(1)(i) and (ii) of this section, the calendar year, if the taxpayer keeps no books, does not have an annual accounting period, or has an annual accounting period that does not qualify as a fiscal year.

(2) *Required taxable year*—(i) *In general*. Certain taxpayers must use the particular taxable year that is required under the Internal Revenue Code and the regulations thereunder (the required taxable year). For example, the required taxable year is—

(A) In the case of a foreign sales corporation or domestic international sales corporation, the taxable year determined under section 441(h) and §1.921–1T (a)(11), (b)(4), and (b)(6);

(B) In the case of a personal service corporation (PSC), the taxable year determined under section 441(i) and §1.441–3;

(C) In the case of a nuclear decommissioning fund, the taxable year determined under §1.468A–4(c)(1);

(D) In the case of a designated settlement fund or a qualified settlement fund, the taxable year determined under §1.468B–2(j);

(E) In the case of a common trust fund, the taxable year determined under section 584(i);

(F) In the case of certain trusts, the taxable year determined under section 644;

(G) In the case of a partnership, the taxable year determined under section 706 and §1.706–1;

(H) In the case of an insurance company, the taxable year determined under section 843 and §1.1502–76(a)(2);

(I) In the case of a real estate investment trust, the taxable year determined under section 859;

(J) In the case of a real estate mortgage investment conduit, the taxable year determined under section 860D(a)(5) and §1.860D–1(b)(6);

(K) In the case of a specified foreign corporation, the taxable year determined under section 898(c) and §§1.898–1 through 1.898–4;

(L) In the case of an S corporation, the taxable year determined under section 1378 and §1.1378–1; or

(M) In the case of a member of an affiliated group that makes a consolidated return, the taxable year determined under §1.1502–76.

(ii) *Exceptions*. Notwithstanding paragraph (b)(2)(i) of this section, the following taxpayers may have a taxable year other than their required taxable year:

(A) *52-53-week taxable years*. Certain taxpayers may elect to use a 52-53-week taxable year that ends with reference to their required taxable year. *See, f*or example, §§1.441–3 (PSCs), 1.706–1 (partnerships), 1.1378–1 (S corporations), and 1.1502–76(a)(1) (members of a consolidated group), and 1.898–4(c)(3) (specified foreign corporations).

(B) *Partnerships, S corporations, and PSCs*. A partnership, S corporation, or PSC may use a taxable year other than its required taxable year if the taxpayer elects a 52-53-week taxable year that ends with reference to its required taxable year as provided in paragraph (b)(2)(ii)(A) of this section, elects to use a taxable year other than its required taxable year under section 444, or establishes a business purpose to the satisfaction of the Commissioner under section 442 (such as a grandfathered fiscal year).

(C) *Specified foreign corporations*. A specified foreign corporation (as defined in section 898(b)) may use a taxable year other than its required taxable year if it elects a 52-53-week taxable year that ends with reference to its required taxable year as provided in paragraph (b)(2)(ii)(A) of this section or makes a one-month deferral election under section 898(c)(1)(B) and §1.898–3(a)(2).

(3) *Annual accounting period. Annual accounting period* means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes its income in keeping its books.

(4) *Calendar year. Calendar year* means a period of 12 consecutive months ending on December 31. A taxpayer who has not established a fiscal year must make its return on the basis of a calendar year.

(5) *Fiscal year*—(i) *Definition. Fiscal year* means—

(A) A period of 12 consecutive months ending on the last day of any month other than December; or

(B) A 52-53-week taxable year, if such period has been elected by the taxpayer. See §1.441–2.

(ii) *Recognition*. A fiscal year will be recognized only if the books of the taxpayer are kept in accordance with such fiscal year.

(6) *Grandfathered fiscal year. Grandfathered fiscal year* means a fiscal year (other than a year that resulted in a three month or less deferral of income) that a partnership or an S corporation received permission to use on or after July 1, 1974, by a letter ruling (*i.e.*, not by automatic approval).

(7) *Books*. *Books* include the taxpayer's regular books of account and such other records and data as may be necessary to support the entries on the taxpayer's books and on the taxpayer's return, as for example, a reconciliation of any difference between such books and the taxpayer's return. Records that are sufficient to reflect income adequately and clearly on the basis of an annual accounting period will be regarded as the keeping of books. See section 6001 and the regulations thereunder for rules relating to the keeping of books and records.

(c) *Adoption of taxable year*—(1) *In general*. Except as provided in paragraph (c)(2) of this section, a new taxpayer may adopt any taxable year that satisfies the requirements of section 441 and the regulations thereunder without the approval of the Commissioner. A taxable year of a new taxpayer is adopted by filing its first federal income tax return using that taxable year. The filing of an application for automatic extension of time to file a federal income tax return (*e.g.*, Form 7004), the filing of an application for an employer identification number *(i.e.*, Form SS-4), or the payment of estimated taxes, for a particular taxable year do not constitute an adoption of that taxable year.

(2) *Approval required*—(i) *Taxpayers with required taxable years*. A newly-formed partnership, electing S corporation, or newly-formed PSC that wants to adopt a taxable year other than its required taxable year, a 52-53-week taxable year that ends with reference to its required taxable year, or a taxable year elected under section 444, must establish a business purpose and obtain the approval of the Commissioner under section 442.

(ii) *Taxpayers without books*. A taxpayer that must use a calendar year under section 441(g) and paragraph (f) of this section may not adopt a fiscal year without obtaining the approval of the Commissioner.

(d) *Retention of taxable year*. In certain cases, a partnership, S corporation, or PSC will be required to change its taxable year unless it obtains the approval of the Commissioner under section 442, or makes an election under section 444, to retain its current taxable year. For example, a corporation using a June 30 fiscal year that either becomes a PSC or elects to be an S corporation and, as a result, is required to use the calendar year under sections 441(i) or 1378, respectively, must obtain the approval of the Commissioner to retain its current fiscal year. Similarly, a partnership using a taxable year that corresponds to its required taxable year must obtain the approval of the Commissioner to retain such taxable year if its required taxable year changes as a result of a change in ownership. However, a partnership that previously established a business purpose to the satisfaction of the Commissioner to use a taxable year is not required to obtain the approval of the Commissioner if its required taxable year changes as a result of a change in ownership.

(e) *Change of taxable year*. Once a taxpayer has adopted a taxable year, such taxable year must be used in computing taxable income and making returns for all subsequent years unless the taxpayer obtains approval from the Commissioner to make a change or the taxpayer is otherwise authorized to change without the approval of the Commissioner under the Internal Revenue Code *(e.g.*, section 444 or section 859) or the regulations thereunder.

(f) *Obtaining approval of the Commissioner or making a section 444 election*. See §1.442–1(b) for procedures for obtaining approval of the Commissioner (automatically or otherwise) to adopt, change, or retain an annual accounting period. See §§1.444–1T and 1.444–2T for qualifications, and 1.444–3T for procedures, for making an election under section 444.

*§1.441–2 Election of taxable year consisting of 52-53 weeks.*

(a) *In general*—(1) *Election*. An eligible taxpayer may elect to compute its taxable income on the basis of a fiscal year that—

(i) Varies from 52 to 53 weeks;

(ii) Ends always on the same day of the week; and

(iii) Ends always on—

(A) Whatever date this same day of the week last occurs in a calendar month; or

(B) Whatever date this same day of the week falls that is the nearest to the last day of the calendar month.

(2) *Eligible taxpayer*. A taxpayer is eligible to elect a 52-53-week taxable year if such fiscal year would otherwise satisfy the requirements of section 441 and the regulations thereunder. For example, a taxpayer that is required to use a calendar year under §1.441–1(b)(1)(D) is not an eligible taxpayer.

(3) *Example*. The provisions of this paragraph (a) are illustrated by the following example:

*Example*. If the taxpayer elects a taxable year ending always on the last Saturday in November, then for the year 2001, the taxable year would end on November 24, 2001. On the other hand, if the taxpayer had elected a taxable year ending always on the Saturday nearest to the end of November, then for the year 2001, the taxable year would end on December 1, 2001. Thus, in the case of a taxable year described in paragraph (a)(1)(iii)(A) of this section, the year will always end within the month and may end on the last day of the month, or as many as six days before the end of the month. In the case of a taxable year described in paragraph (a)(1)(iii)(B) of this section, the year may end on the last day of the month, or as many as three days before or three days after the last day of the month.

(b) *Procedures to elect a 52-53-week taxable year*—(1) *Adoption of a 52-53-week taxable year*—(i) *In general*. A new eligible taxpayer elects a 52-53-week taxable year by adopting such year in accordance with §1.441–1(c). A newly-formed partnership, electing S corporation, or newly-formed personal service corporation (PSC) may adopt a 52-53-week taxable year without the approval of the Commissioner if such year ends with reference to either the taxpayer's required taxable year (as defined in §1.441–1(b)(2)) or the taxable year elected under section 444. *See* §§1.706–1, 1.1378–1 and 1.441–3. Similarly, a newly-formed specified foreign corporation (as defined in section 898(b)) may adopt a 52-53-week taxable year if such year ends with reference to the taxpayer's required taxable year, or, if the one-month deferral election under section 898(c)(1)(B) is made, with reference to the month immediately preceding the required taxable year. See §1.898–4(c)(3). *See* also §1.1502–76(a)(1) for special rules regarding subsidiaries adopting 52-53-week taxable years.

(ii) *Filing requirement*. A taxpayer adopting a 52-53-week taxable year must file with its federal income tax return for its first taxable year a statement containing the following information—

(A) The calendar month with reference to which the new 52-53-week taxable year ends;

(B) The day of the week on which the 52-53-week taxable year always will end; and

(C) Whether the 52-53-week taxable year will always end on the date on which that day of the week last occurs in the calendar month, or on the date on which that day of the week falls that is nearest to the last day of that calendar month.

(2) *Change to (or from) a 52-53-week taxable year*—(i) *In general*. An election of a 52-53-week taxable year by an existing eligible taxpayer with an established taxable year is treated as a change in annual accounting period that requires the approval of the Commissioner in accordance with §1.442–1. Thus, a taxpayer must obtain approval to change from its current taxable year to a 52-53-week taxable year. Similarly, a taxpayer must obtain approval to change from a 52-53-week taxable year, or to change from one 52-53-week taxable year to another 52-53-week taxable year. However, if a change to a 52-53-week taxable year ends with reference to the same calendar month as the existing taxable year, or if a change from a 52-53-week taxable year ends with reference to the same calendar month as the proposed taxable year, the taxpayer may obtain approval for the change automatically pursuant to administrative procedures published by the Commissioner. See §1.442–1(b) for procedures for obtaining such approval.

(ii) *Special rules for the short period required to effect the change*. If a change to or from a 52-53-week taxable year results in a short period (within the meaning of §1.443–1(a)) of 359 days or more, or six days or less, the tax computation under §1.443–1(b) does not apply. If the short period is 359 days or more, it is treated as a full taxable year. If the short period is six days or less, such short period is not a separate taxable year but instead is added to and deemed a part of the following taxable year. (In the case of a change to or from a 52-53-week taxable year not involving a change of the month with reference to which the taxable year ends, the tax computation under §1.443–1(b) does not apply because the short period will always be 359 days or more, or six days or less.) In the case of a short period which is more than six days and less than 359 days, taxable income for the short period is placed on an annual basis for purposes of §1.443–1(b) by multiplying such income by 365 and dividing the result by the number of days in the short period. In such case, the tax for the short period is the same part of the tax computed on such income placed on an annual basis as the number of days in the short period is of 365 days (unless §1.443–1(b)(2), relating to the alternative tax computation, applies). For an adjustment in deduction for personal exemption, *see* §1.443–1(b)(1)(v).

(3) *Examples*. The following examples illustrate paragraph (b)(2)(ii) of this section:

*Example 1*. A taxpayer having a fiscal year ending April 30, obtains approval to change to a 52-53-week taxable year ending the last Saturday in April for taxable years beginning after April 30, 2001. This change involves a short period of 362 days, from May 1, 2001, to April 27, 2002, inclusive. Because the change results in a short period of 359 days or more, it is not placed on an annual basis and is treated as a full taxable year.

*Example 2*. Assume the same conditions as *Example 1*, except that the taxpayer changes for taxable years beginning after April 30, 2002, to a taxable year ending on the Thursday nearest to April 30. This change results in a short period of two days, May 1 to May 2, 2002. Because the short period is less than seven days, tax is not separately computed. This short period is added to and deemed part of the following 52-53-week taxable year, which would otherwise begin on May 3, 2002, and end on May 1, 2003.

(c) *Application of effective dates*—(1) *In general*. Except as provided in paragraph (c)(3) of this section, for purposes of determining the effective date (*e.g.*, of legislative or regulatory changes) or the applicability of any provision of this title that is expressed in terms of taxable years beginning, including, or ending with reference to the first or last day of a specified calendar month, a 52-53-week taxable year is deemed to begin on the first day of the calendar month nearest to the first day of the 52-53-week taxable year, and is deemed to end or close on the last day of the calendar month nearest to the last day of the 52-53-week taxable year, as the case may be. Examples of provisions of this title, the applicability of which is expressed in terms referred to in the preceding sentence, include the provisions relating to the time for filing returns and other documents, paying tax, or performing other acts, and the provisions of part II, subchapter B, chapter 6 (section 1561 and following) relating to surtax exemptions of certain controlled corporations.

(2) *Examples*. The provisions of paragraph (c)(1) of this section may be illustrated by the following examples:

*Example 1*. Assume that an income tax provision is applicable to taxable years beginning on or after January 1, 2001. For that purpose, a 52-53-week taxable year beginning on any day within the period December 26, 2000, to January 4, 2001, inclusive, is treated as beginning on January 1, 2001.

*Example 2*. Assume that an income tax provision requires that a return must be filed on or before the 15th day of the third month following the close of the taxable year. For that purpose, a 52-53-week taxable year ending on any day during the period May 25 to June 3, inclusive, is treated as ending on May 31, the last day of the month ending nearest to the last day of the taxable year, and the return, therefore, must be made on or before August 15.

*Example 3*. X, a corporation created on January 1, 2001, elects a 52-53-week taxable year ending on the Friday nearest the end of December. Thus, X's first taxable year begins on Monday, January 1, 2001, and ends on Friday, December 28, 2001; its next taxable year begins on Saturday, December 29, 2001, and ends on Friday, January 3, 2003; and its next taxable year begins on Saturday, January 4, 2003, and ends on Friday, January 2, 2004. For purposes of applying the provisions of Part II, subchapter B, chapter 6 of the Internal Revenue Code, X's first taxable year is deemed to end on December 31, 2001; its next taxable year is deemed to begin on January 1, 2002, and end on December 31, 2002, and its next taxable year is deemed to begin on January 1, 2003, and end on December 31, 2003. Accordingly, each such taxable year is treated as including one and only one December 31st.

(3) *Changes in tax rates*. If a change in the rate of tax is effective during a 52-53-week taxable year (other than on the first day of such year as determined under paragraph (c)(1) of this section), the tax for the 52-53-week taxable year must be computed in accordance with section 15, relating to effect of changes, and the regulations thereunder. For the purpose of the computation under section 15, the determination of the number of days in the period before the change, and in the period on and after the change, is to be made without regard to the provisions of paragraph (b)(1) of this paragraph.

(4) *Examples*. The provisions of paragraph (c)(3) of this section may be illustrated by the following examples:

*Example 1*. Assume a change in the rate of tax is effective for taxable years beginning after June 30, 2002. For a 52-53-week taxable year beginning on Friday, November 2, 2001, the tax must be computed on the basis of the old rates for the actual number of days from November 2, 2001, to June 30, 2002, inclusive, and on the basis of the new rates for the actual number of days from July 1, 2002, to Thursday, October 31, 2002, inclusive.

*Example 2*. Assume a change in the rate of tax is effective for taxable years beginning after June 30, 2001. For this purpose, a 52-53-week taxable year beginning on any of the days from June 25 to July 4, inclusive, is treated as beginning on July 1. Therefore, no computation under section 15 will be required for such year because of the change in rate.

(d) *Computation of taxable income*. The principles of section 451, relating to the taxable year for inclusion of items of gross income, and section 461, relating to the taxable year for taking deductions, generally are applicable to 52-53-week taxable years. Thus, except as otherwise provided, all items of income and deduction must be determined on the basis of a 52-53-week taxable year. However, a taxpayer may determine particular items as though the 52-53-week taxable year were a taxable year consisting of 12 calendar months, provided that practice is consistently followed by the taxpayer and clearly reflects income. For example, an allowance for depreciation or amortization may be determined on the basis of a 52-53-week taxable year, or as though the 52-53-week taxable year is a taxable year consisting of 12 calendar months, provided the taxpayer consistently follows that practice with respect to all depreciable or amortizable items.

(e) *Treatment of taxable years ending with reference to the same calendar month*—(1) *Pass-through entities*. If a pass-through entity (as defined in paragraph (e)(3)(i) of this section) or an owner of a pass-through entity (as defined in paragraph (e)(3)(ii) of this section), or both, use a 52-53-week taxable year and the taxable year of the pass-through entity and the owner end with reference to the same calendar month, then, for purposes of determining the taxable year in which items of income, gain, loss, deductions, or credits from the pass-through entity are taken into account by the owner of the pass-through, the owner's taxable year will be deemed to end on the last day of the pass-through's taxable year. Thus, if the taxable year of a partnership and a partner end with reference to the same calendar month, then for purposes of determining the taxable year in which that partner takes into account items described in section 702 and items that are deductible by the partnership (including items described in section 707(c)) and includible in the income of that partner, that partner's taxable year will be deemed to end on the last day of the partnership's taxable year. Similarly, if the taxable year of an S corporation and a shareholder end with reference to the same calendar month, then for purposes of determining the taxable year in which that shareholder takes into account items described in section 1366(a) and items that are deductible by the S corporation and includible in the income of that shareholder, that shareholder's taxable year will be deemed to end on the last day of the S corporation's taxable year.

(2) *Personal service corporations and employee-owners*. If the taxable year of a PSC (within the meaning of §1.441–3(c)) and an employee-owner (within the meaning of §1.441–3(g)) end with reference to the same calendar month, then for purposes of determining the taxable year in which an employee-owner takes into account items that are deductible by the PSC and includible in the income of the employee-owner, the employee-owner's taxable year will be deemed to end on the last day of the PSC's taxable year.

(3) *Definitions*—(i) *Pass-through entity*. For purposes of this section, a pass-through entity means a partnership, S corporation, trust, estate, common trust fund (within the meaning of section 584(i)), controlled foreign corporation (within the meaning of section 957), foreign personal holding company (within the meaning of section 552), or passive foreign investment company that is a qualified electing fund (within the meaning of section 1295).

(ii) *Owner of a pass-through entity*. For purposes of this section, an owner of a pass-through entity means a taxpayer that owns an interest in, or stock of, a pass-through entity. For example, an owner of a pass-through entity includes a partner in a partnership, a shareholder of an S corporation, a beneficiary of a trust or an estate, a participant in a common trust fund, a U.S. shareholder (as defined in section 951(b)) of a controlled foreign corporation, a U.S. shareholder (as defined in section 551(a)) of a foreign personal holding company, or a U.S. person that holds stock in a passive foreign investment company that is a qualified electing fund.

(4) *Examples*. The provisions of paragraph (e)(2) of this section may be illustrated by the following examples:

*Example 1*. ABC Partnership uses a 52-53-week taxable year that ends on the Wednesday nearest to December 31, and its partners, A, B, and C, are individual calendar year taxpayers. Assume that, for ABC's taxable year ending January 3, 2001, each partner's distributive share of ABC's taxable income is $10,000. Under section 706(a) and paragraph (e)(1) of this section, for the taxable year ending December 31, 2000, A, B, and C each must include $10,000 in income with respect to the ABC year ending January 3, 2001. Similarly, if ABC makes a guaranteed payment to A on January 2, 2001, A must include the payment in income for A's taxable year ending December 31, 2000.

*Example 2*. X, a PSC, uses a 52-53-week taxable year that ends on the Wednesday nearest to December 31, and all of the employee-owners of X are individual calendar year taxpayers. Assume that, for its taxable year ending January 3, 2001, X pays a bonus of $10,000 to each employee-owner on January 2, 2001. Under paragraph (e)(2) of this section, each employee-owner must include its bonus in income for the taxable year ending December 31, 2000.

(5) *Transition rule*. In the case of an owner of a pass-through entity (other than the owner of a partnership or S corporation) that is required by this paragraph (e) to include in income for its first taxable year ending on or after the date these regulations are published in the **Federal Register** as final regulations amounts attributable to two taxable years of a pass-through entity, the amount that otherwise would be required to be included in income for such first taxable year by reason of this paragraph (e) should be included in income ratably over the four-taxable-year period beginning with such first taxable year under principles similar to §1.702–3T, unless the owner of the pass-through elects to include all such income in its first taxable year ending on or after the date these regulations are published in the **Federal Register** as final regulations.

*§1.441–3 Taxable year of a personal service corporation.*

(a) *Taxable year*—(1) *Required taxable year*. Except as provided in paragraph (a)(2) of this section, the taxable year of a personal service corporation (PSC) (as defined in paragraph (c) of this section) must be the calendar year.

(2) *Exceptions*. A PSC may have a taxable year other than its required taxable year (*i.e.*, a fiscal year) if it elects to use a 52-53-week taxable year that ends with reference to the calendar year, makes an election under section 444, or establishes a business purpose for such fiscal year and obtains the approval of the Commissioner under section 442.

(b) *Adoption, change, or retention of taxable year*—(1) *Adoption of taxable year*. A PSC may adopt, in accordance with §1.441–1(c), the calendar year, a 52-53-week taxable year ending with reference to the calendar year, or a taxable year elected under section 444 without the approval of the Commissioner. See §1.441–1. A PSC that wants to adopt any other taxable year must establish a business purpose and obtain the approval of the Commissioner under section 442.

(2) *Change in taxable year*. A PSC that wants to change its taxable year must obtain the approval of the Commissioner under section 442 or make an election under section 444. However, a PSC may obtain automatic approval for certain changes, including a change to the calendar year or to a 52-53-week taxable year ending with reference to the calendar year, pursuant to administrative procedures published by the Commissioner.

(3) *Retention of taxable year*. In certain cases, a PSC will be required to change its taxable year unless it obtains the approval of the Commissioner under section 442, or makes an election under section 444, to retain its current taxable year. For example, a corporation using a June 30 fiscal year that becomes a PSC and, as a result, is required to use the calendar year must obtain the approval of the Commissioner to retain its current fiscal year.

(4) *Procedures for obtaining approval or making a section 444 election*. See §1.442–1(b) for procedures to obtain the approval of the Commissioner (automatically or otherwise) to adopt, change, or retain a taxable year. *See* §§1.444–1T and 1.444–2T for qualifications, and 1.444–3T for procedures, for making an election under section 444.

(5) *Examples*. The provisions of paragraph (b)(4) of this section may be illustrated by the following examples:

*Example 1*. X, whose taxable year ends on January 31, 2001, becomes a PSC for its taxable year beginning February 1, 2001, and does not obtain the approval of the Commissioner for using a fiscal year. Thus, for taxable years ending before February 1, 2001, this section does not apply with respect to X. For its taxable year beginning on February 1, 2001, however, X will be required to comply with paragraph (a) of this section. Thus, unless X obtains approval of the Commissioner to use a January 31 taxable year, or makes a section 444 election, X will be required to change its taxable year to the calendar year under paragraph (b) of this section by using a short taxable year that begins on February 1, 2001, and ends on December 31, 2001. Under paragraph (b)(1) of this section, X may obtain automatic approval to change its taxable year to a calendar year. See §1.442-1(b).

*Example 2*. Assume the same facts as in *Example 1*, except that X desires to change to a 52-53-week taxable year ending with reference to the month of December. Under paragraph (b)(1) of this section X may obtain automatic approval to make the change. See §1.442–1(b).

(c) *Personal service corporation defined*—(1) *In general*. For purposes of this section and section 442, a taxpayer is a PSC for a taxable year only if—

(i) The taxpayer is a C corporation (as defined in section 1361(a)(2)) for the taxable year;

(ii) The principal activity of the taxpayer during the testing period is the performance of personal services;

(iii) During the testing period, those services are substantially performed by employee-owners (as defined in paragraph (g) of this section); and

(iv) Employee-owners own (as determined under the attribution rules of section 318, except that "any" applies instead of "50 percent" in section 318(a)(2)(C)) more than 10 percent of the fair market value of the outstanding stock in the taxpayer on the last day of the testing period.

(2) *Testing period*—(i) *In general*. Except as otherwise provided in paragraph (c)(2)(ii) of this section, the testing period for any taxable year is the immediately preceding taxable year.

(ii) *New corporations.* The testing period for a taxpayer's first taxable year is the period beginning on the first day of that taxable year and ending on the earlier of—

(A) The last day of that taxable year; or

(B) The last day of the calendar year in which that taxable year begins.

(3) *Examples*. The provisions of paragraph (c)(2)(ii) of this section may be illustrated by the following examples:

*Example 1*. Corporation A's first taxable year begins on June 1, 2001, and A desires to use a September 30 taxable year. However, if A is a personal service corporation, it must obtain the Commissioner's approval to use a September 30 taxable year. Pursuant to paragraph (c)(2)(ii) of this section, A's testing period for its first taxable year beginning June 1, 2001, is the period June 1, 2001, through September 30, 2001. Thus, if, based upon such testing period, A is a personal service corporation, A must obtain the Commissioner's permission to use a September 30 taxable year.

*Example 2*. The facts are the same as in *Example 1*, except that A desires to use a March 31 taxable year. Pursuant to paragraph (c)(2)(ii) of this section, A's testing period for its first taxable year beginning June 1, 2001, is the period June 1, 2001, through December 31, 2001. Thus, if, based upon such testing period, A is a personal service corporation, A must obtain the Commissioner's permission to use a March 31 taxable year.

(d) *Performance of personal services*—(1) *Activities described in section 448(d)(2)(A)*. For purposes of this section, any activity of the taxpayer described in section 448(d)(2)(A) or the regulations thereunder will be treated as the performance of personal services. Therefore, any activity of the taxpayer that involves the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting (as such fields are defined in §1.448–1T) will be treated as the performance of personal services for purposes of this section.

(2) *Activities not described in section 448(d)(2)(A)*. For purposes of this section, any activity of the taxpayer not described in section 448(d)(2)(A) or the regulations thereunder will not be treated as the performance of personal services.

(e) *Principal activity*—(1) *General rule*. For purposes of this section, the principal activity of a corporation for any testing period will be the performance of personal services if the cost of the corporation's compensation (the compensation cost) for such testing period that is attributable to its activities that are treated as the performance of personal services within the meaning of paragraph (d) of this section (*i.e.*, the total compensation for personal service activities) exceeds 50 percent of the corporation's total compensation cost for such testing period.

(2) *Compensation cost*—(i) *Amounts included*. For purposes of this section, the compensation cost of a corporation for a taxable year is equal to the sum of the following amounts allowable as a deduction, allocated to a long-term contract, or otherwise chargeable to a capital account by the corporation during such taxable year—

(A) Wages and salaries; and

(B) Any other amounts, attributable to services performed for or on behalf of the corporation by a person who is an employee of the corporation (including an owner of the corporation who is treated as an employee under paragraph (g)(2) of this section) during the testing period. Such amounts include, but are not limited to, amounts attributable to deferred compensation, commissions, bonuses, compensation includible in income under section 83, compensation for services based on a percentage of profits, and the cost of providing fringe benefits that are includible in income.

(ii) *Amounts excluded*. Notwithstanding paragraph (e)(2)(i) of this section, compensation cost does not include amounts attributable to a plan qualified under section 401(a) or 403(a), or to a simplified employee pension plan defined in section 408(k).

(3) *Attribution of compensation cost to personal service activity*—(i) *Employees involved only in the performance of personal services*. The compensation cost for employees involved only in the performance of activities that are treated as personal services under paragraph (d) of this section, or employees involved only in supporting the work of such employees, are considered to be attributable to the corporation's personal service activity.

(ii) *Employees involved only in activities that are not treated as the performance of personal services*. The compensation cost for employees involved only in the performance of activities that are not treated as personal services under paragraph (d) of this section, or for employees involved only in supporting the work of such employees, are not considered to be attributable to the corporation's personal service activity.

(iii) *Other employees.* The compensation cost for any employee who is not described in either paragraph (e)(3)(i) or paragraph (e)(3)(ii) of this section (a mixed-activity employee) is allocated as follows—

(A) *Compensation cost attributable to personal service activity*. That portion of the compensation cost for a mixed activity employee that is attributable to the corporation's personal service activity equals the compensation cost for that employee multiplied by the percentage of the total time worked for the corporation by that employee during the year that is attributable to activities of the corporation that are treated as the performance of personal services under paragraph (d) of this section. That percentage is to be determined by the taxpayer in any reasonable and consistent manner. Time logs are not required unless maintained for other purposes;

(B) *Compensation cost not attributable to personal service activity*. That portion of the compensation cost for a mixed activity employee that is not considered to be attributable to the corporation's personal service activity is the compensation cost for that employee less the amount determined in paragraph (e)(3)(iii)(A) of this section.

(f) *Services substantially performed by employee-owners*—(1) *General rule*. Personal services are substantially performed during the testing period by employee-owners of the corporation if more than 20 percent of the corporation's compensation cost for that period attributable to its activities that are treated as the performance of personal services within the meaning of paragraph (d) of this section (*i.e.*, the total compensation for personal service activities) is attributable to personal services performed by employee-owners.

(2) *Compensation cost attributable to personal services*. For purposes of paragraph (f)(1) of this section—

(i) The corporation's compensation cost attributable to its activities that are treated as the performance of personal services is determined under paragraph (e)(3) of this section; and

(ii) The portion of the amount determined under paragraph (f)(2)(i) of this section that is attributable to personal services performed by employee-owners is to be determined by the taxpayer in any reasonable and consistent manner.

(3) *Examples*. The provisions of this paragraph (f) may be illustrated by the following examples:

*Example 1*. For its taxable year beginning February 1, 2001, Corp A's testing period is the taxable year ending January 31, 2000. During that testing period, A's only activity was the performance of personal services. The total compensation cost of A (including compensation cost attributable to employee-owners) for the testing period was $1,000,000. The total compensation cost attributable to employee-owners of A for the testing period was $210,000. Pursuant to paragraph (f)(1) of this section, the employee-owners of A substantially performed the personal services of A during the testing period because the compensation cost of A's employee-owners was more than 20 percent of the total compensation cost for all of A's employees (including employee-owners).

*Example 2.* Corp B has the same facts as corporation A in *Example 1*, except that during the taxable year ending January 31, 2001, B also participated in an activity that would not be characterized as the performance of personal services under this section. The total compensation cost of B (including compensation cost attributable to employee-owners) for the testing period was $1,500,000 ($1,000,000 attributable to B's personal service activity and $500,000 attributable to B's other activity). The total compensation cost attributable to employee-owners of B for the testing period was $250,000 ($210,000 attributable to B's personal service activity and $40,000 attributable to B's other activity). Pursuant to paragraph (f)(1) of this section, the employee-owners of B substantially performed the personal services of B during the testing period because more than 20 percent of B's compensation cost during the testing period attributable to its personal service activities was attributable to personal services performed by employee-owners ($210,000).

(g) *Employee-owner defined*—(1) *General rule*. For purposes of this section, a person is an employee-owner of a corporation for a testing period if—

(i) The person is an employee of the corporation on any day of the testing period; and

(ii) The person owns any outstanding stock of the corporation on any day of the testing period.

(2) *Special rule for independent contractors who are owners.* Any person who is an owner of the corporation within the meaning of paragraph (g)(1)(ii) of this section and who performs personal services for, or on behalf of, the corporation is treated as an employee for purposes of this section, even if the legal form of that person's relationship to the corporation is such that the person would be considered an independent contractor for other purposes.

(h) *Special rules for affiliated groups filing consolidated returns*—(1) *In general*. For purposes of applying this section to the members of an affiliated group of corporations filing a consolidated return for the taxable year—

(i) The members of the affiliated group are treated as a single corporation;

(ii) The employees of the members of the affiliated group are treated as employees of such single corporation; and

(iii) All of the stock of the members of the affiliated group that is not owned by any other member of the affiliated group is treated as the outstanding stock of that corporation.

(2) *Examples*. The provisions of this paragraph (h) may be illustrated by the following examples:

*Example 1*. The affiliated group AB, consisting of corporation A and its wholly owned subsidiary B, filed a consolidated federal income tax return for the taxable year ending January 31, 2001, and AB is attempting to determine whether it is affected by this section for its taxable year beginning February 1, 2001. During the testing period (*i.e*., the taxable year ending January 31, 2001), A did not perform personal services. However, B's only activity was the performance of personal services. On the last day of the testing period, employees of A did not own any stock in A. However, some of B's employees own stock in A. In the aggregate, B's employees own 9 percent of A's stock on the last day of the testing period. Pursuant to paragraph (h)(1) of this section, this section is effectively applied on a consolidated basis to members of an affiliated group filing a consolidated federal income tax return. Because the only employee-owners of AB are the employees of B, and because B's employees do not own more than 10 percent of AB on the last day of the testing period, AB is not a PSC subject to the provisions of this section. Thus, AB is not required to determine on a consolidated basis whether, during the testing period, its principal activity is the providing of personal services, or the personal services are substantially performed by employee-owners.

*Example 2*. The facts are the same as in *Example 1*, except that on the last day of the testing period A owns only 80 percent of B. The remaining 20 percent of B is owned by employees of B. The fair market value of A, including its 80 percent interest in B, as of the last day of the testing period, is $1,000,000. In addition, the fair market value of the 20 percent interest in B owned by B's employees is $50,000 as of the last day of the testing period. Pursuant to paragraphs (c)(1)(iv) and paragraph (h)(1) of this section, AB must determine whether the employee-owners of A and B (*i.e*., B's employees) own more than 10 percent of the fair market value of A and B as of the last day of the testing period. Because the $140,000 [($1,000,000 x .09) + $50,000] fair market value of the stock held by B's employees is greater than 10 percent of the aggregate fair market value of A and B as of the last day of the testing period, or $105,000 [$1,000,000 + $50,000 x .10], AB may be subject to this section if, on a consolidated basis during the testing period, the principal activity of AB is the performance of personal services and the personal services are substantially performed by employee-owners.

*§1.441–4 Effective date.*

Sections 1.441–0 through 1.441–3 are applicable for taxable years ending on or after the date these regulations are published in the **Federal Register** as final regulations.

**§§ 1.441–1T, 1.441–2T, 1.441–3T and 1.441–4T [Removed]**

Par. 4. Sections 1.441–1T, 1.441–2T, 1.441–3T, and 1.441–4T are removed.

Par. 5. Section 1.442–1 is revised to read as follows:

*§1.442–1 Change of annual accounting period.*

(a) *Approval of the Commissioner.* A taxpayer that has adopted an annual accounting period (as defined in §1.441–1(b)(3)) as its taxable year generally must continue to use that annual accounting period in computing its taxable income and for making its federal income tax returns. If the taxpayer wants to change its annual accounting period and use a new taxable year, it must obtain the approval of the Commissioner, unless it is otherwise authorized to change without the approval of the Commissioner under either the Internal Revenue Code (*e.g.*, section 444 and section 859) or the regulations thereunder (*e.g.*, paragraph (c) of this section). In addition, as described in §1.441–1(c) and (d), a partnership, S corporation, electing S corporation, or personal service corporation (PSC) generally is required to secure the approval of the Commissioner to adopt or retain an annual accounting period other than its required taxable year. The manner of obtaining approval from the Commissioner to adopt, change, or retain an annual accounting period is provided in paragraph (b) of this section. However, special rules for obtaining approval may be provided in other sections.

(b) *Obtaining approval*—(1) *Time and manner for requesting approval.* Except as otherwise provided in paragraph (b)(3) of this section, in order to secure the approval of the Commissioner to adopt, change, or retain an annual accounting period, a taxpayer must file an application, generally on Form 1128 (*Application to Adopt, Change, or Retain a Tax Year*), with the Commissioner. The Form 1128 must be filed no earlier than the day following the close of the first taxable year in which the taxpayer wants the adoption, change, or retention to be effective (the first effective year) and no later than the 15th day of the third calendar month following the close of the first effective year. However, in the case of a change that results in a short period of six days or less, the Form 1128 must be filed no later than the 15th day of the third calendar month following the close of the short period, even though the short period is not treated as a separate taxable year under §1.441–2(b)(2).

(2) *General requirements for approval*. Except as provided in paragraph (b)(3) of this section, an adoption, change, or retention in annual accounting period will be approved where the taxpayer establishes a business purpose for the requested annual accounting period and agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the adoption, change, or retention. In determining whether a taxpayer has established a business purpose and which terms, conditions, and adjustments will be required, consideration will be given to all the facts and circumstances relating to the adoption, change, or retention, including the tax consequences resulting therefrom. Generally, the requirement of a business purpose will be satisfied, and adjustments to neutralize any tax consequences will not be required, if the requested annual accounting period coincides with the taxpayer's required taxable year (as defined in §1.441–1 (b)(2)), ownership taxable year, or natural business year. In the case of a partnership, S corporation, electing S corporation, or PSC, deferral of income to partners, shareholders, or employee-owners will not be treated as a business purpose.

(3) *Administrative procedures*. Notwithstanding the provisions of paragraphs (b)(1) and (2) of this section, the Commissioner may prescribe administrative procedures under which a taxpayer will be permitted to adopt, change, or retain an annual accounting period. These administrative procedures will describe the business purpose requirements (including an ownership taxable year and a natural business year) and the terms, conditions, and adjustments necessary to obtain approval. Such terms, conditions, and adjustments may include adjustments necessary to neutralize the tax effects of a substantial distortion of income that would otherwise result from the requested annual accounting period including: a deferral of a substantial portion of the taxpayer's income, or shifting of a substantial portion of deductions, from one taxable year to another; a similar deferral or shifting in the case of any other person, such as a beneficiary in an estate; the creation of a short period in which there is a substantial net operating loss, capital loss, or credit (including a general business credit); or the creation of a short period in which there is a substantial amount of income to offset an expiring net operating loss, capital loss, or credit. *See*, for example, Notice 2001–34 (2001–23 I.R.B. 1302), procedures to obtain the Commissioner's prior approval of an adoption, change, or retention in annual accounting period through application to the national office; Rev. Proc. 2000–11 (2000–3 I.R.B. 309), automatic approval procedures for certain corporations; Notice 2001–35 (2001–23 I.R.B. 1314), automatic approval procedures for partnerships, S corporations, electing S corporations, and PSCs; and Rev. Proc. 66–50 (1966–2 C.B. 1260), automatic approval procedures for individuals. For availability of Revenue Procedures and Notices, see §601.601(d)(2) of this chapter.

(4) *Taxpayers to whom section 441(g) applies*. If section 441(g) and §1.441–1(b)(1)(iv) apply to a taxpayer, the adoption of a fiscal year is treated as a change in the taxpayer's annual accounting period under section 442. Therefore, that fiscal year can become the taxpayer's taxable year only with the approval of the Commissioner. In addition to any other terms and conditions that may apply to such a change, the taxpayer must establish and maintain books that adequately and clearly reflect income for the short period involved in the change and for the fiscal year proposed.

(c) *Special rule for change of annual accounting period by subsidiary corporation*. A subsidiary corporation that is required to change its annual accounting period under §1.1502–76, relating to the taxable year of members of an affiliated group that file a consolidated return, does not need to obtain the approval of the Commissioner or file an application on Form 1128 with respect to that change.

(d) *Special rule for newly married couples.* (1) A newly married husband or wife may obtain automatic approval under this paragraph (d) to change his or her annual accounting period in order to use the annual accounting period of the other spouse so that a joint return may be filed for the first or second taxable year of that spouse ending after the date of marriage. Such automatic approval will be granted only if the newly married husband or wife adopting the annual accounting period of the other spouse files a federal income tax return for the short period required by that change on or before the 15th day of the 4th month following the close of the short period. See section 443 and the regulations thereunder. If the due date for any such short-period return occurs before the date of marriage, the first taxable year of the other spouse ending after the date of marriage cannot be adopted under this paragraph (d). The short-period return must contain a statement at the top of page one of the return that it is filed under the authority of this paragraph (d). The newly married husband or wife need not file Form 1128 with respect to a change described in this paragraph (d). For a change of annual accounting period by a husband or wife that does not qualify under this paragraph (d), see paragraph (b) of this section.

(2) The provisions of this paragraph (d) may be illustrated by the following example:

*Example*. H & W marry on September 25, 2001. H is on a fiscal year ending June 30, and W is on a calendar year. H wishes to change to a calendar year in order to file joint returns with W. W's first taxable year after marriage ends on December 31, 2001. H may not change to a calendar year for 2001 since, under this paragraph (d), he would have had to file a return for the short period from July 1 to December 31, 2000, by April 16, 2001. Since the date of marriage occurred subsequent to this due date, the return could not be filed under this paragraph (d). Therefore, H cannot change to a calendar year for 2001. However, H may change to a calendar year for 2002 by filing a return under this paragraph (d) by April 15, 2002, for the short period from July 1 to December 31, 2001. If H files such a return, H and W may file a joint return for calendar year 2002 (which is W's second taxable year ending after the date of marriage).

(e) *Effective date*. The rules of this section are applicable for taxable years ending on or after the date these regulations are published in the **Federal Register** as final regulations.

**§§ 1.442–2T and 1.442–3T [Removed]**

Par. 6. Sections 1.442–2T and 1.442–3T are removed.

Par. 7. Section 1.706–1 is amended by revising paragraphs (a) and (b) and adding paragraph (d) to read as follows:

*§1.706–1 Taxable years of partner and partnership.*

(a) *Year in which partnership income is includible*. (1) In computing taxable income for a taxable year, a partner is required to include the partner's distributive share of partnership items set forth in section 702 and the regulations thereunder for any partnership taxable year ending within or with the partner's taxable year. A partner must also include in taxable income for a taxable year guaranteed payments under section 707(c) that are deductible by the partnership under its method of accounting in the partnership taxable year ending within or with the partner's taxable year.

(2) The rules of this paragraph (a)(1) may be illustrated by the following example:

*Example*. Partner A reports his income using a calendar year, while the partnership of which he is a member reports its income using a fiscal year ending May 31. The partnership reports its income and deductions under the cash method of accounting. During the partnership taxable year ending May 31, 2002, the partnership makes guaranteed payments of $120,000 to A for services and for the use of capital. Of this amount, $70,000 was paid to A between June 1 and December 31, 2001, and the remaining $50,000 was paid to A between January 1 and May 31, 2002. The entire $120,000 paid to A is includible in A's taxable income for the calendar year 2002 (together with A's distributive share of partnership items set forth in section 702 for the partnership taxable year ending May 31, 2002).

(3) If a partner receives distributions under section 731 or sells or exchanges all or part of a partnership interest, any gain or loss arising therefrom does not constitute partnership income.

(b) *Taxable year*—(1) *Partnership treated as a taxpayer*. The taxable year of a partnership must be determined as though the partnership were a taxpayer.

(2) *Partnership's taxable year*—(i) *Required taxable year.* Except as provided in paragraph (b)(2)(ii) of this section, the taxable year of a partnership must be—

(A) The majority interest taxable year, as defined in section 706(b)(4);

(B) If there is no majority interest taxable year, the taxable year of all of the principal partners of the partnership, as defined in 706(b)(3) (the principal partners' taxable year); or;

(C) If there is no majority interest taxable year or principal partners' taxable year, the taxable year that produces the least aggregate deferral of income as determined under §1.706–1(b)(3).

(ii) *Exceptions*. A partnership may have a taxable year other than its required taxable year if it elects to use a 52-53-week taxable year that ends with reference to its required taxable year, makes an election under section 444, or establishes a business purpose for such taxable year and obtains approval of the Commissioner under section 442.

(3) *Least aggregate deferral*—(i) *Taxable year that results in the least aggregate deferral of income.* The taxable year that results in the least aggregate deferral of income will be the taxable year of one or more of the partners in the partnership which will result in the least aggregate deferral of income to the partners. The aggregate deferral for a particular year is equal to the sum of the products determined by multiplying the month(s) of deferral for each partner that would be generated by that year and each partner's interest in partnership profits for that year. The partner's taxable year that produces the lowest sum when compared to the other partner's taxable years is the taxable year that results in the least aggregate deferral of income to the partners. If the calculation results in more than one taxable year qualifying as the taxable year with the least aggregate deferral, the partnership may select any one of those taxable years as its taxable year. However, if one of the qualifying taxable years is also the partnership's existing taxable year, the partnership must maintain its existing taxable year. The determination of the taxable year that results in the least aggregate deferral of income generally must be made as of the beginning of the partnership's current taxable year. The district director, however, may determine that the first day of the current taxable year is not the appropriate testing day and require the use of some other day or period that will more accurately reflect the ownership of the partnership and thereby the actual aggregate deferral to the partners where the partners engage in a transaction that has as its principal purpose the avoidance of the principles of this section. Thus, for example, the preceding sentence would apply where there is a transfer of an interest in the partnership that results in a temporary transfer of that interest principally for purposes of qualifying for a specific taxable year under the principles of this section. For purposes of this section, deferral to each partner is measured in terms of months from the end of the partnership's taxable year forward to the end of the partner's taxable year.

(ii) *Determination of the taxable year of a partner or partnership that uses a 52-53-week taxable year*. For purposes of the calculation described in paragraph (b)(3)(i) of this section, the taxable year of a partner or partnership that uses a 52-53-week taxable year must be the same year determined under the rules of section 441(f) and the regulations thereunder with respect to the inclusion of income by the partner or partnership.

(iii) *Special de minimis rule*. If the taxable year that results in the least aggregate deferral produces an aggregate deferral that is less than .5 when compared to the aggregate deferral of the current taxable year, the partnership's current taxable year will be treated as the taxable year with the least aggregate deferral. Thus, the partnership will not be permitted to change its taxable year.

(iv) *Examples*. The principles of this section may be illustrated by the following examples:

*Example 1*. Partnership P is on a fiscal year ending June 30. Partner A reports income on the fiscal year ending June 30 and Partner B reports income on the fiscal year ending July 31. A and B each have a 50 percent interest in partnership profits. For its taxable year beginning July 1, 1987, the partnership will be required to retain its taxable year since the fiscal year ending June 30 results in the least aggregate deferral of income to the partners. This determination is made as follows:

| Test 6/30 | Year End | Interest in Partnership Profits | Months of Deferral for 6/30 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 6/30 | .5 | 0 | 0 |
| Partner B | 7/31 | .5 | 1 | .5 |
| Aggregate deferral | | | | .5 |

| Test 7/31 | Year End | Interest in Partnership Profits | Months of Deferral for 7/31 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 6/30 | .5 | 11 | 5.5 |
| Partner B | 7/31 | .5 | 0 | 0 |
| Aggregate deferral | | | | 5.5 |

*Example 2*. The facts are the same as in *Example 1* except that A reports income on the calendar year and B reports on the fiscal year ending November 30. For the partnership's taxable year beginning July 1, 1987, the partnership is required to change its taxable year to a fiscal year ending November 30 because such year results in the least aggregate deferral of income to the partners. This determination is made as follows:

| Test 12/31 | Year End | Interest in Partnership Profits | Months of Deferral for 12/31 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 12/31 | .5 | 0 | 0 |
| Partner B | 11/30 | .5 | 11 | 5.5 |
| Aggregate deferral | | | | 5.5 |

| Test 11/30 | Year End | Interest in Partnership Profits | Months of Deferral for 11/30 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 12/31 | .5 | 1 | .5 |
| Partner B | 11/30 | .5 | 0 | 0 |
| Aggregate deferral | | | | .5 |

*Example 3*. The facts are the same as in *Example 2* except that B reports income on the fiscal year ending June 30. For the partnership's taxable year beginning July 1, 1987, each partner's taxable year will result in identical aggregate deferral of income. If the partnership's current taxable year was neither a fiscal year ending June 30 nor the calendar year, the partnership would select either the fiscal year ending June 30 or the calendar year as its taxable year. However, since the partnership's current taxable year ends June 30, it must retain its current taxable year. The determination is made as follows:

| Test 12/31 | Year End | Interest in Partnership Profits | Months of Deferral for 12/31 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 12/31 | .5 | 0 | 0 |
| Partner B | 6/30 | .5 | 6 | 3.0 |
| Aggregate deferral | | | | 3.0 |

| Test 6/30 | Year End | Interest in Partnership Profits | Months of Deferral for 6/30 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 12/31 | .5 | 6 | 3.0 |
| Partner B | 6/30 | .5 | 0 | 0 |
| Aggregate deferral | | | | 3.0 |

*Example 4*. The facts are the same as in *Example 1* except that on December 31, 1987, partner A sells a 4 percent interest in the partnership to Partner C, who reports income on the fiscal year ending June 30, and a 40 percent interest in the partnership to Partner D, who also reports income on the fiscal year ending June 30. The taxable year beginning July 1, 1987, is unaffected by the sale. However, for the taxable year beginning July 31, 1988, the partnership must determine the taxable year resulting in the least aggregate deferral as of July 1, 1988. In this case, the partnership will be required to retain its taxable year since the fiscal year ending June 30 continues to be the taxable year that results in the least aggregate deferral of income to the partners.

*Example 5*. The facts are the same as in *Example 4* except that Partner D reports income on the fiscal year ending April 30. As in Example 4, the taxable year during which the sale took place is unaffected by the shifts in interests. However, for its taxable year beginning July 1, 1988, the partnership will be required to change its taxable year to the fiscal year ending April 30. This determination is made as follows:

| **Test 7/31** | **Year End** | **Interest in Partnership Profits** | **Months of Deferral for 7/31 Year End** | **Interest x Deferral** |
|---|---|---|---|---|
| Partner A | 6/30 | .06 | 11 | .66 |
| Partner B | 7/31 | .5 | 0 | 0 |
| Partner C | 6/30 | .04 | 11 | .44 |
| Partner D | 4/30 | .4 | 9 | 3.60 |
| Aggregate deferral | | | | 4.70 |

| **Test 6/30** | **Year End** | **Interest in Partnership Profits** | **Months of Deferral for 6/30 Year End** | **Interest x Deferral** |
|---|---|---|---|---|
| Partner A | 6/30 | .06 | 0 | 0 |
| Partner B | 7/31 | .5 | 1 | .5 |
| Partner C | 6/30 | .04 | 0 | 0 |
| Partner D | 4/30 | .4 | 10 | 4.0 |
| Aggregate deferral | | | | 4.5 |

| **Test 4/30** | **Year End** | **Interest in Partnership Profits** | **Months of Deferral for 4/30 Year End** | **Interest x Deferral** |
|---|---|---|---|---|
| Partner A | 6/30 | .06 | 2 | .12 |
| Partner B | 7/31 | .5 | 3 | 1.50 |
| Partner C | 6/30 | .04 | 2 | .08 |
| Partner D | 4/30 | .4 | 0 | 0 |
| Aggregate deferral | | | | 1.70 |

| | |
|---|---|
| §1.706-1(b)(3) Test: | |
| Current taxable year (June 30) | 4.5 |
| Less: Taxable year producing the least aggregate deferral (April 30) | 1.7 |
| Additional aggregate deferral (greater than .5) | 2.8 |

*Example 6*. (i) Partnership P has two partners, A who reports income on the fiscal year ending March 31, and B who reports income on the fiscal year ending July 31. A and B share profits equally. P has determined its taxable year under §1.706–1(b)(3) to be the fiscal year ending March 31 as follows:

| **Test 3/31** | **Year End** | **Interest in Partnership Profits** | **Deferral for 3/31 Year End** | **Interest x Deferral** |
|---|---|---|---|---|
| Partner A | 3/31 | .5 | 0 | 0 |
| Partner B | 7/31 | .5 | 4 | 2 |
| Aggregate deferral | | | | 2 |

| **Test 7/31** | **Year End** | **Interest in Partnership Profits** | **Deferral for 7/31 Year End** | **Interest x Deferral** |
|---|---|---|---|---|
| Partner A | 3/31 | .5 | 8 | 4 |
| Partner B | 7/31 | .5 | 0 | 0 |
| Aggregate deferral | | | | 4 |

(ii) In May 1988, Partner A sells a 45 percent interest in the partnership to C, who reports income on the fiscal year ending April 30. For the taxable period beginning April 1, 1989, the fiscal year ending April 30 is the taxable year that produces the least aggregate deferral of income to the partners. However, under paragraph (b)(3)(iii) of this section the partnership is required to retain its fiscal year ending March 31. This determination is made as follows:

| Test 3/31 | Year End | Interest in Partnership Profits | Deferral for 3/31 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 3/31 | .05 | 0 | 0 |
| Partner B | 7/31 | .5 | 4 | 2.0 |
| Partner C | 4/30 | .45 | 1 | .45 |
| Aggregate deferral | | | | 2.45 |

| Test 7/31 | Year End | Interest in Partnership Profits | Deferral for 7/31 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 3/31 | .05 | 8 | .40 |
| Partner B | 7/31 | .5 | 0 | 0 |
| Partner C | 4/30 | .45 | 9 | 4.05 |
| Aggregate deferral | | | | 4.45 |

| Test 4/30 | Year End | Interest in Partnership Profits | Deferral for 4/30 Year End | Interest x Deferral |
|---|---|---|---|---|
| Partner A | 3/31 | .05 | 11 | .55 |
| Partner B | 7/31 | .5 | 3 | 1.50 |
| Partner C | 4/30 | .45 | 0 | 0 |
| Aggregate deferral | | | | 2.05 |

| | |
|---|---|
| §1.706–1(b)(3) Test: | |
| Current taxable year (3/31) | 2.45 |
| Less: Taxable year producing the least aggregate deferral (4/30) | 2.05 |
| Additional aggregate deferral (less than .5) | .40 |

(4) *Measurement of partner's profits and capital interest*— (i) *In general*. The rules of this paragraph (b)(4) apply in determining the majority interest taxable year, the principal partners' taxable year, and the least aggregate deferral taxable year.

(ii) *Profits interest*—(A) *In general*. For purposes of section 706(b), a partner's interest in partnership profits is generally the partner's percentage share of partnership profits for the current partnership taxable year. If the partnership does not expect to have net income for the current partnership taxable year, then a partner's interest in partnership profits instead must be the partner's percentage share of partnership net income for the first taxable year in which the partnership expects to have net income.

(B) *Percentage share of partnership net income*. The partner's percentage share of partnership net income for a partnership taxable year is the ratio of: the partner's distributive share of partnership net income for the taxable year, to the partnership's net income for the year. If a partner's percentage share of partnership net income for the taxable year depends on the amount or nature of partnership income for that year (due to, for example, preferred returns or special allocations of specific partnership items), then the partnership must make a reasonable estimate of the amount and nature of its income for the taxable year. This estimate must be based on all facts and circumstances known to the partnership as of the first day of the current partnership taxable year. The partnership must then use this estimate in determining the partners' interests in partnership profits for the taxable year.

(C) *Distributive share*. For purposes of this paragraph (b)(4)(ii), a partner's distributive share of partnership net income is determined by taking into account all rules and regulations affecting that determination, including, without limitation, section 704(b), (c), and (e), section 736, and section 743.

(iii) *Capital interest*. Generally, a partner's interest in partnership capital is determined by reference to the assets of the partnership that the partner would be entitled to upon withdrawal from the partnership or upon liquidation of the partnership. If the partnership maintains capital accounts in accordance with §1.704–1(b)(2)(iv), then for purposes of section 706(b), the partnership may assume that a partner's interest in partnership capital is the ratio of the partner's capital account to all partners' capital accounts as of the first day of the partnership taxable year.

(5) *Certain tax-exempt partners disregarded*. [Reserved]

(6) *Foreign partners*. [Reserved]

(7) *Adoption of taxable year*. A newly-formed partnership may adopt, in accordance with §1.441–1(c), its required taxable year, a 52-53-week taxable year ending with reference to its required taxable year, or a taxable year elected under section 444 without securing the approval of the Commissioner. If a newly-formed partnership wants to adopt any other taxable year, it must establish a business purpose and secure the approval of the Commissioner under section 442.

(8) *Change in taxable year*—(i) *Partnerships*—(A) *Approval required*. An existing partnership may change its taxable year only by securing the approval of the Commissioner under section 442 or making an election under section 444. How-

ever, a partnership may obtain automatic approval for certain changes, including a change to its required taxable year, pursuant to administrative procedures published by the Commissioner.

(B) *Short period tax return*. A partnership that changes its taxable year must make its return for a short period in accordance with section 443, but must not annualize the partnership taxable income.

(C) *Change in required taxable year*. If a partnership is required to change to its majority interest taxable year, then no further change in the partnership's required taxable year is required for either of the two years following the year of the change. This limitation against a second change within a three-year period applies only if the first change was to the majority interest taxable year and does not apply following a change in the partnership's taxable year to the principal partners' taxable year or the least aggregate deferral taxable year.

(ii) *Partners*. Except as otherwise provided in the Internal Revenue Code or the regulations thereunder (*e.g.*, section 859 regarding real estate investment trusts or §1.442–2(c) regarding a subsidiary changing to its consolidated parent's taxable year), a partner may not change its taxable year without securing the approval of the Commissioner under section 442. However, certain partners may be eligible to obtain automatic approval to change their taxable years pursuant to the regulations or administrative procedures published by the Commissioner. A partner that changes its taxable year must make its return for a short period in accordance with section 443.

(9) *Retention of taxable year*. In certain cases, a partnership will be required to change its taxable year unless it obtains the approval of the Commissioner under section 442, or makes an election under section 444, to retain its current taxable year. For example, a partnership using a taxable year that corresponds to its required taxable year must obtain the approval of the Commissioner to retain such taxable year if its required taxable year changes as a result of a change in ownership, unless the partnership previously obtained approval for its current taxable year or, if appropriate, makes an election under section 444.

(10) *Procedures for obtaining approval or making a section 444 election*. See §1.442–1(b) for procedures to obtain the approval of the Commissioner (automatically or otherwise) to adopt, change, or retain a taxable year. See §§1.444–1T and 1.444–2T for qualifications, and §1.444–3T for procedures, for making an election under section 444.

* * * * *

(d) *Effective date*. The rules of this section are applicable for taxable years ending on or after the date these regulations are published in the **Federal Register** as final regulations, except for paragraph (c) which applies for taxable years beginning after December 31, 1953.

**§1.706–1T [Removed]**

Par. 8. Section 1.706–1T is removed.

Par. 9. Section 1.898–4, as proposed to be added at 58 FR 297, January 5, 1993, is amended by adding paragraph (c)(3)(iv) to read as follows:

*§1.898–4 Special rules.*

*****

(c) ***

(3) ***

(iv) *Recognition of income and deductions*. See §1.441–2(e) for rules regarding the recognition of income and deductions (*e.g.*, amounts includible in gross income pursuant to sections 951(a) or 553) if either the majority United States shareholder, or the specified foreign corporation, or both, elect to use a 52-53-week taxable year under this paragraph (c)(3).

* * * * *

Par. 10. Section 1.1378–1 is added under the undesignated centerheading "Small Business Corporations and Their Shareholders" to read as follows:

*§1.1378–1 Taxable year of S corporation.*

(a) *In general*. The taxable year of an S corporation must be a permitted year or a taxable year elected under section 444. No corporation may make an election to be an S corporation for any taxable year unless the taxable year is a permitted year or a taxable year elected under section 444. In addition, an S corporation may not change its taxable year to any taxable year other than a permitted year or a taxable year elected under section 444. A permitted year is the required taxable year (*i.e.*, a taxable year ending on December 31), a 52-53-week taxable year ending with reference to the required taxable year, or any other taxable year for which the corporation establishes a business purpose to the satisfaction of the Commissioner under section 442.

(b) *Adoption of taxable year.* An electing S corporation may adopt, in accordance with §1.441–1(c), its required taxable year, a 52-53-week taxable year ending with reference to its required taxable year, or a taxable year elected under section 444 without the approval of the Commissioner. See §1.441–1. An electing S corporation that wants to adopt any other taxable year, must establish a business purpose and obtain the approval of the Commissioner under section 442.

(c) *Change in taxable year.* An S corporation or electing S corporation that wants to change its taxable year must obtain the approval of the Commissioner under section 442 or make an election under section 444. However, an S corporation or electing S corporation may obtain automatic approval for certain changes, including a change to its required taxable year, pursuant to administrative procedures published by the Commissioner.

(d) *Retention of taxable year*. In certain cases, an S corporation or electing S corporation will be required to change its taxable year unless it obtains the approval of the Commissioner under section 442, or makes an election under section 444, to retain its current taxable year. For example, a corporation using a June 30 fiscal year that elects to be an S corporation and, as a result, is required to use the calendar year must obtain the approval of the Commissioner to retain its current fiscal year.

(e) *Procedures for obtaining approval or making a section 444 election*—(1) *In general*. See §1.442–1(b) for procedures to obtain the approval of the Commissioner (automatically or otherwise) to adopt, change, or retain a taxable year. See §§1.444–1T and 1.444–2T for qualifications, and 1.444–3T for procedures, for making an election under section 444.

(2) *Special rules for electing S corporations.* An electing S corporation that wants to adopt, change to, or retain a taxable year other than its required taxable year must request approval of the Commissioner on Form 2553 (*Election by a Small Business Corporation*) when the election to be an S corporation is filed pursuant to section 1362(b) and §1.1362–6. See §1.1362–6(a)(2)(i) for

the manner of making an election to be an S corporation. If such corporation receives permission to adopt, change to, or retain a taxable year other than its required taxable year, the election to be an S corporation will be effective. Denial of the request renders the election ineffective unless the corporation agrees that, in the event the request to adopt, change to, or retain a taxable year other than its required taxable year is denied, it will adopt, change to, or retain its required taxable year or, if applicable, make an election under section 444.

(f) *Effective date*. The rules of this section are applicable for taxable years ending on or after the date these regulations are published in the **Federal Register** as final regulations.

PART 5c—TEMPORARY INCOME TAX REGULATIONS UNDER THE ECONOMIC RECOVERY TAX ACT OF 1981

Par. 11. The authority citation for part 5c continues to read as follows:

Authority 26 U.S.C. 168(f)(8)(G) and 7805.

**§5c.442–1 [Removed]**

Par. 12. Section 5c.442–1 is removed.

PART 5f—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

Par. 13. The authority citation for part 5f continues to read in part as follows:

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

**§5f.442–1 [Removed]**

Par. 14. Section 5f.442–1 is removed.

PART 18—TEMPORARY INCOME TAX REGULATIONS UNDER THE SUBCHAPTER S REVISION ACT OF 1982

Par. 15. The authority citation for part 18 continues to read as follows:

Authority 26 U.S.C. 7805.

**§18.1378–1 [Removed]**

Par. 16. Section 18.1378–1 is removed.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on June 12, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 13, 2001, 66 F.R. 31850)

## New Form 2290SP Available for Spanish-Speaking Taxpayers

## Announcement 2001–69

New Form 2290SP, *Declaración del Impuesto sobre el Uso de Vehículos Pesados en las Carreteras*, and its separate instructions are available for use by Spanish-speaking taxpayers. This return is used to pay the tax on highway motor vehicles with a taxable gross weight of 55,000 pounds or more. Form 2290SP and its separate instructions will be available from IRS offices in the states of Texas, New Mexico, Arizona, and California.

You can also obtain Form 2290SP by telephone or by using IRS electronic information services.

| *Request by* | *Number or address* |
|---|---|
| Telephone | **1-800-TAX-FORM** (1-800-829-3676) |
| Personal computer: | |
| IRS Web Site | **www.irs.gov** |
| File transfer protocol | **ftp.irs.gov** |

## Foundations Status of Certain Organizations

## Announcement 2001–70

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

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

20th St. Hope House, Inc., Baltimore, MD
Abundant Life Foundation, Washington, DC
Action-Maryland Foundation, Inc., Potomac, MD
Adoptive Family Network, Inc., Columbia, MD
Advanced Technology & Training Center, Inc., Silver Spring, MD
Advocates for Child Care Professionals, Inc., Rockville, MD
Afcom Foundation, Inc., Fairfax, VA
African American Heritage Society of Charles County, Inc., Waldorf, MD
African Rural Development Concepts, Inc., Burtonsville, MD
African Women’s Project, Greenbelt, MD
Afriserve, Inc., Washington, DC
Alexandria Environmental Policy Foundation, Alexandria, VA
Alpha Employment, Inc., Wilmington, DE
American Boating Safety & Education Association, Inc., Bowie, MD
American Center for Patient Decision-Making, Inc., Baltimore, MD
American Committee on Jerusalem, Washington, DC
American Education & Allied Health Career Center, Inc., College Park, MD
American Friends of the Gdansk Theatre Foundation, Washington, DC
Angels International, Inc., Rockville, MD
Apollo Productions, Inc., Washington, DC
Arna Valley Community Health Clinic, Arlington, VA
Assoc. of Lutherans Specializing in Pastoral Care Ministries, Inc., Annapolis, MD
Association of Formulation Chemists, Inc., Wayne, NJ
Athenas Place, Inc., Poolesville, MD
Balkan Institute, Inc., Yorktown Hts., NY
Baltimore County Housing Education Fund, Inc., Baltimore, MD
Believers in Christ Fellowships Ministries, Washington, DC
Betty Newman Residential Center, Inc., Jackson, MS
Big Brothers, Incorporated, Joplin, MO
Black Congress on Health Law and Economics Foundation, Inc., Washington, DC
Brown Memorial, Inc., Washington, DC
Calvert T-Ball, Inc., Dunkirk, MD
Cam-Tech Power, Inc., Gaithersburg, MD

Candidates and Issues Facts Foundation, Inc., McLean, VA
Capital City Youth and Amateur Foundation, Richmond, VA
Cardinal & Gold Football Foundation, Inc., Timonium, MD
Caren Development Company, Adelphi, MD
Carver Langston Coalition, Inc., Washington, DC
Center for Creative Coalitions, Inc., Portsmouth, VA
Central Asia Research and Development Center, Washington, DC
Central Virginia Bluegrass Association, Stafford, VA
Cherry Hill Hope Development Corporation, Baltimore, MD
Children's Choice, Inc., Staunton, VA
Children's Educational Opportunity Foundation of Kansas City, Inc., Shawnee, KS
Chillum Oaks Adventist Apts., Inc., Upper Marlboro, MD
Christs Bride Ministries, Inc., Merrifield, VA
Chung San Gol Mission, Inc., Herndon, VA
Church Street Apartments, Jackson, MS
Colin L. Murray Foundation, Inc., Baltimore, MD
Committee for the Capital City, Washington, DC
Community Resource Development Center, Inc., Bethesda, MD
Computer Smarts Community to Community, Inc., Arlington, TX
Congregations United for Compassion and Empowerment, Inc., Hyattsville, MD
Cornerstone-Cascade, Inc., Columbia, MD
Cultural Alliance of Charles City County VA, Inc., Charles City, VA
D.C. Corporate Volunteer Council, Inc., Washington, DC
D.C. Mental Health Consumers League, Washington, DC
Dinwiddie County Historical Society, Dinwiddie, VA
E. Doris Carney Scholarship Fund, Inc., Warwick, RI
Earth Keep, Manassas, VA
East Coast Childrens Home, Inc., Chillum, MD
Eastern Deaf Timberfest, Inc., Lanham, MD
Educators Basketball Association, Inc., Boyds, MD
Enuff is Enuff, Washington, DC
Fair Trade Market, Inc., Arlington, VA
Fauquier Artists Alliance, Warrenton, VA
Fire and Rescue Foundation of Prince Georges County, Inc., College Park, MD
First #1 Place, Inc., Upper Marlboro, MD
Fort Washington Community Fund, Fort Washington, MD
Foundation for Genetic Research Brain and Behavior, Inc., Silver Spring, MD
Foundation for Global Environmental Education, Washington, DC
Foundation for Interactive Educational Activities, New York, NY
Frederick Athletic Academy, Frederick, MD
Frederick County Human Services Foundation, Inc., Frederick, MD
Friends for Friends, Incorporated, Forestville, MD
Friends of Surratts-Clinton Branch Library, Inc., Clinton, MD
Friends of the Academy of Law Justice and Security, Inc., Washington, DC
Friends of the Silver Theater, Inc., Silver Spring, MD
Glade Valley Nursing & Rehabilitation Center, Inc., Walkersville, MD
Global Harmony Through Personal Excellence, Washington, DC
Global Sustainable Development Fund, New York, NY
Golden Age Providers, Inc., Chillum, MD
Greater Cleveland Health Education and Service Council, Inc., Cleveland, OH
Hare Krishna Food for Life Global, Inc., Potomac, MD
Harris Hill Family Resource Center, Incorporated, Baltimore, MD
Health Care International, Inc., Baltimore, MD
Healthpeace, Washington, DC
Healthy Harford, Inc., Fallston, MD
Heart to Heart House, Lake Jackson, TX
Helen Titter Park Committee, Chesapeake Cy, MD
Helix Foundation, Incorporated, Chevy Chase, MD
Help our Outdoor Playgrounds, Inc., Laurel, MD
Human Capital Development Corporation, Easton, MD
Ibpat Joint Apprenticeship and Training Fund, Washington, DC
Inabangnons in the United States and Canada Inausca, Baltimore, MD
Initiative for the Development of an East Shore Altn. High School, Inc., Bozman, MD
Institute for Technology Assessment, Washington, DC
Inter City Community Aids Network of Greater Washington, Inc., Washington, DC
International Association of Homes and Services for the Ageing, Washington, DC
International Planned Giving Foundation, Inc., Baltimore, MD
International Society for Twin Studies, Bethesda, MD
Israel Heritage, Inc., Westport, CT
James E. Morgan Cancer Research Fund, Annapolis, MD
Jessup-Provinces Youth Organization, Hanover, MD
Jillian Foundation, Incorporated, Hagerstown, MD
Jorieum Health Affiliates, Baltimore, MD
Juwan Howard Foundation, Inc., Washington, DC
Kent Island Youth Center, Inc., Stevensville, MD
Kids First Tutorial, Inc., Lithonia, GA
Kings Court Project, Inc., Washington, DC
Knox Hope Development Corporation, Baltimore, MD
Lambs Nest, Suffolk, VA
Lance Johnson Foundation, Inc., Bethesda, MD
Legal Reform Institute, Washington, DC
Leonard E. Hicks Multi-Purpose Community Center, Incorporated, Baltimore, MD
Literacy Extension Project, Incorporated, Baltimore, MD
Madison Hope Development Corporation, Baltimore, MD
Margate Little Theatre, Inc, Berlin, NJ
Mariadjom Cape Verdean Childrens Foundation, Inc., Adelphi, MD
Marion Creative Play Area, Inc., Marion, VA
Maryland Energy Conservation, Inc., Fallston, MD
Maryland Neuro Rehab Foundation, Inc., Frederick, MD
Maryland Stallions Youth Association, Inc., Suitland, MD
Maryland World War II Memorial Fund, Inc., Baltimore, MD
McS Referral & Resources, Inc., Baltimore, MD

Medical Missions, Inc., Hunt Valley, MD
Mega Institute, Washington, DC
Memories, Inc., Fort Lauderdale, FL
Metro Deaf-Blind Service Center, Inc, Rockville, MD
Metropolis Uplift, Inc., Washington, DC
Mid-Shore Athletic Association, Inc., Preston, MD
Moms Ink, Inkorporated, San Juan Capistrano, CA
Montessori Resource Center of Delaware, Inc., Wilmington, DE
Montgomery County Alliance for Educational Excellence, Inc., Silver Spring, MD
Mountain Wilderness Camp, Easley, SC
Multimedia Productions, Inc., College Park, MD
Multi-Ventures Community Services, Inc., Randallstown, MD
National Amputee Empowerment Foundation, Washington, DC
National Anti-Child Abuse Movement, Inc., Washington, DC
National Association for Recreational Equality, Inc., Rockville, MD
National Family for the Advancement of Minorities with Disabilities, Washington, DC
National Law Enforcement Integrity Institute, Inc., Annapolis, MD
National Lesbian and Gay Health Association, Washington, DC
Nebo Christian Ministries, Inc., Baltimore, MD
New Jersey Center for Economic Policy and Education, Inc., New Brunswick, NJ
New Moment, Inc., Washington, DC
Northumberland Preservation, Inc., Heathsville, VA
Open Arms Foundation, Inc, Capitol Heights, MD
Operation Shield, Inc., Roselle, NJ
Opportunity, Inc., Gambrills, MD
Oppositional Poster Conservation Initiative Opci, Washington, DC
Orwell Institute, Washington, DC
Oxford Academy of the Arts, Washington, DC
Paik-Inje Memorial Institute for Biomedical Science, La Jolla, CA
Pandoras Closet, Inc., Towson, MD
Panthers Playground Foundation, Inc, Huntington, MD
Parent Support Group for Children with Sickle Cell Disease, Washington, DC
Partners for Americas Success, Washington, DC
PATS Pregnant Adolescent Teen Services, Incorporated, Daytona Beach, FL
Peace or War Calm or Storm Foundation, Lusby, MD
Pets for Luv Animal Rescue, Alexandria, VA
Pillar of Truth, Baltimore, MD
Pip Ministries, Washington, DC
Pride in America Leadership Institute, Alexandria, VA
Prince Georges County Tricentennial Celebration Foundation, Inc., Riverdale, MD
Prof. Assoc. of Teachers Foundation, Virginia Beach, VA
Project Promise, Baltimore, MD
Project Soar, Washington, DC
Prophecy, Inc., Washington, DC
Rapid Action Food Team, Dublin, OH
Reigning Cats & Dogs, Inc., Stafford, VA
Remy Foundation for Batten Disease, Woodinville, WA
Research Education and Action on Poverty, Inc., Washington, DC
Reservoir Hill H.O.P.E., Inc., Baltimore, MD
Riverside Walter Reed Hospital Auxiliary, Inc., Gloucester, VA
Rockville Football League, Inc., Rockville, MD
Rural Health Missions, Inc., Gaithersburg, MD
Safe Eddy Childrens Educational Foundation, Tustin, CA
Sandtown-Winchester Senior Center, Inc., Baltimore, MD
Save Another Youth, Inc., Baltimore, MD
Schools Around the World, Arlington, VA
Scott Anderson Christian Baseball Scholarship Fund, Arlington, TX
Senior Services of Charles County, Inc., La Plata, MD
Serve, Washington, DC
Shane Chadwick Memorial Scholarship Fund, Chester, MT
Society to Prevent Trade in Stolen Art, Ltd., Washington, DC
Something Simple Foundation, Newark, NJ
Southern Virginia Rail Trail Committee, Charlotte Court House, VA
Southwest Community Council, Inc., Baltimore, MD
St. Marys County Football Organization, Inc., California, MD
St. Marys County Youth Lacrosse Club, Inc., Lexington Park, MD
Stop Looking the Other Way (SLOW), Inc., Bethesda, MD
Sturdy Black Bridges, Washington, DC
Success International, Ltd., Alexandria, VA
Suitland Housing Corporation A Community Housing Development, Org., McLean, VA
Sunday Suppers, Washington, DC
Sunflower House, Inc., Washington, DC
Sustainable Earth, Inc., Arlington, VA
Teen Drama Productions, Inc., Sterling, VA
Theatre Conspiracy, Washington, DC
Tranquility Breast Cancer Foundation, Salem, VA
Trees for Frederick Project, Ltd., Frederick, MD
Trinity Hope Development Corporation, Baltimore, MD
Truth Publications, Incorporated, Camdenton, MO
Uet-Lahore Alumni Association America, Inc., Gaithersburg, MD
UMOJA of Illinois, Homewood, IL
Unified Committee for Afro-American Contributions, Lexington Park, MD
United for Change Community Development Corporation, Washington, DC
United States Deaf Soccer Organization, Bethesda, MD
United States Military Polo Association, Inc., Fairfax, VA
Unlimited Sports Abroad, Quinton, VA
Upper Room Emmaus of Lynchburg Central Virginia, Lynchburg, VA
US-Azerbaijan Humanitarian Fund, Inc., Rockville, MD
Vegetarian Institute of Nutrition and Culinary Arts, Inc., Ellicott City, MD
Vietnamese American Society, Washington, DC
Wacel Memorial Scholarship Fund, Inc., Bethesda, MD
Washington Campus for Academic Programs, Inc., Washington, DC
Washington County Public Schools Foundation, Inc., Hagerstown, MD
Washington Sports Foundation, Inc., Bethesda, MD
Widowed Persons Service of the Eastern Shore Virginia, Onancock, VA
Winfield Park Teachers Association Philanthropic Fund, Inc., Winfield Park, NJ
Women's Education Foundation, Denver, CO
Women's Research and Education Institute Fund - The Wrei Fund, Washington, DC

Wood Bros. Museums & Virginia Motorsports Hall of Fame, Stuart, VA
Worcester Chorale, Inc., Berlin, MD
World Medical Mission, Inc., Gaithersburg, MD
Yonatans Story, Inc., Silver Spring, MD
Youth Enrichment Services, Inc., Baltimore, MD
Youth Works, Inc., Gosburg, VA

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

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## Electronic Payee Statements; Hearing

## Announcement 2001–71

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Rescheduled public hearing on proposed rulemaking.

SUMMARY: This document reschedules the public hearing on proposed regulations (REG–107186–00, 2001–13 I.R.B. 973) relating to voluntary electronic furnishing of payee statements on Forms W-2.

DATES: The public hearing is being held on Wednesday, July 25, 2001, at 10 a.m. Outlines of oral comments must be received by July 6, 2001.

ADDRESSES: The public hearing is being held in room 4716, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Send submissions to: Regulations Unit CC (REG-107186-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: Regulations Unit CC (REG-107186-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit outlines of oral comments electronically directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Laura Nash (202) 622-4910; concerning submissions, Sonya M. Cruse (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

A notice of proposed rulemaking and notice of public hearing, appearing in the **Federal Register** on Wednesday, February 14, 2001 (66 FR 10247), announced that a public hearing was being held on June 4, 2001, regarding proposed regulations under sections 6041 and 6051. A hearing cancellation document was inadvertently published in the **Federal Register** on May 23, 2001 (66 FR 28408). Thus, the IRS is rescheduling the public hearing for Wednesday, July 25, 2001, at 10 a.m. in room 4716. Outlines of oral comments must be received by July 6, 2001.

Cynthia E. Grigsby,
*Chief, Regulations Unit,*
*Office of Special Counsel*
*(Modernization & Strategic Planning).*

(Filed by the Office of the Federal Register on June 13, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 14, 2001, 66 F.R. 32279)

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

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, page 31.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, page 31.

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

The adjusted applicable federal long-term rate is set forth for the month of July 2001. See Rev. Rul. 2001–34, page 31.

## Section 420.— Transfers of Excess Pension Assets to Retiree Health Accounts

*26 CFR 1.420–1: Significant reduction in retiree health coverage during the cost maintenance period.*

## T.D. 8948

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Part 1

## Minimum Cost Requirement Permitting the Transfer of Excess Assets of a Defined Benefit Pension Plan to a Retiree Health Account

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final Income Tax Regulations relating to the minimum cost requirement under section 420, which permits the transfer of excess assets of a defined benefit pension plan to a retiree health account. Pursuant to section 420(c)(3)(E), these regulations provide that an employer who significantly reduces retiree health coverage during the cost maintenance period does not satisfy the minimum cost requirement of section 420(c)(3). In addition, these regulations clarify the circumstances under which an employer is considered to have significantly reduced retiree health coverage during the cost maintenance period.

DATES: *Effective Date*: These regulations are effective June 19, 2001.

*Applicability Date:* These regulations are applicable to transfers of excess pension assets occurring on or after December 18, 1999. See the *Effective Date* portion of this preamble.

FOR FURTHER INFORMATION CONTACT: Janet A. Laufer or Vernon S. Carter (202) 622-6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains final regulations (26 CFR Part 1) under section 420 of the Internal Revenue Code of 1986 (Code). These regulations provide guidance concerning the minimum cost requirement under section 420. The Revenue Reconciliation Act of 1990 (Public Law 101–508) (104 Stat. 1388), section 12011, added section 420 of the Code, a temporary provision permitting certain qualified transfers of excess pension assets from a non-multiemployer defined benefit pension plan to a health benefits account. A health benefits account is defined as an account established and maintained under section 401(h) of the Code (401(h) account) that is part of the plan.[1]

[1] Section 420(a)(1) and (2) provide that the trust that is part of the plan is not treated as failing to satisfy the qualification requirements of section 401(a) or (h) of the Code, and no amount is includible in the gross income of the employer maintaining the plan, solely by reason of such transfer. Also, section 420(a)(3) provides that a qualified transfer is not treated as either an employer reversion for purposes of section 4980 or a prohibited transaction for purposes of section 4975.

In addition, Title I of the Employee Retirement Income Security Act of 1974 (88 Stat. 829), as amended (ERISA), provides that a qualified transfer pursuant to section 420 is not a prohibited transaction under ERISA (ERISA section 408(b)(13)) or a prohibited reversion of assets to the employer (ERISA section 403(c)(1)). ERISA also provides certain notification requirements with respect to such qualified transfers.

One of the conditions of a qualified section 420 transfer was that the employer satisfy a maintenance of effort requirement in the form of a "minimum cost requirement" under which the employer was required to maintain employer-provided retiree health expenditures for covered retirees, their spouses, and dependents at a minimum dollar level for a 5-year cost maintenance period, beginning with the taxable year in which the qualified transfer occurs.

The Uruguay Round Agreements Act (Public Law 103–465) (108 Stat. 4809) (December 8, 1994) extended the availability of section 420 through December 31, 2000. In conjunction with the extension, Congress modified the maintenance of effort rules for plans transferring assets for retiree health benefits so that employers could take into account cost savings realized in their health benefit plans. As a result, the focus of the maintenance of effort requirement was shifted from health costs to health benefits. Under this "benefit maintenance requirement," which applied to qualified transfers made after December 8, 1994, an employer had to maintain substantially the same level of employer-provided retiree health coverage for the taxable year of the transfer and the following 4 years. The level of coverage required to be maintained was based on the coverage provided in the taxable year immediately preceding the taxable year of the transfer.

The Tax Relief Extension Act of 1999 (title V of H.R. 1180, the Ticket to Work and Work Incentives Improvement Act of 1999) (Public Law 106–170,113 Stat. 1860) (TREA-99) extended section 420 through December 31, 2005. In conjunction with this extension, the minimum cost requirement was reinstated as the applicable "maintenance of effort" provision (in lieu of requiring the maintenance of the level of coverage) for qualified transfers made after December 17, 1999. Because the minimum cost requirement relates to *per capita* cost, an employer could satisfy the minimum cost requirement by maintaining the average cost even though the employer defeats the purpose of the maintenance of effort requirement by reducing the number of people covered by the health plan. In response to concerns regarding this possibility, TREA-99 also added section 420(c)(3)(E), which requires the Secretary of the Treasury to prescribe such regulations as may be necessary to prevent an employer who significantly reduces retiree health coverage during the cost maintenance period from being treated as satisfying the minimum cost requirement of section 420(c)(3). If the minimum cost requirement of section 420(c)(3) is not satisfied, the transfer of assets from the pension plan to the 401(h) account is not a "qualified transfer" to which the provisions of section 420(a) apply.

On January 5, 2001, a notice of proposed rulemaking (REG–116468–00, 2001–6 I.R.B. 522) was published in the **Federal Register** (66 FR 1066). Written comments were received on the proposed regulations. A public hearing scheduled for March 15, 2001, was canceled because no one had requested to speak (66 FR 13864). After consideration of all the comments received on the proposed regulations, the regulations are adopted as modified by this Treasury decision.

**Explanation of Provisions**

*General Framework*

Following the approach taken in the proposed regulations, these regulations provide that the minimum cost requirement of section 420(c)(3) is not met if an employer significantly reduces retiree health coverage during the cost maintenance period. Whether an employer has significantly reduced retiree health coverage is determined by looking at the number of individuals (retirees, their spouses, and dependents) who lose coverage during the cost maintenance period as a result of employer actions, measured on both an annual basis and a cumulative basis.

In determining whether an employer has significantly reduced retiree health coverage, the regulations provide that the employer does not satisfy the minimum cost requirement if the percentage decrease in the number of individuals provided with applicable health benefits that is attributable to employer action exceeds 10 percent in any year, or if the sum of the annual percentage decreases during the cost maintenance period exceeds 20 percent.

*Employer Action*

The regulations retain the broad definition of employer action contained in the proposed regulations. Thus, employer action includes not only plan amendments but also situations in which other employer actions, such as the sale of all or part of the employer's business, operate in conjunction with the existing plan terms to have the indirect effect of ending an individual's coverage.

The proposed regulations contained no exceptions from the rule that treats individuals as losing health coverage by reason of employer action if those individuals' coverage ends by reason of a sale of all or part of the employer's business, even if the buyer provides coverage for such individuals (on the implicit assumption that a buyer of less than an entire corporation rarely undertakes to provide such coverage to retirees in these transactions). The preamble to the proposed regulations specifically requested comments as to (1) the circumstances, if any, in which buyers commonly provide the seller's retirees, and their spouses and dependents, with health coverage following a corporate transaction, and (2) in such cases, criteria that should apply to the replacement coverage in determining whether to treat those individuals as not having lost coverage.

Commentators disagreed with the assumption stated in the preamble to the proposed regulations that a buyer acquiring a portion of a seller's business rarely undertakes to provide retiree health coverage to retirees in these transactions and expressed concern about the approach taken in the proposed regulations concerning individuals who lose retiree health coverage in such situations. One commentator stated that in the case of business combinations involving organizations that contract with the United States Government, the relevant procurement regulations encourage buyers to assume a seller's obligations for retirees' pension and retiree medical benefits. Other commentators expressed a desire to retain flexibility in structuring future business dispositions so that a buyer or transferee of a business could undertake to provide retiree health coverage for the seller's employees.

Generally, commentators requested that the regulations allow an employer who sells or transfers a business to take into account health coverage that a buyer or transferee provides to retired employees of the employer. Various approaches were suggested, most of them centering around allowing an employer to take credit for retiree health benefits provided by a buyer or transferee that are substantially similar to the benefits provided by the employer.

In cases in which a buyer acquires the entire employer sponsoring the pension plan that is the subject of the maintenance of effort requirement under section 420(c)(3)(E), no special rule is required, because the buyer as the successor employer maintaining the plan is responsible for continuing to satisfy the minimum cost requirements of section 420(c)(3) with respect to that transfer. However, based upon comments received, these final regulations include a special rule that allows the employer responsible for satisfying the maintenance of effort requirement of section 420(c)(3)(E) to take credit for a buyer's or transferee's provision of retiree health benefits in certain other situations.

Under the final regulations, an employer may, but is not required to, treat retiree health coverage as not having ended for individuals whose coverage is provided by a buyer. In such a case, for the year of the sale and future taxable years of the cost maintenance period, the employer must apply the minimum cost requirement contained in section 420(c)(3) by treating the individuals whose coverage is provided by the buyer as individuals to whom coverage for applicable health benefits is provided during the year (*i.e.*, including all such individuals in the denominator in the determination of applicable employer cost) and treating amounts the buyer spends on health benefits for those individuals as qualified current retiree health liabilities. After the buyer commences providing the retiree health benefits, action of the buyer is attributed to the employer for purposes of determining whether an individual's coverage ends by reason of employer action. Accordingly, if a buyer initially provides retiree health benefits to individuals affected by the sale, but later amends its plan to stop providing benefits to those individuals, the employer must treat those individuals as having lost coverage by reason of employer action.

These final regulations also add a definition of "sale" to clarify that the rule for sales applies as well to other transfers of a business. In the case of a transfer, the transferee is treated as the buyer. Thus, for example, the rule applies in a situation in which an employer spins off all or part of its business, and also applies when a contractor that operates a government-owned facility is replaced by another contractor and the replacement contractor hires the employees of the prior contractor to operate the facility.

*Effective Date*

The proposed regulations provided that the 10 percent annual limit would not apply to a taxable year beginning before February 5, 2001 (30 days after publication of the proposed regulations in the **Federal Register**). However, under the proposed regulations, the 20 percent cumulative limit applied with respect to cost maintenance periods pertaining to any transfers made on or after December 18, 1999. Thus, if an employer reduced coverage by more than 20 percent prior to issuance of the proposed regulations, the employer would have failed the cumulative test.

Several commentators expressed concern about the proposed effective date of transfers occurring on or after December 18, 1999. None of the comments indicated that any employers had in fact reduced coverage by more than 20 percent prior to issuance of the proposed regulations, and one of the commentators stated that as a practical matter, the issue of retroactivity is moot. However, a number of the commentators expressed concern over retroactive effective dates in Treasury regulations as a matter of principle.

These final regulations, like the proposed regulations, provide that the 20 percent cumulative test will apply with respect to transfers of excess pension assets occurring on or after December 18, 1999. In order to address concerns raised by commentators, however, the final regulations take into account any reinstatement of coverage that occurs during the portion of a cost maintenance period that precedes the first day of the first taxable year beginning on or after January 1, 2002 (the initial period). Thus, for purposes of the cumulative test, if an employer reduced retiree health coverage by more than 20 percent, the employer can, before the end of the initial period, resume providing coverage for individuals who lost coverage and treat those individuals as not having lost coverage. However, if an employer reduces retiree health coverage by more than 20 percent during the initial period and does not "correct" by again providing coverage for individuals who lost coverage, the employer would fail the cumulative test. Also, the annual test of significant reduction applies only to taxable years beginning on or after January 1, 2002, which reflects a further delay from the date in the proposed regulation.

*Additional changes*

The proposed regulations contained a special rule that addresses situations in which an employer adopts plan terms that establish eligibility for health coverage for some individuals, but provide that those same individuals lose health coverage upon the occurrence of a particular event or after a stated period of time. In those cases, an individual is not counted as having lost health coverage by reason of employer action merely because that individual's coverage ends upon the occurrence of the event or after a certain period of time, such as when health benefits are provided to employees retiring as a result of a plant closing only for the period during which they receive severance pay (see example 2 of the regulations). As a result of the changes discussed above that address "corrections" through restoration of coverage during the initial period and sale transactions, these final regulations contain two modifications of the special rule for contemporaneously-adopted plan terms. First, the special rule is not available with respect to an amendment that restores coverage before the end of the initial period. Second, in the context of an amendment of a buyer's health plan to provide retiree health coverage for a seller's employees, the special rule is available only to the extent that any terms that have the effect of ending an individual's coverage are the same as the terms of the plan maintained by the seller, and only if the terms of the seller's plan that terminate coverage were adopted contemporaneously with the provision under which the individual became eligible for retiree health coverage under the seller's plan.

**Special Analyses**

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

**Drafting Information**

The principal authors of these regulations are Janet A. Laufer and Vernon S. Carter, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 – INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding a new entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805, 26 U.S.C. 420(c)(3)(E)***

Par. 2. Section 1.420–1 is added under the undesignated centerheading "Pension, Profit-Sharing, Stock Bonus Plans, etc." to read as follows:

*§1.420–1 Significant reduction in retiree health coverage during the cost maintenance period.*

(a) *In general*. Notwithstanding section 420(c)(3)(A), the minimum cost requirements of section 420(c)(3) are not met if the employer significantly reduces retiree health coverage during the cost maintenance period.

(b) *Significant reduction*—(1) *In general*. An employer significantly reduces retiree health coverage during the cost maintenance period if, for any taxable year beginning on or after January 1, 2002, that is included in the cost maintenance period, either —

(i) The employer-initiated reduction percentage for that taxable year exceeds 10 percent; or

(ii) The sum of the employer-initiated reduction percentages for that taxable year and all prior taxable years during the cost maintenance period exceeds 20 percent.

(2) *Employer-initiated reduction percentage*. The employer-initiated reduction percentage for any taxable year is the fraction B/A, expressed as a percentage, where:

A = The total number of individuals (retired employees plus their spouses plus their dependents) receiving coverage for applicable health benefits as of the day before the first day of the taxable year.

B = The total number of individuals included in A whose coverage for applicable health benefits ended during the taxable year by reason of employer action.

(3) *Special rules for taxable years beginning before January 1, 2002*. The following rules apply for purposes of computing the amount in paragraph (b)(1)(ii) of this section if any portion of the cost maintenance period precedes the first day of the first taxable year beginning on or after January 1, 2002—

(i) *Aggregation of taxable years*. The portion of the cost maintenance period that precedes the first day of the first taxable year beginning on or after January 1, 2002 (the initial period), is treated as a single taxable year and the employer-initiated reduction percentage for the initial period is computed as set forth in paragraph (b)(2) of this section, except that the words "initial period" apply instead of "taxable year."

(ii) *Loss of coverage*. If coverage for applicable health benefits for an individual ends by reason of employer action at any time during the initial period, an employer may treat that coverage as not having ended if the employer restores coverage for applicable health benefits to that individual by the end of the initial period.

(4) *Employer action*—(i) *General rule*. For purposes of paragraph (b)(2) of this section, an individual's coverage for applicable health benefits ends during a taxable year by reason of employer action, if on any day within the taxable year, the individual's eligibility for applicable health benefits ends as a result of a plan amendment or any other action of the employer (*e.g.*, the sale of all or part of the employer's business) that, in conjunction with the plan terms, has the effect of ending the individual's eligibility. An employer action is taken into account for this purpose regardless of when the employer action actually occurs (*e.g.*, the date the plan amendment is executed), except that employer actions occurring before the later of December 18, 1999, and the date that is 5 years before the start of the cost maintenance period are disregarded.

(ii) *Special rule*. Notwithstanding paragraph (b)(4)(i) of this section, coverage for an individual will not be treated as having ended by reason of employer action merely because such coverage ends under the terms of the plan if those terms were adopted contemporaneously with the provision under which the individual became eligible for retiree health coverage. This paragraph (b)(4)(ii) does not apply with respect to plan terms adopted contemporaneously with a plan amendment that restores coverage for applicable health benefits before the end of the initial period in accordance with paragraph (b)(3)(ii) of this section.

(iii) *Sale transactions*. If a purchaser provides coverage for retiree health benefits to one or more individuals whose coverage ends by reason of a sale of all or part of the employer's business, the employer may treat the coverage of those individuals as not having ended by reason of employer action. In such a case, for the remainder of the year of the sale and future taxable years of the cost maintenance period —

(A) For purposes of computing the applicable employer cost under section 420(c)(3), those individuals are treated as individuals to whom coverage for applicable health benefits was provided (for as long as the purchaser provides retiree health coverage to them), and any amounts expended by the purchaser of the business to provide for health benefits for those individuals are treated as paid by the employer;

(B) For purposes of determining whether a subsequent termination of coverage is by reason of employer action under this paragraph (b)(4), the purchaser is treated as the employer. However, the special rule in paragraph (b)(4)(ii) of this section applies only to the extent that any terms of the plan maintained by the purchaser that have the effect of ending retiree health coverage for an individual are the same as terms of the plan maintained by the employer that were adopted contemporaneously with the provision under which the individual became eligible for retiree health coverage under the plan maintained by the employer.

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

(1) *Applicable health benefits*. Applicable health benefits means applicable health benefits as defined in section 420(e)(1)(C).

(2) *Cost maintenance period*. Cost maintenance period means the cost maintenance period as defined in section 420(c)(3)(D).

(3) *Sale*. A sale of all or part of an employer's business means a sale or other transfer in connection with which the employees of a trade or business of the employer become employees of another person. In the case of such a transfer, the term *purchaser* means a transferee of the trade or business.

(d) *Examples*. The following examples illustrate the application of this section:

*Example 1*. (i) Employer W maintains a defined benefit pension plan that includes a 401(h) account and permits qualified transfers that satisfy section 420. The number of individuals receiving coverage for applicable health benefits as of the day before the first day of Year 1 is 100. In Year 1, Employer W makes a qualified transfer under section 420. There is no change in the number of individuals receiving health benefits during Year 1. As of the last day of Year 2, applicable health benefits are provided to 99 individuals, because 2 individuals became eligible for coverage due to retirement and 3 individuals died in Year 2. During Year 3, Employer W amends its health plan to eliminate coverage for 5 individuals, 1 new retiree becomes eligible for coverage and an additional 3 individuals are no longer covered due to their own decision to drop coverage. Thus, as of the last day of Year 3, applicable health benefits are provided to 92 individuals. During Year 4, Employer W amends its health plan to eliminate coverage under its health plan for 8 more individuals, so that as of the last day of Year 4, applicable health benefits are provided to 84 individuals. During Year 5, Employer W amends its health plan to eliminate coverage for 8 more individuals.

(ii) There is no significant reduction in retiree health coverage in either Year 1 or Year 2, because there is no reduction in health coverage as a result of employer action in those years.

(iii) There is no significant reduction in Year 3. The number of individuals whose health coverage ended during Year 3 by reason of employer action (amendment of the plan) is 5. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 2 is 99, the employer-initiated reduction percentage for Year 3 is 5.05 percent (5/99), which is less than the 10 percent annual limit.

(iv) There is no significant reduction in Year 4. The number of individuals whose health coverage ended during Year 4 by reason of employer action is 8. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 3 is 92, the employer-initiated reduction percentage for Year 4 is 8.70 percent (8/92), which is less than the 10 percent annual limit. The sum of the employer-initiated reduction percentages for Year 3 and Year 4 is 13.75 percent, which is less than the 20 percent cumulative limit.

(v) In Year 5, there is a significant reduction under paragraph (b)(1)(ii) of this section. The number of individuals whose health coverage ended during Year 5 by reason of employer action (amendment of the plan) is 8. Since the number of individuals receiving coverage for applicable health benefits as of the last day of Year 4 is 84, the employer-initiated reduction percentage for Year 5 is 9.52 percent (8/84), which is less than the 10 percent annual limit. However, the sum of the employer-initiated reduction percentages for Year 3, Year 4, and Year 5 is 5.05 percent + 8.70 percent + 9.52 percent = 23.27 percent, which exceeds the 20 percent cumulative limit.

*Example 2.* (i) Employer X, a calendar year taxpayer, maintains a defined benefit pension plan that includes a 401(h) account and permits qualified transfers that satisfy section 420. X also provides lifetime health benefits to employees who retire from Division A as a result of a plant shutdown, no health benefits to employees who retire from Division B, and lifetime health benefits to all employees who retire from Division C. In 2000, X amends its health plan to provide coverage for employees who retire from Division B as a result of a plant shutdown, but only for the 2-year period coinciding with their severance pay. Also in 2000, X amends the health plan to provide that employees who retire from Division A as a result of a plant shutdown receive health coverage only for the 2-year period coinciding with their severance pay. A plant shutdown that affects Division A and Division B employees occurs in 2000. The number of individuals receiving coverage for applicable health benefits as of the last day of 2001 is 200. In 2002, Employer X makes a qualified transfer under section 420. As of the last day of 2002, applicable health benefits are provided to 170 individuals, because the 2-year period of benefits ends for 10 employees who retired from Division A and 20 employees who retired from Division B as a result of the plant shutdown that occurred in 2000.

(ii) There is no significant reduction in retiree health coverage in 2002. Coverage for the 10 retirees from Division A who lose coverage as a result of the end of the 2-year period is treated as having ended by reason of employer action, because coverage for those Division A retirees ended by reason of a plan amendment made after December 17, 1999. However, the terms of the health plan that limit coverage for employees who retired from Division B as a result of the 2000 plant shutdown (to the 2-year period) were adopted contemporaneously with the provision under which those employees became eligible for retiree coverage under the health plan. Accordingly, under the rule provided in paragraph (b)(4)(ii) of this section, coverage for those 20 retirees from Division B is not treated as having ended by reason of employer action. Thus, the number of individuals whose health benefits ended by reason of employer action in 2002 is 10. Since the number of individuals receiving coverage for applicable health benefits as of the last day of 2001 is 200, the employer-initiated reduction percentage for 2002 is 5 percent (10/200), which is less than the 10 percent annual limit.

(e) *Regulatory effective date.* This section is applicable to transfers of excess pension assets occurring on or after December 18, 1999.

David A. Mader,
*Acting Deputy Commissioner of Internal Revenue.*

Approved June 12, 2001.

Mark A. Weinberger,
*Assistant Secretary of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on June 14, 2001, at 2:45 p.m., and published in the issue of the Federal Register for June 19, 2001, 66 FR 32897)

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on this page.

## Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on this page.

## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on this page.

## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on this page.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on this page.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on this page.

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

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

**Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2001.

## Rev. Rul. 2001–34

This revenue ruling provides various prescribed rates for federal income tax purposes for July 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the blended annual rate for 2001 for purposes of section 7872

REV. RUL. 2001–34 TABLE 1

Applicable Federal Rates (AFR) for July 2001

| | *Period for Compounding* | | | |
|---|---|---|---|---|
| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
| *Short-Term* | | | | |
| AFR | 4.07% | 4.03% | 4.01% | 4.00% |
| 110% AFR | 4.48% | 4.43% | 4.41% | 4.39% |
| 120% AFR | 4.90% | 4.84% | 4.81% | 4.79% |
| 130% AFR | 5.31% | 5.24% | 5.21% | 5.18% |
| *Mid-Term* | | | | |
| AFR | 5.12% | 5.06% | 5.03% | 5.01% |
| 110% AFR | 5.65% | 5.57% | 5.53% | 5.51% |
| 120% AFR | 6.16% | 6.07% | 6.02% | 5.99% |
| 130% AFR | 6.69% | 6.58% | 6.53% | 6.49% |
| 150% AFR | 7.73% | 7.59% | 7.52% | 7.47% |
| 175% AFR | 9.06% | 8.86% | 8.76% | 8.70% |
| *Long-Term* | | | | |
| AFR | 5.82% | 5.74% | 5.70% | 5.67% |
| 110% AFR | 6.41% | 6.31% | 6.26% | 6.23% |
| 120% AFR | 7.01% | 6.89% | 6.83% | 6.79% |
| 130% AFR | 7.60% | 7.46% | 7.39% | 7.35% |

REV. RUL. 2001–34 TABLE 2

Adjusted AFR for July 2001

| | *Period for Compounding* | | | |
|---|---|---|---|---|
| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
| Short-term adjusted AFR | 3.16% | 3.14% | 3.13% | 3.12% |
| Mid-term adjusted AFR | 3.87% | 3.83% | 3.81% | 3.80% |
| Long-term adjusted AFR | 5.00% | 4.94% | 4.91% | 4.89% |

REV. RUL. 2001–34 TABLE 3

Rates Under Section 382 for July 2001

| | |
|---|---|
| Adjusted federal long-term rate for the current month | 5.00% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 5.01% |

| REV. RUL. 2001–34 TABLE 4 | |
|---|---|
| Appropriate Percentages Under Section 42(b)(2) for July 2001 | |
| Appropriate percentage for the 70% present value low-income housing credit | 8.28% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.55% |

| REV. RUL. 2001–34 TABLE 5 | |
|---|---|
| Rate Under Section 7520 for July 2001 | |
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | 6.2% |

| REV. RUL. 2001–34 TABLE 6 | |
|---|---|
| Blended Annual Rate for 2001 | |
| Section 7872(e)(2) blended annual rate for 2001 | 4.98% |

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, on page 31.

## Section 1502.—Regulations

*26 CFR 1.1502–34: Special aggregate stock ownership rules.*

## T.D. 8949

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Special Aggregate Stock Ownership Rules

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the aggregation of stock ownership in a corporation of members of a consolidated group. These regulations reflect a technical correction enacted in section 311(c) of the Community Renewal Tax Relief Act of 2000 that, in substance, provides that the special aggregate stock ownership rules shall apply for purposes of section 732(f) of the Code. These final regulations may affect all consolidated groups.

DATES: *Effective Date:* June 19, 2001.

FOR FURTHER INFORMATION CONTACT: Frances L. Kelly or David H. Kessler (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1986 (Code).Section 1.1502–34 generally provides that, for purposes of the consolidated return regulations, the stock ownership of all members of a consolidated group in another corporation is aggregated in determining the application of certain Code provisions, including section 332(b)(1), in a consolidated return year.

Section 538 of the Ticket to Work and Work Incentives Improvement Act of 1999 (Public Law 106–170, 113 Stat. 1939) (the 1999 Act) enacted section 732(f) on December 17, 1999. With certain exceptions, section 732(f) generally provides that if (1) a corporate partner of a partnership receives a distribution from that partnership of stock in another corporation, (2) the corporate partner has control of the distributed corporation immediately after the distribution or at any time thereafter, and (3) the partnership's adjusted basis in such stock immediately before the distribution exceeded the corporate partner's adjusted basis in such stock immediately after the distribution, then an amount equal to such excess shall reduce the basis of the property held by the distributed corporation at such time.

On December 21, 2000, Congress enacted section 311(c) of the Community Renewal Tax Relief Act of 2000 (Public Law 106–554, 114 Stat. 2763) (the 2000 Act), a technical correction to section 538 of the 1999 Act. Section 311(c) of the 2000 Act states "[t]he reference to section 332(b)(1) of the Internal Revenue Code of 1986 in Treasury Regulation section 1.1502–34 shall be deemed to include a reference to section 732(f) of such Code." The Conference Report states that the rule in the consolidated return regulations (§1.1502–34) aggregating stock ownership for purposes of section 332 (relating to a complete liquidation of a subsidiary that is a controlled corporation) also applies for purposes of section 732(f) (relating to basis adjustments to assets of a controlled corporation received in a partnership distribution). H.R. Conf. Rep. No. 1033, 106th Cong., 2d Sess. 1022 (2000).

Section 311(d) of the 2000 Act provides that section 311(c) of the 2000 Act takes effect as if included in the provisions of the 1999 Act to which it relates. Thus, the effective date of section 311(c) of the 2000 Act is the same as that for section 538(a) of the 1999 Act, which is contained in section 538(b) of the 1999 Act.

**Explanation of Provisions**

These final regulations conform § 1.1502–34 to a technical correction enacted in section 311(c) of the 2000 Act and add a regulation under section 732 reflecting that correction. These regulations reflect this statutory provision clarifying that the stock aggregation rules under § 1.1502–34 apply for purposes of section 732(f).

Because section 311(d) of the 2000 Act provides that section 311(c) of the 2000 Act shall take effect as if it had been included in the provisions of the 1999 Act, the effective date provisions of section 538(b) of the 1999 Act apply to these regulations. Section 538(b) generally provides that the amendments made by section 538(a) of the 1999 Act apply to distributions made after July 14, 1999. In the case of a corporation that was a partner in a partnership as of July 14, 1999, the amendments made by section 538(a) of the 1999 Act apply to distributions made (or treated as made) to that partner from that partnership after June 30, 2001. In the case of any such distribution made after December 17, 1999, and before July 1, 2001, the rule of the preceding sentence does not apply unless that partner makes an election to have the rule apply to the distribution on the partner's income tax return for the year in which the distribution occurs.

**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. Because no notice of proposed rulemaking is required for this final regulation, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply.

This final rule merely conforms § 1.1502–34 to the statutory amendment made by section 311(c) of the 2000 Act. Pursuant to 5 U.S.C. 553, it is determined that prior notice and comment are unnecessary and contrary to the public interest. For the same reason, good cause exists for not delaying the effective date of this final rule.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.732–3 also issued under 26 U.S.C. 732(f). * * *

Section 1.1502–34 also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.732–3 is added to read as follows:

*§ 1.732–3 Corresponding adjustment to basis of assets of a distributed corporation controlled by a corporate partner.*

The determination of whether a corporate partner has control of a distributed corporation for purposes of section 732(f) shall be made by applying the special aggregate stock ownership rules of § 1.1502–34.

**§ 1.1502–34 [Amended]**

Par. 3. In §1.1502–34, the first sentence is amended by adding "732(f)," immediately after "351(a),".

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

Approved June 8, 2001.

Mark A. Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on June 13, 2001, at 8:45 a.m., and published in the issue of the Federal Register for June 19, 2001, 66 FR 32901)

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*26 CFR 1.1502–78: Tentative carryback adjustments.*

## T.D. 8950

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Guidance on Filing an Application for a Tentative Carryback Adjustment in a Consolidated Return Context

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the filing of an application for a tentative carryback adjustment. These regulations provide guidance as to the time for filing such application by a consolidated group and by certain corporations for the separate return year created by their becoming a member of a consolidated group. These final regulations may affect all consolidated groups.

DATES: *Effective Date:* June 22, 2001.

*Applicability Date:* For dates of applicability, see §1.1502–78(e)(2)(v) of these regulations.

FOR FURTHER INFORMATION CONTACT: Christopher M. Bass or Frances L. Kelly (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1986 (Code) relating to the filing of an application for a tentative carryback adjustment. The amendments provide guidance as to the time for filing an application for a tentative carryback adjustment by a consolidated group. The amendments also extend the time for filing an application for a tentative carryback adjustment by certain corporations for the separate return year created by their becoming new members of a consolidated group.

On January 4, 2001, a temporary regulation (T.D. 8919, 2001–6 I.R.B. 505) was published in the **Federal Register** (66 FR 713). On this same day, a notice of proposed rulemaking (REG–119352–00, 2001–6 I.R.B. 525) cross-referencing the temporary regulation and a notice of public hearing were published in the **Federal Register** (66 FR 747). No comments or requests to speak were received from the public in response to the notice of proposed rulemaking. Accordingly, the public hearing scheduled for April 26, 2001 was canceled in the **Federal Register** (66 FR 19104) on April 13, 2001. The proposed regulation is adopted as amended by this Treasury Decision, and the corresponding temporary regulation is removed.

**Explanation of Provisions**

The amendments adopted by this Treasury decision provide a general rule for all corporations filing consolidated returns stating that the provisions of section 6411(a) shall apply to determine the time for filing an application for a tentative carryback adjustment by a consolidated group. In addition, the amendments provide a special rule for applications filed by certain corporations that become new members of a consolidated group, extending the period of time for filing an application for a tentative carryback adjustment resulting from losses or credits arising in the new member's last separate return year. For these purposes, the separate return year is treated as ending on the same date as the end of the current taxable year of the consolidated group.

Until Form 1139 (*Application for a Tentative Carryback Adjustment*) is modified to reflect the changes made by this regulation, an application for a tentative carryback adjustment filed under the special rule must include additional information in the form of a statement, "Filed pursuant to Treas. Reg. section 1.1502–78(e)(2)," in red, at the top of the current Form 1139. In addition, the Form 1139 must state, in red, the "year end" of the consolidated group that the new member joins. In response to the changes made by this regulation, IRS Service Centers developed a procedure to assist in processing applications filed under §1.1502–78(e)(2). This procedure requires that the additional information, as set forth above, be included on the Form 1139. This procedure supplements existing guidelines for filing and processing Form 1139.

The proposed regulation (66 FR 747) was issued as §1.1502–78T(g). This final regulation adopts the substance of the proposed regulation and renumbers such provision as §1.1502–78(e).

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that this regulation will not impose a significant economic impact on a substantial number of small entities because it affects a relatively small number of corporations and few, if any, of those corporations are likely to be small businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal authors of these regulations are Christopher M. Bass and Frances L. Kelly, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entries for sections 1.1502–78(b) and 1.1502–78T and by adding an entry in numerical order to read in part as follows:

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

Section 1.1502–78 also issued under 26 U.S.C. 1502, 6402(k), and 6411(c). * * *

Par. 2. Section 1.1502–78 is amended by adding paragraph (e) to read as follows:

*§1.1502–78 Tentative carryback adjustments.*

* * * * *

(e) *Time for filing application*—(1) *General rule*. The provisions of section 6411(a) apply to the filing of an application for a tentative carryback adjustment by a consolidated group.

(2) *Special rule for new members*—(i) *New member*. A new member is a corporation that, in the preceding taxable year, did not qualify as a member, as defined in §1.1502–1(b), of the consolidated group that it now joins.

(ii) *End of taxable year.* Solely for the purpose of complying with the twelve-month requirement for making an application for a tentative carryback adjustment under section 6411(a), the separate return year of a qualified new member shall be treated as ending on the same date as the end of the current taxable year of the consolidated group that the qualified new member joins.

(iii) *Qualified new member*. A new member of a consolidated group qualifies for purposes of the provisions of this paragraph (e)(2) if, immediately prior to becoming a new member, either—

(A) It was the common parent of a consolidated group; or

(B) It was not required to join in the filing of a consolidated return.

(iv) *Examples*. The provisions of this paragraph (e)(2) may be illustrated by the following examples:

*Example 1.* Individual A owns 100 percent of the stock of X, a corporation that is not a member of a consolidated group and files separate tax returns on a calendar year basis. On January 31 of year 1, X becomes a member of the Y consolidated group, which also files returns on a calendar year basis. X is a qualified new member as defined in paragraph (e)(2)(iii)(B) of this section because, immediately prior to becoming a new member of the Y consolidated group, X was not required to join in the filing of a consolidated return. As a result of its becoming a new member of Group Y, X's separate return for the short taxable year (January 1 of year 1 through January 31 of year 1) is due September 15 of year 2 (with extensions). See §1.1502–76(c). Group Y's consolidated return is also due September 15 of year 2 (with extensions). See §1.1502–76(c). Solely for the purpose of complying with the twelve-month requirement for making an application for a tentative carryback adjustment under section 6411(a), X's taxable year for the separate return year is treated as ending on December 31 of year 1. X's application for a tentative carryback adjustment is therefore due on or before December 31 of year 2.

*Example 2*. Assume the same facts as in *Example 1* except that immediately prior to becoming a new member of Group Y, X was a member of the Z consolidated group. Because X was required to join in the filing of the consolidated return for Group Z, X is not a qualified new member as defined in paragraph (e)(2)(iii) of this section. X's items for the one-month period will be included in the consolidated return for Group Z. Group Z's application for a tentative carryback adjustment, if any, continues to be due within 12 months of the end of its taxable year, which is not affected by X's change in status as a new member of Group Y.

(v) *Effective date*. The provisions of this paragraph (e)(2) apply for applications by new members of consolidated groups for tentative carryback adjustments resulting from net operating losses, net capital losses, or unused business credits arising in separate return years of new members that begin on or after January 1, 2001.

**§1.1502–78T [Removed]**

Par. 3. Section 1.1502–78T is removed.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved June 13, 2001.

Mark A. Weinberger,
*Assistant Secretary*
*of the Treasury.*

(Filed by the Office of the Federal Register on June 21, 2001, at 8:45 a.m., and published in the issue of the Federal Register for June 22, 2001, 66 FR 33462)

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## Section 6302.—Mode or Time of Collection

*26 CFR 1.6302–1: Use of Government depositaries in connection with corporation income and estimated income taxes and certain taxes of tax-exempt organizations.*

## T.D. 8947

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Parts 1, 31, 301, and 602

## Penalties for Underpayments of Deposits and Overstated Deposit Claims

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of final regulations.

SUMMARY: This document makes conforming amendments to certain final regulations to reflect the removal of final regulations, relating to the penalty for underpayment of deposits of taxes and the penalty for overstated deposit claims. These regulations are obsolete due to amendments to section 6656 of the Internal Revenue Code. The removal of these regulations will not affect taxpayers.

DATES: The amendments and removal of these regulations is effective June 15, 2001.

FOR FURTHER INFORMATION CONTACT: Robin M. Tuczak (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background and Explanation of Provisions**

This document removes two sections from the Procedure and Administration Regulations (26 CFR part 301) relating to penalties for underpayment of Federal tax deposits and overstated deposit claims under section 6656 of the Internal Revenue Code.The Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (103 Stat. 2106, 1989) amended section 6656, modifying the penalty rates relating to a failure to make a Federal tax deposit and removing the penalty relating to overstatement of Federal tax deposits. These changes have rendered §§301.6656–1 and 301.6656–2 obsolete.

Section 301.6656–1 was revised and §301.6656–2 was added by T.D. 7925 (1984–1 C.B. 261), published in the **Federal Register** for December 13, 1983 (LR–311–81, 1982–1 C.B. 570), 48 FR 5453). Section 301.6656–2 was added to implement changes made by the Economic Recovery Tax Act of 1981, Public Law 97–34 (95 Stat. 172, 1981). Section 301.6656–1 was revised to remove outdated provisions relating to deposits made before January 1, 1970, based on the law in effect for those deposits.

Section 301.6656–1 reflects that, at the time it was revised, the penalty for underpayment of deposits was five percent of the amount of the underpayment without regard to the period during which the underpayment continued, absent reasonable cause. The Omnibus Budget Reconciliation Act of 1986, Public Law 99–509 (100 Stat. 1874, 1986) amended section 6656 to impose a ten percent penalty for underpayment. The Omnibus Budget Reconciliation Act of 1989 further amended this section to provide for a penalty that is equal to an applicable percentage of the amount of the underpayment based on the duration of the underpayment. This regulation does not reflect the most recent amendments to section 6656. Furthermore, all relevant information regarding underpayment penalties is put forth in the code section or in other published guidance. This regulation does not provide any additional guidance regarding the current underpayment penalties as set forth in section 6656 and therefore may be removed.

Section 301.6656–2 explains and expands upon former section 6656(b), Overstated Deposit Claims. The Omnibus Budget Reconciliation Act of 1989 removed former section 6656(b), making this regulation obsolete.

In addition, §301.6656–3 is redesignated as §301.6656–1. Further, §§1.6302–1(d) and 1.6302–2(d) of the Income Tax Regulations and §§31.6302–1(m)(1) and 31.6302(c)–4(a) of the Employment Tax Regulations are revised to remove references to the removed regulations under section 6656.

**Effect on other Documents**

The final regulations §§301.6656–1 and 301.6656–2 published in the **Federal Register** for December 13, 1983 (LR–311–81, 48 FR 5453), are removed as of June 15, 2001.

**Special Analyses**

It has been determined that the removal of these regulations is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because this rule merely removes regulatory provisions made obsolete by statute, prior notice and comment and a delayed effective date are unnecessary and contrary to the public interest. 5 U.S.C. 553(b)(B) and (d) Because no notice of proposed rulemaking is required, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

**Drafting Information**

The principal author of the removal of the regulations is Robin M. Tuczak of the

Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division).

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR parts 1, 31, 301, and 602 are amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. In §1.6302–1, paragraph (d) is revised to read as follows:

*§1.6302–1 Use of Government depositaries in connection with corporation income and estimated income taxes and certain taxes of tax-exempt organizations.*

* * * * *

(d) *Failure to deposit.* For provisions relating to the penalty for failure to make a deposit within the prescribed time, see section 6656.

Par. 3. In §1.6302–2, paragraph (d) is revised to read as follows:

*§1.6302–2 Use of Government depositaries for payment of tax withheld on nonresident aliens and foreign corporations.*

* * * * *

(d) *Penalties for failure to make deposits*. For provisions relating to the penalty for failure to make a deposit within the prescribed time, see section 6656.

* * * * *

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

Par. 4. The authority citation for part 31 continues to read in part as follows:

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

Par. 5. In §31.6302–1, paragraph (m)(1) is revised to read as follows:

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

* * * * *

(m) * * *(1) *Failure to deposit penalty.* For provisions relating to the penalty for failure to make a deposit within the prescribed time, see section 6656.

* * * * *

Par. 6. In §31.6302(c)–4, paragraph (a) is revised to read as follows:

*§31.6302(c)–4 Cross references.*

(a) *Failure to deposit*. For provisions relating to the penalty for failure to make a deposit within the prescribed time, see section 6656.

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par. 7. The authority citation for part 301 continues to read in part as follows:

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

**§§301.6656–1 and 301.6656–2 [Removed]**

Par. 8. Sections 301.6656–1 and 301.6656–2 are removed.

**§301.6656–3 [Redesignated as §301.6656–1]**

Par. 9. Section 301.6656–3 is redesignated as new §301.6656–1.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

Par. 11. In §602.101, paragraph (b) is amended by removing the entries for 301.6656–1 and 301.6656–2 from the table.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

Approved June 1, 2001.

Mark A. Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on June 14, 2001, at 8:45 a.m., and published in the issue of the Federal Register for June 15, 2001, 66 FR 32541)

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, page 31.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2001. See Rev. Rul. 2001–34, page 31.

# Part III. Administrative, Procedural, and Miscellanous

*26 CFR 601.601: Rules and regulations.*
*(Also Part I, §§ 103, 141, 145; 1.141–3, 1.145–2.)*

## Rev. Proc. 2001–39

SECTION 1. PURPOSE

This revenue procedure modifies the definitions of capitation fee and per-unit fee in Rev. Proc. 97–13, 1997–1 C.B. 632, to permit an automatic increase of those fees according to a specified, objective, external standard that is not linked to the output or efficiency of a facility (for example, the Consumer Price Index).

SECTION 2. BACKGROUND

.01 Rev. Proc. 97–13 sets forth conditions under which a management contract does not result in private business use under § 141(b) of the Internal Revenue Code. The revenue procedure also applies to determinations of whether a management contract causes the test in § 145(a)(2)(B) to be met.

.02 Section 3 of Rev. Proc. 97–13 defines various terms, including capitation fee, periodic fixed fee, and per-unit fee.

.03 Section 3.02 of Rev. Proc. 97–13 defines a capitation fee as a fixed periodic amount for each person for whom the service provider or the qualified user assumes the responsibility to provide all needed services for a specified period so long as the quantity and type of services actually provided to covered persons varies substantially. A capitation fee may include a variable component of up to 20 percent of the total capitation fee designed to protect the service provider against risks such as catastrophic loss.

.04 Section 3.05 of Rev. Proc. 97–13 defines a periodic fixed fee as a stated dollar amount for services rendered for a specified period of time. The definition of periodic fixed fee provides that the stated dollar amount may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of a facility.

.05 Section 3.06 of Rev. Proc. 97–13 defines a per-unit fee as a fee based on a unit of service provided specified in the contract or otherwise specifically determined by an independent third party, such as the administrator of the Medicare program, or the qualified user.

.06 Neither the capitation fee definition nor the per-unit fee definition expressly contemplates an automatic increase based on a specified, objective, external standard not linked to the output or efficiency of the facility.

.07 This revenue procedure clarifies that a capitation fee and a per-unit fee may be determined using an automatic increase according to a specified, objective, external standard that is not linked to the output or efficiency of a facility (for example, the Consumer Price Index).

SECTION 3. SCOPE

This revenue procedure applies when, under a management contract, a service provider provides management or other services involving property financed with proceeds of an issue of state or local bonds subject to § 141 or § 145(a)(2)(B).

SECTION 4. MODIFICATIONS

.01 Section 3.02 of Rev. Proc. 97–13 is modified to add the following text immediately before the last sentence:

> A fixed periodic amount may include an automatic increase according to a specified, objective, external standard that is not linked to the output or efficiency of a facility. For example, the Consumer Price Index and similar external indices that track increases in prices in an area or increases in revenues or costs in an industry are objective, external standards.

.02 Section 3.06 of Rev. Proc. 97–13 is modified to add the following text at the end:

> A fee that is a stated dollar amount specified in the contract does not fail to be a per-unit fee as a result of a provision under which the fee may automatically increase according to a specified, objective, external standard that is not linked to the output or efficiency of a facility. For example, the Consumer Price Index and similar external indices that track increases in prices in an area or increases in revenues or costs in an industry are objective, external standards.

SECTION 5. INQUIRIES

For further information regarding this revenue procedure, contact David White at (202) 622-3980 (not a toll-free call).

SECTION 6. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies Rev. Proc. 97–13, 1997–1 C.B. 632.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for any management contract entered into, materially modified, or extended (other than pursuant to a renewal option) on or after July 9, 2001. In addition, an issuer may apply this revenue procedure to any management contract entered into prior to July 9, 2001.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Mary Truchly and Rebecca Harrigal, Office of Chief Counsel.

# Part IV. Items of General Interest

## Foundations Status of Certain Organizations

## Announcement 2001–72

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

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

1st Generation Community Development Corporation, Jefferson City, MO
Academy, Cedar Rapids, IA
Afro-American Military Historical A Association, Inc., Kansas City, MO
Akwaaba, Inc., St. Louis, MO
American Research Center, Mt. Pleasant, IA
Americharities, Eden Prairie, MN
Athletics for Disadvantaged and Disabled Athletes, Inc., White Bear Lake, MN
Aware Committee, St. James, MO
Before and After School Services, Spirit Lake, IA
Bernard Whittington Foundation, St. Louis, MO
Black Belt Parents Association of Missouri, Inc., St. Louis, MO
Brainerd South Housing Group, Inc., Brainerd, MN
Bridges Institute for Health Services Research, St. Louis, MO
Central Lakes Snowmobile Club, Watkins, MN
Cherryfest, Cherryville Community Betterment Organization, Cherryville, MO
Christian Ministry Center, Willmar, MN
Christian Teachers College St. John Under the Rock Fund, Chambersburg, PA
Christopher Foundation, Burnsville, MN
Clay Central Everly Community School District Foundation, Everly, IA
C.O.I.N. Betterment, Coin, IA
Committed by Choice Ministries, Minneapolis, MN
Community Development University and Entertainment Center, Inc., Boone, IA
Community Health Resources, Woodbury, MN
Compass Institute, Springfield, MO
Computer Information Age Expo, Inc., St. Louis, MO
Concerned Citizens for the Emergency Room & Spelman Hospital, Smithville, MO
Council Bluffs Parenting Coalition, Inc., Council Bluffs, IA
Crossroads Ministries, Goldfield, IA
Do the Right Thing of Greater St. Louis, Inc., St. Louis, MO
Doug Stanton Ministries International, Big Lake, MN
Duluth Woodland Community Center, Inc., Duluth, MN
Dutchmen Dutchgirl Athletic Booster Club, Owensville, MO
Eden Prairie ABC Foundation, Eden Prairie, MN
Education & Housing Equity Project, Minneapolis, MN
Egbe Omo Oduduwa, Inc., Minneapolis, MN
Equipment Replacement Fund, St. Louis, MO
Evangelical Human Care, St. Paul, MN
Exchange Club Foundation of Brainerd, Inc., Brainerd, MN
Family Life Skills Learning Center, Inc., Plano, IA
Family YMCA of Muscatine Endowment Foundation, Muscatine, IA
Faribault Ice Arena Association, Faribault, MN
Feed the Children, Inc., University City, MO
Foundation for Senior Housing Options, Minneapolis, MN
Freedom Foundation, Inc., Lees Summit, MO
Friends of Decorah Public Library, Inc., Decorah, IA
Friends of Lacey-Keosauqua State Park, Keosauqua, IA
Friends of the Green, Inc., Litchfield, CT
Friends of the Saint Paul Riverfront Stadium, St. Paul, MN
Fully Reciprocal Theatre Company, Minneapolis, MN
Gateway Center for Development and Learning, Inc., St. Louis, MO
Great Northern Ball Association, Minneapolis, MN
Hale Mahaolu Ehiku, Inc., Kahului, HI
Hopkins Varsity Basketball College Scholarship Fund, Minnetonka, MN
House of Pain, Inc., Waterloo, IA
H.R. Services of St. Paul, St. Paul, MN
Hurricanes E.S.A., Edina, MN
Immaculate Heart of Mary Our Lady Queen of Heaven, Minnetonka, MN
Interfaith Council of Greater Sun Lakes, Inc., Sun Lakes, AZ
Interns, Inc., Pleasant Hill, CA
Iowa Citizens for the Arts Education, Inc., Des Moines, IA
Jazz Partners, Des Moines, IA
Joplin Area Aids Resource Center, Inc., Joplin, MO
Juneteenth Historical Commemoration Association, St. Louis, MO
Karaoke Kare of Missouri, Inc., Marthasville, MO
Keenes Creek Youth Organization, Duluth, MN
Koshkonong Volunteer Fire Dept., Koshkonong, MO
Lakeville Area Historical Society, Lakeville, MN
Lee County Rabbitary, Inc., Bishopville, SC
Legion of Friends, Carmel, CA
Library of Lives, Lees Summit, MO
L.O.V.E. Home, Inc., Hermantown, MN
LRC Partners Foundation, Inc., Troy, NY
Lubavitch of Iowa, Inc., Des Moines, IA
Luv-N-Care, Inc., Sedalia, MO
Mabel Youth, Inc., Mabel, MN
Macon County Crisis Center, New Cambria, MO
Main Stage Productions, Inc., Kansas City, MO
Marathon Area Historical Society, Marathon, IA
Marquette Learning Institute, St. Louis, MO
Matoska Neighborhood Association, White Bear Lake, MN
Midwest Tarlton Institute of Marine Education, Bloomington, MN

Minnesota Aviation History and Education Center, Inc., St. Paul, MN
Mission-A Catholic Worker Community, St. Cloud, MN
Missouri Black Bass Unlimited, Inc., Clinton, MO
Mt. Pleasant Neighborhood, St. Louis, MO
National Native American War Memorial Complex, Incorporated, Chapter Oak, IA
Network for Prep., Inc., Bettendorf, IA
New Harmony Care Center, Inc., Richfield, MN
Nguzo Saba Community Studio, St. Paul, MN
Nisswa Enhanced Reading Foundation, Nisswa, MN
North Lilbourn Development, Inc., Lilbourn, MO
Northland Opera Theater Experience, Duluth, MN
Northside Economic Development Council, Inc., Minneapolis, MN
One Small Step, St. Paul, MN
Parents Together Network, Inc., Marion, IA
Patch, Ballwin, MO
Paths Unlimited, Minneapolis, MN
People Place, Minneapolis, MN
Philip & Adeline Woods Memorial Fund, Yanceyville, NC
Pilot Grove Community Athletic Association, Pilot Grove, MO
Playground, Inc., Buffalo, MO
Port Morris Neighborhood Development Corporation, Bronx, NY
Presbyterian Homes-Wedum Affordable Housing, Inc., Arden Hills, MN
Quite Light Opera Company, St. Joseph, MN
Ralls County Community 2000, Inc., Perry, MO
Recover America, Inc., Joplin, MO
Recovery Road, Inc., St. Paul, MN
Red Wing Public Schools Foundation, Red Wing, MN
Responsible Adults & Youths, Ofallon, MO
R.O.F. Reins of Freedom, Avon, MN
Roots Program, St. Paul, MN
Save Iowas Civil War Monument Foundation, W. Branch, IA
Shelly Dorgan Memorial Scholarship Fund, Minneapolis, MN
Simien Foundation for Seniors, Inc., Kansas City, MO
Southern California Allstars, Garden Grove, CA
Southwest Missouri Youth Baseball Club, Carl Junction, MO
Special Needs Association, Cresco, IA
Springfield Community Theatre Group, Springfield, MN
St. Andrews Assisted Living Services, St. Louis, MO
St. Charles Basketball Club, St. Charles, MO
St. James Opera House Restoration Project, Inc., St. James, MN
St. Louis Northside Coaches Association, St. Louis, MO
Starving Artists Entertainment Group, Inc., Edina, MN
Stewartsville Community Betterment Association, Stewartsville, MO
Stoddard County Inter-Agency Council, Dexter, MO
Suburban Documentation Project, St. Paul, MN
Summit Psych Care, Pleasant Hill, MO
Teen Pregnancy Prevention Action Council, Alexandria, MN
Tom Peterson Memorial Foundation, Sioux City, IA
Trees for Tomorrow, Newton, IA
Tumwater Hardball Association, Tumwater, WA
Twin Cities Business Foundation, St. Paul, MN
United Neighborhoods of Jennings, Inc., Jennings, MO
Urban Hope Ministries, Inc., Minneapolis, MN
Voce Magna, Blaine, MN
West End Elderly Housing Corporation, Saint Louis, MO
Wild Rice Electric Trust, Mahnomen, MN
Willow Springs Medical Assistance Program, Willow Springs, MO
Winterset Fire Fighters Association, Inc., Winterset, IA
Youth Gospel Music Conference, Inc., St. Louis, MO

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

## Rev. Proc. 2000–39, Business and Traveling Expenses; Correction

## Announcement 2001–73

This document contains a correction to Rev. Proc. 2000–39 (2000–41 I.R.B. 340) published on October 10, 2000, relating to business and traveling expenses, and *per diem* allowances.

Under SECTION 5. HIGH-LOW SUBSTANTIATION METHOD, .01 *General rule.*, toward the end of the paragraph on page 343 of the Internal Revenue Bulletin, the text below in brackets is missing.

…substantiated for each calendar day is equal [to the lesser of the *per diem* allowance for such day or the amount computed at the rate set forth in section 5.02 of this revenue procedure for the locality of travel for such 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.

## New Filing Locations for Estate, Gift, and Generation-Skipping Transfer Tax Returns

## Announcement 2001–74

Beginning with returns filed on or after January 1, 2001, the filing locations for some states have changed for the following tax returns:

Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*
Form 706–CE, *Certificate of Payment of Foreign Death Tax*
Form 706–GS(D), *Generation-Skipping Transfer Tax Return for Distributions*
Form 706–GS(D–1), *Notification of Distribution From a Generation-Skipping Trust*

Form 706–GS(T), *Generation-Skipping Transfer Tax Return for Terminations*
Form 709, *United States Gift (and Generation-Skipping Transfer) Tax Return*
Form 709–A, *United States Short Form Gift Tax Return*

Send these forms to the applicable IRS address listed below. Note that all returns filed in 2002 and thereafter, except those with a foreign, APO, or FPO address, will be filed at the Cincinnati Service Center.

| For estates of decedents domiciled in, donees residing in, and settlors (now or at the time of death) residing in | Use the following Internal Revenue Service address — For returns filed | |
|---|---|---|
| | During 2001 | Beginning January 1, 2002 |
| New York (*New York City and counties of Nassau, Rockland, Suffolk, and Westchester)* | Brookhaven Service Center Holtsville, NY 00501 | USPS: Cincinnati, OH 45999<br>Courier service: 201 W. Rivercenter Blvd. Covington, KY 41015 |
| New York *(all other counties)*, Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont | Andover, MA 05501 | |
| Florida, Georgia | Atlanta, GA 39901 | |
| Arkansas, Delaware, District of Columbia, Hawaii, Indiana, Iowa, Kentucky, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Missouri, New Jersey, North Carolina, Ohio, Pennsylvania, South Carolina, Texas, West Virginia, Wisconsin | Cincinnati, OH 45999 | |
| Kansas, New Mexico, Oklahoma | Austin, TX 73301 | |
| Alaska, Arizona, California *(counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solona, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba)*, Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming | Ogden, UT 84201 | |
| California *(all other counties)* | Fresno, CA 93888 | |
| Illinois | Kansas City, MO 64999 | |
| Alabama, Tennessee | Memphis, TN 37501 | |
| Virginia | Philadelphia, PA 19255 | |
| American Samoa, Guam, the U.S. Virgin Islands, Puerto Rico, a foreign address, or have an APO or FPO address | Philadelphia, PA 19255 | Philadelphia, PA 19255 |

**Important**

Any return filed before the date this announcement is published in the Internal Revenue Bulletin will be considered correctly filed if it was filed in accordance with the instructions for that return at the time it was filed. Do not file a duplicate of a return that has already been filed solely because the filing location has changed.

## Waivers for Form 1065 Electronic Filing Due to Unavailability of the Necessary Software

## Announcement 2001–75

Section 6011(e)(2) of the Internal Revenue Code and section 301.6011–3(a) of the Regulations on Procedure and Administration require partnerships with more than 100 partners to file their partnership returns (Form 1065 series) on magnetic media. The regulations define "magnetic media" to include electronic filing, if electronic filing is required by the Internal Revenue Service ("Service").

The Service has become aware that some partnerships cannot file electronically because the necessary software for some required forms is unavailable. This announcement describes how partnerships required to file electronically under section 6011(e)(2) may request a section 6724(a) reasonable cause waiver for failing to file electronically.

**<u>This announcement is applicable only to waiver requests made by taxpayers who are required to file forms and schedules that are not supported by electronic filing software and who cannot file those forms and schedules as paper attachments to the Form 8453-P.</u>** The forms that may be attached to the Form 8453-P are listed later in this announcement. This announcement is not applicable to other types of waiver requests (i.e. economic hardship). Announcement 2000–101 describes how to request waivers from filing electronically under section 6011(e) for other reasons.

**Waiver Request Procedures**

Taxpayers are required to submit a waiver request to the Memphis Submission Processing Center by October 1, 2001. To initiate a waiver request, the following information must be submitted for each partnership:

| Partnership Name | Federal Tax Identification Number | Number Of K-1's | Name Of Software Being Used | Unavailable Forms And Schedules |
|---|---|---|---|---|
| | | | | |
| | | | | |

Taxpayers may mail or fax the waiver request to the following:

**<u>Mail to:</u>** Internal Revenue Service
P.O. Box 420
Memphis, TN 38101-0420

Attn: Electronic Filing Unit,
Stop 2711

or

**<u>Fax to:</u>** 901-546-2544

Requests from the partnerships' tax advisor/preparer do not have to be accompanied by a valid power of attorney. If a valid power of attorney is not on file, the Service will address questions about the waiver to the partnership. Also, partnerships need not file Form 8800 before submitting a waiver request under this procedure. However, approval of a waiver request will not relieve the partnership of a failure to file penalty for returns filed after the original due date without a valid extension.

To complete the waiver request process, taxpayers must attach a signed waiver request to the Form 1065 return at the time it is filed. The signed waiver request must include the following information:

1. A notation in large red letters at the top of page 1 of the Form 1065 return, ***"Waiver Request: IRC Section 6011(e)(2)"***;
2. The Waiver Request Attached must contain:
   a) A notation at the top *"Waiver Request: IRC Section 6011(e)(2)"*;
   b) The name, federal tax identification number, and mailing address of the partnership;
   c) The taxable year for which the waiver is requested;
   d) A detailed statement which lists:
      (i) What steps the partnership has taken in an attempt to meet its requirement to file its return electronically,
      (ii) Why the steps were unsuccessful,
      (iii) What steps the partnership will take to assure its ability to electronically file its partnership return for the next tax year.
   e) *A statement* ***signed by the Tax Matters Partner,*** as defined in section 6231(a)(7) of the Code, stating:

*"Under penalties of perjury, I declare that the information contained in this waiver request is true, correct and complete to the best of my knowledge and belief."*

Failure to complete the entire process will result in the Service denying the waiver request and assessing the penalty for failure to file electronically.

**Service Determination**

Within 30 days after receipt of the initial waiver request, the Service will notify the partnership if the Service is denying the waiver request. Partnerships may not appeal a denial of a waiver request at any time. After verifying that a listed form is unavailable and may not be filed with the Form 8453-P, the Service will process initial waiver requests to prevent the assessment of the penalty for failure to file eletronically. However, the Service must also receive the required waiver request attached to the filed Form 1065 to ensure the penalty will not be subsequently assessed. If the Service processes an initial waiver request and a form listed in the initial waiver request becomes available before the partnership files its Form 1065, the Service will not deny the waiver request based on the subsequent availability of the form.

The Service will not grant waiver requests for the following forms that may be attached to the 8453-P, allowing the rest of the return to be filed electronically: Schedule A (Form 5713), Schedule A (Form 8847), Schedule B (Form 5713), Schedule C (Form 5713), Schedule J (Form 5471), Schedule M (Form 5471), Schedule N (Form 5471), Schedule O (Form 5471), Form T, Form 982, Form 4255, Form 5471, Form 6478, Form 8283, Form 8582-CR, Form 8594, Form 8820, Form 8861, Form 8866, Form 8873.

**Failure to File Penalty**

It is not the Service's intent to assess penalties for failure to file electronically because the necessary software is not available and the partnership cannot file the forms with the Form 8453-P. However, penalties may inadvertently be assessed. If a filer receives an improper penalty notice, the filer should request an abatement of the penalties by sending a letter to the IRS at the address provided in this annoucement. Filers must include the information requested in the CP Notice 162 assessing the penalty.

**Late Filing Penalties**

The electronic postmark is not available for the current tax year for electronic Forms 1065. However, the IRS will accept the transmitter's date and time acknowledgement for purposes of evaluating requests to abate late-filing penalties assessed on partnership returns.

For questions concerning a request for waiver or a late filing penalty of an electronic Form 1065, contact the Memphis Submission Processing Center at 901-546-2690 (not a toll-free call).

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

## Section 32.—Earned Income

*26 CFR 1.32–3: Eligibility requirements after denial of the earned income credit.*

## T.D. 8953

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

## Eligibility Requirements After Denial of the Earned Income Credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance to taxpayers who have been denied the earned income credit (EIC) as a result of the deficiency procedures and wish to claim the EIC in a subsequent year. The temporary regulations apply to taxpayers claiming the EIC for taxable years beginning after December 31, 1997, where the taxpayer's EIC claim was denied for a taxable year beginning after December 31, 1996.

DATES: *Effective date*: These regulations are effective June 25, 2001.

*Applicability dates*: For dates of applicability, see §1.32–3(f) of these regulations.

FOR FURTHER INFORMATION CONTACT: Karin Loverud at 202-622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Paperwork Reduction Act**

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1575. Responses to this collection of information are mandatory.

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

The burden is reflected in the burden of Form 8862.

Comments and suggestions for reducing the burden imposed by this regulation should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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

**Background**

Section 32(k) was added by the Taxpayer Relief Act of 1997. Section 32(k)(2) provides that, in the case of a taxpayer who is denied the EIC as a result of the deficiency procedures, no EIC is allowed for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate eligibility for the credit. On June 25, 1998, temporary regulations (T.D. 8773, 1998–2 C.B. 70) relating to earned income credit eligibility requirements under section 32(k)(2) were published in the **Federal Register** (63 FR 34594). A notice of proposed rulemaking (REG–116608–97, 1998–2 C.B. 78) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (63 FR 34615).

No written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held.

As part of an audit pertaining to the IRS's management of the EIC eligibility program, the Treasury Inspector General for Tax Administration recommended that the Treasury and the IRS reconsider (1) the time at which the taxpayer should be required to establish eligibility to claim the EIC, and (2) whether the eligibility requirement should pertain to the reason the EIC was denied. For example, under the temporary regulations, a taxpayer who is denied the credit on the basis of a child who is determined not to be a qualifying child must establish eligibility the next time the taxpayer claims the EIC, regardless of whether the taxpayer is claiming the credit on the basis of one or more qualifying children or on the basis of no qualifying children. Treasury and the IRS believe that the purpose of the eligibility requirement (to prevent erroneous claims) is better effectuated if the taxpayer establishes eligibility the next time the taxpayer claims the credit with one or more qualifying children, rather than the next time the taxpayer claims the credit.

The IRS is currently exploring whether, and to what extent, its system is capable of undertaking such a change. If a change is made, it would not affect the method of establishing eligibility, that is, the taxpayer would continue to be required to attach a completed Form 8862 to his or her tax return. The Treasury and the IRS do not expect any change will affect returns for tax year 2001.

If a change is made, the IRS expects to inform taxpayers of the change in two specific ways. First, the IRS would revise Letter 3094, which informs the taxpayer of the eligibility requirements. Second, the IRS would revise the instructions for Form 8862 to clarify the return to which it must be attached. In addition, the IRS would include information regarding the change in all IRS taxpayer publications that deal with the EIC eligibility requirements.

The proposed regulations under section 32(k)(2) are adopted as revised by this Treasury decision. The revisions are discussed below.

**Explanation of Revisions**

To permit the IRS to make changes to the EIC eligibility program as indicated above, §1.32–3(c) is revised to state that the Form 8862 instructions will instruct the taxpayer when to file Form 8862. A new sentence is added to §1.32–3(c) to the effect that, if the taxpayer attaches Form 8862 to an incorrect return, the taxpayer will nevertheless be required to attach Form 8862 to the correct return.

The IRS and Treasury will consider written comments pertaining to these revisions. Submissions should be sent to: CC:ITA:RU (T.D. 8953), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (T.D. 8953), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html.*

**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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the underlying statute applies only to individuals. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

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

**Drafting Information**

The principal author of these regulations is Karin Loverud, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.32–3 is added to read as follows:

*§1.32–3 Eligibility requirements after denial of the earned income credit.*

(a) *In general*. A taxpayer who has been denied the earned income credit (EIC), in whole or in part, as a result of the deficiency procedures under subchapter B of chapter 63 (deficiency procedures) is ineligible to file a return claiming the EIC subsequent to the denial until the taxpayer demonstrates eligibility for the EIC in accordance with paragraph (c) of this section. If a taxpayer demonstrates eligibility for a taxable year in accordance with paragraph (c) of this section, the taxpayer need not comply with those requirements for any subsequent taxable year unless the Service again denies the EIC as a result of the deficiency procedures.

(b) *Denial of the EIC as a result of the deficiency procedures*. For purposes of this section, denial of the EIC as a result of the deficiency procedures occurs when a tax on account of the EIC is assessed as a deficiency (other than as a mathematical or clerical error under section 6213(b)(1)).

(c) *Demonstration of eligibility*. In the case of a taxpayer to whom paragraph (a) of this section applies, and except as otherwise provided by the Commissioner in the instructions for Form 8862, "*Information To Claim Earned Income Credit After Disallowance*," no claim for the EIC filed subsequent to the denial is allowed unless the taxpayer properly completes Form 8862, demonstrating eligibility for the EIC, and otherwise is eligible for the EIC. If any item of information on Form 8862 is incorrect or inconsistent with any item on the return, the taxpayer will be treated as not demonstrating eligibility for the EIC. The taxpayer must follow the instructions for Form 8862 to determine the income tax return to which Form 8862 must be attached. If the taxpayer attaches Form 8862 to an incorrect tax return, the taxpayer will not be relieved of the requirement that the taxpayer attach Form 8862 to the correct tax return and will, therefore, not be treated as meeting the taxpayer's obligation under paragraph (a) of this section.

(d) *Failure to demonstrate eligibility*. If a taxpayer to whom paragraph (a) of this section applies fails to satisfy the requirements of paragraph (c) of this section with respect to a particular taxable year, the IRS can deny the EIC as a mathematical or clerical error under section 6213(g)(2)(K).

(e) *Special rule where one spouse denied EIC*. The eligibility requirements set forth in this section apply to taxpayers filing a joint return where one spouse was denied the EIC for a taxable year prior to marriage and has not established eligibility as either an unmarried or married taxpayer for a subsequent taxable year.

(f) *Effective date*. This section applies to returns claiming the EIC for taxable years beginning after December 31, 1997, where the EIC was denied for a taxable year beginning after December 31, 1996.

**§1.32–3T [Removed]**

Par. 3. Section 1.32–3T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by:

1. Removing the entry for 1.32–3T from the table.

2. Adding an entry for 1.32–3 to read as follows:

*§602.101 OMB Control numbers.*

* * * * *

(b) * * *

| CFR part or section where identified and described | Current OMB control No. |
|---|---|
| * * * * * | |
| 1.32–3 | 1545–1575 |
| * * * * * | |

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved June 20, 2001.

Mark Weinberger,
*Assistant Secretary*
*of the Treasury.*

(Filed by the Office of the Federal Register on June 22, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 25, 2001, 66 F.R. 33636)

## Section 401.—Qualified Pension, Profit Sharing and Stock Bonus Plans

*26 CFR 1.401(a)(4)–8: Cross-testing.*

This revenue ruling describes specific conditions in order for defined benefit replacement allocations under a defined contribution plan to meet section 1.401(a)(4)–8(b) of the Income Tax Regulations.

## Rev. Rul. 2001–30

I. PURPOSE

This revenue ruling provides guidance with respect to the application of § 1.401(a)(4)–8(b) of the Income Tax Regulations relating to compliance of certain new comparability and similar defined contribution plans with the nondiscrimination requirements of § 401(a)(4) of the Internal Revenue Code.

Under those regulations, a qualified defined contribution plan that has broadly available allocation rates can be tested for nondiscrimination based on plan benefits (rather than contributions) whether or not it meets the minimum allocation gateway. In determining whether a plan has broadly available allocation rates, the regulations permit an allocation to be disregarded to the extent that it is a defined benefit replacement allocation or other transition allocation. Allocations are defined benefit replacement allocations if they satisfy the basic conditions in the regulations and the specific conditions prescribed in this revenue ruling.

II. BACKGROUND

Under final regulations (T.D. 8954, 2001–29 I.R.B. 47) amending §1.401(a)(4)–8(b), published in the Federal Register on June 29, 2001, a defined contribution plan must satisfy a minimum allocation gateway in order to be eligible to meet the nondiscrimination requirements of § 401(a)(4) on the basis of plan benefits rather than contributions, unless, for the plan year, the plan has broadly available allocation rates (as defined in the regulations) or certain age-based allocations.

Section 1.401(a)(4)–8(b)(1)(iii)(A) provides that a plan has broadly available allocation rates for a plan year if each allocation rate under the plan is currently available during the plan year (within the meaning of § 1.401(a)(4)–4(b)(2)) to a group of employees that satisfies § 410(b) (without regard to the average benefit percentage test of § 1.410(b)–5). In determining whether a plan has broadly available allocation rates for the plan year, an employee's allocation may be disregarded to the extent that it is a transition allocation. In order to be treated as a transition allocation, the allocation must be either a defined benefit replacement allocation (DBRA) described in § 1.401(a)(4)–8(b)(1)(iii)(D), or a pre-existing replacement allocation or pre-existing merger and acquisition allocation described in § 1.401(a)(4)–8(b)(1)(iii)(E). Plan provisions relating to transition allocations must meet the requirements of § 1.401(a)(4)–8(b)(1)(iii)(C).

Under § 1.401(a)(4)–8(b)(1)(iii)(D), in order for an allocation to be a DBRA it must be provided in accordance with guidance prescribed by the Commissioner in the Internal Revenue Bulletin (see "III. Specific Conditions" below) and the basic conditions set forth in § 1.401(a)(4)–8(b)(1)(iii)(D)(*1*)–(*4*).

III. SPECIFIC CONDITIONS

(1) This revenue ruling sets forth the specific conditions that an allocation must satisfy to be treated as a DBRA under § 1.401(a)(4)–8(b)(1)(iii)(D). These specific conditions are designed to permit employers to provide, in a nondiscriminatory manner, allocations replacing the retirement benefits that would have been provided under a defined benefit plan, without having to satisfy the minimum allocation gateway. At the same time, the specific conditions are designed to prevent the inappropriate avoidance of the gateway in the case of plans that provide special allocations for employees who formerly benefited under a defined benefit plan.

(2) Pursuant to this revenue ruling, to be treated as a DBRA, an allocation must meet the following conditions for a plan year:

(a) To satisfy the basic condition in § 1.401(a)(4)–8(b)(1)(iii)(D)(*1*) that the allocations are provided to a group of employees who formerly benefitted under an established nondiscriminatory defined benefit plan of the employer or of a prior employer that provided age-based equivalent allocation rates, the allocations must be based on a defined benefit plan that satisfies the following specific conditions:

(i) The defined benefit plan's benefit formula applicable to the group of employees generated equivalent normal allocation rates (determined without regard to changes in accrual rates attributable to changes in an employee's years of service) that increased from year to year as employees attained higher ages.

(ii) The defined benefit plan satisfied §§ 410(b) and 401(a)(4), without regard to § 410(b)(6)(C) and without aggregating with any other plan, for the plan year immediately preceding the first plan year for which the allocation is provided to the employees. If the defined benefit plan was sponsored by a prior employer, but not by the employer, this condition does not apply.

(iii) The defined benefit plan was in effect for at least the 5-year period ending on the date benefit accruals for the employees under the defined benefit plan cease (with one year substituted for 5 years in the case of a defined benefit plan of a former employer), and neither the plan formula nor the coverage of the plan has been substantially changed during such period.

(b) To satisfy the basic condition in § 1.401(a)(4)–8(b)(1)(iii)(D)(*2*) that the allocations for each employee in the group were reasonably calculated, in a consistent manner, to replace the retirement benefits that the employee would have been provided under a defined benefit plan of the employer or of the prior employer, the allocation must be reasonably calculated to replace the employee's retirement benefits under the defined benefit plan based on the terms of the defined benefit plan (including the § 415(b)(1)(A) limit) as in effect immediately prior to the date benefit accruals under the defined benefit plan ceased.

(c) To satisfy the basic condition in § 1.401(a)(4)–8(b)(1)(iii)(D)(*4*) that the composition of the group of employees who receive the allocations for the plan year is nondiscriminatory, the group of employees who receive the allocations must satisfy § 410(b) (determined without regard to the average benefit percentage test of § 1.410(b)–5) for the plan year.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Kenneth R. Conn of the Employee Plans, Tax Exempt and Government Entities Division and John T. Ricotta and Linda S. F. Marshall of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service between the hours of 1:30 and 3:30 p.m. Eastern time, Monday through Thursday, by calling (202) 283-9516. Mr. Conn's number is (202) 283-9526. Mr. Ricotta's number is (202) 622-6060. Ms. Marshall's number is (202) 622-6090. (These telephone numbers are not toll-free.)

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*26 CFR 1.401(a)(4)–8: Cross-testing.*

## T.D. 8954

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Part 1

## Nondiscrimination Requirements for Certain Defined Contribution Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that permit certain defined contribution retirement plans to demonstrate compliance with the nondiscrimination requirements based on plan benefits rather than contributions. Under the final regulations, a defined contribution plan can test on a benefits basis if it provides broadly available allocation rates, age-based allocations, or passes a gateway requiring allocation rates for nonhighly compensated employees to be at least 5% of pay or at least 1/3 of the highest allocation rate for highly compensated employees. The regulations also permit qualified defined contribution and defined benefit plans that are tested together as a single, aggregated plan (and that are not primarily defined benefit or broadly available separate plans) to test on a benefits basis after passing a similar gateway, under which the allocation rate for nonhighly compensated employees need not exceed 7 1/2 % of pay. These final regulations affect employers that maintain qualified retirement plans and qualified retirement plan participants.

DATES: *Effective Date*: These regulations are effective June 29, 2001.

*Applicability Date*: These regulations apply for plan years beginning on or after January 1, 2002.

FOR FURTHER INFORMATION CONTACT: John T. Ricotta, 202-622-6060, or Linda S. F. Marshall, 202-622-6090 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains amendments to 26 CFR part 1 under section 401(a)(4) of the Internal Revenue Code of 1986 (Code).

Section 401(a)(4) provides that a plan or trust forming part of a stock bonus, pension, or profit-sharing plan of an employer shall not constitute a qualified plan under section 401(a) of the Code unless the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (HCEs) (within the meaning of section 414(q)). Whether a plan satisfies this requirement depends on the form of the plan and its effect in operation.

Section 415(b)(6)(A) provides that the computation of benefits under a defined contribution plan, for purposes of section 401(a)(4), shall not be made on a basis inconsistent with regulations prescribed by the Secretary. The legislative history of this provision explains that, in the case of target benefit and other defined contribution plans, "regulations may establish reasonable earnings assumptions and other factors for these plans to prevent discrimination." Conf. Rep. No. 1280, 93d Cong., 2d Sess. 277 (1974).

Under the section 401(a)(4) regulations, a plan can demonstrate that either the contributions or the benefits provided under the plan are nondiscriminatory in amount. Defined contribution plans generally satisfy the regulations by demonstrating that contributions are nondiscriminatory in amount, through certain safe harbors provided for under the regulations or through general testing.

A defined contribution plan (other than an ESOP) may, however, satisfy the regulations on the basis of benefits by using cross-testing pursuant to rules provided in §1.401(a)(4)–8 of the regulations. Under this cross-testing method, contributions are converted, using actuarial assumptions, to equivalent benefits payable at normal retirement age, and these equivalent benefits are tested in a manner similar to the testing of employer-provided benefits under a defined benefit plan.

In Notice 2000–14 (2000–10 I.R.B. 737), released February 24, 2000, the IRS and the Treasury Department initiated a review of issues related to use of the cross-testing method by so-called new comparability plans and requested public comments on this plan design from plan sponsors, participants and other interested parties. In general, new comparability plans are defined contribution plans that have built-in disparities between the allocation rates for classifications of participants consisting entirely or predominantly of HCEs and the allocation rates for other employees.

In a typical new comparability plan, HCEs receive high allocation rates, while nonhighly compensated employees (NHCEs), regardless of their age or years of service, receive comparatively low allocation rates. For example, HCEs in such a plan might receive allocations of 18 or 20% of compensation, while NHCEs might receive allocations of 3% of compensation. A similar plan design, sometimes known as a super-integrated plan, provides for an additional allocation rate that applies only to compensation in excess of a specified threshold, but the specified threshold (*e.g.*, $100,000) or the additional allocation rate (*e.g.*, 10%) is higher than the maximum threshold and rate allowed under the permitted disparity rules of section 401(*l*).

These new comparability and similar plans rely on the cross-testing method to demonstrate compliance with the nondiscrimination rules by comparing the actuarially projected value of the employer contributions for the younger NHCEs with the actuarial projections of the larger contributions (as a percentage of compensation) for the older HCEs. As a result, these plans are able generally to provide higher rates of employer contributions to HCEs, while NHCEs are not allowed to earn the higher allocation rates as they work additional years for the employer or grow older. Notwithstanding the analytical underpinnings of cross-testing, the IRS and Treasury Department became concerned that new comparability and similar plans were not consistent with the basic purpose of the nondiscrimination rules under section 401(a)(4).

After consideration of the comments received in response to Notice 2000–14, the IRS and Treasury issued proposed regulations on this subject (REG–114697–00, 2000–43 I.R.B. 421), which were published in the **Federal Register** on October 6, 2000 (65 FR 59774). The proposed regulations preserved the cross-testing rules of the section 401(a)(4) regulations, but prescribed a gateway condition for new comparability and similar plans to meet in order to be eligible to use cross-testing to satisfy the nondiscrimination rules on the basis of benefits. However, defined contribution plans that provide broadly available allocation rates, as defined in the proposed regulations, did not have to satisfy the gateway. The definition of broadly available allocation rates under the proposed regulations covered plans that provide different allocation rates to different, nondiscriminatory groups of employees. Under the proposed regulations, the definition also covered plans that base allocations or allocation rates on age or years of service, that, in contrast to new comparability plans, provide an opportunity for participants to "grow into" higher allocation rates as they age or accumulate additional service.

The proposed regulations also addressed a new comparability-type plan design that aggregates a defined benefit plan that benefits primarily HCEs with a defined contribution plan that benefits primarily NHCEs. This design would permit an employer to circumvent the minimum allocation gateway by aggregating (for purposes of the nondiscrimination rules) a new comparability or similar defined contribution plan with a defined benefit plan that provides only minimal benefits to NHCEs or covers only a relatively small number of NHCEs. In addition, a defined benefit plan that benefits primarily HCEs, and that is aggregated with a defined contribution plan for nondiscrimination testing, could produce results similar to a new comparability plan but with a potential for substantially more valuable benefits for HCEs. The proposed regulations provided a gateway for testing the aggregated plans on the basis of benefits that must be satisfied unless the aggregated defined contribution and defined benefit plan (the DB/DC plan) is primarily defined benefit in character (as defined in the proposed regulations), or unless each of the defined contribution and defined benefit portions of the DB/DC plan is a broadly available separate plan (as defined in the proposed regulations).

Written comments responding to the notice of proposed rulemaking were received, and a public hearing was held on January 25, 2001, at the request of one commentator. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

**Explanation of Provisions**

A. *Overview*

Like the proposed regulations, these final regulations permit defined contribution plans with either broadly available allocation rates or certain age-based allocation rates to test on a benefits basis (cross-test) in the same manner as under current law, and permit other defined contribution plans to cross-test once they pass a gateway that prescribes minimum allocation rates for NHCEs. Similarly, these final regulations retain the rule in the proposed regulations that permits a DB/DC plan to test on a benefits basis in the same manner as under current law if the DB/DC plan either is primarily defined benefit in character or consists of broadly available separate plans. Other DB/DC plans are permitted to test on a benefits basis once they pass a corresponding gateway prescribing minimum aggregate normal allocation rates for NHCEs.

B. *Gateway for Cross-Testing of New Comparability and Similar Plans*

These final regulations retain the rule in the proposed regulations that requires a defined contribution plan that does not provide broadly available allocation rates or certain age-based allocation rates (as these terms are defined in these final regulations) to satisfy a gateway in order to be eligible to use the cross-testing rules to meet the nondiscrimination requirements of section 401(a)(4). Under these final regulations, as under the proposed regulations, a plan satisfies this minimum allocation gateway if each NHCE in the plan has an allocation rate that is at least one third of the allocation rate of the HCE with the highest allocation rate, but a plan is deemed to satisfy the gateway if each NHCE receives an allocation of at least 5% of the NHCE's compensation (within the meaning of section 415(c)(3)).

Several commentators raised questions about the interaction of the requirements under the proposed regulations and other regulatory rules relating to testing for nondiscrimination. For example, some commentators asked what was intended by the gateway requirement that all NHCEs receive the minimum required allocation. Except as specifically provided, the regulatory definitions and rules that apply for purposes of section 401(a)(4) also apply for purposes of these regulations. For example, the term employee, as used in these regulations, is defined in §1.401(a)(4)–12 as an employee (within the meaning of §1.410(b)–9) who benefits as an employee under the plan for the plan year, and an NHCE is defined in §1.401(a)(4)–12 as an employee who is not an HCE. Thus, an individual who does not otherwise benefit under the plan for the plan year is not an employee under these regulations, hence not an NHCE, and need not be given the minimum required allocation under the gateway.

Similarly, the allocation rate referred to in the gateway is determined under §1.401(a)(4)–2(c) as the allocations to an employee's account for a plan year, expressed either as a percentage of plan year compensation (which must be calculated using a definition of compensation that satisfies the requirements of section 414(s)) or as a dollar amount.

The general rules and regulatory definitions applicable under section 410(b) apply also for purposes of these regulations. For example, these regulations do not change the general rule prohibiting aggregation of a 401(k) plan or 401(m) plan with a plan providing nonelective contributions. Accordingly, matching contributions are not taken into account for purposes of the gateway. Similarly, pursuant to §1.410(b)–6(b)(3), if a plan benefits employees who have not met the minimum age and service requirements of section 410(a)(1), the plan may be treated as two separate plans, one for those otherwise excludable employees and one for the other employees benefitting under the plan. Thus, if the plan is treated as two separate plans in this manner, cross-testing the portion of the plan benefitting the nonexcludable employees will not result in minimum required allocations under the gateway for the employees who have not met the section 410(a)(1) minimum age and service requirements.

One commentator suggested that the regulatory provision that permits a plan to satisfy the gateway requirement by providing an allocation of at least 5% of compensation within the meaning of section 415(c)(3) not require that the allocation be based on a full year's compensation in the case of an employee who participates in the plan for only a portion of the plan year. The final regulations modify this requirement as suggested. The final regulations allow a plan to satisfy the gateway by providing an allocation of at least 5% of compensation within the meaning of section 415(c)(3), limited to a period otherwise permissible under the timing rules applicable under the definition of plan year compensation, in the same manner as the general rules under the section 401(a)(4) regulations. The definition of plan year compensation permits use of amounts paid only during the period of participation within the plan year.

Some commentators questioned whether it was necessary to require the use of compensation within the meaning of section 415(c)(3) for purposes of the 5% of compensation component of the minimum allocation gateway. One of these commentators argued that using compensation within the meaning of section 414(s) would be more appropriate. Two other commentators argued that, for this purpose, plans should be able to use a definition of compensation that would be a reasonable definition of compensation for purposes of section 414(s) without regard to whether the definition of compensation meets the nondiscrimination standard under the section 414(s) regulations.

After consideration of these comments, the requirement that section 415(c)(3) compensation be used for purposes of the 5% of compensation component of the minimum allocation gateway has been retained. For purposes of the "one third" component of the gateway, a definition of compensation that satisfies section 414(s) is an appropriate measure because this component is based on the ratio of HCE allocation rates to NHCE allocation rates. By contrast, the 5% of compensation component of the gateway does not reflect a comparison of NHCE allocations to HCE allocations, but is based on a particular level of NHCE allocations. Without the comparison between HCE and NHCE allocations, a rule permitting the use of a definition of compensation that satisfies section 414(s), but is less inclusive than total compensation, could lead to NHCE allocations that are significantly smaller than the minimum that is contemplated by the regulations. Therefore, it is appropriate to require the use of total compensation, as defined in section 415(c)(3), for the 5% allocation component of the gateway. Furthermore, permitting the use of a potentially discriminatory definition of compensation would be inconsistent with the nondiscrimination requirements in general, including the minimum allocation gateway.

### C. *Plans with Broadly Available Allocation Rates*

Like the proposed regulations, these final regulations provide that a plan that has broadly available allocation rates need not satisfy the minimum allocation gateway. In order to be broadly available, each allocation rate under the plan must be currently available to a group of employees that satisfies section 410(b) (without regard to the average benefit percentage test). Thus, if, within one plan, an employer provides different allocation rates for nondiscriminatory groups of employees at different locations or different profit centers, the plan would not need to satisfy the minimum allocation gateway in order to use cross-testing.

For purposes of determining whether an allocation rate that was available only to employees who satisfied an age or service condition was currently available to a section 410(b) group, the proposed regulations allowed such a condition to be disregarded if certain standards were met. The final regulations retain this exception from the application of the minimum allocation gateway. However, this exception has been relocated and is now part of an expanded provision for plans with age-based allocations (see Plans with Age-Based Allocations portion of this preamble).

In response to comments, the final regulations also liberalize the determination of whether a plan has broadly available allocation rates. First, the final regulations permit two allocation rates to be aggregated in a manner similar to the rule that permits aggregation of certain benefits, rights or features. This rule permits excess NHCEs with a higher allocation rate to be used to support a lower allocation rate. For example, under this rule, if under a plan there are two groups of participants, one group that receives an allocation rate of 10% and another that receives an allocation rate of 3%, and if the group of employees who receive the 10% allocation rate satisfies section 410(b) (without regard to the average benefit percentage test), then the 10% rate and the 3% rate can be aggregated and treated as a single allocation rate for purposes of determining whether the plan has broadly available allocation rates. In addition, the final regulations provide that, in determining whether a plan provides broadly available allocation rates, differences in allocation rates resulting from any method of permitted disparity provided for under the section 401(l) regulations are disregarded.

### D. *Transition Allocations*

Several commentators raised the concern that a defined contribution plan may fail the broadly available test because of grandfathered allocation rates provided to employees who formerly participated in a defined benefit plan or provided to a group of employees in connection with a merger, acquisition, or other similar transaction. In response to these comments, the final regulations permit an employee's allocation to be disregarded, to the extent the employee's allocation is a transition allocation (as defined in the regulations) for the plan year. Transition allocations which can be disregarded can be defined benefit replacement allocations, pre-existing replacement allocations, or pre-existing merger and acquisition allocations (as defined in the regulations).

In each case, the transition allocations must be provided to a closed group of employees and must be established under plan provisions. Once the allocations are established under the plan, they cannot be modified, except to reduce allocations for HCEs, or because of *de minimis* changes (such as a change in the definition of compensation to include section 132(f) elective reductions). A plan also does not violate this requirement because of an amendment that either adds or removes a provision applicable to all employees in the group eligible for the allocations under which each employee who is eligible for a transition allocation receives the greater of the transition allocation or another allocation for which the employee would otherwise be eligible. If the plan provides that all employees who are eligible for the transition allocation receive the greater of the transition allocation or an otherwise available allocation, the otherwise available allocation is considered currently available to all such employees, including employees for whom the transition allocation is greater.

These final regulations set forth basic conditions for defined benefit replacement allocations. These conditions provide a framework that is designed to ensure that these allocations are provided in a manner consistent with the general principles underlying the provisions for broadly available allocation rates under these regulations. The regulations then delegate authority to the Commissioner to prescribe rules for defined benefit replacement allocations in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin. Rev. Rul. 2001–30 (2001–29 I.R.B. 46), dated July 16, 2001, published in conjunction with these final regulations, prescribes specific conditions for defined benefit replacement allocations that relate to the basic conditions set forth in the regulations. This division of the medium of guidance is designed to provide ongoing flexibility to the IRS and Treasury to respond to changing circumstances, or additional information relating to defined benefit replacement allocations.

The basic conditions that allocations must satisfy in order to be defined benefit replacement allocations are as follows: (1) The allocations are provided to a group of employees who formerly benefitted under an established nondiscriminatory defined benefit plan of the employer or of a prior employer that provided age-based equivalent allocation rates; (2) the allocations for each employee were reasonably calculated, in a consistent manner, to replace the retirement benefits that the employee would have been provided under the defined benefit plan if the employee had continued to benefit under the defined benefit plan; (3) no employee who receives the allocation receives any other allocations under the plan for the plan year (except as provided in these regulations); and (4) the composition of the group of employees who receive the allocations is nondiscriminatory.

Rev. Rul. 2001–30 fleshes out these basic conditions for determining whether an allocation is a defined benefit replacement allocation. Under the revenue ruling, the defined benefit plan's benefit formula applicable to the group of employees must be one that generated equivalent normal allocation rates (determined without regard to changes in accrual rates attributable to changes in an employee's years of service) that increased from year to year as employees attained higher ages. Further, if the defined benefit plan was sponsored by the employer, the defined benefit plan satisfied sections 410(b) and 401(a)(4), without regard to section 410(b)(6)(C) and without aggregating with any other plan, for the plan year which immediately precedes the first plan year for which the allocations are provided. Finally, the defined benefit plan must be one that has been established and maintained without substantial change for at least the 5 years ending on the date benefit accruals under the defined benefit plan cease (with one year substituted for 5 years in the case of a defined benefit plan of a former employer).

In order to be defined benefit replacement allocations for the plan year, the allocations for each employee in the group must be reasonably calculated, in a consistent manner, to replace the employee's retirement benefits under the defined benefit plan based on the terms of the defined benefit plan (including the section 415(b)(1)(A) limit) as in effect immediately prior to the date accruals under the defined benefit plan cease. In addition, the group of employees who receive the allocations in a plan year must satisfy section 410(b) (determined without regard to the average benefit percentage test of §1.410(b)–5).

Although the regulations and Rev. Rul. 2001–30 prescribe conditions for the defined benefit replacement allocations, they still leave employers with flexibility in structuring these benefits. For example, there is more than one way in which the allocations may reasonably be calculated, such as a level percentage of pay for each year or an amount that increases as the employee ages.

The final regulations provide special rules applicable to allocations that are either pre-existing replacement allocations or pre-existing merger and acquisition allocations. Allocations are pre-existing replacement allocations if the allocations are provided pursuant to a plan provision adopted before June 29, 2001, are provided to employees who formerly benefitted under a defined benefit plan and are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under the defined benefit plan and any other plan or arrangement of the employer if the employee had continued to benefit under such defined benefit plan and such other plan or arrangement. Allocations are pre-existing merger and acquisition allocations if the allocations were established in connection with a stock or asset acquisition, merger, or other similar transaction occurring prior to August 28, 2001, for a group of employees who were employed by the acquired trade or business prior to a specified date, provided that the class of employees eligible for the allocations is closed no later than two years after the transaction (or January 1, 2002, if earlier), the allocations are provided pursuant to a plan amendment adopted by the date the class was closed, and the allocations for each employee in the group are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under any plan of the employer if the new employer had continued to provide the retirement benefits that the prior employer was providing for employees of the trade or business.

E. *Plans with Age-Based Allocations*

These final regulations provide a separate exception from the application of the minimum allocation gateway for certain plans with age-based allocation rates. This provision incorporates the exception under the proposed regulations for plans with gradual age or service schedules, and expands the exception to include plans that provide for allocation rates based on a uniform target benefit allocation.

A plan has a gradual age or service schedule if the schedule of allocation rates under the plan's formula is available to all employees in the plan and provides for allocation rates that increase smoothly at regular intervals. The rules applicable to the schedule of allocation rates are designed to be sufficiently flexible to accommodate a wide variety of age- or service-based plans (including age-weighted profit-sharing plans that provide for allocations resulting in the same equivalent accrual rate for all employees). The final regulations clarify that a plan projecting future age or service may not use imputed disparity in determining whether the allocation rates under the schedule increase smoothly at regular intervals. In response to comments, the final regulations also accommodate smoothly increasing schedules of allocation rates that are based on the sum of age and years of service. In addition, to conform with the rules for computation of service under §1.401(a)(4)–12, references to service have been changed to years of service.

The requirement that the allocation rates under a schedule increase smoothly at regular intervals provides important protection for employees, because this requirement limits the exception from the minimum allocation gateway to plans in which NHCEs actually receive the benefit of higher rates as they attain higher ages or complete additional years of service. Some commentators expressed concern that employers could be forced to reduce allocations to younger or shorter-service NHCEs in order to satisfy the conditions for allocation rates that increase smoothly at regular intervals. In response to these comments, the final regulations provide that a plan's schedule of allocation rates does not fail to increase smoothly at regular intervals merely because a specified minimum uniform allocation rate is provided for all employees or because the minimum benefit described in section 416(c)(2) is provided for all non-key employees (either because the plan is top heavy or without regard to whether the plan is top heavy) if one of two alternative conditions is satisfied. These two alternative conditions are intended to limit the potential use of a minimum allocation to provide a schedule of rates that delivers allocations similar to those under a new comparability plan (*i.e*., a flat allocation rate applicable for all employees below a certain age, followed by a sharply increasing schedule of rates that effectively benefits only HCEs) without satisfying the minimum allocation gateway.

A plan satisfies the first alternative condition if the allocation rates under the plan that exceed the specified minimum rate could form part of a schedule of allocation rates that increase smoothly at regular intervals (as defined in these regulations) in which the lowest allocation rate is at least 1% of plan year compensation. The second alternative condition, available for a plan using an age-based schedule, allows the use of a minimum allocation rate if, for each age band above the minimum allocation rate, the allocation rate applicable for that band is less than or equal to the allocation rate that would yield an equivalent accrual rate at the highest age in the band that is the same as the equivalent accrual rate determined for the oldest hypothetical employee who would receive just the minimum allocation rate. Thus, under this condition, the allocation rates above the minimum allocation rate do not rise more steeply than expected under an age-weighted profit-sharing plan generally intended to provide the same accrual rate at all ages.

The exception to the minimum allocation gateway for plans with age-based allocation rates also applies to certain uniform target benefit plans that do not comply with the safe-harbor testing method provided in §1.401(a)(4)–8(b)(3).[1] A plan has allocation rates based on a uniform target benefit allocation if it would comply with the requirements for a safe harbor target benefit plan in §1.401(a)(4)–8(b)(3) except that the interest rate for determining the actuarial present value of the stated plan benefit and the theoretical reserve is lower than a standard interest rate, the stated benefit is calculated assuming compensation increases, or the plan computes the current year contribution using the actual account balance instead of the theoretical reserve.

F. *Application to Defined Contribution Plans That Are Combined with Defined Benefit Plans (DB/DC Plans)*

These regulations prescribe rules for testing defined contribution plans that are aggregated with defined benefit plans for purposes of sections 401(a)(4) and 410(b). These rules apply in situations in which the employer aggregates the plans because one of the plans does not satisfy sections 401(a)(4) and 410(b) standing alone. These rules do not apply to safe harbor floor-offset arrangements described in §1.401(a)(4)–8(d), or to the situation in which plans are aggregated solely for purposes of satisfying the average benefit percentage test of §1.410(b)–5.

These regulations retain the rule of the proposed regulations that the combination of a defined contribution plan and a defined benefit plan may demonstrate nondiscrimination on the basis of benefits if the combined plan (the DB/DC plan) is primarily defined benefit in character, consists of broadly available separate plans (as these terms are defined in the regulations), or satisfies a minimum aggregate allocation gateway requirement that is generally similar to the minimum allocation gateway for defined contribution plans that are not combined with a defined benefit plan.

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[1] No exception to the minimum allocation gateway is needed for target benefit plans that comply with the safe-harbor testing provisions of §1.401(a)(4)-8(b)(3), because they are deemed to satisfy section 401(a)(4) with respect to an equivalent amount of benefits.

1. *Gateway for benefits testing of combined plans*

In order to apply this minimum aggregate allocation gateway, the employee's aggregate normal allocation rate is determined by adding the employee's allocation rate under the defined contribution plan to the employee's equivalent allocation rate under the defined benefit plan. This aggregation allows an employer that provides NHCEs with both a defined contribution and a defined benefit plan to take both plans into account in determining whether the minimum aggregate allocation gateway is met.

Under the gateway, if the aggregate normal allocation rate of the HCE with the highest aggregate normal allocation rate under the plan (HCE rate) is less than 15%, the aggregate normal allocation rate for all NHCEs must be at least 1/3 of the HCE rate. If the HCE rate is between 15% and 25%, the aggregate normal allocation rate for all NHCEs must be at least 5%. If the HCE rate exceeds 25%, then the aggregate normal allocation rate for each NHCE must be at least 5% plus one percentage point for each 5-percentage-point increment (or portion thereof) by which the HCE rate exceeds 25% (*e.g.*, the NHCE minimum is 6% for an HCE rate that exceeds 25% but not 30%, and 7% for an HCE rate that exceeds 30% but not 35%).

Several commentators expressed a concern that the minimum aggregate allocation gateway in the proposed regulations could require contributions for NHCEs that would make DB/DC plans too expensive for employers in certain circumstances. This could occur in cases where one HCE had a very high equivalent allocation rate on account of age or some other factor, and could prompt such an employer to redesign its plans in ways that could disadvantage NHCEs. In response to these comments, these final regulations provide that a plan is deemed to satisfy this minimum aggregate allocation gateway if the aggregate normal allocation rate for each NHCE is at least 7 1/2% of compensation within the meaning of section 415(c)(3), determined over a period otherwise permissible under the timing rules applicable under the definition of plan year compensation.

These regulations retain the rule that, in determining the equivalent allocation rate for an NHCE under a defined benefit plan, a plan is permitted to treat each NHCE who benefits under the defined benefit plan as having an equivalent allocation rate equal to the average of the equivalent allocation rates under the defined benefit plan for all NHCEs benefitting under that plan. This averaging rule recognizes the grow-in feature inherent in traditional defined benefit plans (*i.e.*, the defined benefit plan provides higher equivalent allocation rates at higher ages).

2. *Primarily defined benefit in character*

Like the proposed regulations, these final regulations provide that a DB/DC plan that is primarily defined benefit in character is not subject to the gateway requirement and may continue to be tested for nondiscrimination on the basis of benefits as under former law. A DB/DC plan is primarily defined benefit in character if, for more than 50% of the NHCEs benefitting under the plan, the normal accrual rate attributable to benefits provided under defined benefit plans for the NHCE exceeds the equivalent accrual rate attributable to contributions under defined contribution plans for the NHCE. For example, a DB/DC plan is primarily defined benefit in character where the defined contribution plan covers only salaried employees, the defined benefit plan covers only hourly employees, and more than half of the NHCEs participating in the DB/DC plan are hourly employees participating only in the defined benefit plan.

Some comments suggested a loosening of the standard as to when a DB/DC plan is primarily defined benefit in character, but no changes have been made. The Treasury and IRS believe that the determination of whether a DB/DC plan is primarily defined benefit in character should be based on the relative size of the defined benefit accruals and the defined contribution allocations for individual employees, as reflected in the actual benefits testing that is being done under section 401(a)(4). In particular, the actuarial assumptions used to determine whether a DB/DC plan is primarily defined benefit in character must be the same assumptions that are used to apply the cross-testing rules.

3. *Broadly available separate plans*

Like the proposed regulations, these final regulations provide that a DB/DC plan that consists of broadly available separate plans may continue to be tested for nondiscrimination on the basis of benefits as under current law, even if it does not satisfy the gateway requirement. A DB/DC plan consists of broadly available separate plans if the defined contribution plan and the defined benefit plan, tested separately, would each satisfy the requirements of section 410(b) and the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2), assuming satisfaction of the average benefit percentage test of §1.410(b)–5. Thus, the defined contribution plan must separately satisfy the nondiscrimination requirements (taking into account these regulations as applicable), but for this purpose assuming satisfaction of the average benefit percentage test. Similarly, the defined benefit plan must separately satisfy the nondiscrimination requirements, assuming for this purpose satisfaction of the average benefit percentage test. In conducting the required separate testing, all plans of a single type (defined contribution or defined benefit) within the DB/DC plan are aggregated, but those plans are tested without regard to plans of the other type.

This alternative is useful, for example, where an employer maintains a defined contribution plan that provides a uniform allocation rate for all covered employees at one business unit and a safe harbor defined benefit plan for all covered employees at another unit, and where the group of employees covered by each of those plans is a group that satisfies the nondiscriminatory classification requirement of section 410(b). Because the employer provides broadly available separate plans, it may continue to aggregate the plans and test for nondiscrimination on the basis of benefits, as an alternative to using the qualified separate line of business rules or demonstrating satisfaction of the average benefit percentage test.

G. *Use of Component Plans*

As under the proposed regulations, the rules set forth in these final regulations cannot be satisfied using component plans under the restructuring rules. Although some commentators requested that restructuring be permitted for this purpose, the IRS and Treasury have determined that such use of component plans would be inconsistent with the purpose of these regulations.

## Effective Date

These regulations apply for plan years beginning on or after January 1, 2002.

## Special Analyses

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

## Drafting Information

The principal authors of these regulations are John T. Ricotta and Linda S. F. Marshall of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

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## Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1 — INCOME TAXES

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

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

Par. 2. In §1.401(a)(4)–0, the entry for §1.401(a)(4)–8(b)(1) is revised to read as follows:

*§1.401(a)(4)–0 Table of contents.*

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*§1.401(a)(4)–8 Cross-testing.*

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(b) * * *

(1) General rule and gateway.

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Par. 3. In §1.401(a)(4)–8, paragraph (b)(1) is revised to read as follows:

*§1.401(a)(4)–8 Cross-testing.*

* * * * *

(b) *Nondiscrimination in amount of benefits provided under a defined contribution plan*—(1) *General rule and gateway*—(i) *General rule*. Equivalent benefits under a defined contribution plan (other than an ESOP) are nondiscriminatory in amount for a plan year if—

(A) The plan would satisfy §1.401(a)(4)–2(c)(1) for the plan year if an equivalent accrual rate, as determined under paragraph (b)(2) of this section, were substituted for each employee's allocation rate in the determination of rate groups; and

(B) For plan years beginning on or after January 1, 2002, the plan satisfies one of the following conditions—

(*1*) The plan has broadly available allocation rates (within the meaning of paragraph (b)(1)(iii) of this section) for the plan year;

(*2*) The plan has age-based allocation rates that are based on either a gradual age or service schedule (within the meaning of paragraph (b)(1)(iv) of this section) or a uniform target benefit allocation (within the meaning of paragraph (b)(1)(v) of this section) for the plan year; or

(*3*) The plan satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section for the plan year.

(ii) *Allocations after testing age*. A plan does not fail to satisfy paragraph (b)(1)(i)(A) of this section merely because allocations are made at the same rate for employees who are older than their testing age (determined without regard to the current-age rule in paragraph (4) of the definition of *testing age* in §1.401(a)(4)–12) as they are made for employees who are at that age.

(iii) *Broadly available allocation rates*—(A) *In general*. A plan has broadly available allocation rates for the plan year if each allocation rate under the plan is currently available during the plan year (within the meaning of §1.401(a)(4)–4(b)(2)), to a group of employees that satisfies section 410(b) (without regard to the average benefit percentage test of §1.410(b)–5). For this purpose, if two allocation rates could be permissively aggregated under §1.401(a)(4)–4(d)(4), assuming the allocation rates were treated as benefits, rights or features, they may be aggregated and treated as a single allocation rate. In addition, the disregard of age and service conditions described in §1.401(a)(4)–4(b)(2)(ii)(A) does not apply for purposes of this paragraph (b)(1)(iii)(A).

(B) *Certain transition allocations*. In determining whether a plan has broadly available allocation rates for the plan year within the meaning of paragraph (b)(1)(iii)(A) of this section, an employee's allocation may be disregarded to the extent that the allocation is a transition allocation for the plan year. In order for an allocation to be a transition allocation, the allocation must comply with the requirements of paragraph (b)(1)(iii)(C) of this section and must be either—

(*1*) A defined benefit replacement allocation within the meaning of paragraph (b)(1)(iii)(D) of this section; or

(*2*) A pre-existing replacement allocation or pre-existing merger and acquisition allocation, within the meaning of paragraph (b)(1)(iii)(E) of this section.

(C) *Plan provisions relating to transition allocations*—(*1*) *In general*. Plan provisions providing for transition allocations for the plan year must specify both the group of employees who are eligible for the transition allocations and the amount of the transition allocations.

(*2*) *Limited plan amendments*. Allocations are not transition allocations within the meaning of paragraph (b)(1)(iii)(B) of this section for the plan year if the plan provisions relating to the allocations are amended after the date those plan provisions are both adopted and effective. The preceding sentence in this paragraph (b)(1)(iii)(C)(*2*) does not apply to a plan amendment that reduces transition allocations to HCEs, makes *de minimis* changes in the calculation of the transition allocations (such as a change in the definition of compensation to include section 132(f) elective reductions), or adds or removes a provision permitted under paragraph (b)(1)(iii)(C)(*3*) of this section.

(*3*) *Certain permitted plan provisions*. An allocation does not fail to be a transition allocation within the meaning of paragraph (b)(1)(iii)(B) of this section merely because the plan provides that each employee who is eligible for a transition allocation receives the greater of such allocation and the allocation for which the employee would otherwise be eligible under the plan. In a plan that contains such a provision, for purposes of determining whether the plan has broadly available allocation rates within the meaning of paragraph (b)(1)(iii)(A) of this section, the allocation for which an employee would otherwise be eligible is considered currently available to the employee, even if the employee's transition allocation is greater.

(D) *Defined benefit replacement allocation*. An allocation is a defined benefit replacement allocation for the plan year if it is provided in accordance with guidance prescribed by the Commissioner published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(*b*) of this chapter) and satisfies the following conditions—

(*1*) The allocations are provided to a group of employees who formerly benefitted under an established nondiscriminatory defined benefit plan of the employer or of a prior employer that provided age-based equivalent allocation rates;

(*2*) The allocations for each employee in the group were reasonably calculated, in a consistent manner, to replace the retirement benefits that the employee would have been provided under the defined benefit plan if the employee had continued to benefit under the defined benefit plan;

(*3*) Except as provided in paragraph (b)(1)(iii)(C) of this section, no employee who receives the allocation receives any other allocations under the plan for the plan year; and

(*4*) The composition of the group of employees who receive the allocations is nondiscriminatory.

(E) *Pre-existing transition allocations*—(*1*) *Pre-existing replacement allocations*. An allocation is a pre-existing replacement allocation for the plan year if the allocation satisfies the following conditions—

(*i*) The allocations are provided pursuant to a plan provision adopted before June 29, 2001;

(*ii*) The allocations are provided to employees who formerly benefitted under a defined benefit plan of the employer; and

(*iii*) The allocations for each employee in the group are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under the defined benefit plan and any other plan or arrangement of the employer if the employee had continued to benefit under such defined benefit plan and such other plan or arrangement.

(*2*) *Pre-existing merger and acquisition allocations*. An allocation is a pre-existing merger and acquisition allocation for the plan year if the allocation satisfies the following conditions—

(*i*) The allocations are provided solely to employees of a trade or business that has been acquired by the employer in a stock or asset acquisition, merger, or other similar transaction occurring prior to August 28, 2001, involving a change in the employer of the employees of the trade or business;

(*ii*) The allocations are provided only to employees who were employed by the acquired trade or business before a specified date that is no later than two years after the transaction (or January 1, 2002, if earlier);

(*iii*) The allocations are provided pursuant to a plan provision adopted no later than the specified date; and

(*iv*) The allocations for each employee in the group are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under any plan of the employer if the new employer had continued to provide the retirement benefits that the prior employer was providing for employees of the trade or business.

(F) *Successor employers*. An employer that accepts a transfer of assets (within the meaning of section 414(l)) from the plan of a prior employer may continue to treat any transition allocations provided under that plan as transition allocations under paragraph (b)(1)(iii)(B) of this section, provided that the successor employer continues to satisfy the applicable requirements set forth in paragraphs (b)(1)(iii)(C) through (E) of this section for the plan year.

(iv) *Gradual age or service schedule*—(A) *In general*. A plan has a gradual age or service schedule for the plan year if the allocation formula for all employees under the plan provides for a single schedule of allocation rates under which—

(*1*) The schedule defines a series of bands based solely on age, years of service, or the number of points representing the sum of age and years of service (age and service points), under which the same allocation rate applies to all employees whose age, years of service, or age and service points are within each band; and

(*2*) The allocation rates under the schedule increase smoothly at regular intervals, within the meaning of paragraphs (b)(1)(iv)(B) and (C) of this section.

(B) *Smoothly increasing schedule of allocation rates*. A schedule of allocation rates increases smoothly if the allocation rate for each band within the schedule is greater than the allocation rate for the immediately preceding band (*i.e.*, the band with the next lower number of years of age, years of service, or age and service points) but by no more than 5 percentage points. However, a schedule of allocation rates will not be treated as increasing smoothly if the ratio of the allocation rate for any band to the rate for the immediately preceding band is more than 2.0 or if it exceeds the ratio of allocation rates between the two immediately preceding bands.

(C) *Regular intervals*. A schedule of allocation rates has regular intervals of age, years of service or age and service points, if each band, other than the band associated with the highest age, years of service, or age and service points, is the same length. For this purpose, if the schedule is based on age, the first band is deemed to be of the same length as the other bands if it ends at or before age 25. If the first age band ends after age 25, then, in determining whether the length of the first band is the same as the length of other bands, the starting age for the first age band is permitted to be treated as age 25 or any age earlier than 25. For a schedule of allocation rates based on age and service points, the rules of the preceding two sentences are applied by substituting 25 age and service points for age 25. For a schedule of allocation rates based on service, the starting service for the first service band is permitted to be treated as one year of service or any lesser amount of service.

(D) *Minimum allocation rates permitted*. A schedule of allocation rates under a plan does not fail to increase smoothly at regular intervals, within the meaning of paragraphs (b)(1)(iv)(B) and (C) of this section, merely because a minimum uniform allocation rate is provided for all employees or the minimum benefit described in section 416(c)(2) is provided for all non-key employees (either because the plan is top heavy or without regard to whether the plan is top heavy) if the schedule satisfies one of the following conditions—

(*1*) The allocation rates under the plan that are greater than the minimum allocation rate can be included in a hypothetical schedule of allocation rates that increases smoothly at regular intervals, within the meaning of paragraphs (b)(1)(iv)(B) and (C) of this section, where the hypothetical schedule has a lowest allocation rate no lower than 1% of plan year compensation; or

(*2*) For a plan using a schedule of allocation rates based on age, for each age band in the schedule that provides an allocation rate greater than the minimum allocation rate, there could be an employee in that age band with an equivalent accrual rate that is less than or equal to the equivalent accrual rate that would apply to an employee whose age is the highest age for which the allocation rate equals the minimum allocation rate.

(v) *Uniform target benefit allocations*. A plan has allocation rates that are based on a uniform target benefit allocation for the plan year if the plan fails to satisfy the requirements for the safe harbor testing method in paragraph (b)(3) of this section merely because the determination of the allocations under the plan differs from the allocations determined under that safe harbor testing method for any of the following reasons—

(A) The interest rate used for determining the actuarial present value of the stated plan benefit and the theoretical reserve is lower than a standard interest rate;

(B) The stated benefit is calculated assuming compensation increases at a specified rate; or

(C) The plan computes the current year contribution using the actual account balance instead of the theoretical reserve.

(vi) *Minimum allocation gateway*—(A) *General rule*. A plan satisfies the minimum allocation gateway of this paragraph (b)(1)(vi) if each NHCE has an allocation rate that is at least one third of the allocation rate of the HCE with the highest allocation rate.

(B) *Deemed satisfaction*. A plan is deemed to satisfy the minimum allocation gateway of this paragraph (b)(1)(vi) if each NHCE receives an allocation of at least 5% of the NHCE's compensation within the meaning of section 415(c)(3), measured over a period of time permitted under the definition of plan year compensation.

(vii) *Determination of allocation rate*. For purposes of paragraph (b)(1)(i)(B) of this section, allocations and allocation rates are determined under §1.401(a)(4)–2(c)(2), but without taking into account the imputation of permitted disparity under §1.401(a)(4)–7. However, in determining whether the plan has broadly available allocation rates as provided in paragraph (b)(1)(iii) of this section, differences in allocation rates attributable solely to the use of permitted disparity described in §1.401(l)–2 are disregarded.

(viii) *Examples*. The following examples illustrate the rules in this paragraph (b)(1):

*Example 1*. (i) Plan M, a defined contribution plan without a minimum service requirement, provides an allocation formula under which allocations are provided to all employees according to the following schedule:

| Completed Years of Service | Allocation Rate | Ratio of Allocation Rate for Band to Allocation Rate for Immediately Preceding Band |
|---|---|---|
| 0-5 | 3.0% | not applicable |
| 6-10 | 4.5% | 1.50 |
| 11-15 | 6.5% | 1.44 |
| 16-20 | 8.5% | 1.31 |
| 21-25 | 10.0% | 1.18 |
| 26 or more | 11.5% | 1.15 |

(ii) Plan M provides that allocation rates for all employees are determined using a single schedule based solely on service, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The schedule of allocation rates under Plan M does not increase by more than 5 percentage points between adjacent bands and the ratio of the allocation rate for any band to the allocation rate for the immediately preceding band is never more than 2.0 and does not increase. Therefore, the allocation rates increase smoothly as described in paragraph (b)(1)(iv)(B) of this section. In addition, the bands (other than the highest band) are all 5 years long, so the increases occur at regular intervals as described in paragraph (b)(1)(iv)(C) of this section. Thus, the allocation rates under the plan's schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section. Accordingly, the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iv) Under paragraph (b)(1)(i) of this section, Plan M satisfies the nondiscrimination in amount requirement of §1.401(a)(4)-1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

*Example 2*. (i) The facts are the same as in *Example 1*, except that the 4.5% allocation rate applies for all employees with 10 years of service or less.

(ii) Plan M provides that allocation rates for all employees are determined using a single schedule based solely on service, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The bands (other than the highest band) in the schedule are not all the same length, since the first band is 10 years long while other bands are 5 years long. Thus, the schedule does not have regular intervals as described in paragraph (b)(1)(iv)(C) of this section. However, under paragraph (b)(1)(iv)(D) of this section, the schedule of allocation rates does not fail to increase smoothly at regular intervals merely because the minimum allocation rate of 4.5% results in a first band that is longer than the other bands, if either of the conditions of paragraph (b)(1)(iv)(D)(*1*) or (*2*) of this section is satisfied.

(iv) In this case, the schedule of allocation rates satisfies the condition in paragraph (b)(1)(iv)(D)(*1*) of this section because the allocation rates under the plan that are greater than the 4.5% minimum allocation rate can be included in the following hypothetical schedule of allocation rates that increases smoothly at regular intervals and has a lowest allocation rate of at least 1% of plan year compensation:

| Completed Years of Service | Allocation Rate | Ratio of Allocation Rate for Band to Allocation Rate for Immediately Preceding Band |
|---|---|---|
| 0-5 | 2.5% | not applicable |
| 6-10 | 4.5% | 1.80 |
| 11-15 | 6.5% | 1.44 |
| 16-20 | 8.5% | 1.31 |
| 21-25 | 10.0% | 1.18 |
| 26 or more | 11.5% | 1.15 |

(v) Accordingly, the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section. Under paragraph (b)(1)(i) of this section, Plan M satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

*Example 3.* (i) Plan N, a defined contribution plan, provides an allocation formula under which allocations are provided to all employees according to the following schedule:

| Age | Allocation rate | Ratio of Allocation Rate for Band to Allocation Rate for Immediately Preceding Band |
|---|---|---|
| under 25 | 3.0% | not applicable |
| 25-34 | 6.0% | 2.00 |
| 35-44 | 9.0% | 1.50 |
| 45-54 | 12.0% | 1.33 |
| 55-64 | 16.0% | 1.33 |
| 65 or older | 21.0% | 1.31 |

(ii) Plan N provides that allocation rates for all employees are determined using a single schedule based solely on age, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The schedule of allocation rates under Plan N does not increase by more than 5 percentage points between adjacent bands and the ratio of the allocation rate for any band to the allocation rate for the immediately preceding band is never more than 2.0 and does not increase. Therefore, the allocation rates increase smoothly as described in paragraph (b)(1)(iv)(B) of this section. In addition, the bands (other than the highest band and the first band, which is deemed to be the same length as the other bands because it ends prior to age 25) are all 5 years long, so the increases occur at regular intervals as described in paragraph (b)(1)(iv)(C) of this section. Thus, the allocation rates under the plan's schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section. Accordingly, the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iv) Under paragraph (b)(1)(i) of this section, Plan N satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section, regardless of whether it satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

*Example 4*. (i) Plan O, a defined contribution plan, provides an allocation formula under which allocations are provided to all employees according to the following schedule:

| Age | Allocation rate | Ratio of Allocation Rate for Band to Allocation Rate for Immediately Preceding Band |
|---|---|---|
| under 40 | 3% | not applicable |
| 40-44 | 6% | 2.00 |
| 45-49 | 9% | 1.50 |
| 50-54 | 12% | 1.33 |
| 55-59 | 16% | 1.33 |
| 60-64 | 20% | 1.25 |
| 65 or older | 25% | 1.25 |

(ii) Plan O provides that allocation rates for all employees are determined using a single schedule based solely on age, as described in paragraph (b)(1)(iv)(A)(*1*) of this section. Therefore, if the allocation rates under the schedule increase smoothly at regular intervals as described in paragraph (b)(1)(iv)(A)(*2*) of this section, then the plan has a gradual age or service schedule described in paragraph (b)(1)(iv) of this section.

(iii) The bands (other than the highest band) in the schedule are not all the same length, since the first band is treated as 15 years long while other bands are 5 years long. Thus, the schedule does not have regular intervals as described in paragraph (b)(1)(iv)(C) of this section. However, under paragraph (b)(1)(iv)(D) of this section, the schedule of allocation rates does not fail to increase smoothly at regular intervals merely because the minimum allocation rate of 3% results in a first band that is longer than the other bands, if either of the conditions of paragraph (b)(1)(iv)(D)(*1*) or (*2*) of this section is satisfied.

(iv) In this case, in order to define a hypothetical schedule that could include the allocation rates in the actual schedule of allocation rates, each of the bands below age 40 would have to be 5 years long (or be treated as 5 years long). Accordingly, the hypothetical schedule would have to provide for a band for employees under age 30, a band for employees in the range 30-34 and a band for employees age 35-39.

(v) The ratio of the allocation rate for the age 40-44 band to the next lower band is 2.0. Accordingly, in order for the applicable allocations rates under this hypothetical schedule to increase smoothly, the ratio of the allocation rate for each band in the hypothetical schedule below age 40 to the allocation rate for the immediately preceding band would have to be 2.0. Thus, the allocation rate for the hypothetical band applicable for employees under age 30 would be .75%, the allocation rate for the hypothetical band for employees in the range 30-34 would be 1.5% and the allocation rate for employees in the range 35-39 would be 3%.

(vi) Because the lowest allocation rate under any possible hypothetical schedule is less than 1% of plan year compensation, Plan O will be treated as satisfying the requirements of paragraphs (b)(1)(iv)(B) and (C) of this section only if the schedule of allocation rates satisfies the steepness condition described in paragraph (b)(1)(iv)(D)(*2*) of this section. In this case, the steepness condition is not satisfied because the equivalent accrual rate for an employee age 39 is 2.81%, but there is no hypothetical employee in the band for ages 40-44 with an equal or lower equivalent accrual rate (since the lowest equivalent accrual rate for hypothetical employees within this band is 3.74% at age 44).

(vii) Since the schedule of allocation rates under the plan does not increase smoothly at regular intervals, Plan O's schedule of allocation rates is not a gradual age or service schedule. Further, Plan O does not provide uniform target benefit allocations. Therefore, under paragraph (b)(1)(i) of this section, Plan O cannot satisfy the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) for the plan year on the basis of benefits unless either Plan O provides for broadly available allocation rates for the plan year as described in paragraph (b)(1)(iii) of this section (*i.e.*, the allocation rate at each age is provided to a group of employees that satisfies section 410(b) without regard to the average benefit percentage test), or Plan O satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section for the plan year.

*Example 5*. (i) Plan P is a profit-sharing plan maintained by Employer A that covers all of Employer A's employees, consisting of two HCEs, X and Y, and 7 NHCEs. Employee X's compensation is $170,000 and Employee Y's compensation is $150,000. The allocation for Employees X and Y is $30,000 each, resulting in an allocation rate of 17.65% for Employee X and 20% for Employee Y. Under Plan P, each NHCE receives an allocation of 5% of compensation within the meaning of section 415(c)(3), measured over a period of time permitted under the definition of plan year compensation.

(ii) Because the allocation rate for X is not currently available to any NHCE, Plan P does not have broadly available allocation rates within the meaning of paragraph (b)(1)(iii) of this section. Furthermore, Plan P does not provide for age based-allocation rates within the meaning of paragraph (b)(1)(iv) or (v) of this section. Thus, under paragraph (b)(1)(i) of this section, Plan P can satisfy the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) for the plan year on the basis of benefits only if Plan P satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section for the plan year.

(iii) The highest allocation rate for any HCE under Plan P is 20%. Accordingly, Plan P would satisfy the minimum allocation gateway of paragraph (b)(1)(vi) of this section if all NHCEs have an allocation rate of at least 6.67%, or if all NHCEs receive an allocation of at least 5% of compensation within the meaning of section 415(c)(3) (measured over a period of time permitted under the definition of plan year compensation).

(iv) Under Plan P, each NHCE receives an allocation of 5% of compensation within the meaning of section 415(c)(3) (measured over a period of time permitted under the definition of plan year compensation). Accordingly, Plan P satisfies the minimum allocation gateway of paragraph (b)(1)(vi) of this section.

(v) Under paragraph (b)(1)(i) of this section, Plan P satisfies the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits if it satisfies paragraph (b)(1)(i)(A) of this section.

* * * * *

Par. 4. Section 1.401(a)(4)–9 is amended by adding paragraph (b)(2)(v) and revising paragraph (c)(3)(ii) to read as follows:

*§1.401(a)(4)–9 Plan aggregation and restructuring.*

* * * * *

(b) * * *

(2) * * *

(v) *Eligibility for testing on a benefits basis*—(A) *General rule*. For plan years beginning on or after January 1, 2002, unless, for the plan year, a DB/DC plan is primarily defined benefit in character (within the meaning of paragraph (b)(2)(v)(B) of this section) or consists of broadly available separate plans (within the meaning of paragraph (b)(2)(v)(C) of this section), the DB/DC plan must satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section for the plan year in order to be permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits.

(B) *Primarily defined benefit in character.* A DB/DC plan is primarily defined benefit in character if, for more than 50% of the NHCEs benefitting under the plan, the normal accrual rate for the NHCE attributable to benefits provided under defined benefit plans that are part of the DB/DC plan exceeds the equivalent accrual rate for the NHCE attributable to contributions under defined contribution plans that are part of the DB/DC plan.

(C) *Broadly available separate plans*. A DB/DC plan consists of broadly available separate plans if the defined contribution plan and the defined benefit plan that are part of the DB/DC plan each would satisfy the requirements of section 410(b) and the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) if each plan were tested separately and assuming that the average benefit percentage test of §1.410(b)–5 were satisfied. For this purpose, all defined contribution plans that are part of the DB/DC plan are treated as a single defined contribution plan and all defined benefit plans that are part of the DB/DC plan are treated as a single defined benefit plan. In addition, if permitted disparity is used for an employee for purposes of satisfying the separate testing requirement of this paragraph (b)(2)(v)(C) for plans of one type, it may not be used in satisfying the separate testing requirement for plans of the other type for the employee.

(D) *Minimum aggregate allocation gateway*—(*1*) *General rule*. A DB/DC plan satisfies the minimum aggregate allocation gateway if each NHCE has an aggregate normal allocation rate that is at least one third of the aggregate normal allocation rate of the HCE with the highest such rate (HCE rate), or, if less, 5% of the NHCE's compensation, provided that the HCE rate does not exceed 25% of compensation. If the HCE rate exceeds 25%

of compensation, then the aggregate normal allocation rate for each NHCE must be at least 5% increased by one percentage point for each 5-percentage-point increment (or portion thereof) by which the HCE rate exceeds 25% (*e.g.*, the NHCE minimum is 6% for an HCE rate that exceeds 25% but not 30%, and 7% for an HCE rate that exceeds 30% but not 35%).

(*2*) *Deemed satisfaction*. A plan is deemed to satisfy the minimum aggregate allocation gateway of this paragraph (b)(2)(v)(D) if the aggregate normal allocation rate for each NHCE is at least 7 1/2% of the NHCE's compensation within the meaning of section 415(c)(3), measured over a period of time permitted under the definition of plan year compensation.

(*3*) *Averaging of equivalent allocation rates for NHCEs*. For purposes of this paragraph (b)(2)(v)(D), a plan is permitted to treat each NHCE who benefits under the defined benefit plan as having an equivalent normal allocation rate equal to the average of the equivalent normal allocation rates under the defined benefit plan for all NHCEs benefitting under that plan.

(E) *Determination of rates*. For purposes of this paragraph (b)(2)(v), the normal accrual rate and the equivalent normal allocation rate attributable to defined benefit plans, the equivalent accrual rate attributable to defined contribution plans, and the aggregate normal allocation rate are determined under paragraph (b)(2)(ii) of this section, but without taking into account the imputation of permitted disparity under §1.401(a)(4)–7, except as otherwise permitted under paragraph (b)(2)(v)(C) of this section.

(F) *Examples*. The following examples illustrate the application of this paragraph (b)(2)(v):

*Example 1*. (i) Employer A maintains Plan M, a defined benefit plan, and Plan N, a defined contribution plan. All HCEs of Employer A are covered by Plan M (at a 1% accrual rate), but are not covered by Plan N. All NHCEs of Employer A are covered by Plan N (at a 3% allocation rate), but are not covered by Plan M. Because Plan M does not satisfy section 410(b) standing alone, Plans M and N are aggregated for purposes of satisfying sections 410(b) and 401(a)(4).

(ii) Because none of the NHCEs participate in the defined benefit plan, the aggregated DB/DC plan is not primarily defined benefit in character within the meaning of paragraph (b)(2)(v)(B) of this section nor does it consist of broadly available separate plans within the meaning of paragraph (b)(2)(v)(C) of this section. Accordingly, the aggregated Plan M and Plan N must satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section in order to be permitted to demonstrate satisfaction of the nondiscrimination in amount requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits.

*Example 2*. (i) Employer B maintains Plan O, a defined benefit plan, and Plan P, a defined contribution plan. All of the six employees of Employer B are covered under both Plan O and Plan P. Under Plan O, all employees have a uniform normal accrual rate of 1% of compensation. Under Plan P, Employees A and B, who are HCEs, receive an allocation rate of 15%, and participants C, D, E and F, who are NHCEs, receive an allocation rate of 3%. Employer B aggregates Plans O and P for purposes of satisfying sections 410(b) and 401(a)(4). The equivalent normal allocation and normal accrual rates under Plans O and P are as follows:

| Employee | Equivalent Normal Allocation Rates for the 1% Accrual under Plan O (defined benefit plan) | Equivalent Normal Accrual Rates for the 15%/3% Allocations under Plan P (defined contribution plan) |
|---|---|---|
| HCE A (age 55) | 3.93% | 3.82% |
| HCE B (age 50) | 2.61% | 5.74% |
| C (age 60) | 5.91% | .51% |
| D (age 45) | 1.74% | 1.73% |
| E (age 35) | .77% | 3.90% |
| F (age 25) | .34% | 8.82% |

(ii) Although all of the NHCEs benefit under Plan O (the defined benefit plan), the aggregated DB/DC plan is not primarily defined benefit in character because the normal accrual rate attributable to defined benefit plans (which is 1% for each of the NHCEs) is greater than the equivalent accrual rate under defined contribution plans only for Employee C. In addition, because the 15% allocation rate is available only to HCEs, the defined contribution plan cannot satisfy the requirements of §1.401(a)(4)–2 and does not have broadly available allocation rates within the meaning of §1.401(a)(4)–8(b)(1)(iii). Further, the defined contribution plan does not satisfy the minimum allocation gateway of §1.401(a)(4)–8(b)(1)(vi) (3% is less than 1/3 of the 15% HCE rate). Therefore, the defined contribution plan within the DB/DC plan cannot separately satisfy §1.401(a)(4)–1(b)(2) and does not constitute a broadly available separate plan within the meaning of paragraph (b)(2)(v)(C) of this section. Accordingly, the aggregated plans are permitted to demonstrate satisfaction of the nondiscrimination in amounts requirement of §1.401(a)(4)–1(b)(2) on the basis of benefits only if the aggregated plans satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

(iii) Employee A has an aggregate normal allocation rate of 18.93% under the aggregated plans (3.93% from Plan O plus 15% from Plan P), which is the highest aggregate normal allocation rate for any HCE under the plans. Employee F has an aggregate normal allocation rate of 3.34% under the aggregated plans (.34% from Plan O plus 3% from Plan P) which is less than the 5% aggregate normal allocation rate that Employee F would be required to have to satisfy the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

(iv) However, for purposes of satisfying the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section, Employer B is permitted to treat each NHCE who benefits under Plan O (the defined benefit plan) as having an equivalent allocation rate equal to the average of the equivalent allocation rates under Plan O for all NHCEs benefitting under that plan. The average of the equivalent allocation rates for all of the NHCEs under Plan O is 2.19% (the sum of 5.91%, 1.74%, .77%, and .34%, divided by 4). Accordingly, Employer B is permitted to treat all of the NHCEs as having an equivalent allocation rate attributable to Plan O equal to 2.19%. Thus, all of the NHCEs can be treated as having an aggregate normal allocation rate of 5.19% for this purpose (3% from the defined contribution plan and 2.19% from the defined benefit plan) and the aggregated DB/DC plan satisfies the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section.

* * * * *

(c) * * *

(3) * * *

(ii) *Restructuring not available for certain testing purposes*. The safe harbor in §1.401(a)(4)–2(b)(3) for plans with uniform points allocation formulas is not available in testing (and thus cannot be satisfied by) contributions under a component plan. Similarly, component plans cannot be used for purposes of determining whether a plan provides broadly available allocation rates (as defined in §1.401(a)(4)–8(b)(1)(iii)), determining whether a plan has a gradual age or service schedule (as defined in §1.401 (a)(4)–8(b)(1)(iv)), determining whether a plan has allocation rates that are based on a uniform target benefit allocation (as defined in §1.401(a)(4)–8(b)(1)(v)), or determining whether a plan is primarily defined benefit in character or consists of broadly available separate plans (as defined in paragraphs (b)(2)(v)(B) and (C) of this section). In addition, the minimum allocation gateway of §1.401(a)(4)–8(b)(1)(vi) and the minimum aggregate allocation gateway of paragraph (b)(2)(v)(D) of this section cannot be satisfied on the basis of component plans. See §§1.401(k)–1(b)(3)(iii) and 1.401(m)–1(b)(3)(iii) for rules regarding the inapplicability of restructuring to section 401(k) plans and section 401(m) plans.

* * * * *

Par. 5. Section 1.401(a)(4)–12 is amended by adding a sentence to the end of the definition of *Standard mortality table* to read as follows:

*§1.401(a)(4)–12 Definitions.*

* * * * *

*Standard mortality table.* * * * The applicable mortality table under section 417(e)(3)(A)(ii)(I) is also a standard mortality table.

* * * * *

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

Approved June 21, 2001.

Mark Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on June 28, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 29, 2001, 66 F.R. 34545)

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

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

**LIFO; price indexes; department stores.** The May 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, May 31, 2001.

## Rev. Rul. 2001–35

The following Department Store Inventory Price Indexes for May 2001 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, May 31, 2001.

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

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

| | Groups | May 2000 | May 2001 | Percent Change from May 2000 to May 2001[1] |
|---|---|---|---|---|
| 1. | Piece Goods | 501.7 | 491.2 | -2.1 |
| 2. | Domestics and Draperies | 620.4 | 598.8 | -3.5 |
| 3. | Women's and Children's Shoes | 642.2 | 653.9 | 1.8 |
| 4. | Men's Shoes | 923.1 | 889.7 | -3.6 |
| 5. | Infants' Wear | 641.0 | 625.4 | -2.4 |
| 6. | Women's Underwear | 573.4 | 570.4 | -0.5 |
| 7. | Women's Hosiery | 335.1 | 352.0 | 5.0 |
| 8. | Women's and Girls' Accessories | 543.4 | 553.1 | 1.8 |
| 9. | Women's Outerwear and Girls' Wear | 401.5 | 394.6 | -1.7 |
| 10. | Men's Clothing | 623.7 | 595.5 | -4.5 |
| 11. | Men's Furnishings | 636.3 | 619.2 | -2.7 |
| 12. | Boys' Clothing and Furnishings | 502.5 | 497.1 | -1.1 |
| 13. | Jewelry | 943.4 | 934.7 | -0.9 |
| 14. | Notions | 775.9 | 776.3 | 0.1 |
| 15. | Toilet Articles and Drugs | 971.1 | 947.8 | -2.4 |
| 16. | Furniture and Bedding | 672.5 | 641.8 | -4.6 |
| 17. | Floor Coverings | 608.6 | 623.7 | 2.5 |
| 18. | Housewares | 779.4 | 767.1 | -1.6 |
| 19. | Major Appliances | 233.7 | 224.3 | -4.0 |

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

| Groups | May 2000 | May 2001 | Percent Change from May 2000 to May 2001[1] |
|---|---|---|---|
| 20. Radio and Television | 60.1 | 54.7 | -9.0 |
| 21. Recreation and Education[2] | 93.9 | 90.2 | -3.9 |
| 22. Home Improvements[2] | 128.5 | 125.7 | -2.2 |
| 23. Auto Accessories[2] | 106.5 | 108.9 | 2.3 |
| Groups 1 - 15: Soft Goods | 604.5 | 594.0 | -1.7 |
| Groups 16 - 20: Durable Goods | 438.3 | 423.0 | -3.5 |
| Groups 21 - 23: Misc. Goods[2] | 100.9 | 98.6 | -2.3 |
| Store Total[3] | 542.5 | 530.8 | -2.2 |

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

[2] Indexes on a January 1986 =100 base.

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

DRAFTING INFORMATION

The principal author of this revenue ruling is Alan J. Tomsic of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic at (202) 622-4970 (not a toll-free call).

## Section 6302.—Mode or Time of Collection

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

## T.D. 8952

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1, 31, 35, 36, 40, 301, and 601

## Removal of Federal Reserve Banks as Federal Depositaries

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations which remove the Federal Reserve Banks as authorized depositaries for Federal tax deposits. The regulations affect taxpayers who make Federal tax deposits using paper Federal Tax Deposit (FTD) coupons (Form 8109) at Federal Reserve Banks.

DATES: *Effective Date*: These regulations are effective June 26, 2001.

*Applicability Date:* These regulations apply to deposits made after December 31, 2000.

FOR FURTHER INFORMATION CONTACT: Brinton T. Warren (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION

**Background**

This document contains amendments to 26 CFR parts 1, 31, 35, 36, 40, 301, and 601 relating to Federal tax deposits under section 6302(c) of the Internal Revenue Code (Code). On December 26, 2000, temporary regulations (T.D. 8918, 2001–4 I.R.B. 372) relating to the removal of Federal Reserve Banks as federal depositaries were published in the **Federal Register** (65 FR 81356). A notice of proposed rulemaking (REG–107176–00, 2001–4 I.R.B. 428) that proposed the removal of Federal Reserve Banks as federal depositaries was published in the **Federal Register** for the same day (65 FR 81453). No comments were received from the public in response to the notice of proposed rulemaking.

**Explanation of Provisions**

These final regulations, which permanently remove Federal Reserve Banks as authorized depositaries for Federal tax deposits, adopt the rules of the proposed regulations and remove the corresponding temporary regulations. The term Federal Reserve Bank includes twelve banks and their approximately two dozen branches that constitute the nation's central banking system. The term does not include the thousands of federally and state chartered banks that are recognized as members of the Federal Reserve System. Accordingly, these final regulations do not affect Federal Tax Deposits (FTDs) made with paper coupons at any of the more than 10,000 financial institutions nationwide that serve as Treasury Tax and Loan (TT&L) depositaries. Deposits made through the Electronic Federal Tax Payment System (EFTPS) are also not affected.

**Special Analyses**

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

**Drafting Information**

The principal author of these regulations is Brinton T. Warren of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, and under the authority of 26 U.S.C. 7805 and 5 U.S.C. 301, 26 CFR parts 1, 31, 35, 36, 40, 301 and 601 are amended as follows:

PART 1—INCOME TAXES

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

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

**§1.6302–1 [Amended]**

Par. 2. Section 1.6302–1 is amended by removing the fifth sentence in paragraph (b)(1).

**§1.6302–2 [Amended]**

Par. 3. Section 1.6302–2 is amended by removing the third sentence in paragraph (b)(1).

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

Par. 4. The authority citation for part 31 continues to read in part as follows:

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

**§31.6302–1 [Amended]**

Par. 5. Section 31.6302–1 is amended by removing the fourth sentence in paragraph (i)(3).

**§31.6302(c)–3 [Amended]**

Par. 6. Section 31.6302(c)–3 is amended by removing the third sentence in paragraph (b)(2).

PART 301—PROCEDURE AND ADMINISTRATION

Par. 7. The authority for part 301 continues to read in part as follows:

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

**§301.6302–1T [Removed]**

Par. 8. Section 301.6302–1T is removed.

**PARTS 1, 31, 35, 36, 40, 301, 601 [AMENDED]**

Par. 9. In the list below, for each section indicated in the left column, remove the language in the middle column and add, if any, the language in the right column:

| *Section* | *Remove* | *Add* |
|---|---|---|
| 1.1461–1(a)(1), first sentence | a Federal reserve bank or | an |
| 1.1502–5(a)(1), fourth sentence | commercial dispositary or Federal Reserve Bank | financial institution |
| 1.6151–1(d)(1) | Federal Reserve Banks or | |
| 1.6302–1(b)(1) fourth sentence | 214 or, at the election of the corporation, to a Federal Reserve bank | 203 |
| 1.6302–1(b)(1), fifth sentence | the Federal Reserve bank or | |
| 1.6302–2(a)(1)(i), first sentence | a Federal Reserve bank or | an |
| 1.6302–2(a)(1)(ii), first sentence | a Federal Reserve bank or | an |
| 1.6302–2(a)(1)(iv), first sentence | a Federal Reserve bank or | an |
| 1.6302–2(b)(1), second sentence | 214 or, at the election of the withholding agent, to a Federal Reserve bank | 203 |
| 1.6302–2(b)(1), third sentence | the Federal Reserve bank or | |
| 1.6302–3(a) | or with a Federal Reserve Bank | |
| 31.6071(a)–1(a)(1), last sentence | or by a Federal Reserve bank | |

| *Section* | *Remove* | *Add* |
|---|---|---|
| 31.6071(a)–1(c), last sentence | a Federal Reserve bank or by | |
| 31.6151–1(b), first sentence | Federal Reserve banks and | |
| 31.6302–1(c)(1), first sentence | a Federal Reserve bank or | an |
| 31.6302–1(c)(2)(i) introductory text | a Federal Reserve bank or | an |
| 31.6302–1(c)(3) | a Federal Reserve bank or | an |
| 31.6302–1(i)(3) introductory text, first sentence | 214 or, at the election of the employer, to a Federal Reserve bank | 203 |
| 31.6302–1(i)(5) | the Federal Reserve bank or | |
| 31.6302(c)–2A(b)(1)(i) | with a Federal Reserve bank or | |
| 31.6302(c)–2A(b)(3) | with a Federal Reserve bank or | |
| 31.6302(c)–3(a)(1)(i) | with a Federal Reserve bank or | |
| 31.6302(c)–3(a)(1)(ii) | with a Federal Reserve bank or | |
| 31.6302(c)–3(a)(3) | with a Federal Reserve bank or | |
| 31.6302(c)–3(b)(2) second sentence | 214 or, at the election of the employer, to a Federal Reserve bank | 203 |
| 31.6302(c)–3(b)(2), third sentence | the Federal Reserve bank or | |
| 35.3405–1T e–10A., first sentence | a Federal Reserve Bank or | |
| 36.3121(l)(10)–4 | a Federal Reserve bank or | an |
| 40.6302(c)–1(d)(1) | 214) or to a Federal Reserve bank | 203) |
| 301.6302–1(a) | Federal Reserve banks and authorized commercial banks | authorized financial institutions |
| 301.6302–1(b)(1) | Federal Reserve banks or authorized commercial banks | authorized financial institutions |
| 301.6302–1(b)(2) | Federal Reserve banks or authorized commercial banks | authorized financial institutions |
| 301.9100–5T(c) concluding text | Federal Reserve banks and | |
| 601.401(a)(5) heading | Federal Reserve banks and | |
| 601.401(a)(5)(iii) first sentence | a Federal Reserve bank or | an |
| 601.401(a)(5)(iii) second sentence | a Federal Reserve bank or | an |
| 601.401(a)(5)(iv), first sentence | a Federal Reserve bank or a financial institution authorized in accordance with Treasury Department Circular No. 1079, revised, to accept remittances of these taxes for transmission to a Federal Reserve bank | an authorized financial institution |

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved June 15, 2001.

Mark A. Weinberger,
*Assistant Secretary*
*of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on June 25, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 26, 2001, 66 F.R. 33830)

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## Section 6323.—Validity and Priority Against Certain Persons

*26 CFR 301.6323(j)–1: Withdrawal of notice of federal tax lien in certain circumstances.*

### T.D. 8951

### DEPARTMENT OF THE TREASURY
### Internal Revenue Service
### 26 CFR Part 301

### Withdrawal of Notice of Federal Tax Lien in Certain Circumstances

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations relating to the withdrawal of notices of federal tax liens in certain circumstances. The final regulations reflect changes made to section 6323 of the Internal Revenue Code of 1986 by the Taxpayer Bill of Rights 2. The final regulations affect all taxpayers seeking withdrawals of notices of federal tax liens.

EFFECTIVE DATE: These regulations apply on or after June 22, 2001.

FOR FURTHER INFORMATION CONTACT: Kevin B. Connelly, (202) 622-3630 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to the withdrawal of notices of federal tax liens under section 6323 of the Internal Revenue Code (Code). Section 501(a) of the Taxpayer Bill of Rights 2 (TBOR2), Public Law 104–168, 110 Stat. 1452 (1996), amended section 6323 to authorize the Secretary to withdraw a notice of federal tax lien in certain limited circumstances. Section 501(a) also requires the Secretary to notify credit reporting agencies, financial institutions, and creditors of the withdrawal upon the written request of the taxpayer. On June 30, 1999, a notice of proposed rulemaking (REG–101519–97, 1999–2 C.B. 114) reflecting these changes was published in the **Federal Register** (64 FR 35102). Several parties commented on the notice of proposed rulemaking and a hearing was held on November 30, 1999. The final regulations are adopted with minor changes.

**Explanation of Provisions**

Section 501(a) of TBOR2 amended section 6323 of the Code by authorizing the Secretary to withdraw a notice of federal tax lien under certain conditions and providing that upon written request of the taxpayer the Secretary will notify any credit reporting agency and any financial institution or creditor identified by the taxpayer. These regulations implement section 501(a).

The proposed regulations provided that the district director had the authority to withdraw a notice of federal tax lien if the district director determined that one of the four conditions enumerated in paragraph (b) of the regulations existed. Because of the reorganization of the Internal Revenue Service (IRS), which eliminated the district director position, the final regulations provide that the Commissioner or his delegate (Commissioner) may withdraw a notice of federal tax lien under the proper conditions.

The notice of federal tax lien is withdrawn by filing a notice of withdrawal in the office in which the notice of federal tax lien is filed and providing the taxpayer with a copy of the notice. Following the withdrawal of a notice of federal tax lien, chapter 64 of subtitle F, relating to collection, is applied as if the IRS had never filed a notice of federal tax lien. The withdrawal of a notice of federal tax lien does not affect the underlying tax lien. The withdrawal simply relinquishes any lien priority the IRS had obtained under section 6323 of the Code when the IRS filed the notice being withdrawn.

Paragraph (b) of the regulations provides that the Commissioner has the authority to withdraw a notice of federal tax lien if one of the following conditions exists: (1) the filing of the notice of federal tax lien was premature or otherwise not in accordance with the administrative procedures of the Secretary; (2) the taxpayer has entered into an agreement under section 6159 to satisfy the liability for which the lien was imposed by means of installment payments, unless the agreement by its terms provides that the notice will not be withdrawn; (3) the withdrawal of notice will facilitate collection of the tax liability for which the lien was imposed; or (4) the withdrawal of notice is in the best interests of the taxpayer and the United States.

A new example has been added (*Example 1*) that illustrates when the Commissioner may withdraw a notice of federal tax lien under paragraph (b)(1) because the IRS failed to follow administrative procedures when filing notice. Each example now refers to just one of the four withdrawal criteria under paragraph (b)(1). In addition, the examples have been renumbered to correspond to the numbers of the criteria in paragraph (b) that the examples illustrate.

One of the commenting parties recommended that the final regulations define the terms "facilitate collection" and "best interests of the taxpayer and the United States," found in paragraphs (b)(3) and (b)(4). The final regulations purposely do not define these terms. Congress intended "to give the IRS discretion to withdraw a notice of lien" in these circumstances. H.R. Rep. No. 506, 104th Cong., 2d Sess. 32 (Mar. 28, 1996). The circumstances under which a lien may be withdrawn are inherently factual. Further refinement of the statutory terms may unnecessarily limit the IRS's ability to withdraw a notice where appropriate.

A commenting party asked the IRS to add a paragraph providing that, if the National Taxpayer Advocate (or his delegate) determines that a taxpayer is suffering or about to suffer a significant hardship, the National Taxpayer Advocate (or his delegate) may, in appropriate cases, issue a taxpayer assistance order

(TAO) requiring the Commissioner to withdraw a notice of federal tax lien. This issue, concerning whether the National Taxpayer Advocate (or his delegate) may issue a TAO ordering the withdrawal of a notice, involves an interpretation of section 7811, and the authority granted to the National Taxpayer Advocate, which are not pertinent to this regulation.

The final regulations provide that a person may request the withdrawal of a notice of federal tax lien by writing to the Commissioner. A written request for withdrawal must include: (1) the name, current address, and taxpayer identification number of the person requesting withdrawal of the notice of federal tax lien; (2) a copy of the notice of federal tax lien affecting the property, if available; (3) the grounds upon which the withdrawal of notice of federal tax lien is being requested; (4) a list of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the Commissioner to notify of the withdrawal of notice of federal tax lien; and (5) a request to disclose information relating to the withdrawal to the persons or entities listed.

The Commissioner must consider each taxpayer's request for withdrawal of notice of federal tax lien and determine whether any of the conditions authorizing withdrawal exist and whether to issue a withdrawal. The Commissioner also may issue a notice of withdrawal based on information received from a source other than the taxpayer.

If the Commissioner grants a request for the withdrawal of notice of federal tax lien, the taxpayer may supplement the list of credit reporting agencies and financial institutions or creditors provided with the request for withdrawal. If no list was submitted with the request for withdrawal, a list may be submitted after the notice is withdrawn. A request to supplement the list must be sent in writing to the Commissioner. The request must contain: (1) the name, current address, and taxpayer identification number of the person requesting the notification; (2) a copy of the notice of withdrawal; (3) the names and addresses of the persons or entities the taxpayer wishes the IRS to contact; and (4) a request to disclose the withdrawal to the persons or entities listed.

A commenting party suggested that the IRS send notification to credit agencies and financial institutions by certified mail. Certified mail generally is required where there is a statute of limitations dependent on service. This is not the case with respect to notification under section 6323(j)(2).

A commenting party also requested that language be added to the regulations stating that, upon receipt of notification that the IRS has withdrawn a notice of federal tax lien, a credit agency will be immune from any damage claim a taxpayer may have against it for its handling of the notice if the credit agency acts within reasonable time after receiving notice. The statute simply instructs the IRS to notify credit agencies of a notice of withdrawal upon request of the taxpayer. The IRS does not have the statutory authority to shield a credit agency from a taxpayer's claim for damages due to how the credit agency handled the notice.

The regulations will be applicable on or after June 22, 2001, with respect to withdrawals of any notice of federal tax lien occurring after such date regardless of when the notice was filed.

**Special Analyses**

It has been determined that this final regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the collection of information in the regulations is exempt pursuant to 5 U.S.C. 601(7)(B), the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

**Drafting Information**

The principal author of these regulations is Kevin B. Connelly, Office of Associate Chief Counsel (Procedure and Administration), Collection Bankruptcy & Summons Division, CC:PA:CBS, IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Final Amendments to the Regulations**

Accordingly, the IRS amends 26 CFR part 301 as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.6323(j)–1 is added to read as follows:

*§301.6323(j)–1 Withdrawal of notice of federal tax lien in certain circumstances.*

(a) *In general.* The Commissioner or his delegate (Commissioner) may withdraw a notice of federal tax lien filed under this section, if the Commissioner determines that any of the conditions in paragraph (b) of this section exist. A notice of federal tax lien is withdrawn by the filing by the Commissioner of a notice of withdrawal in the office in which the notice of federal tax lien is filed. If a notice of withdrawal is filed, chapter 64 of subtitle F, relating to collection, will be applied as if the withdrawn notice had never been filed. A copy of the notice of withdrawal will be provided to the taxpayer. Upon written request by a taxpayer with respect to whom a notice of federal tax lien has been or will be withdrawn, the Commissioner will promptly make reasonable efforts to notify any credit reporting agency and any financial institution or creditor identified by the taxpayer of the withdrawal of such notice. The withdrawal of a notice of federal tax lien will not affect the underlying federal tax lien.

(b) *Conditions authorizing withdrawal*. The Commissioner may authorize the withdrawal of a notice of federal tax lien upon determining that one of the following conditions exists:

(1) *Premature or not in accordance with administrative procedures*. The filing of the notice of federal tax lien was premature or otherwise not in accordance with the administrative procedures of the Secretary.

(2) *Installment agreement*. The taxpayer has entered into an agreement under section 6159 to satisfy the liability for

which the lien was imposed by means of installment payments. Entry into an installment agreement may not, however, be the basis for withdrawal of a notice of lien if the installment agreement specifically provides that a notice of federal tax lien will not be withdrawn.

(3) *Facilitate collection*. The withdrawal of the notice of federal tax lien will facilitate the collection of the tax liability for which the lien was imposed.

(4) *Best interests of the United States and the taxpayer*—(i) *In general*. The taxpayer or the National Taxpayer Advocate (or his delegate) has consented to the withdrawal of the notice of federal tax lien, and withdrawal of the notice would be in the best interest of the taxpayer, as determined by the taxpayer or the National Taxpayer Advocate (or his delegate), and in the best interest of the United States, as determined by the Commissioner.

(ii) *Best interest of the taxpayer*. When a taxpayer requests the withdrawal of notice of federal tax lien based on the best interests of the United States and the taxpayer, the National Taxpayer Advocate (or his delegate) generally will determine whether the withdrawal of the notice of federal tax lien is in the best interest of the taxpayer. If, however, a taxpayer requests the Commissioner to withdraw a notice and has not specifically requested the National Taxpayer Advocate (or his delegate) to determine the taxpayer's best interest, a finding by the Commissioner that the withdrawal of notice is in the best interest of the taxpayer will be sufficient to support withdrawal. If the Commissioner decides independently of a request by the taxpayer to withdraw a notice of federal tax lien, the taxpayer or the National Taxpayer Advocate (or his delegate) must consent to the withdrawal.

(5) *Examples*. The following examples illustrate the provisions of this paragraph (b):

*Example 1*. A owes $1,000 in Federal income taxes. The IRS files a notice of federal tax lien to secure A's tax liability. However, the IRS failed to follow procedure provided by the Internal Revenue Manual (but not required by statute) with regard to managerial approval prior to the filing of a notice of federal tax lien. The Commissioner may withdraw the notice of federal tax lien because the filing of the notice was not in accordance with the Secretary's administrative procedures.

*Example 2*. A owes $1,000 in federal income taxes. A enters into an agreement to pay the outstanding federal income tax liability in installments. The agreement provides that a notice of federal tax lien may be filed if the taxpayer defaults. A timely pays the installments each month and has not defaulted in any way. Eleven months after entering into the installment agreement, the Internal Revenue Service files a notice of federal tax lien. Noting that there has been no default, the taxpayer asks the Internal Revenue Service to withdraw the notice of federal tax lien. In this situation, the Commissioner may withdraw the notice of federal tax lien because the taxpayer has entered into an installment agreement.

*Example 3*. A is an employee of X Corporation. A notice of federal tax lien has been filed to secure an outstanding tax liability against A. A, who has no assets and no other secured creditors, has agreed to pay the balance of tax due through payroll deductions at a rate higher than the Internal Revenue Service could obtain through a wage levy in order to get the notice of federal tax lien withdrawn. X Corporation has agreed to allow A to enter into a payroll deduction agreement. In this situation, the Commissioner may withdraw the notice of federal tax lien to facilitate collection.

*Example 4*. A is owner of a farm machinery dealership against whom a notice of federal tax lien has been filed to secure an outstanding tax liability. A currently is paying the tax liability by an installment agreement. X Corporation has agreed to provide A with 100 tractors to increase A's inventory if the notice of federal tax lien is withdrawn. A asks the Internal Revenue Service to withdraw the notice of federal tax lien. The Commissioner determines that the larger inventory would enable A to generate additional tractor sales. Increased sales would enable A to increase the amount of installment payments and, consequently, reduce the amount of time needed to satisfy the liability. A, who has no other assets or secured creditors, has agreed to modify the installment agreement. The Commissioner may withdraw the notice of federal tax lien because the withdrawal is in the best interest of the taxpayer and the United States.

(c) *Determinations by the Commissioner.* The Commissioner must determine whether any of the conditions authorizing the withdrawal of a notice of federal tax lien exist if a taxpayer submits a request for withdrawal in accordance with paragraph (d) of this section. The Commissioner may also make this determination independent of a request from the taxpayer based on information received from a source other than the taxpayer. If the Commissioner determines that conditions authorizing the withdrawal are not present, the Commissioner may not authorize the withdrawal. If the Commissioner determines conditions for withdrawal are present, the Commissioner may (but is not required to) authorize the withdrawal.

(d) *Procedures for request for withdrawal*—(1) *Manner*. A request for the withdrawal of a notice of federal tax lien must be made in writing in accordance with procedures prescribed by the Commissioner.

(2) *Form.* The written request will include the following information and documents—

(i) Name, current address, and taxpayer identification number of the person requesting the withdrawal of notice of federal tax lien;

(ii) A copy of the notice of federal tax lien affecting the taxpayer's property, if available;

(iii) The grounds upon which the withdrawal of notice of federal tax lien is being requested;

(iv) A list of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the Commissioner to notify of the withdrawal of notice of federal tax lien; and

(v) A request to disclose the withdrawal of notice of federal tax lien to the persons listed in paragraph (d)(2)(iv) of this section.

(e) *Supplemental list of credit agencies, financial institutions, and creditors*—(1) *In general.* If the Commissioner grants a withdrawal of notice of federal tax lien, the taxpayer may supplement the list in paragraph (d)(2)(iv) of this section. If no list was provided in the request to withdraw the notice of federal tax lien, the list in paragraph (d)(2)(iv) of this section and the request for notification in paragraph (d)(2)(v) of this section may be submitted after the notice is withdrawn.

(2) *Manner*. A request to supplement the list of any credit agencies and any financial institutions or creditors that the taxpayer wishes the Commissioner to notify of the withdrawal of notice of federal tax lien must be made in writing in accordance with procedures prescribed by the Commissioner.

(3) *Form*. The request must include the following information and documents—

(i) Name, current address, and taxpayer identification number of the taxpayer requesting the notification of any credit agency or any financial institution or creditor of the withdrawal of notice of federal tax lien;

(ii) A copy of the notice of withdrawal, if available;

(iii) A supplemental list, identified as such, of the names and addresses of any credit reporting agency and any financial institution or creditor that the taxpayer wishes the Commissioner to notify of the withdrawal of notice of federal tax lien; and

(iv) A request to disclose the withdrawal of notice of federal tax lien to the persons listed in paragraph (e)(3)(iii) of this section.

(f) *Effective date*. This section applies on or after June 22, 2001, with respect to a withdrawal of any notice of federal tax lien.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

Approved June 13, 2001.

Mark A. Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on June 21, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 22, 2001, 66 F.R. 33464)

# Part IV. Items of General Interest

## Withdrawal of Notices of Proposed Rulemaking

## Withdrawal of Proposed Regulations Relating to Corporations Filing Consolidated Returns and Proposed Regulations Relating to Collapsible Corporations

## REG–100548–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notices of proposed rulemaking.

SUMMARY: This document withdraws two notices of proposed rulemaking, one relating to corporations filing consolidated income tax returns and the other relating to collapsible corporations. The proposed regulations were published before the enactment of the Internal Revenue Code of 1986, do not reflect changes to the tax law made after their publication, and will not be finalized unless reproposed.

DATES: These proposed regulations are withdrawn June 27, 2001.

FOR FURTHER INFORMATION CONTACT: Charles M. Whedbee (202) 622-7550 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

**Background**

On July 31, 1984, the IRS issued proposed regulations (LR–97–79, 1984–2 C.B. 821) relating to corporations filing consolidated returns (49 FR 30528). Portions of these proposed consolidated return regulations were withdrawn by subsequent notices of proposed rulemaking (CO–78–90, 1991–1 C.B. 757 and REG–103805–99, 2000–42 I.R.B. 376) published in the **Federal Register** on February 4, 1991 (56 FR 4228) and September 26, 2000 (65 FR 57755).

On August 31, 1984, the IRS issued proposed regulations (LR–107–84, 1984–2 C.B. 902) relating to collapsible corporations (49 FR 34523).

The IRS is withdrawing these proposed regulations because of intervening amendments to the Internal Revenue Code and because these regulations projects will not be undertaken in the foreseeable future (or if undertaken, the regulations will be reproposed).

**Drafting Information**

The principal author of this withdrawal notice is Charles M. Whedbee of the Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury participated in its development.

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**Withdrawal of Notices of Proposed Rulemaking**

Accordingly, under the authority of 26 U.S.C. 7805, the notices of proposed rulemaking published in the **Federal Register** on July 31, 1984 (49 FR 30528) and August 31, 1984 (49 FR 34523) are withdrawn.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on June 26, 2001, 8:45 a.m., and published in the issue of the Federal Register for June 27, 2001, 66 F.R. 34136)

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## Foundations Status of Certain Organizations

## Announcement 2001–76

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

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

ACFE Foundation, Inc., Springfield, MO
Akaryd Trust, Inc., Leawood, KS
American Institute of Jewish Studies, Overland Park, KS
American Neuropsychiatric Association, Detroit, MI
Another Way the Fund for Progress, Wichita, KS
Association for a Free Burma, Fairbanks, AK
Avonda Land, Inc., St. Louis, MO
Bethany Free Methodist Church-District 40 School Historical Preservation Society, Inc., Bennington, KS
Beyond Bounds, Inc., Kansas City, MO
Biblical Archeology Educational Services, Inc., Lincoln, NE
Bismarck-Mandan Interfaith Hospitality Network, Bismarck, ND
Boomerang Kids, Inc., Kirksville, MO
Boonslick Area Citizens Advisory Board, Columbia, MO
Box Butte County Family Focus Coalition, Inc., Alliance, NE
Boys and Girls Club of Standing Rock, Fort Yates, ND
Brown Hotel, Inc., Neodesha, KS
Brown Institute Association of Topeka, Topeka, KS
BSDC Foundation, Inc., Beatrice, NE
Call to Commitment, Branson, MO
Capital City Men of Integrity, Jefferson City, MO
Care of Poor People, Inc., Kansas City, MO
City Sprouts, Inc., Omaha, NE
Civil War Round Table of Wilmington Delaware, Inc., Wilmington, DE
Concerned Citizens for Topeka, Inc., Topeka, KS
Crawford County Domestic Violence Coalition, Steelville, MO
Crete Athletic Booster Club, Inc., Crete, NE
Crown, Inc., Fulton, MO
Dakota Flyers, Inc., Fargo, ND
Derby Historical Society, Derby, KS
Divine Resurrection Ministries, Inc., Oakland, CA
Dolan Residential Care Centers, Inc., Chesterfield, MO
Douglas County Fire-Rescue Departments, Inc., Boys Town, NE
Eagle Feather Indian Center, Inc., Minot, ND
Emerald Door, Inc., Fargo, ND

En Gedi Ministries, Inc., Branson, MO
Eye Laser Center, Springfield, MO
Fargo-Moorehead Express, Inc., Saint Paul, MN
Farm & Ranch Educational Exchange, Morrill, NE
First Place Racing Ministries Foundation, Lawrence, KS
Flying Circus Air and Sea Museum, Gravois Mills, MO
Fowler Hospital District, Inc., Fowler, KS
Freedom Prison Ministries, Inc., Minot, ND
Friends of Kagawad, St. Louis, MO
Gateway Moo Do Kwan Association, Inc., St. Louis, MO
Gentle Giants Equestrian Therapy, Incorporation, Russell, KS
Gladd, Inc., Jefferson City, MO
Greater Missouri Area C.A., University City, MO
Greater St. Louis Community Prevention Partnership, St. Louis, MO
Greater St. Louis Regional, Inc., St. Louis, MO
Greenway Manor Resident Management Association, Inc., Wichita, KS
Grundy County R-VI Instructional Fund, Inc., Trenton, MO
Harvey Sports Boosters, Harvey, ND
Heartland Dance Company, Bellevue, NE
Henderson Health Care Foundation, Henderson, NE
Home Charitable Foundation, Kensington, KS
Idhal, Inc., Poplar Bluff, MO
Igbo Union of St. Louis, Inc., Florissant, MO
Improve the Educational Process, Inc., Topeka, KS
Innovation Institute, Inc., Lawrence, KS
John H. Hinrichs PDCA Scholarship Fund, St. Louis, MO
Johnson County Volleyball Club, Inc., Kansas City, KS
Juda, Inc., Buffalo Gap, SD
Kanarts, Incorporated, Lawrence, KS
Kansas Business Education Coalition, Inc., Overland Park, KS
Kansas City Irish Festival Organization, Olathe, KS
Kansas International Museum, Inc., Topeka, KS
Kansas Search & Rescue Dog Association, Topeka, KS
Kanza Development, Inc., Wilson, KS
Kids Can Foundation, Inc., Blair, NE
Kids First, Inc., Independence, MO
Kidspace Childrens Museum, Inc., Springfield, MO
Kinder Town, Inc., Waverly, KS
La Roca Boxing Club of Leavenworth, Leavenworth, KS
Lawson Cardinal Soccer Club, Lawson, MO
Lexington Senior Center, Inc., Lexington, MO
Liberty Area Chamber Community Foundation, Inc., Liberty, MO
Long Time Coming, Inc., Kansas City, MO
Maize Youth Baseball & Softball Association, Maize, KS
Masonic Charity Fund of Wichita AF&AM, Inc., Wichita, KS
May Morley Elementary School Parent Teacher Organization, Lincoln, NE
Merry Go Round Day Care Center, Inc., Boonville, MO
Midwest Ecological Resources Foundation, Inc., Lawrence, KS
Midwest Railroad Workers Scholarship Foundation, St. Louis, MO
Mission Out-Reach to Siberia, Frohna, MO
Missouri Kids with Neimann-Pick C, Imperial, MO
Molly M. Rickel Research Library, Inc., Manhattan, KS
Myria Lee Youth House, St. Louis, MO
Native American Foundation of Nebraska, Lincoln, NE
Nebraska Operation Lifesaver, Lincoln, NE
New Wineskins, Inc., Omaha, NE
Noel Community Development Council, Inc., Noel, MO
North American Fiddlers Association - NAFA, Warrenburg, MO
North Dakota Olympic Dreamers, Inc., Williston, ND
North Kansas City Kiwanis Foundation, Gladstone, MO
Old Engine Company 8, Inc., Ottawa, KS
Omicron XI Foundation, Kansas City, MO
Optimist Club of Deep River - Northview North Carolina, Sanford, NC
Over the Road Gang, Inc., Ottawa, KS
Pakistan American Society of Greater Kansas City, Olathe, KS
Parshall 2000, Inc., Parshall, ND
Parsons Community Service Fund, Inc., Parsons, KS
Partners in Progress, Portland, ND
Pet Adoption & Welfare Society, Inc., Branson, MO
Peter Erickson Ministries, Inc., Fargo, ND
Pi Bear Childrens Charities, Inc., Hays, KS
Polk County Foundation, Inc., Osceola, NE
Posi-Rx, Wichita, KS
Quakes Softball, Inc., Omaha, NE
Ray Menefee Amateur Boxing Club, Inc., Lincoln, NE
Reno County Planning Council for Children and Families, Inc., Hutchinson, KS
Saddle Champ Therapeutic Riding Center, Inc., Kansas City, MO
Safe Harbor, Inc., Scottsbluff, NE
Saline County Fair Association, Marshall, MO
Sarcoidosis Resource Center of Delaware, Inc., Wilmington, DE
Seeds for Leadership, Talmage, NE
Senior Center of Carroll County, Carrollton, MO
S.E.T. Community Youth Center of the Kansas Business Womens Assn., Inc., Kansas City, KS
Shawnee Mission East Friends of the Arts, Inc., Prairie Village, KS
Shelton Township Library Foundation, Shelton, NE
Sioux Empire Housing Partnership, Inc., Sioux Falls, SD
Smart Motorcyclists Attend Rider Training, Inc., (S.M.A.R.T., Inc.), Topeka, KS
Soft Steps, Inc., Mandan, ND
Spirit Four Indian Center of Topeka, Inc., Topeka, KS
Splitrock Rail Station, Garretson, SD
St. Louis Advisory Board of Caring Communities, St. Louis, MO
St. Peters Beautification Task Force, Inc., St. Louis, MO
Stepping-Stone Ranch, Inc., Spearfish, SD
Sumner Youth Services, Inc., Wellington, KS
Teton Lakota Museum Board, Hill City, SD
Topeka Model Railroaders, Incorporated, Topeka, KS
Tuttle Area Development Corporation, Tuttle, ND
Veterans Foundation of America, Columbia, MO

Vietnam Veterans Support Foundation, Inc., Kansas City, MO
Voices of the Children Auxiliary Fund, Wichita, KS
Watertown Banquet, Watertown, SD
Watertown Inline Skating Association, Watertown, SD
Wilco Interagency Corporation, Fredonia, KS
Wilmington Youth Organization, Inc., Wilmington, DE

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

## Amendment of Qualified Plans for the Economic Growth and Tax Relief Reconciliation Act of 2001

## Notice 2001–42

I. Purpose

This notice provides guidance concerning amendments to plans qualified under §§ 401(a) and 403(a) of the Internal Revenue Code related to the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16 ("EGTRRA"). Changes made by EGTRRA to the Code provisions related to qualified plans include changes that require plan amendment to preserve qualification and changes that require plan amendment only if the plan sponsor chooses to change the plan.

The effects of this notice are to:

- avoid further delays in amending plans for GUST[1];
- prevent disruption of the GUST determination letter process that has already been undertaken by thousands of plan sponsors;
- facilitate timely adoption of EGTRRA plan amendments;
- ensure that plan terms reflect the actual operation of the plan;
- allow plan sponsors to minimize the cost and burden of adopting EGTRRA plan amendments;
- provide plan sponsors with the opportunity to retroactively amend their "good faith" EGTRRA plan amendments, if necessary; and
- facilitate the timely amendment of master and prototype ("M&P") and volume submitter plans ("pre-approved plans") for GUST and EGTRRA.

Specifically, this notice provides the following:

- The GUST remedial amendment period for individually designed plans, which ends on the last day of the 2001 plan year, is not being extended. However, a separate, later remedial amendment period is being provided for EGTRRA.
- The GUST remedial amendment period provided to prior adopters of pre-approved plans and employers that timely certify their intent to adopt a pre-approved plan that has been restated for GUST will be treated as not expiring earlier than December 31, 2002. This change will simplify the determination of the GUST amendment deadline for these plans and facilitate timely amendment of the plans for GUST and EGTRRA.
- A plan is required to have a "good faith" EGTRRA plan amendment in effect for a year if:
  (1) the plan is required to implement a provision of EGTRRA for the year, or the plan sponsor chooses to implement an optional provision of EGTRRA for the year, and
  (2) the plan language, prior to the amendment, is not consistent either with the provision of EGTRRA or with the operation of the plan in a manner consistent with EGTRRA, as applicable.
- Before the end of August 2001, the Service will publish sample EGTRRA plan amendments that plan sponsors and sponsors of pre-approved plans can adopt or use in drafting individualized plan amendments. A sample EGTRRA plan amendment, or a plan amendment that is materially similar to a sample EGTRRA plan amendment, will be a "good faith" EGTRRA plan amendment.
- Plan provisions that are amended by a timely "good faith" EGTRRA plan amendment or that automatically reflect a statutory EGTRRA change (for example, as a result of permitted incorporation by reference) have a remedial amendment period ending no earlier than the end of the 2005 plan year in which any needed retroactive remedial EGTRRA plan amendments may be adopted.
- "Good faith" EGTRRA plan amendments must be adopted no later than the later of (1) the end of the plan year in which the amendments are required to be, or are optionally, put into effect or (2) the end of the GUST remedial amendment period. In limited situations, earlier amendment may be required to avoid a decrease or elimination of benefits prohibited by § 411(d)(6).
- Individually designed plans submitted for GUST determination letters may reflect the changes made by EGTRRA. Also, pre-approved plans submitted for GUST determination letters may include EGTRRA amendments in the form of a separate, clearly identified addendum to the plan (or basic plan document) and/or adoption agreement that is limited to the provisions of EGTRRA. However, until further notice, determination, opinion, and advisory letters will not consider the EGTRRA changes.

II. Background

*Section 401(b).* Section 401(b) and the regulations thereunder provide a remedial amendment period during which an amendment to a disqualifying provision may be made retroactively effective, under certain circumstances, to comply with the requirements of § 401(a). Section 1.401(b)–1(b)(3) authorizes the Commissioner to designate as a disqualifying provision under § 401(b) a plan provision that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements, or (2) is integral to a qualification requirement that has been changed. Section 1.401(b)–1(c)(3) authorizes the Commissioner to impose limits and provide additional rules regarding the amendments that may be made within the remedial amendment period with respect to a plan provision designated as a disqualifying provision. Section 1.401(b)–1(f) grants the Commissioner the discretion to extend the remedial amendment period.

[1] The term "GUST" refers to the following:
- the Uruguay Round Agreements Act, Pub. L. 103-465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353;
- the Small Business Job Protection Act of 1996, Pub. L. 104-188;
- the Taxpayer Relief Act of 1997, Pub. L. 105-34 ("TRA '97");
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106-554 ("CRA").

*The GUST Remedial Amendment Period and Determination Letter Program.* The remedial amendment period for GUST disqualifying provisions for individually designed plans generally ends on the last day of the first plan year beginning on or after January 1, 2001 ("the 2001 plan year"). Many sponsors of individually designed plans have already amended or are in the process of amending plans for GUST.

Sponsors of pre-approved plans were required to submit these plans to the Service by December 31, 2000. The Service is currently reviewing and issuing opinion and advisory letters for pre-approved plans that have been amended for GUST. Section 19 of Rev. Proc. 2000–20, 2000–6 I.R.B. 553, as modified by Rev. Proc. 2000–27, 2000–26 I.R.B. 1272, provides an extension of the GUST remedial amendment period for employers that have adopted a pre-approved plan, or certified their intent to adopt a pre-approved plan that has been restated for GUST, by the end of the 2001 plan year. If the requirements for the extension are satisfied, the GUST remedial amendment period for the employer's plan will not end before the end of the 12th month beginning after the date on which the Service issues a GUST opinion or advisory letter for the pre-approved plan.

*EGTRRA*. EGTRRA, which was enacted on June 7, 2001, includes numerous changes to the qualified plan rules. Almost all of these changes are effective in years beginning after December 31, 2001. While many of the changes are not mandatory, a plan sponsor that chooses to implement an optional provision of EGTRRA will have to amend its plan to conform plan provisions to plan operation.

*White Paper on Future Determination Letter Process*. The Service is considering the design of the Employee Plans determination letter process and will publish in the near future a white paper that explores some options for long-term changes and alternatives to the current process. Some of the options in the white paper will deal with the timing of plan amendments to comply with law changes and the application of the remedial amendment provisions of § 401(b).

## III. Remedial Amendment Period for EGTRRA

*Designation as Disqualifying Provisions*. A plan provision is hereby designated as a disqualifying provision under § 1.401(b)–1(b) if:

(1) the plan provision either (i) causes the plan to fail to satisfy the qualification requirements of the Code because of a change in those requirements made by EGTRRA or (ii) is integral to a qualification requirement that has been changed by EGTRRA; and

(2) if a "good faith" EGTRRA plan amendment is required to be in effect with respect to the provision, the plan provision was added or changed by a "good faith" EGTRRA plan amendment adopted no later than the later of (i) the end of the plan year in which the EGTRRA change in the qualification requirements is required to be, or is optionally, put into effect under the plan or (ii) the end of the GUST remedial amendment period for the plan.

*Extension of the EGTRRA Remedial Amendment Period*. The remedial amendment period under § 401(b) for a disqualifying provision described in the preceding paragraph shall not end prior to the last day of the first plan year beginning on or after January 1, 2005 ("the 2005 plan year").

*Good Faith EGTRRA Plan Amendments.* A plan is required to have a "good faith" EGTRRA plan amendment in effect for a year if:

(1) the plan is required to implement a provision of EGTRRA for the year, or the plan sponsor chooses to implement an optional provision of EGTRRA for the year, and

(2) the plan language, prior to the amendment, is not consistent either with the provision of EGTRRA or with the operation of the plan in a manner consistent with EGTRRA, as applicable.

For purposes of this notice, a plan amendment is a "good faith" EGTRRA plan amendment if the amendment represents a reasonable effort to take into account all of the requirements of the applicable EGTRRA provision and does not reflect an unreasonable or inconsistent interpretation of the provision. A plan amendment that merely incorporates by reference an EGTRRA change in a qualification requirement that would not otherwise be permitted to be incorporated by reference is not a "good faith" EGTRRA plan amendment.

*Section 411(d)(6).* Section 411(d)(6) generally prohibits plan amendments that decrease accrued benefits or have the effect of eliminating or reducing an early retirement benefit or retirement-type subsidy, or eliminating an optional form of benefit, for benefits attributable to service before the amendment.

EGTRRA does not provide relief from the requirements of § 411(d)(6) for plan amendments adopted as a result of EGTRRA changes in the plan qualification requirements. Therefore, in order to have a provision effective for a plan year, a plan may have to be amended for provisions of EGTRRA before the time when "good faith" EGTRRA plan amendments would otherwise be required under this notice. However, a plan amendment that eliminates or decreases benefits that have not yet accrued does not violate § 411(d)(6).

For example, in a top-heavy defined contribution plan, only those non-key employees who are participants and have not separated from service by the end of the plan year must receive the top-heavy minimum benefit. (See § 1.416–1, Q&A M–10.) A benefit that is conditioned on employment at the end of the plan year does not accrue until the participant satisfies the end-of-the-plan-year employment requirement. Thus, the top-heavy minimum benefit in a defined contribution plan that provides minimum contributions only to non-key employees who have not separated from service by the end of the plan year does not accrue until the end of the plan year. A "good faith" amendment of such a plan that modifies the plan's top-heavy rules in accordance with § 613 of EGTRRA will not result in an impermissible decrease of accrued minimum benefits provided the amendment is adopted before the end of the 2002 plan year.

In a top-heavy defined benefit plan, under §1.416–1, Q&A M–4, only those non-key employees who are participants and have at least one thousand hours of service for an accrual computation period must accrue the top-heavy minimum benefit for that accrual computation period. (In a top-heavy defined benefit plan that credits benefit accrual service using the elapsed time method described in § 1.410(a)–7, minimum benefits must be credited for all periods of service required to be credited for benefit accrual.) A benefit that is conditioned on completion of one thousand hours of service does not accrue until the participant satisfies the service requirement. Thus, the top-heavy minimum benefit in a defined benefit plan that provides minimum benefits only to non-key employees who have at least one thousand hours of service in an accrual computation period does not accrue until the participant has one thousand hours of service in the period. A "good faith" amendment of a defined benefit plan that modifies the plan's top-heavy rules in accordance with § 613 of EGTRRA will not be treated as impermissibly decreasing accrued minimum benefits provided the amendment is adopted on or before May 31, 2002, or, in the case of a plan that credits service using elapsed time, March 31, 2002.

*Effect of This Section*. A plan amendment to a disqualifying provision described in this section III can be made retroactively effective within the EGTRRA remedial amendment period to the extent necessary either to satisfy the qualification requirements as amended by EGTRRA, as interpreted in published guidance, or to make the plan provisions consistent with plan operation. To the extent necessary, such a remedial amendment may be made retroactively effective as of the effective date of the "good faith" EGTRRA plan amendment or, where the plan provision automatically reflects the EGTRRA change, as of the effective date of the change.

*No Extension of GUST Remedial Amendment Period*. The EGTRRA remedial amendment period applies only to disqualifying provisions described in this section. It does not extend the GUST remedial amendment period.

IV. Sample EGTRRA Plan Amendments

*Publication of Sample "Good Faith" EGTRRA Plan Amendments*. Before the end of August 2001, the Service will publish sample EGTRRA plan amendments that can be adopted verbatim or used in drafting individualized plan amendments for individually designed and pre-approved plans. The sample EGTRRA plan amendments will be for both the required and optional changes under EGTRRA. Additional guidance on amending pre-approved plans will be included with the sample EGTRRA amendments. A sample EGTRRA plan amendment, or a plan amendment that is materially similar to a sample EGTRRA plan amendment, will be a "good faith" EGTRRA plan amendment for purposes of this notice. However, plan amendments will not fail to be "good faith" plan amendments merely because they differ materially from the sample EGTRRA plan amendments.

*Possible Subsequent Required Amendments*. Plans amended by adoption of the sample EGTRRA amendments may have to be amended again within the EGTRRA remedial amendment period to continue to satisfy the plan qualification requirements as amended by EGTRRA.

V. Effect on Determination Letter Programs and Reliance

*In General*. Until further notice, determination, opinion and advisory letters will not consider and may not be relied on with respect to the EGTRRA changes. However, an employer's ability to rely on a favorable determination, opinion, or advisory letter will not be adversely affected by the timely adoption of "good faith" EGTRRA plan amendments.

*Individually Designed Plans*. Individually designed plans submitted for GUST determination letters may incorporate the changes made by EGTRRA; however the GUST determination letter will not extend to amendments incorporating EGTRRA provisions.

*Pre-Approved Plans*. M&P sponsors and volume submitter practitioners may amend pre-approved plans for EGTRRA through the adoption of a separate, clearly identified addendum to the plan (or basic plan document) and/or adoption agreement that is limited to the provisions of EGTRRA. The sample EGTRRA plan amendments will provide additional guidance on the amendment of pre-approved plans. Until further notice, EGTRRA amendments of pre-approved plans should not be submitted to the Service.

*Determination Letter Applications for Pre-Approved Plans*. Until further notice, determination letter applications for pre-approved plans that include EGTRRA amendments in a form other than a separate, clearly identified addendum to the plan (or basic plan document) and/or adoption agreement that is limited to the provisions of EGTRRA will be treated as individually designed plans.

VI. Extension of 12-Month Period Under Rev. Proc. 2000–20

The extended GUST remedial amendment period available to certain adopters of pre-approved plans is determined by reference to the date on which the Service issues a favorable GUST opinion or advisory letter for the pre-approved plan. Pursuant to this notice, if the requirements of section 19 of Rev. Proc. 2000–20, as modified, and Announcement 2001–77, page 83, this bulletin, are satisfied, the extension of the GUST remedial amendment period thereunder will be treated as not expiring earlier than December 31, 2002. This change will simplify the determination of the GUST remedial amendment deadline for pre-approved plans and facilitate timely amendment of the plans for GUST and EGTRRA.

VII. Effect on Other Documents

Rev. Proc. 2000–20 and Rev. Proc. 2001–6, 2001–1 I.R.B. 194, are modified.

DRAFTING INFORMATION

The principal drafter of this notice is James Flannery of Employee Plans. For further information regarding this notice, please contact Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Mr. Flannery may be reached at (202) 283-9613. These telephone numbers are not toll-free.

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## Guidance on Implementation of Withholding and Reporting Regulations

## Notice 2001–43

This notice provides guidance on the implementation of the withholding and reporting regulations (T.D. 8734, 1997–2 C.B. 109, and T.D. 8881, 2000–23 I.R.B. 1158). Specifically, this notice:

(1) provides a temporary alternative procedure for withholding and reporting on

payments made to certain nonqualified intermediaries (NQIs) and foreign trusts, which is available only for payments made to NQIs or foreign trusts on or after January 1, 2001, and before January 1, 2002;

(2) clarifies and corrects sections 1.1441–6(b)(1) and 301.6114–1 of the regulations, which require disclosure of certain treaty based return positions;

(3) adds a new alternative convention for converting payments in foreign currency into U.S. dollars to those listed in section 1.1441–3(e)(2);

(4) modifies section III. A. 1. of Notice 2001–4, 2001–2 I.R.B. 267, to permit an applicant for a qualified intermediary agreement that has been issued a QI-EIN to represent that it is a qualified intermediary (QI) until the IRS revokes its QI-EIN and to permit an applicant that has been issued a QI-EIN before January 1, 2002, to apply all of the provisions of the QI agreement beginning January 1, 2001;

(5) clarifies section III. C. of Notice 2001–4, which provides documentation and reporting relief for simple and grantor trusts; and

(6) modifies Announcement 2000–48, 2000–23 I.R.B. 1243, to permit a branch of a QI to act as a qualified intermediary under the QI's home country know-your-customer (KYC) rules if the branch is located in a country for which KYC rules have been submitted to IRS for approval.

1. Transitional relief for certain nonqualified intermediaries and foreign trusts.

In October 1997, Treasury and the IRS issued T.D. 8734, 1997–2 C.B. 109 (modified by T.D. 8881, 2000–23 I.R.B. 1158), which provided comprehensive regulations under chapter 3 (sections 1441–1445) and subpart G of subchapter A of chapter 61 (sections 6041–6050S) of the Internal Revenue Code. These regulations, which became effective on January 1, 2001, were developed after years of discussion with the U.S. and foreign financial services industry regarding how to improve compliance with the U.S. withholding rules without unduly impeding foreign investments in the United States or burdening financial institutions.

A key component of the new rules is the introduction of the qualified intermediary (QI) concept. In basic terms, a QI is a foreign financial institution that enters into an agreement with the IRS to verify the beneficial ownership of payments of U.S. source income for purposes of determining whether any reductions in the statutory 30 percent U.S. withholding tax rate under sections 871 and 881 are appropriate. To make this determination, a QI generally may rely on the documentation that it collects under the bank regulatory rules requiring it to establish the identity and residency of its account holders ("know your customer" (KYC) rules). The QI is required to transmit "pooled" information (but generally not the identity of its non-U.S. customers) to the U.S. withholding agent to enable the withholding agent to determine the correct amount of tax to withhold on payments made to the QI's customers. The QI is also required to report certain pooled information to the IRS, as specified in the regulations. By allowing QIs to transmit information on a pooled basis, the regulations reduce the QI's compliance burden (by minimizing the amount of information that is required to be reported to the IRS) and protect the QI's customer base (by minimizing the amount of information that must be reported to the U.S. withholding agent, who will often be a competitor of the QI).

Sections 1.1441–1(e)(3)(iii) and (iv) of the regulations require a nonqualified intermediary (NQI) to supply the U.S. withholding agent or a QI with customer-specific documentation, rather than pooled information, to establish that its customers qualify for a reduction in the statutory 30 percent withholding rate.

The NQI does this by attaching appropriate documentation and a withholding statement identifying customers and allocating payments among them to an intermediary certificate that it forwards to the U.S. withholding agent or QI. To ensure the proper withholding and reporting of a payment, the U.S. withholding agent or QI must receive this intermediary certificate before it makes a payment of a reportable amount (as defined in section 1.1441–1(e)(3)(vi)) to the NQI. Finally, unless its withholding agent has done so, the NQI must report payment information to the IRS on Forms 1042 and 1042–S and must send the foreign income recipient a corresponding Form 1042–S. In the same way, foreign simple trusts and foreign grantor trusts are required to forward to the U.S. withholding agent or QI a flow-through withholding certificate with attached documentation and a withholding statement identifying beneficiaries and grantors and to report payment information to the IRS.

Treasury and the IRS understand that, despite significant efforts by U.S. withholding agents and QIs to establish automated systems to process information received from NQIs and foreign trusts for withholding and reporting purposes, in some cases these systems are not yet fully operational. Treasury and the IRS have been advised, however, that the automated systems in those cases will be fully operational before the end of 2001. Accordingly, Treasury and the IRS believe that limited relief is warranted to ensure a smooth transition into the new withholding procedures. Treasury and the IRS emphasize, however, that the NQI and foreign trust documentation and reporting rules in the regulations are central to the appropriate administration of the U.S. withholding regulations, and U.S. withholding agents and QIs are expected to complete the development of automated systems that will ensure compliance with these rules.

To achieve a smoother transition period for withholding agents that make payments to NQIs and foreign trusts, the IRS will permit a withholding agent and NQI or foreign trust to apply the alternative procedures of section 1.1441–1(e)(3)(iv)(D) of the regulations as modified below for calendar year 2001, provided the withholding agent and NQI or foreign trust comply with all the conditions set forth below. This modified alternative procedure may not be used by flow-through entities or U.S. branches described in section 1.1441–1(e)(3)(iv)(D)(*8*) of the regulations. (See sections III. C. and IV. of Notice 2001–4, 2001–2 I.R.B. 267 for certain other relief provisions relating to trusts and partnerships.) A withholding agent may use this modified alternative procedure only for payments made to NQIs and to foreign simple or grantor trusts. This modified alternative procedure may not be used by a withholding agent if the withholding agent would be responsible for filing fewer than 250 Forms 1042–S for calendar year 2001 without using this modified alternative procedure. This modified alternative procedure may not be used for payments to U.S. nonexempt recipients.

An NQI or foreign trust and its withholding agent that comply with the conditions set forth below may rely on this notice for payments made on or after January 1, 2001, and before January 1, 2002: (1) to permit pooled basis reporting on Form 1042–S instead of the payee specific reporting otherwise required under the alternative procedure of section 1.1441–1(e)(3)(iv)(D); and (2) to permit the NQI or foreign trust to provide the withholding agent with a withholding statement containing the beneficial owner information required under sections 1.1441–1(e)(3)(iv)(C)(*1*) and (D)(*2*) after a payment is made but no later than January 31, 2002.

In order to qualify for this transitional relief, the following conditions must be met:

(1) The withholding agent submits a notification no later than January 31, 2002, that it is using the temporary alternative procedure under this notice. Notifications should be sent to:

Internal Revenue Service
Pre-Filing Services LM:PFT:PF
New Mint Building, 3rd Floor
1111 Constitution Avenue, NW
Washington, DC 20224

(2) The withholding agent includes the following in its notification under penalties of perjury:

(a) a statement listing the NQIs and foreign trusts that are participating with the withholding agent in using the temporary alternative procedure under this notice;

(b) a statement (i) that during 2001 the withholding agent was engaged in the building and implementation of computerized information systems for transfer and processing of withholding statement information between the withholding agent and the NQI or foreign trust and for Form 1042–S reporting to the IRS, and (ii) that they were relying on completion of those systems for purposes of complying with section 1.1441–1(e)(3)(iii) and (iv) of the regulations;

(c) a representation that the withholding agent has exercised its best efforts to complete those systems;

(d) a statement that those systems are not capable of complying with the requirements of section 1.1441–1(e)(3)(iii) and (iv) regarding timely provision of withholding statement information by the NQI or foreign trust and Form 1042–S reporting by the withholding agent for calendar year 2001;

(e) a statement of the number of Forms 1042–S that the withholding agent would be responsible for filing for calendar year 2001 if it were not using this modified alternative procedure; and

(f) a representation that the systems will be capable of complying with those withholding statement and Form 1042–S reporting requirements for calendar year 2002.

(3) The withholding agent and NQI or foreign trust comply with all applicable requirements of section 1.1441–1(e)(3)(iv)(D) of regulations, except as modified by conditions (4), (5) and (6).

(4) The NQI or foreign trust provides the withholding agent with withholding rate pool information prior to the payment of a reportable amount in accordance with section 1.1441–1(e)(3)(iv)(D)(*2*) of the regulations. The NQI or foreign trust must also provide appropriate documentation with respect to its customers to the withholding agent prior to the payment being made. The NQI or foreign trust need not, however, provide the withholding statement information identifying and classifying foreign persons as required by sections 1.1441–1(e)(3)(iv)(C)(*1*) and (D)(*2*) and assigning each listed foreign person to a withholding rate pool as required by section 1.1441–1(e)(3)(iv)(D)(*2*) prior to payment. The NQI or foreign trust is required to provide that withholding statement information to the withholding agent no later than January 31, 2002. The NQI or foreign trust must provide the withholding agent with withholding statement information allocating the income in each withholding rate pool to each payee within the pool no later than January 31, 2002, as required under sections 1.1441–1(e)(3)(iv)(C)(*2*) and (D)(*3*) of the regulations.

(5) The withholding agent withholds and timely files Forms 1042–S based on the withholding rate pool information provided by the NQI or foreign trust.

(6) The withholding agent submits a copy of the withholding statement that it receives from the NQI or foreign trust (which must identify each beneficial owner of payments to the NQI or foreign trust and allocate payments among these beneficial owners) for calendar year 2001 to the IRS at the address stated in condition (1) on or before the due date for filing Forms 1042–S for calendar year 2001.

If the NQI or foreign trust fails to provide the withholding statement information required under condition (4) by January 31, 2002, for any withholding rate pool, then the withholding agent may apply the provisions of sections 1.1441–1(e)(3)(iv)(D)(*4*), (*5*), (*6*), and (*7*). The NQI or foreign trust will be responsible for withholding, filing Form 1042 and filing Forms1042–S for each beneficial owner for which it has received payments.

The IRS will accept the pooled basis reporting and withholding statements filed under this temporary procedure in lieu of the payee specific reporting otherwise required of an NQI or foreign trust and its withholding agent only if the NQI or foreign trust and its withholding agent satisfy all of the conditions set forth above. The withholding agent and NQI or foreign trust must retain all records, documentation and other evidence relevant to the above conditions for the same retention period as would be required for information relevant to an audit of Form 1042–S for calendar year 2001. In determining on audit whether a withholding agent has exercised its best efforts to complete building and implementing their information systems, the IRS will take into account all the facts and circumstances including the efforts and performance of similarly situated withholding agents.

2. Disclosing treaty based return positions.

Section 1.1441–6(b)(1) of the regulations provides that withholding under sections 1441, 1442 and 1443 on a payment to a foreign person is eligible for reduction under the terms of an income tax treaty only to the extent that the payment is treated as derived by a resident of an applicable treaty jurisdiction, such resident is a beneficial owner, and all other requirements for benefits under the treaty are satisfied. It provides further that if the beneficial owner is a person related to the withholding agent within the meaning of section 482, the beneficial owner's withholding certificate must contain a representation that the beneficial owner will file the statement required under section 301.6114–1(d) if applicable. This requirement applies only to amounts of income subject to withholding received during the calendar year that exceed $500,000 in the aggregate.

Section 301.6114–1(a) of the regulations provides that if a taxpayer takes a return position that a tax treaty overrules or modifies any provision of the Internal Revenue Code and thereby effects a reduction of any tax at any time, the taxpayer shall disclose such return position on a statement attached to the return. If a tax return would not otherwise be required to be filed, a return must nevertheless be filed to make this disclosure. For this purpose, the taxpayer's taxable year is deemed to be the calendar year, unless the taxpayer has established or timely chooses to establish a different taxable year. The taxpayer must make the disclosure statement on a fully completed Form 8833 (*Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*) attached to the return.

Section 301.6114–1(b) provides that reporting is required unless it is expressly waived, and it further provides a nonexclusive list of particular positions for which reporting is required. Among the positions listed are those described in section 301.6114–1(b)(4)(ii)(C) or (D).

Paragraph (b)(4)(ii)(C) requires a taxpayer to report a position taken under a treaty that contains a limitation on benefits provision if: (1) the treaty exempts from tax or reduces the rate of tax on income subject to withholding; (2) the income is received by a foreign person other than an individual or State that is the beneficial owner of the income and the foreign person is related to the person obligated to pay the income within the meaning of sections 267(b) and 707(b)(5); (3) the income exceeds $500,000; and (4) the foreign person meets the requirements of the limitation on benefits provision. Paragraph (b)(4)(ii)(D) requires reporting a position taken under a treaty that imposes any other conditions for the entitlement to treaty benefits if the position is that such conditions are met.

Section 301.6114–1(c) lists positions for which reporting is expressly waived. Paragraph (c)(1)(i) waives reporting for the position that a treaty has reduced the rate of withholding tax otherwise applicable to a particular type of income subject to withholding to the extent that the income is beneficially owned by an individual or a State. Paragraph (c)(2) waives reporting by an individual who receives payments or income items during the taxable year that do not exceed $10,000 in the aggregate.

Taxpayers have requested guidance on the scope of the reporting required under section 301.6114–1(b) in the case of treaty claims for exemption or reduced rates of tax on income subject to withholding made by foreign persons that are not individuals or States. Taxpayers have expressed concerns that:

(1) Because paragraph (c)(1)(i) of that section waives reporting only for individuals and States, it is unclear whether taxpayers that are not individuals or States and that are not required to report under paragraph (b)(4)(ii)(C) are required nevertheless to disclose treaty based return positions described in paragraph (b)(4)(ii) under the general rule of paragraph (b).

(2) Because paragraph (c)(2) waives reporting only for individuals who receive less than the threshold amount, taxpayers that are not individuals must report under paragraph (b)(4)(ii)(D) even when they have received *de minimis* amounts of income subject to withholding.

(3) Because the representation under section 1.1441–6(b)(1) is required when the beneficial owner is related to the withholding agent within the meaning of section 482 and the filing under section 301.6114–1(b)(4)(ii)(C) is required when the beneficial owner is related to the person obligated to pay the income within the meaning of sections 267(b) and 707(b), it is unclear how the representation requirement coordinates with the filing requirement.

(4) Because section 1.1441–6(b)(1) states that the filing requirement applies only to amounts received during the calendar year that exceed $500,000 in the aggregate and section 301.6114–1(b)(1) permits a taxpayer to adopt a taxable year for filing different from the calendar year, it is unclear how a fiscal year taxpayer is to report those amounts.

To address these concerns, Treasury and the IRS intend to amend sections 1.1441–6(b)(1) and 301.6114–1 of the regulations, as described below, effective January 1, 2001.

(1) Treasury and the IRS intend to amend section 301.6114–1(c) to provide that reporting is waived for taxpayers that are taking a treaty based return position described in section 301.6114–1(b)(4)(ii), unless those taxpayers are described in paragraph (b)(4)(ii)(A) and (B), or (C) or (D).

(2) Treasury and the IRS intend to amend section 301.6114–1(c) to waive reporting under section 301.6114–(b)(4)(ii)(D) for taxpayers that are not individuals or States and that receive amounts of income subject to withholding that do not exceed $10,000 in the aggregate.

(3) Treasury and the IRS intend to amend section 1.1441–6(b)(1) to conform the representation requirement to the filing requirement of section 301.6114–1(b)(4)(ii)(C). Thus, section 1.1441–6(b)(1) will require a representation if the taxpayer takes the position under a treaty that contains a limitation on benefits provision that the treaty exempts from tax or reduces the rate of tax on income subject to withholding, the income is received by a foreign person other than an individual or State that is the beneficial owner of the income, the foreign person is related to the person obligated to pay the income within the meaning of sections 267(b) and 707(b), the income exceeds $500,000 in the aggregate, and the foreign person meets the requirements of the limitation on benefits provision.

(4) Treasury and the IRS intend to amend section 1.1441–6(b)(1) to conform to section 301.6114–1(b)(1) by changing the rule that the filing requirement applies only to amounts received during the calendar year that exceed $500,000 in the aggregate. The conformed rule will provide that the filing requirement applies only to income received during the taxpayer's taxable year that exceeds $500,000 in the aggregate.

A taxpayer that is required to make the disclosure statement on Form 8833 under sections 301.6114–1 (b)(4)(ii)(A) and (B) or (C) or (D) taking into account the modifications described in the notice will be considered to have timely filed Form 8833 if, in the case of a calendar year taxpayer, the taxpayer files the Form 8833 with its return for its taxable year ending on December 31, 2001, or in the case of a fiscal year taxpayer, the taxpayer files Form 8833 with its return for its first taxable year ending after December 31, 2001.

Taxpayers may rely on the authority of this notice until the regulations are amended.

3. Converting payments in foreign currency to U.S. dollars.

Section 1.1441–3(e)(2) provides that if an amount subject to tax is paid in a currency other than the U.S. dollar, the amount of withholding under section 1441 shall be determined by applying the applicable rate of withholding to the foreign currency amount and converting the amount withheld into U.S. dollars at the spot rate on the date of payment. A withholding agent that makes regular or frequent payments in foreign currency is permitted to use a month end spot rate or a monthly average spot rate.

Certain withholding agents that make regular and frequent payments in foreign currency have expressed concern that the permitted conversion conventions can expose them to currency risks that would require management by means of hedging transactions. Also, they have expressed concern that permitted conventions can require multiple accounting adjustments when payment amounts in the base currency are adjusted or corrected in the course of processing and settlement. They have suggested that using the spot rate on the day of deposit of the amount of tax withheld would eliminate the currency risks and the need for those accounting adjustments.

In response to those concerns, Treasury and the IRS intend to amend section 1.1441–3(e)(2) to add the suggested alternative conversion convention to the conventions already permitted. Section 1.1441–3(e)(2) will permit a withholding agent that makes regular or frequent payments in foreign currency to convert the amount withheld into U.S. dollars at the spot rate on the day the tax is deposited provided that the deposit is made within seven days of the date of payment. As is the case with the conversion conventions currently in the regulations, taxpayers using this alternative convention must do so consistently for all nondollar amounts withheld and from year to year. Such convention cannot be changed without the consent of the Commissioner. Taxpayers may rely on the authority of this notice until the regulations are amended.

4. Representing QI status and applying QI agreement beginning January 1, 2001.

Section III. A. 1. of Notice 2001–4 provides that an applicant that has submitted a QI application before January 1, 2001, may represent on Form W-8IMY that it is a QI without being in possession of a fully executed QI agreement until June 30, 2001. It further provides that an applicant that has submitted a QI application after December 31, 2000, may represent on Form W-8IMY that it is a QI until the end of the sixth full month after the month in which it submits its QI application. Applicants have been issued QI-EINs upon application to permit them to complete Forms W-8IMY. Finally, it provides that a potential QI may apply all of the provisions of the QI agreement beginning January 1, 2001, provided that it submits its application before July 1, 2001.

Taxpayers have requested extension of the time during which an applicant may represent that it is a QI without being in possession of a fully executed QI agreement and extension of the July 1, 2001, application deadline for application of the QI agreement beginning January 1, 2001, in order to allow adequate time for the process of review and execution by both the applicants and the IRS.

In response, this notice modifies those provisions of Notice 2001–4. An applicant to which IRS has issued a QI-EIN may represent on Form W–8IMY that it is a QI without being in possession of a fully executed QI agreement until the IRS revokes its QI-EIN. The IRS will revoke an applicant's QI-EIN if the applicant does not execute and return its QI agreement to the IRS within a reasonable time after the IRS has sent the QI agreement to the applicant for signature. An applicant to which the IRS has issued a QI-EIN before January 1, 2002, may apply all of the provisions of the QI agreement beginning January 1, 2001.

5. Documentation and reporting relief for simple and grantor trusts.

The QI agreement generally requires a QI to obtain a Form W-8IMY from a foreign simple or grantor trust together with appropriate documentation from beneficiaries and grantors and requires the QI to file separate Forms 1042–S for each beneficiary or grantor.

Section III. C. of Notice 2001–4, 2001–2 I.R.B. 267, provides documentation and reporting relief for simple and grantor trusts. It permits a QI to treat the beneficiaries or grantors as direct account holders, and thus permits them to be incorporated into the pooled basis reporting permitted for direct account holders rather than requiring separate Forms 1042–S for each of them, provided three criteria are met. (1) The QI must be required, pursuant to the applicable KYC rules, to determine the identity of the beneficiaries or owners of foreign simple or grantor trusts. (2) The QI must obtain the type of documentation set forth in the appropriate KYC attachment to the agreement. (3) The QI must obtain a valid Form W–8BEN from the beneficiary or owner of the trust.

Some QIs have suggested that the scope of criterion (1) may be unclear, because local KYC rules in certain jurisdictions require the QI to determine the identity of the beneficiaries or owners of foreign simple or grantor trusts, but do not require the QI to obtain documentation confirming their identities. These QIs have expressed the concern that the reporting relief for trusts may be unavailable in such jurisdictions.

This notice clarifies that criterion (1) is satisfied if the local KYC rules require the QI to determine the identity of trust beneficiaries and grantors, even if those rules do not require the QI to obtain documentation confirming their identities. The QI must nevertheless obtain any documentation necessary to satisfy criterion (2), which is based on the applicable KYC documentation.

6. Branches permitted to apply QI's home country KYC.

Announcement 2000–48, 2000–23 I.R.B. 1243, provides that the IRS generally will not extend the QI system to any country that does not have KYC rules or that has unacceptable KYC rules. The IRS will, however, permit a branch of a financial institution (but not a separate juridical entity affiliated with the financial institution) located in such a country to act as a QI if the branch is part of an entity organized in a country that has acceptable KYC rules and the entity agrees to apply its home country KYC rules to the branch.

Taxpayers have requested that this rule be extended to include branches of QIs in countries for which KYC rules have been submitted to IRS for approval during the time those rules are pending approval.

In response, this notice modifies Announcement 2000–48. IRS will permit a branch of a financial institution (but not a separate juridical entity affiliated with the financial institution) to act as a QI if the branch is located in a country identified by the IRS as a jurisdiction awaiting approval of KYC rules on the IRS website at *www.irs.ustreas.gov*, if the branch is part of an entity organized in a country that has acceptable KYC rules and if the entity agrees to apply its home country KYC rules to the branch. The branch will be permitted to act as a QI under this rule only for the period of time during which the jurisdiction in which it is located is identified as awaiting approval. If the IRS approves the KYC rules of the jurisdiction, then the branch must apply the KYC rules of the jurisdiction beginning on the date that an attachment to the QI agreement for the jurisdiction is posted on the IRS website at *www.irs.ustreas.gov*.

Contact Information

For further information regarding this notice, contact Carl Cooper or Laurie Hatten-Boyd of the Office of the Associate Chief Counsel (International), Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Mr. Cooper and Ms. Hatten-Boyd may be contacted by telephone at 202-622-3840 (not a toll-free call).

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## Notional Principal Contracts

## Notice 2001–44

**I. PURPOSE**

The IRS and the Treasury Department are soliciting comments on the appropriate method for the inclusion into income or deduction of contingent nonperiodic payments made pursuant to a notional principal contract and the treatment of such inclusions or deductions.

**II. BACKGROUND**

**A. In General**

Section 1.446–3 of the Income Tax Regulations provides rules on the timing of inclusion of income and deductions for amounts paid or received pursuant to notional principal contracts. T.D. 8491, 1993–2 C.B. 215. The regulations define a notional principal contract ("a NPC") as a "financial instrument that provides for the payment of amounts by one party to another at specified intervals calculated by reference to a specified index upon a notional principal amount, in exchange for specified consideration or a promise to pay similar amounts." Section 1.446–3(c)(1)(i). Payments made pursuant to NPCs are divided into three categories (periodic, nonperiodic, and termination payments), and the regulations provide separate timing regimes for each. However, no guidance is provided in the regulations for the timing of inclusion or deduction of contingent nonperiodic payments made under NPCs. In addition, neither § 1.446–3 nor any other section provides specific rules governing the character of the various types of payments that could be made pursuant to a NPC.

The lack of comprehensive guidance in this area of the law has created significant uncertainty for taxpayers. For some, this uncertainty adds a considerable burden to the tax compliance process, and may discourage certain taxpayers from entering into NPCs. Other taxpayers welcome the ability to pick and choose among various tax law theories as to the character and timing of NPC payments, but this can lead to a whipsaw of the government. Both result in lack of confidence in the tax system, and inefficiencies in the capital markets.

The IRS and Treasury have reviewed several methods for including into income or deducting contingent nonperiodic payments made pursuant to NPCs. In evaluating each method, the IRS and Treasury have considered the extent to which it reflects certain fundamental tax policy principles. These policy principles include: whether the method provides sufficient certainty as to the amount and timing of inclusions or deductions (certainty/clarity); whether the method is complex, and the compliance and administrability burden created by that complexity (administrability); whether the method creates or increases inconsistencies in the tax treatment of financial instruments with similar economic characteristics (neutrality); whether the method creates or increases inconsistencies in the tax treatment of different taxpayers entering into the same instruments (symmetry); whether the method accurately reflects the accretion or reduction in economic wealth in the period in which the taxpayer is measuring the tax consequence of being a party to the NPC (economic accuracy); and whether the method is flexible enough to readily accommodate new financial arrangements (flexibility). It is clear that these principles are frequently in conflict, and there is no method of accounting that would satisfy all the criteria. However, the examination of an accounting method in the light of these principles can highlight the strengths and weaknesses of the method and inform the rulemaking process.

The methods the IRS and Treasury are considering for the inclusion into income or deduction of contingent nonperiodic payments made pursuant to NPCs are described below under the following headings: the Noncontingent Swap Method; the Full Allocation Method; the Modified Full Allocation Method; and the Mark-to-Market Method. The IRS and Treasury are seeking comments on the relative merits of each of these methods, as well as suggestions as to other methods that may be superior to these methods with respect to the fundamental tax policy principles listed above. The IRS and Treasury are interested in what authority taxpayers believe exists for mandating any and each of these methods.

Although this notice is addressing the timing issues regarding NPCs with a contingent component, the IRS and Treasury are aware that there must be some coordination between the existing NPC rules and any new applicable rules. The IRS and Treasury are interested in comments on the need to revise the current rules for NPCs and related instruments if new rules for contingent NPCs are introduced. The IRS and Treasury are also interested in whether taxpayers believe it is necessary to develop rules on a much wider range of instruments before any kind of rule is issued with respect to contingent NPCs, which are only one specific type of instrument, *i.e*., whether the proliferation of individualized rules is more harmful than helpful in this area.

The IRS and Treasury are interested in comments from taxpayers as to the appropriateness of special, simplified rules for short-term or standardized contracts, and what form the simplified rules should take. If taxpayers suggest that a simplified rule should be provided for certain contracts, the IRS and Treasury are interested in what kind of test should be used to determine whether the simplified rule applies.

In addition to reviewing methods for the timing of income and expense with respect to contingent nonperiodic payments, the IRS and Treasury are considering what the character should be for all types of payments made pursuant to NPCs. In the current tax law, the distinction between capital gain and ordinary income is significant in two ways. First, taxpayers cannot offset capital losses against ordinary income (with a small exception for individuals). One policy reason for the rule against offsetting of capital losses against ordinary income is that taxpayers are able to choose the timing of their sales or exchanges of capital assets much more easily than the timing of their ordinary income or loss ("cherry picking"). They could, therefore, sell their loss assets at a time when they are expecting large amounts of ordinary income while deferring recognition on their gain assets. Second, for individuals, long-term capital gains are taxed at lower rates than ordinary income.

In determining whether particular payments made pursuant to a NPC should most appropriately be characterized as capital or as ordinary, attention should be given to the goals of minimizing cherry picking of character results and consistent application of the policy rationale for the current capital gains preference. In addition, in the financial products area, it is particularly important to pay attention to the neutrality principle, *i.e*., consistent treatment of different instruments with similar economic characteristics. There is almost limitless flexibility in the design of derivatives, and tax rules that provide for differences in tax treatment that do not reflect economic differences may produce inappropriate tax consequences. For example, some taxpayers are permitted to treat certain payments received pursuant to forward and option contracts as capital. If these taxpayers entered into NPCs with the same economic characteristics as the options or forwards contracts, but did not receive the same tax character treatment, tax-advantaged products might develop to arbitrage the tax differences between the various instruments. The particular problem the IRS and Treasury face with regard to neutrality is that the existing rules for various financial instruments are so inconsistent with each other, that it is difficult to decide, when developing rules for new instruments that can mimic many types of instruments, which set of existing rules should be followed. The IRS and Treasury are interested in comments on how the neutrality principle can best be given consistent effect for complex financial instruments.

The IRS and Treasury invite comments on the appropriate policy considerations for making character designations for NPC payments, as well as the application of those principles illustrated by the examples in the notice. The IRS and Treasury also seek comments on: the authority governing the character of NPC payments and whether and what legislative change may be necessary to rationalize the rules.

The IRS and Treasury are aware that the definition of NPC as provided in § 1.446–3 covers only one class of the possible notional principal contracts that are transacted in the marketplace. For example, a contract that provides for a single payment at maturity based on some notional amount and specified index may not be covered by the definition because there are no "payments" made at "specified intervals." Such a contract is sometimes called a "bullet swap." There may be little difference in economics between a NPC as defined in § 1.446–3 and a series of bullet swaps, yet the payments made under one are covered by the regulation, whereas the payments under the other may not. The IRS and Treasury seek comments on how the tax accounting methods described in this notice, or other methods, could be made applicable to a broader group of contracts that serve similar purposes as NPCs. The IRS and Treasury also seek comments on the appropriate character of payments made pursuant to contracts similar to NPCs.

**A. Methods for Determining the Timing of Payments under NPCs**

1. *The Noncontingent Swap Method*

a. *Timing*. The noncontingent swap ("NCS") method provides an approach to accruing contingent payments made pursuant to a NPC. The method provides techniques for taxpayers to convert the contingent nonperiodic payment provided for in the NPC into a noncontingent periodic amount. The method would provide rules for creating a payment schedule that spreads the recognition of income or deduction of this noncontingent amount over the life of the NPC on a constant yield basis.

b. *Illustration*. This method is illustrated using the following example of a simple equity swap contract, on a notional amount of 100 shares of XYZ stock, entered into on January 1, 2001, between A and B with the following terms:

A pays B:

Every six months until expiration – any dividend payments to the holder of one share of XYZ times 100.

At expiration, December 31, 2002 – any appreciation in a share of XYZ since contract inception times 100.

B pays A:

Every six months until expiration – 7.00% (annual rate) of notional amount at inception.

At expiration, December 31, 2002 – any depreciation in a share of XYZ since contract inception times 100.

The contingent payment is equal to the appreciation or depreciation in the value of a share during the period between the inception and expiration of the contract, multiplied by 100 shares. The payments are netted, and only the net amounts are transferred. The net payments can flow from either A to B or from B to A.

Under the NCS method, the cost of hedging the exposure to the contingent NPC payment is used as a proxy for the contingent payment itself. The cost of hedging the contingent payment under the NPC is the current price of a portfolio of financial assets that, if liquidated on December 31, 2002, will exactly cover the cost of the contingent payment. This approach has been chosen because if a party to a contingent NPC assumed the hedging cost, both counterparties would be in the same position as if the contingent future obligation were actually paid. This hedging cost is therefore deemed to be paid, for example, by A to B, in satisfaction of the contingent obligation (for purposes of making calculations under the NCS method). The NCS method then provides a mechanism for amortizing this deemed payment by A to B into B's income throughout the life of the swap. It should be noted that the hedge transaction need not be entered into by either A or B. The deemed hedge merely provides a computational mechanism for converting the contingent payment into a fixed payment. Further details regarding this illustration, with computations of the hedging cost and the amounts of deductions and income inclusions, are provided in the Appendix.

c. *Policy Considerations*. The NCS method has the policy advantage of being certain and clear in many cases. It depends, however, on the ability to establish the cost of hedging the contingent payment exposures using forward pricing analysis. The methodology may be difficult to administer and apply in other cases because of the subjectivity in pricing forward contracts where there is no active market. This problem may be partially overcome by requiring appropriate record keeping and information reporting. The NCS method provides relative neutrality of tax treatment compared to contingent debt, but does not provide neutrality of tax treatment as compared to forwards and options, or as compared to ownership of the underlying equity (in the example of an equity NPC). Given that for many NPCs, at least one counterparty is on a mark-to-market method of accounting with respect to the NPC under § 475 of the Internal Revenue Code, in many cases there would be asymmetry of tax treatment between counterparties. The NCS method does not accurately reflect the change in economic position over time of either counterparty as a result of being a party to the NPC, because the schedule that determines inclusions and deductions is fixed at the outset and, in the simplest description of the method, does not change with market conditions. Finally, it is unclear how flexible the method is in accommodating variations in NPCs and related instruments.

d. *Request for Comments*.

(i) The IRS and Treasury request comments on a number of aspects of this method. The amount of inclusions and deductions under this method could significantly diverge from market prices as the swap runs its course. The ability of this method to meet the policy principles outlined above may be reduced unless the counterparties to the swap are required to revise their payment schedules with changes in market conditions. The IRS and Treasury invite comments on if and when it would be appropriate to require taxpayers to make such revisions to the payment schedule (*e.g.*, every three years), or if the underlying index changes a certain percentage from its level at the inception of the contract, or both. Comments are also solicited on the treatment of adjustments resulting from updated projections. For example, should adjustments from updated projections be taken into account in the year of the updated projections or should they be spread over the remaining term of the NPC?

The IRS and Treasury are aware that the more frequently payment schedules are required to be updated, the more the method begins to resemble a mark-to-market method. We are seeking comments on the relative effectiveness of the NCS method, given the inaccuracies that are possible when only one market observation is required at the inception of the contract, and the fact that as the number of adjustments to that initial observation is increased, the benefits of using this technique (*e.g.*, certainty of tax result) decline.

(ii) The IRS and Treasury also request comments on the treatment of contingent payments that are made prior to their expected payment date, and how this should be coordinated with the treatment of revised payment schedules.

(iii) The character of payments generated by the NCS method is unclear under current law. The IRS and Treasury are seeking comments on what the character of payments under the NCS method would be under current law, both originally projected payments and any periodic revisions (see (i), above). In addition, comments are solicited on whether it would be appropriate to change or clarify the character rules, either statutorily or through regulations, so that the various policy goals can be achieved

(iv) One commentator suggested an interpretation of § 1234A that would conform the character treatment of NPCs with the character of the underlying position or positions. Comments would be welcome on the desirability of this approach, including the authority for its adoption under current law, and the feasibility of administration.

(v) More generally, comments are invited on the problem of mismatching of the character of payments and receipts and on methods of avoiding or minimizing such mismatches.

2. *The Full Allocation Method*

a. *Timing*. Under the full allocation method, taxpayers would not include or deduct any payment that is required to be made under the NPC (periodic, nonperiodic, contingent, and noncontingent) until the taxable year in which all contingencies are resolved. When the final contingency is resolved, the parties would treat all payments as made or received in the year of the resolution of the contingency.

b. *Policy Considerations*. This method has the policy advantages of being certain, clear, and administrable. The method provides partial neutrality of tax treatment compared to options and forwards, and compared to ownership of the underlying equity, but does not provide neutrality of tax treatment compared to contingent debt. There would be asymmetry of tax treatment between the counterparties if only one party to the contingent NPC were on a mark-to-market method of accounting with respect to the NPC. The full allocation method does not reflect the change in economic position over time of either counterparty as a result of being a party to the NPC, because all tax consequences are postponed until the contract matures, is terminated, etc. This result is particularly open for manipulation to the extent taxpayers have the ability to terminate a contract if it has decreased in value but can retain the contract if it has increased in value. Finally, it would appear that the method is flexible enough to accommodate many financial instruments, although it is unclear whether the method would be appropriate for all forms of NPCs and related contracts.

c. *Request for Comments*. The IRS and Treasury request comments on a number of aspects of this method:

(i) The IRS and Treasury are aware that this method permits complete deferral for taxpayers entering into NPCs with contingent elements, in contrast to the accrual method required for NPCs without such contingent elements. However, even though the full allocation method would create discontinuities between different types of NPCs, it is somewhat consistent with the treatment of both straight equity and certain other derivatives, such as options and forward contracts, as noted above. The IRS and Treasury are soliciting comments on whether the inconsistency between contingent and noncontingent NPCs could be mitigated through the use of an anti-abuse rule (and on what the nature and scope of such an anti-abuse rule might be), or whether a more global change in the treatment of derivatives would be necessary to overcome this problem.

(ii) It is unclear how current law would characterize the various payments made pursuant to a contingent NPC under the full allocation method. Based on one interpretation of § 1234A, it is possible that taxpayers could elect the character of their NPC payments by terminating their NPC early or holding it until maturity. Comments are solicited on how taxpayers could be prevented from manipulating the character of payments made pursuant to a NPC under current law if the full allocation method is required. Comments are also solicited on whether and how a modification of current law could improve the character treatment of payments made pursuant to a contingent NPC under the full allocation method.

(iii) The IRS and Treasury seek comments on how the full allocation method should apply when contingencies under a NPC are resolved at a time other than at the maturity of the contract.

3. *Modified Full Allocation Method*

a. *Timing*. Under this method, each party to a NPC would offset any noncontingent payments made by that party in a taxable year against any payments received in that year with respect to the NPC, but would not be able to claim a deduction if the amount received were less than the amount paid out. Any net deductions with respect to the NPC would be deferred until all contingencies are resolved. In effect, this method accords with those tax principles that provide for income to be recognized when received and deductions to be deferred until all contingencies with respect to that deduction are resolved. However, this method modifies the effects of these principles by first determining income on an annual net basis.

b. *Policy Considerations*. This method has the advantages of being certain and clear, and being relatively easy to administer. However, the method does not provide for neutrality of tax treatment with respect to any financial instrument or combination of instruments that have economic characteristics similar to a contingent NPC. The method does not accurately reflect the change in economic position over time of a counterparty subject to the method because of the differing treatment of net receipts and payments under the NPC. In addition, there would be asymmetry of tax treatment of the counterparties to the NPC if one of the parties were subject to the mark-to-market method of accounting with respect to the NPC. Finally, it is unclear how flexible the method would be in accommodating variations in NPCs and related instruments.

c. *Request for Comments*. The IRS and Treasury request comments on a number of aspects of this method:

(i) The IRS and Treasury are aware that the modified full allocation method may result in mismatching of income and deductions. This is because income from the NPC would be recognized when received while deductions would be deferred until all contingencies are resolved. The IRS and Treasury are seeking assistance in developing rules to ensure that the asymmetrical treatment of the income and deductions under this method does not lead to undesirable consequences for either taxpayers or the government.

(ii) It is unclear how the payments made pursuant to a NPC would be characterized under the modified full allocation method. It is possible that application of current law to the modified full allocation method could result in differences in character for current inclusions and for gains or losses on final settlement of the NPC. For example, a taxpayer may be taxable currently on net receipts as ordinary income but have an offsetting capital loss subject to loss limitations on the final settlement of the NPC. Mismatches of timing and character could be reduced if deductions were permitted in years before the resolution of all contingencies, in a manner similar to the treatment of unreversed inclusions under § 1296(a)(2). The IRS and Treasury request comments on ways to avoid this mismatching of character, and whether a regime similar to that used under § 1296(a)(2) would be administratively burdensome to implement.

(iii) The IRS and Treasury seek comments on how the modified full allocation method should apply when contingencies under a NPC are resolved at a time other than at the maturity of the contract.

4. *Mark-to-Market Method*

a. *Timing*. Under this method, taxpayers would mark their NPCs to market and recognize gain or loss at year end, or when the contract is terminated, assigned, etc.

b. *Policy Considerations*. The mark-to-market method has the advantages of being certain and clear with respect to timing and character. It would likely, however, be difficult to administer for non-exchange traded instruments to the extent that there is no consensus on the fair market value of the NPC. This problem may be partially overcome by requiring appropriate record keeping and information reporting. The mark-to-market method does not provide neutrality of tax treatment compared to almost any financial instrument or combination of instruments or compared to the underlying property. It would, however, provide equitable tax treatment between counterparties. The mark-to-market method accurately reflects the change in economic position over time of both counterparties as a result of being a party to the NPC, to the extent that the mark is accurate. Finally, the mark-to-market method is the most flexible of the methods, as it is constrained only by the ability to provide a consistent system for measuring the market value of instruments.

c. *Request for Comments*. The IRS and Treasury request comments on a number of aspects of this method:

(i) The IRS and Treasury are interested in comments generally on the benefits and burdens of imposing a mark-to-market regime.

(ii) The IRS and Treasury are interested in what the character of a gain or loss on a mark would be under current law, and how the law may be modified to ensure appropriate characterization of the mark, based on policy principles.

(iii) The IRS and Treasury are interested in comments on what authority taxpayers believe exists to mandate a mark-to-market regime for NPCs. We are also requesting comments on whether this regime should be made elective if another regime is used as the primary regime.

(iv) The IRS and Treasury seek comments on how to ensure that the values taxpayers use as market values are truly related to the market, and are not subject to consistently biased manipulation by taxpayers. It appears that substantial investment has been made by the financial community into technology that enables a regular mark-to-market of many types of derivatives.[1] The IRS and Treasury are requesting comments on how a valuation regime could be developed to ensure some consistency by a single taxpayer with different NPCs, and between taxpayers.

### C. Recordkeeping and Information Reporting

The IRS and Treasury are seeking comments on what kinds of record keeping and information reporting would be necessary for each and any of the methods of accounting for contingent NPCs that would enable the IRS to verify the inclusions and deductions of counterparties to contingent NPCs and minimize the compliance burdens for taxpayers. In particular, the IRS and Treasury are interested in the following:

1. Are there any special kinds of information necessary for the IRS to obtain from taxpayers in order to verify their tax return positions with respect to contingent NPCs?

2. If there are special kinds of information relating to tax return positions for contingent NPCs, how should that information be made available to the IRS? Is it sufficient for taxpayers to keep detailed books and records which an agent can request if necessary? Or should specific information be required to be reported with the tax return? If the information is reported with a tax return, what form should the reporting take?

3. Is there sufficient justification to require third party reporting with respect to any of the methods of accounting for NPCs, particularly for the NCS method and the mark-to-market method? Should counterparties who are dealers be required to report their marks to nondealer counterparties under the mark-to-market method?

4. If certain types of record keeping or information reporting are recommended in comments to the IRS and Treasury, what would be the appropriate penalties for failure to keep the required records or provide the information?

## III. REQUEST FOR COMMENTS

Written comments are requested to be submitted no later than November 20, 2001, to CC:FIP (Notice 2001–44), room 4300, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:FIP (Notice 2001–44), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html.* All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this notice are: Elizabeth Handler and Dale S. Collinson, Office of Associate Chief Counsel (Financial Institutions and Products), Internal Revenue Service; Viva Hammer, Office of the Tax Legislative Counsel, Office of Tax Policy, United States Department of the Treasury; and Matthew J. Eichner, Office of Tax Analysis, Office of Tax Policy, United States Department of the Treasury. However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this notice contact Viva Hammer at (202) 622-0869 or Dale Collinson at (202) 622-3900 (not toll-free calls).

APPENDIX

The method described in Section II.B.1.b. is illustrated using the following example of a simple equity swap contract on a notional amount of 100 shares of XYZ stock, entered into on January 1, 2001, between A and B with the following terms:

A pays B:

Every six months until expiration – any dividend payments to the holder of one share of XYZ times 100.

At expiration, December 31, 2002 – any appreciation in a share of XYZ since contract inception times 100.

B pays A:

Every six months until expiration – 7.00% (annual rate) of notional amount at inception.

At expiration, December 31, 2002 – any depreciation in a share of XYZ since contract inception times 100.

Assume that the market price of a share of XYZ was $975 at the inception of the contract, and the forward price for future delivery of a share of XYZ was $1,062. For computational purposes only, A is deemed under the NCS method to have hedged itself by entering into a forward contract at the inception of the NPC for the purchase of 100 shares of XYZ, in exchange for $106,200, on December 31, 2002. In order to make the $106,200 payment, A would need to set aside at the inception of the contract an amount that equals the present value of $106,200, *i.e.*, $92,547 (based on a 7% annual interest rate compounded semiannually).

With this forward contract in place, A would be able to make the required payment to party B.[2] However, the arrangement described thus far would involve A committing more funds to building the hedge than is absolutely necessary. A is required to pay B only the difference be-

[1] Much of the impetus for this has come from the Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by Statement of Financial Accounting Standards No. 138, which requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. However, this is not the only source of interest in technology to enable a regular marking of derivatives. Treasury departments of many corporations require a tool to assess the impact of financial stress on their portfolios, and this requires a mechanism for marking their securities in various scenarios. In addition, in a different context entirely, mutual funds must have some mechanism for regularly assessing the value of their portfolios (including derivatives) as they have to report a daily net asset value.

[2] The terms of the contract require B to make a payment to A if the XYZ stock decreases in value. Because forward pricing for investment property such as corporate stock always assumes an increase in price, the method would also assume at the outset that the contingent payment would be made by A to B.

tween the price of the shares on December 31, 2002, and the price of the shares on January 1, 2001, and not the entire value of the shares on December 31, 2002. For example, suppose that the price of the 100 XYZ shares has risen to $110,000 by expiration of the NPC. If this happens, A would be obligated to pay B $12,500. A would purchase the shares pursuant to the forward contract for $106,200, sell them for $110,000, and pay party B the $12,500 required under the terms of the swap. The remaining $97,500 in proceeds would belong to A. This $97,500 (the market price of the shares on January 1, 2001) would always remain in A's possession at maturity no matter how the value of XYZ stock changes through the life of the NPC. Therefore, simply entering into a forward contract for the purchase of the XYZ stock is not an exact hedge for A's commitment under the swap contract. To further refine the hedge, A could borrow the present value of $97,500, *i.e.*, $84,966 on January 1, 2001. Borrowing this amount would mean that the cost of assembling the hedge would be ($92,547 - $84,966), or $7,582.

The net cash flow from these two transactions - purchasing the forward contract and borrowing the present value of the current price of the 100 shares - would always enable A to exactly make the payment due to B under the NPC on December 31, 2002, no less and no more. If the share price rises to $1,000 by December 31, 2002, A would sell the stock delivered in satisfaction of the forward contract for $100,000, pay $2,500 to B and repay the loan with the remaining $97,500. If, instead, the price were to fall to $935 by December 31, 2002, A would actually receive $4,000 from B which, in combination with the proceeds from selling the stock delivered under the forward contract for $93,500, would allow A to repay the loan balance of $97,500.

Once the present value of A's deemed hedge for the contingent payment is determined, this amount must be amortized into B's income. This can be done by deeming A to provide to B a zero coupon bond with a present value of $7,582. Such a bond has a face value, payable at maturity, of $8,700 (assuming again an annual rate of 7.00% and compounded semiannually).

The original issue discount (OID) is found by multiplying the present value of the bond at the beginning of each six month period by the periodic rate, 7.00%/2 or 3.50%:

| Period Ending | OID | Present Value of Bond (at end of period) |
|---|---|---|
| 6/30/01 | $265 [= $7,582 * 3.50%] | $7,847 [= $7,582 + $265] |
| 12/31/01 | $275 [= $7,847 * 3.50%] | $8,122 [= $7,847 + $275] |
| 6/30/02 | $284 | $8,406 |
| 12/31/02 | $294 | $8,700 |

Note that the total OID sums to $1,118, precisely the difference between the present value of the bond ($7,582) and the face value of the bond ($8,700).

This OID is the first component of income for each period; amortization of the principal of $7,582 is the other piece. The following table summarizes the annuity calculation:

| Period Ending | Payment | Interest | Principal | Balance (end of period) |
|---|---|---|---|---|
| 6/30/01 | $2,064 | $265 [= $7,582 x 3.5%] | $1,799 [= $2,064 - $265 | $5,783 [= $7,582 - $1,799] |
| 12/31/01 | $2,064 | $202 | $1,862 | $3,921 |
| 6/30/02 | $2,064 | $137 | $1,927 | $1,994 |
| 12/31/02 | $2,064 | $120 | $1,994 | $0 |

The principal allocated to each period is then added to the OID to reach a total income allocation for the period. This would become the "payment schedule" which determines the tax inclusions required for B through the life of the contingent NPC.

| Period Ending | OID | Principal | Income |
|---|---|---|---|
| 6/30/01 | $265 | $1,799 | $2,064 |
| 12/31/01 | $275 | $1,862 | $2,137 |
| 6/30/02 | $284 | $1,927 | $2,211 |
| 12/31/02 | $294 | $1,994 | $2,288 |
| Total | | | $8,700 |

# Part IV. Items of General Interest

## Simplification of Employee Plans Determination Letter Application Procedures

## Announcement 2001–77

The Service is simplifying its application procedures for determination letters on the qualification of pension, profit-sharing, stock bonus, and annuity plans under §§ 401(a) and 403(a) of the Internal Revenue Code. These changes will give plan sponsors the flexibility to request a determination letter that considers either the form of the plan only or both the form of the plan and compliance with the requirements of §§ 401(a)(4), 401(a)(26), and 410(b). The Service is also modifying its procedures to facilitate plan compliance with new final regulations on the use of cross-testing in the application of the nondiscrimination requirements of § 401(a)(4).

Specifically, the Service is:

- Modifying its procedures and revising the determination letter application forms to give plan sponsors the option to request determination letters without furnishing information on how plans satisfy the nondiscrimination requirements of § 401(a)(4), the additional participation requirements of § 401(a)(26) or the minimum coverage requirements of § 410(b).
- Modifying its procedures to allow adopting employers of nonstandardized master and prototype (M&P) plans or certain volume submitter plans to rely on a favorable opinion or advisory letter with respect to most qualification requirements without requesting a determination letter.
- Modifying its procedures to allow an employer maintaining a multiple employer plan to rely on a favorable determination letter for the plan with respect to most qualification requirements without submitting a separate Form 5300.
- Encouraging practitioners to highlight the changes to plans that have previously received favorable determination letters.
- Making available, during the second half of 2001, and updating periodically, a list of the M&P plans and volume submitter specimen plans that were submitted to the Service for GUST[1] advisory and opinion letters by December 31, 2000, indicating the dates on which opinion and advisory letters were issued or the applications were withdrawn.
- Allowing practitioners to amend volume submitter specimen plans to reflect the recently published final regulations on cross-testing.
- Allowing plan sponsors to request determination letters that take into account the final regulations on cross-testing, beginning August 22, 2001.

The Service is also taking a number of other steps to improve the efficiency of its case processing. The changes described in this announcement are separate from any long-term changes to the determination letter program that may result from the Service's ongoing study of the future of the Employee Plans determination letter program. The Service expects to publish a white paper as part of this study in the near future.

SECTION I. CHANGES TO DETERMINATION LETTER APPLICATION PROCEDURES AND FORMS

A. Current Procedures

Under current procedures, plans are generally reviewed for compliance with form and operational coverage and nondiscrimination requirements, including, for example, the ratio-percentage test of § 410(b)(1). In addition, at the election of the plan sponsor, a plan may also be reviewed for compliance with the average benefit test of § 410(b)(2) and the nondiscriminatory availability of benefits, rights and features requirement and the general test for nondiscrimination in amount of contributions or benefits of § 401(a)(4).

[1] The term "GUST" refers to:

- the Uruguay Round Agreements Act, Pub. L. 103-465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353;
- the Small Business Job Protection Act of 1996, Pub. L. 104-188;
- the Taxpayer Relief Act of 1997, Pub. L. 105-34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106-554 ("CRA").

Applicants must file Schedule Q (Form 5300), *Nondiscrimination Requirements*, providing demographic data for coverage and nondiscrimination requirements to be considered by the Service in reviewing the plan.

B. New Procedures

Under the new procedures, plan sponsors can elect to have a plan reviewed for compliance with the form requirements only or with both the form requirements and the coverage and nondiscrimination requirements of §§ 401(a)(4), 401(a)(26) and 410(b) that the plan sponsor elects to have considered. For example, a plan sponsor no longer must provide demographic data for the ratio-percentage test, but may choose to do so to have compliance with § 410(b) considered in the determination letter. Thus, the filing of Schedule Q is now optional.

C. Revised Application Forms

The following forms are being revised:
Form 5300, *Application for Determination for Employee Benefit Plan*
Schedule Q (Form 5300), *Nondiscrimination Requirements*
Form 5307, *Application for Determination for Adopters of Master or Prototype, Regional Prototype or Volume Submitter Plans*
Form 5309, *Application for Determination of Employee Stock Ownership Plan*
Form 5310, *Application for Determination for Terminating Plan*
Form 5310–A, *Notice of Plan Merger or Consolidation, Spinoff, or Transfer of Plan Assets or Liabilities; Notice of Qualified Separate Lines of Business*
Form 6088, *Distributable Benefits From Employee Benefit Pension Plans*
Form 6406, *Short Form Application for Determination for Minor Amendment of Employee Benefit Plan*
Form 8717, *User Fee for Employee Plan Determination Letter Request*.

Form 5303, *Application for Determination for Collectively Bargained Plan*, currently used to apply for a determination letter for a collectively bargained plan, is eliminated. Applications previously submitted using Form 5303 will now be submitted using Form 5300.

D. Draft Forms Will Be Available on the Internet

To assist entities developing software used in preparing determination letter applications, as well as plan sponsors and practitioners, the Service will soon post draft Forms 5300, 5307, 5310, 6406, and Schedule Q to: *http://www.irs.gov/ep*. Although the Service does not anticipate making changes to the content of these draft forms, users are cautioned that these forms are subject to substantive and formatting changes before final versions are available. It is anticipated that final forms will be available in August.

E. Changes to Forms 5300, 5307, 5310, and Schedule Q

The following are the principal changes regarding Forms 5300, 5307, 5310, and Schedule Q:

1. Schedule Q, an optional form, must be attached to Form 5300 or Form 5307 if the applicant wishes to request a determination letter that covers one or more of certain coverage and nondiscrimination requirements.

2. Certain questions are being eliminated from the Schedule Q, including those related to § 401(a)(26). A determination letter application for a defined benefit plan will be reviewed for compliance with § 401(a)(26) if the application requests consideration of § 410(b), or if a cover letter requests consideration of § 401(a)(26) and the applicant provides data supporting the request.

3. Questions related to the ratio-percentage test under § 410(b) and the nondiscriminatory amount design-based safe harbors under § 401(a)(4) are included in Forms 5300 and 5307 as optional questions.

4. Questions related to the minimum coverage requirements, including the average benefit test, and the nondiscriminatory amounts requirement, including the general test and the design-based safe harbors, are being added to Form 5310. Form 5310 applicants will continue to be required to demonstrate compliance with the minimum coverage and nondiscriminatory amounts requirements, including the average benefit and general tests, unless the conditions described in section 12.04 of Rev. Proc. 2001–6, 2001–1 I.R.B. 194, have been satisfied. Applicants may file Schedule Q with Form 5310 to request a determination that covers any of the other nondiscrimination requirements addressed by the Schedule Q, such as the requirement that a plan not discriminate in the availability of benefits, rights and features under the plan.

F. Changes Regarding Favorable Determination Letters

Under current procedures, determination letters may include separate caveats indicating that the applicant has demonstrated that the plan satisfies specific coverage and nondiscrimination requirements, such as the average benefit test and the general test. However, the actual scope of reliance on a favorable determination letter is based on the information and demonstrations submitted with the application and the failure of an applicant to retain this information might limit the scope of reliance. (See section 21.01 of Rev. Proc. 2001–6.) The use of multiple caveats has sometimes resulted in confusion and administrative complications.

To improve the quality of the letters and processing efficiency, the Service will generally discontinue the use of separate caveats for the coverage and nondiscrimination requirements. The extent of reliance on a favorable letter will not change. Thus, a letter may be relied on with regard to specific determination requests made with the application, provided the relevant information and demonstrations are retained by the applicant.

G. Effective Dates and Transition Rules

1. Determination letter applications filed before July 23, 2001, must comply with the procedures in Rev. Proc. 2001–6 and the current determination letter application forms.
2. Between July 23, 2001, and December 31, 2001, applicants requesting determination letters on Form 5300 or 5307 may choose to:
   - submit the revised Form 5300 or 5307 either including or omitting the revised Schedule Q, once the forms are finalized;
   - submit the current Form 5300 or 5307 with the current Schedule Q, following the procedures in Rev. Proc. 2001–6;
   - submit the current Form 5300 or 5307 omitting Schedule Q; or
   - submit the current Form 5300 or 5307 with the current Schedule Q, completing only Part I of the Schedule Q and those line items relating to the specific coverage and nondiscrimination requirements for which the applicant requests a determination.

   In the latter two cases, the applicant must include a cover letter indicating that the determination requested is only on the form of the plan or on both the form of the plan and those issues selected on Schedule Q. If this information is not included in the cover letter, the Service will not contact the applicant but will assume the omission or partial completion of the Schedule Q correctly reflects the scope of the determination requested by the applicant.
3. Determination letter applications filed on Form 5310 before January 1, 2002, must comply with the procedures in Rev. Proc. 2001–6 and the current forms.

4. Determination letter applications filed after December 31, 2001, must be submitted on the revised forms.

H. User Fees

The user fee for an application will continue to be based on the form on which the application is submitted and whether the application involves a determination of the average benefit or general test.

SECTION II. CHANGES TO RELIANCE PROCEDURES FOR ADOPTING EMPLOYERS OF M&P AND VOLUME SUBMITTER PLANS

A. Current Reliance Procedures

Under current procedures, an employer that adopts a nonstandardized M&P plan or a volume submitter plan must request a determination letter to have reliance. An employer that adopts a standardized M&P plan (including paired plans) generally must request a determination letter to have reliance if the employer maintains another plan.

B. New Reliance Procedures

Adopting employers of M&P and volume submitter plans can rely on a favorable opinion or advisory letter issued to the M&P sponsor or volume submitter practitioner as described below if the employer adopts a plan that is identical to an approved M&P or specimen plan and chooses only options permitted under the terms of the approved plan. These employers can forego filing Form 5307 and rely on a favorable opinion or advisory letter issued to the M&P sponsor or volume submitter practitioner with respect to the qualification requirements, except as provided in 1 through 5 of this paragraph B and in paragraph C of this section, below.

1. Except as provided herein, adopting employers of nonstandardized M&P plans and volume submitter plans cannot rely on a favorable opinion or advisory letter with respect to the requirements of:
   (a) § 401(a)(4), 401(a)(26), 401(l), 410(b) or 414(s); or
   (b) if the employer maintains or has ever maintained another plan covering some of the same participants[2], § 415 or 416.
2. Adopting employers of nonstandardized M&P plans and volume submitter plans can rely on the opinion or advisory letter with respect to the requirements of §§410(b) and 401(a)(26) (other than the § 401(a)(26) requirements that apply to a prior benefit structure) if 100 percent of all nonexcludable employees benefit under the plan.
3. Nonstandardized M&P plans must give adopting employers the option to elect a safe harbor allocation or benefit formula and a safe harbor compensation definition. Adopting employers of nonstandardized M&P plans that elect a safe harbor allocation or benefit formula and a safe harbor compensation definition can rely on an opinion letter with respect to the nondiscriminatory amounts requirement under § 401(a)(4) and the requirements of §§ 401(k) and 401(m) (except where the M&P plan is a safe harbor § 401(k) plan that provides for the safe harbor contribution to be made under another plan).
4. Adopting employers of nonstandardized safe harbor M&P plans (which require adopting employers to elect a safe harbor allocation or benefit formula) are entitled to the same reliance as adopting employers of nonstandardized plans except that they have automatic reliance with respect to the nondiscriminatory amounts requirement if they elect a safe harbor definition of compensation.
5. Adopting employers of standardized M&P plans (including paired plans) that maintain or have ever maintained another plan can rely on a favorable opinion letter except with respect to the requirements of §§ 415 and 416 and the requirements of § 401(a)(26) that apply to prior benefit structures.

C. Other Limitations and Conditions on Reliance

1. An adopting employer of an M&P or volume submitter plan can rely on a favorable opinion or advisory letter only if the letter has taken into account the requirements of GUST and the plan has been amended to the extent necessary to comply with the requirements of § 314(e) of CRA, relating to changes to the definition of compensation under §§ 414(s) and 415(c)(3). In addition, if the opinion or advisory letter is a "GUST I" letter (as defined in Rev. Proc. 2000–27, 2000–26 I.R.B. 1272), the plan must have been amended to the extent necessary to comply with the requirements of GUST that are effective after 1998.
2. An adopting employer can rely on a favorable opinion or advisory letter for a plan that amends or restates a plan of the employer only if the plan that is being amended or restated satisfies the qualification requirements as in effect prior to GUST and the operational compliance requirements of GUST, and the GUST amendments are retroactively effective to the extent required.
3. An adopting employer cannot rely on an opinion or advisory letter for a plan if the repealed family aggregation rules continued to apply under the plan after 1996 or if the repealed § 415(e) limits continued to apply under the plan after 1999. The continued application of these rules and limits in years following their repeal could cause a plan to fail to satisfy one or more requirements of § 401(a).
4. An adopting employer cannot rely on an advisory letter issued after the date the employer adopts the GUST-amended plan.
5. An adopting employer can rely on an opinion or advisory letter only if the employer has not added any terms to the approved M&P or volume submitter plan document and has not modified or deleted any terms of the document other than choosing options permitted under the document or, in the case of an M&P plan, amending the document as permitted under sections 5.07 and 5.11 of Rev. Proc. 2000–20. Thus, for example, in the case of a volume submitter plan, the employer's plan must be identical to the approved specimen plan except as the result of the employer's selection among options that are permitted under the terms of the approved specimen plan.
6. An adopting employer cannot rely on an opinion or advisory letter if the adopting employer has modified the terms of the plan's approved trust in a manner that would cause the plan to fail to be qualified.

D. Reliance Equivalent to Determination Letter

To the extent an employer can rely on a favorable opinion or advisory letter pursuant to this announcement or Rev. Proc. 2000–20 and Rev. Proc. 2001–6, the opinion or advisory letter shall be equivalent to a favorable determination letter. For example, the favorable opinion or advisory letter shall be treated as a favorable determination letter for purposes of section 21 of Rev. Proc. 2000–6, regarding the effect of a determination letter, and section 5.01(4) of Rev. Proc. 2001–17, 2001–7 I.R.B. 589, regarding the definition of "favorable letter" for purposes of the Employee Plans Compliance Resolution System.

E. Change to Conditions for Extended Remedial Amendment Period

The GUST remedial amendment period generally ends on the last day of the first plan year beginning on or after January 1, 2001. However, certain plans may be eligible for an extended remedial amendment period under the provisions of section 19 of Rev. Proc. 2000–20. Section 19.04 of Rev. Proc. 2000–20 requires plans eligible for the extension to request a determination letter by the end of the

[2] For this purpose, whether an employer maintains or has ever maintained another plan will be determined using principles consistent with section 6.02 of Rev. Proc. 2000-20, 2000-6 I.R.B. 553.

extended period if a determination letter is required for reliance. Thus, current procedures would require adopting employers of nonstandardized M&P plans and volume submitter plans to request determination letters within the extended period.

An employer eligible for reliance without a determination letter, as described in this section, is not required to request a determination letter to be entitled to the extension of the remedial amendment period under section 19 of Rev. Proc. 2000–20, provided that the employer adopts the GUST-approved M&P or specimen plan within the extended remedial amendment period.

SECTION III. CHANGES TO APPLICATION PROCEDURES FOR EMPLOYERS THAT MAINTAIN MULTIPLE EMPLOYER PLANS

A. Current Application Procedures

Under current procedures, an application for a determination letter for a multiple employer plan must include separate Form 5300 applications for each employer maintaining the plan. In addition, demonstrations to be included with Schedule Q must separately demonstrate compliance with the relevant coverage or nondiscrimination requirement by each employer.

B. New Application Procedures

A determination letter applicant can request either (1) a letter for the plan or (2) a letter for the plan and a letter for each employer maintaining the plan with respect to whom a separate Form 5300 is filed.

1. An applicant requesting a letter for the plan submits one Form 5300 application for the plan, filed on behalf of one employer, omitting the optional minimum coverage questions and Schedule Q and either including or omitting the design-based safe harbor questions. The user fee for a single employer plan will apply. An employer maintaining a multiple employer plan can rely on a favorable determination letter issued for the plan except with respect to the requirements of §§ 401(a)(4), 401(a)(26), 401(l), 410(b) and 414(s), and, if the employer maintains or has ever maintained another plan, §§ 415 and 416.

2. An applicant requesting a letter for the plan and an employer must submit the filing required in (1) above and a separate Form 5300 application, completed through line 8, for each employer requesting a separate letter. Each employer may elect to respond to the Form 5300 questions regarding minimum coverage and design-based safe harbors and to file Schedule Q to request a determination on the average benefit test, the general test, or any other nondiscrimination requirement addressed by the Schedule Q. The user fee for the application will be determined under the user fee schedules for multiple employer plans in section 6.06 of Rev. Proc. 2001–8, 2001–1 I.R.B. 239, substituting the number of Forms 5300 filed for the number of employers maintaining the plan and treating the entire application as a general test or average benefit test application if any employer requests a determination on either of these tests.

C. Other Limitations and Conditions

Rules similar to the rules in Section II.C and D above also apply in the case of an employer maintaining a multiple employer plan.

SECTION IV. HIGHLIGHTING DOCUMENT CHANGES

The Service encourages practitioners to highlight changes to plan documents that have previously received determination letters in such a way as makes the nature and purpose of the changes apparent and assists Service personnel in reviewing the plan. This practice may speed the review of plan documents; however, the Service retains the discretion to review the entire document.

SECTION V. LISTS OF M&P AND VOLUME SUBMITTER PLANS

The period of extension of the GUST remedial amendment period under section 19 of Rev. Proc. 2000–20 is 12 months. The 12-month period begins on the date of approval of the last M&P or specimen plan of the employer's M&P sponsor or volume submitter practitioner to receive a favorable GUST opinion or advisory letter. In Notice 2001–42, page 70, this bulletin, the Service has provided that the 12-month period shall be treated as not ending before December 31, 2002.

The Service has been asked to make available lists of M&P and volume submitter plans to assist employers in determining the expiration of their GUST remedial amendment period. Therefore, the Service plans to make available on the Internet a list of all the M&P and volume submitter plans that were submitted to the Service for GUST opinion or advisory letters by December 31, 2000, the deadline for filing under Rev. Proc. 2000–20. This list will include the name of the M&P sponsor or volume submitter practitioner, the name of each plan submitted by the sponsor or practitioner, and the file folder or other number assigned to each plan. This list will be posted as early as possible in the second half of 2001.

As soon as practical after publication of the list, and periodically thereafter, the Service will amend the list to include the date on which each plan is approved or the application is otherwise closed.

SECTION VI. FINAL CROSS-TESTING REGULATIONS

A. Publication of Final Regulations

Final regulations under § 401(a)(4), published in the Federal Register on June 29, 2001 (the "final cross-testing regulations") amend §§ 1.401(a)(4)–8, 1.401(a)(4)–9 and 1.401(a)(4)–12 of the Income Tax Regulations. The final cross-testing regulations describe the conditions under which defined contribution plans, and defined contribution and defined benefit plans that are tested together, are permitted to demonstrate compliance with nondiscrimination requirements on a benefits basis. The regulations are effective for plan years beginning on or after January 1, 2002.

B. Permitted Amendment of Pending Specimen Plans in Conjunction with GUST

Practitioners that sponsor volume submitter plans with "cross-testing formulas" or provisions may wish to amend their specimen plans for the regulations to help adopting employers ensure that their plans will be eligible to cross-test. In order to facilitate the amendment of specimen plans for the final cross-testing regulations during the GUST plan restatement process, the Service will allow practitioners to submit final regulation amendments to their specimen defined contribution plans to be reviewed in conjunction with the review of the plan for compliance with GUST, provided the amendments are submitted by October 22, 2001. When submitting such amendments, practitioners should include a cover letter that identifies the specimen plan to which the amendments relate and the status of the application (if known) and that describes the nature of the amendments. The Service will not issue an advisory letter for a defined contribution specimen plan before October 22, 2001, without first obtaining the concurrence of the practitioner.

C. Permitted Amendment of Previously Approved Specimen Plans

Practitioners that have already received a GUST advisory letter for a defined contribution specimen plan may resubmit the plan by October 22, 2001, to include final regulation amendments. The submission should include the plan and any amendments, a copy of the GUST advisory letter, and a cover letter which describes the nature of the changes to the specimen plan and indicates that the application is being submitted pursuant to Announcement 2001–77. In this case, a favorable advisory letter issued with respect to the amendments will be treated as the initial GUST advisory letter for the specimen plan for purposes of determining the 12-month period under Rev. Proc. 2000–20.

D. Determination Letter Applications

For determination letter applications filed on or after August 22, 2001, employers may request a determination that takes the final cross-testing regulations into account. If a demonstration involving cross-testing relates to the 2002 or later plan year, the demonstration must address the requirements of the regulations. Estimated data for the 2002 plan year may be used for purposes of this demonstration.

SECTION VII. RELIANCE PRIOR TO PUBLICATION OF MODIFIED REVENUE PROCEDURES

The changes described in this announcement will be published as modifications to Rev. Procs. 2000–20, 2001–6 and 2001–8. Until the modifications to the revenue procedures are published, plan sponsors may rely on this announcement regarding the changes.

DRAFTING INFORMATION

The principal drafter of this announcement is James Flannery of Employee Plans. For further information regarding this announcement, please contact Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Mr. Flannery may be reached at (202) 283-9613. These telephone numbers are not toll-free.

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## Foundations Status of Certain Organizations

## Announcement 2001–78

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

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

African American Cultural Center, Inc., Lumberton, NC
Algerian Relief Foundation, Inc., Cary, NC
Alliance Educational Fund, Alexandria, VA
American Friends of English National Opera, New York, NY
Andrews Youth Football Association, Andrews, NC
Apollon Art Research Foundation, Inc., Claverack, NY
Arc of Mecklenburg County Condominiums, Inc., Charlotte, NC
Asian-American Cultural Society, Philadelphia, PA
Assistance in Dialysis Expenses, Inc., Charlotte, NC
Assisted Living Legal Defense & Education Fund, Inc., Herndon, VA
Association of Virginia Artisans, Inc., Waynesboro, VA
Badin-Harristown in Home Enrichment in Reading Program, Badin, NC
Belyi Foundation, Brevard, NC
Benco, Corvallis, OR
Bethany Bible Institute, Inc., Plainfield, NJ
Bone and Muscle Cancer Research and Awareness Foundation, Bala Cynwyd, PA
Brownlee Non-Profit Housing Corporation, Durham, NC
Build, Inc., Sanford, NC
Cape Fear Community Development Corporation, Fayetteville, NC
Carolina Stage Company, Fayettville, NC
Cary First Planned Partners Ministry, Inc., Cary, NC
Center for Academic Excellence, Naples, NC
Center for Children of Separation and Divorce, Charlotte, NC
Chaparral Rails to Trails, Inc., Roxton, TX
Charlotte Wine & Food Weekend, Inc., Charlotte, NC
Chatham Citizens for Responsible Development, Siler City, NC
Cherubs the Assoc. of Congenital Diaphragmatic Hernia Research, Creedmor, NC
Childcare Advocates for Response & Empowerment, Inc., Smithfield, NC
Christian Relief Ministries, Incorporated, Advance, NC
Community Networking Association, Virginia Beach, VA
Concerned Citizens Coalition for Equal Opportunity and Equality, Naperville, IL
Constitutional Tradition and Education Corporation, Durham NC
Craven Community Chorus, New Bern, NC
Cross Ministries, Garner, NC
Cub Scout Pack 52 Endowment Fund, Inc., Morgantown, WV
Danny McLean Memorial Scholarship, St. Paul, NC
Disability Express, Raleigh, NC
Eagles Wings Ministries International, Burke, VA
Ease, Inc., Durham, NC

East Coast State Community Development Corporation, Virginia Beach, VA
East Mecklenburg Exceptional Childrens Booster Club, Charlotte, NC
Ebenezer Baptist Church Child Care Center, Rocky Mount, NC
Ebony-Ivory International, Inc., Baltimore, MD
Egregor, Inc., Faith, NC
Elizabeth City Neighborhood Corporation, Elizabeth City, NC
Fat Guy Charities, Inc., Charlotte, NC
Filipino-American Senior Citizens of Los Angeles, Los Angeles, CA
First Baptist Housing Development, Inc. II, Lumberton, NC
First in Families, Inc., Charlotte, NC
Foundation for Sustainable Development, Carrboro, NC
Foundation for the Historical and Cultural Preservation of Inigenou, Elkins, WV
Friends for Animals of Green County, Snow Hill, NC
Friends of the Belle Haven Marina, Alexandria, VA
Fund for Investigative Reporting, Inc., Asheville, NC
Garlyn, Inc., Shelby, NC
G.E.M. Community Services, Inc., Edison, NJ
Gilbert Theater, Fayetteville, NC
Global Institute of Environmental Scientists, Alexandria, VA
Global Response Service Corporation, Herndon, VA
Golf Shop-Headquarters for Jr. Golf, Inc., Norfolk, VA
Greater Manassas Tournament Softball Foundation, Manassas, VA
Guardians of Wildlife, Dale City, Va
Guilford County Association of Scuba Personnel, Oak Ridge, NC
Hampton Roads Early Music Society, Norfolk, VA
Hand to Eye Workshop & Studio, Incorporated, Durham, NC
Harold C. Enloe Lodge No. 1 of the Fraternal Order of Police Foundation, Inc., Asheville, NC
Heritage Square Apartments, Inc., Siloam Springs, AR
High Point Youth Sports Council, Inc., High Point, NC
Highlands-Cashiers National Public Radio Assoc., Inc., Cashiers, NC
HR Housing, Inc., Milwaukee, WI
Hyline Rescue Team, Inc., Harrisonburg, VA
In Step Ministries, Inc., Greensboro, NC
Institute for Training and Development, Herndon, Va
International Coalition for Aids Research and Education, Sterling, VA
International Federation of Conservation & Wildlife, Cleveland, OH
Isle of Wight Educational Foundation, Smithfield, VA
J.D. Grant Ministries, Inc., Sylva, NC
Joint Committee for Persons with Disabilities, Elizabeth City, NC
Joyland Foundation, Durham, NC
Justice for Children Corporation, Durham, NC
Kehilah Kashrus, Inc., Brooklyn, NY
Kelly M. Alexander Sr. Leadership Institute, Charlotte, NC
Kennesaw Non-Profit Housing Corporation, Santa Monica, CA
Knights of Windmaster, Inc., Lillington, NC
Laurel Springs Educational Foundation, Ojai, CA
Limits, Washington, DC
Living Free Program, Inc., Roanoke, VA
Living in the Word International, Midlothian, VA
Love Foundation, Winston Salem, NC
Lumbee Tribe of Cheraw Indians Dept. of Programs & Administration, Inc., Pembroke, NC
Lyric Theatre, Inc., Poquoson, VA
Mackall Foundation for the Arts, Inc., Arlington, VA
Mary’s Learning Center, Inc., Thomasville, NC
Mecklenburg Youth Council, Inc., Charlotte, NC
Metropolitan Washington Council for Homeless Veteran, Inc., Washington, DC
Montgomery County Young Mens Christian Association, Troy, NC
Music Mothers of Meagher County, Incorporated, White Sulphur Springs, MT
Neighborhood Community Builders, Inc., Greensboro, NC
New Bern Volunteer Firefighters Ladies’ Auxiliary, New Bern, NC
New Covenant Christian Center, Philadelphia, PA
New Tomorrow World Ministries, Inc., Kearneysville, WV
New Vinland Foundation, Rockport, ME
NFL Alumni Charities of Arizona, Tucson, AZ
Noble Quest, Ltd., Hillsborough, NC
Northern Wizards Wrestling Club, Cambridge, MN
Nutrition for Children, Inc., Demopolis, AL
Ohio Valley Multiple Sclerosis Society, Inc., Weirton, WV
Panhandle Humane Society, Inc., Kearneysville, WV
Park II Non-Profit Housing Corporation, Santa Monica, CA
Pastoral Biblical Counseling Center, Inc., Scotts, MI
Peacehaven, Inc., Warrensville, NC
Peter Gammons Ministries International, Altamonte, VA
Pets are Worth Saving, Inc., Sanford, NC
Pitt County Historical Reenactors, Greenville, NC
Plaza II Non-Profit Housing Corporation, Redono Beach, CA
Project Motivation Education, Inc., Charlotte, NC
Racers Reward, Inc., Concord, NC
Radical Changes Ministry, Raleigh, NC
Reach Teach and Touch Ministries, Bryson City, NC
Real Theatre Company, Boone, NC
Rebecca Gray Davis Memorial Fund for Children, Inc., Morgantown, NC
Reclaiming Our Youth, Inc., Centerville, VA
Regional Family Service Enterprise, Inc., High Point, NC
Rough River Area Enhancement, Inc., Leitchfield, KY
Rowan County Youth Soccer Association, Inc., Salisbury, NC
Severt-Holston League of Residents, Marion, VA
Sisters in the Name of Love of the Roanoke Valley, Inc., Roanoke, VA
SMP Retreat Center, Twin Lake, MI
Soar Corp. International, Virginia Beach, VA
Soaring In Education, Dresden, ME
Soldiers Memorial A.M.E. Zion Church Foundation, Inc., Salisbury, NC
Southeastern Case Management Network, Greensboro, NC
Southwest Area Network, Inc., Birmingham, AL
Spruce Pine Housing Authority, Inc., Spruce Pine, NC
St. Paul’s Family Resources, St. Paul, MN

Statesmen, Inc., Charlotte, NC
Sunset Ministries, Ft. Worth, TX
Third World Outreach (TWO), Inc., Bronx, NY
Timberlake Restoration Fund, Inc., Lynchburg, VA
Tithe Luv, Inc., Norfolk, VA
Triad Community Artspace, Inc., Greensboro, NC
Triad Radio Project, Greensboro, NC
Tularcitos Parent Club, Carmel Valley, CA
Twin Rivers Quilters, New Bern, NC
Ujamma, Incorporated, Charlotte, NC
United Burial Fund, Inc., Chesapeake, VA
United Ralph Bell Crusade for Christ Ministry of Billy Graham, Clarksburg, WV
Voter Education and Equal Representation, Inc., Charlotte, NC
VQHA Ray Melton Youth Scholarship Fund, Montpelier, VA
Wake Electric Care, Inc., Wake Forest, NC
Walking by Faith Prophetic Ministry, Inc., North Chicago, IL
Westview Bible College, Inc., Rocky Point, NC
Westview Summer Baseball Softball Association Norton, CT
Willow Care, Raleigh, NC
Woodbridge Foundation, Inc., Woodbridge, VA
World Engineering Partnership for Sustainable Development, Inc., Alexandria, VA
York Non-Profit Housing Corporation, Santa Monica, CA
Youth Taking Charge, Arlington, VA

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

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

## Section 3111.—Rate of Tax

## Ct. D. 2070

**SUPREME COURT OF THE UNITED STATES**

No. 00–203

UNITED STATES v. CLEVELAND INDIANS BASEBALL CO.

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

April 17, 2001

Syllabus

Under a grievance settlement agreement, respondent Cleveland Indians Baseball Company (Company) owed 8 players backpay for wages due in 1986 and 14 players backpay for wages due in 1987. The Company paid the back wages in 1994. This case presents the question whether, under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA), the back wages should be taxed by reference to the year they were actually paid (1994) or, instead, by reference to the years they should have been paid (1986 and 1987). Both tax rates and the amount of the wages subject to tax (the wage base) have risen over time. Consequently, allocating the 1994 payments back to 1986 and 1987 would generate no additional FICA or FUTA tax liability for the Company and its former employees, while treating the back wages as taxable in 1994 would subject both the Company and the employees to significant tax liability. The Company paid its share of employment taxes on the back wages according to 1994 tax rates and wage bases. After the Internal Revenue Service denied its claims for a refund of those payments, the Company initiated this action in District Court. The Company relied on Sixth Circuit precedent holding that a settlement for back wages should not be allocated to the period when the employer finally pays but to the periods when the wages were not paid as usual. The District Court, bound by that precedent, entered judgment for the Company and ordered the Government to refund FICA and FUTA taxes. The Sixth Circuit affirmed.

*Held:* Back wages are subject to FICA and FUTA taxes by reference to the year the wages are in fact paid. Pp. 5-19.

(a) The Internal Revenue Code imposes FICA and FUTA taxes "on every employer . . . equal to [a percentage of] wages . . . paid by him with respect to employment." 26 U.S.C. Sections 3111(a), 3111(b), 3301. The Social Security tax provision, Sec. 3111(a), prescribes tax rates applicable to "wages paid during" each year from 1984 onward. The Medicare tax provision, Sec. 3111(b)(6), sets the tax rate "with respect to wages paid after December 31, 1985." And the FUTA tax provision, Sec. 3301, sets the rate as a percentage "in the case of calendar years 1988 through 2007 . . . of the total wages . . . paid by [the employer] during the calendar year." Section 3121(a) establishes the annual ceiling on wages subject to Social Security tax by defining "wages" to exclude any remuneration "paid to [an] individual by [an] employer during [a] calendar year" that exceeds "remuneration . . . equal to the contribution and benefit base . . . paid to [such] individual . . . during the calendar year with respect to which such contribution and benefit base is effective." Section 3306(b)(1) similarly limits annual wages subject to FUTA tax. Pp. 5-6.

(b) The Government calls attention to these provisions' constant references to *wages paid during a calendar year* as the touchstone for determining the applicable tax rate and wage base. The meaning of this language, the Government contends, is plain: Wages are taxed according to the calendar year they are in fact paid, regardless of when they should have been paid. The Court agrees with the Company that *Social Security Bd. v. Nierotko*, 327 U.S. 358, undermines the Government's plain language argument. The *Nierotko* Court concluded that, for purposes of determining a wrongfully discharged worker's eligibility for Social Security benefits under Sec. 209(g), as that provision was formulated in the 1939 Amendments to the Social Security Act, a backpay award had to be allocated as wages to calendar quarters of the year "when the regular wages were not paid as usual." *Id.* at 370, and n. 25. The Court found no conflict between this allocation-back rule and language in Sec. 209(g) tying benefits eligibility to the number of calendar quarters "in which" a minimum amount of "wages" "has been paid." *Nierotko's* allocation holding for benefits eligibility purposes, which the Government does not here urge the Court to overrule, thus turned on an implicit construction of Sec. 209(g)'s terms — "wages" "paid" "in" "a calendar quarter" — to include "regular wages" that should have been paid but "were not paid as usual," 327 U.S. at 370. Given this construction, it cannot be said that the FICA and FUTA provisions prescribing tax rates based on *wages paid during a calendar year* have a plain meaning that precludes allocation of backpay to the year it should have been paid. Pp. 6-10.

(c) However, the Court rejects the Company's contention that, because *Nierotko* read the 1939 "wages paid" language for benefits eligibility purposes to accommodate an allocation-back rule for backpay, the identical 1939 "wages paid" language for tax purposes must be read the same way. *Nierotko* dealt specifically and only with Social Security benefits eligibility, not with taxation. The Court's allocation holding in *Nierotko* in all likelihood reflected concern that the benefits scheme created in 1939 would be disserved by allowing an employer's wrongdoing to reduce the quarters of coverage an employee would otherwise be entitled to claim toward eligibility. No similar concern underlies the tax provisions. The legislative history demonstrates that the 1939 Amendments adopting the "wages paid" rule for taxation were designed to address Congress' worry that, as tax rates increased from year to year, administrative difficulties and confusion would attend the taxation of wages payable in one year, but not actually paid until another year.

(d) The Court is not persuaded Congress incorporated *Nierotko's* treatment of backpay into the tax provisions when it amended the Social Security Act shortly after *Nierotko* was decided. Prior to 1946, the FICA and FUTA wage bases were defined in terms of remuneration paid with respect to employment during a given year. The 1946 law amended Sec. 209(a), which defines the Social Security wage base for purposes of benefits calculation, by adopting the "wages paid" language already present in Sec. 209(g), the provision construed in *Nierotko*. Congress also used identical "wages paid" language in redefining the FICA and FUTA wage bases for tax purposes. Although the legislative history makes clear that Congress sought to achieve conformity between the tax and benefits provisions, the conformity Congress sought had nothing to do with *Nierotko's* treatment of backpay. Rather, Congress' purpose in amending the FICA and FUTA wage bases for tax and benefits purposes was to define the yardstick for measuring "wages" as *the amount paid during the calendar year without regard to the year in which the employment occurred*. Because the concern that animates *Nierotko's* treatment of backpay in the benefits context has no relevance to the tax side, it makes no sense to attribute to Congress a desire for conformity not only with respect to the general rule for measuring "wages," but also with respect to *Nierotko's* backpay exception. Pp. 10-14.

(e) There is some force to the Company's contention that the Government's refusal to allocate back wages to the year they should have been paid creates inequities in taxation and incentives for strategic behavior that Congress did not intend. But this case presents no structural unfairness in taxation comparable to the structural inequity in *Nierotko's* context. In *Nierotko*, an inflexible rule allocating backpay to the year it is actually paid would never work to the employee's advantage; it could inure *only* to the detriment of the employee, counter to the thrust of the benefits eligibility provisions. Here, by contrast, the Government's rule sometimes disadvantages the taxpayer, as in this case; other times it works to the disadvantage of the fisc. Anomalous results must be considered in light of Congress' evident interest in reducing complexity and minimizing administrative confusion within the FICA and FUTA tax schemes. Given these concerns, it cannot be said that the Government's rule is incompatible with the statutory scheme. The most that can be said is that Congress intended the tax provisions to be both efficiently administrable and fair, and that this case reveals the tension that sometimes exists when Congress seeks to meet those twin aims. Pp. 14-17.

(f) Confronted with this tension, the Court defers to the Internal Revenue Service's interpretation. The Court does not sit as a committee of revision to perfect the administration of the tax laws. *United States v. Correll*, 389 U.S. 299, 306–307. Instead, it defers to the Commissioner's regulations as long as they implement the congressional mandate in a reasonable manner. *Id.*, at 307. The Internal Revenue Service has long maintained regulations interpreting the FICA and FUTA tax provisions. In their current form, the regulations specify that wages must be taxed according to the year they are actually paid. Echoing the language in 26 U.S.C. Sec. 3111(a) (FICA) and Sec. 3301 (FUTA), these regulations have continued unchanged in their basic substance since 1940. Although the regulations, like the statute, do not specifically address backpay, the Service has consistently interpreted them to require taxation of back wages according to the year the wages are actually paid, regardless of when those wages were earned or should have been paid. The Court need not decide whether the Revenue Rulings themselves are entitled to deference. In this case, the Rulings simply reflect the agency's longstanding interpretation of its own regulations. Because that interpretation is reasonable, it attracts substantial judicial deference. *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512. Pp. 17-18.

215 F.3d 1325, reversed.

GINSBURG, J., delivered the opinion of the Court, in which REHNQUIST, C.J., and STEVENS, O'CONNOR, KENNEDY, SOUTER, THOMAS, and BREYER, JJ., joined. SCALIA, J., filed an opinion concurring in the judgment.

**SUPREME COURT OF THE UNITED STATES**

No. 00–203

UNITED STATES, PETITIONER *v.* CLEVELAND INDIANS BASEBALL COMPANY

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

[April 17, 2001]

JUSTICE GINSBURG delivered the opinion of the Court.

The Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) impose excise taxes on employee wages to fund Social Security, Medicare, and unemployment compensation programs. This case concerns the application of FICA and FUTA taxes to payments of back wages. The Internal Revenue Service has consistently maintained that, for tax purposes, backpay awards should be attributed to the year the award is actually paid. Respondent Cleveland Indians Baseball Company (Company) urges, and the Court of Appeals for the Sixth Circuit held, that such awards must be allocated, as they are for purposes of Social Security benefits eligibility, to the periods in which the wages should have been paid. According due respect to the Service's reasonable, longstanding construction of the governing statutes and its own regulations, we hold that back wages are subject to FICA and FUTA taxes by reference to the year the wages are in fact paid.

I

Pursuant to a settlement of grievances asserted by the Major League Baseball Players Association concerning players' free agency rights, several Major League Baseball clubs agreed to pay $280 million to players with valid claims for salary damages. Under the agreement, the Company owed 8 players a total of $610,000 in salary damages for 1986, and it owed 14 players a total of $1,457,848 in salary damages for 1987. The Company paid the awards in 1994. No award recipient was a Company employee in that year.

This case concerns the proper FICA and FUTA tax treatment of the 1994 payments. Under FICA, both employees and employers must pay tax on wages to fund Social Security and Medicare; under FUTA, employers (but not employees) must pay tax on wages to fund unemployment benefits. For purposes of this litigation, the Government and the Company stipulated that the settlement payments awarded to the players qualify as "wages" within the meaning of FICA and FUTA. The question presented is whether those payments, characterized as back wages, should be taxed by reference to the year they were actually paid (1994), as the Government urges, or by reference to the years they should have been paid (1986 and 1987), as the Company and its supporting *amicus*, the Major League Baseball Players Association, contend.

In any given year, the amount of FICA and FUTA tax owed depends on two determinants. The first is the tax rate. 26 U.S.C. Sections 3101, 3111 (FICA), Sec. 3301 (FUTA). The second is the statutory ceiling on taxable wages (also called the wage base), which limits the amount of annual wages subject to tax. Sec. 3121(a)(1) (FICA), Sec. 3306(b)(1) (FUTA). Both determinants have increased over time. In 1986, the Social Security tax on employees and employers was 5.7 percent on wages up to $42,000;[1] in 1987, it was 5.7 percent on wages up to $43,800;[2] and in 1994, 6.2 percent on wages up to $60,600.[3] Although the Medicare tax on employees and employers remained constant at 1.45 percent from 1986 to 1994,[4] the taxable wage base rose from $42,000 in 1986 to $43,800 in 1987,[5] and by 1994, Congress had abolished the wage ceiling, thereby subjecting all wages to the Medicare tax.[6] In 1986 and 1987, the FUTA tax was 6.0 percent on wages up to $7,000;[7] in 1994, it was 6.2 percent on wages up to $7,000.[8]

In this case, allocating the 1994 payments back to 1986 and 1987 works to the advantage of the Company and its former employees. The reason is that all but one of the employees who received back wages in 1994 had already collected wages from the Company exceeding the taxable maximum in 1986 and 1987. Because those employees as well as the Company paid the maximum amount of employment taxes chargeable in 1986 and 1987, allocating the 1994 payments back to those years would generate no additional FICA or FUTA tax liability. By contrast, treating the back wages as taxable in 1994 would subject both the Company and its former employees to significant tax liability. The Company paid none of the employees any other wages in 1994,[9] and FICA and FUTA taxes attributable to that year would be calculated according to tax rates and wage bases higher than their levels in 1986 and 1987.

Uncertain about the proper rule of taxation, the Company paid its share of employment taxes on the back wages according to 1994 tax rates and wage bases. Its FICA payment totaled $99,382, and its FUTA payment totaled $1,008.[10] After the Internal Revenue Service denied its claims for a refund of those payments, the Company initiated this action in District Court, relying on *Bowman v. United States*, 824 F.2d 528 (CA6 1987). In *Bowman*, the Sixth Circuit held that "[a] settlement for back wages should not be allocated to the period when the employer finally pays but 'should be allocated to the periods when the regular wages were not paid as usual.'" *Id.*, at 530 (quoting *Social Security Bd. v. Nierotko*, 327 U.S. 358, 370 (1946)). The District Court, bound by *Bowman*, entered judgment for the Company and ordered the Government to refund $97,202 in FICA and FUTA taxes.[11]

On appeal, the Government observed that two Courts of Appeals have held, in disagreement with *Bowman*, that under the law as implemented by Treasury Regulations, wages are to be taxed for FICA purposes in the year they are actually received. *Walker v. United States*, 202 F.3d 1290, 1292–1293 (CA10 2000) (finding *Nierotko* "inapposite" and *Bowman* "unpersuasive"); *Hemelt v. United States*, 122 F.3d 204, 210 (CA4 1997) (finding it "clear under the Treasury Regulations that 'wages' are to be taxed for FICA purposes in the year in which they are received"). The Court of Appeals for the Sixth Circuit nevertheless affirmed on the authority of *Bowman*. 215 F.3d 1325 (2000) (judgt. order).

We granted certiorari to resolve the conflict among the Courts of Appeals, 531 U.S. 943 (2000), and now reverse the Sixth Circuit's judgment.

## II

The Internal Revenue Code imposes employment taxes "on every employer . . . equal to [a percentage of] wages . . . paid by him with respect to employment." 26 U.S.C. Secs. 3111(a), 3111(b), 3301. The Social Security tax provision, Sec. 3111(a), contains a table prescribing tax rates applicable to "wages paid during" each year from 1984 onward (*e.g.*, "In cases of wages paid during . . . 1990 or thereafter . . . [t]he rate shall be . . . 6.2 percent."). The Medicare tax provision, Sec. 3111(b)(6), says "with respect to wages paid after December 31, 1985, the rate shall be 1.45 percent." And the FUTA tax provision, 26 U.S.C. Sec. 3301 (1994 ed., Supp. IV), says the rate shall be "6.2 percent in the case of calendar years 1988 through 2007 . . . of the total wages (as defined in section 3306(b)) paid by [the employer] during the calendar year."

Section 3121(a) of the Code establishes the annual ceiling on wages subject to Social Security tax. It does so by defining "wages" to exclude any remuneration "paid to [an] individual by [an] employer during [a] calendar year" that exceeds "remuneration . . . equal to the contribution and benefit base . . . paid to [such] individual by [such] employer during the calendar year with respect to which such contribution and benefit base is effective." Section 3306(b)(1) similarly limits annual wages subject to FUTA tax by excluding

[1] 26 U.S.C. Secs. 3101(a), 3111(a), 3121(a)(1); 51 Fed. Reg. 40256, 40257 (1986).

[2] Secs. 3101(a), 3111(a), 3121(a)(1); 50 Fed. Reg. 45558, 45559 (1985).

[3] Secs. 3101(a), 3111(a), 3121(a)(1); 58 Fed. Reg. 58004, 58005 (1993).

[4] Secs. 3101(b), 3111(b).

[5] 26 U.S.C. Sec. 3121(a)(1) (1982 ed.); 51 Fed. Reg. 40256, 40257 (1986); 50 Fed. Reg. 45558, 45559 (1985).

[6] 26 U.S.C. Sec. 3121(a)(1).

[7] 26 U.S.C. Secs. 3301, 3306(b)(1) (1982 ed. and Supp. III).

[8] 26 U.S.C. Secs. 3301, 3306(b)(1).

[9] If a player received wages in 1994 from another employer in addition to receiving back wages from the Company, the player — but not the Company — would be entitled to a credit or refund of any Social Security tax paid in excess of the amount of tax due on a single taxable wage base ($60,600). 26 U.S.C. Sec. 6413(c)(1). To illustrate, suppose a player received $50,000 in back wages from the Cleveland Indians and an additional $50,000 in wages from the New York Mets in 1994. Assuming all $100,000 in wages are taxed in 1994, the player would be entitled to a credit or refund of Social Security tax paid in excess of the amount of tax due on $60,600. By contrast, the Indians and the Mets would *each* be liable for Social Security taxes on $50,000 in wages paid to that player. 26 U.S.C. Sec. 3111 (Social Security tax is "an excise tax, with respect to having individuals in his employ"). Thus, under the Government's proposed rule, the Cleveland Indians would owe Social Security taxes on all amounts up to $60,600 that it paid to each player in 1994, regardless of whether the players themselves had reached or exceeded the $60,600 ceiling through multiple wage sources.

[10] Although the Company also withheld $99,382 to pay the employees' share of FICA taxes, it does not seek to recover any taxes paid on behalf of the employees in this suit.

[11] This amount is slightly less than the total FICA and FUTA taxes paid by the Company in 1994. The reason is that one of the employees who received a 1994 payment for wages due in 1987 received no wages from the Company in 1987. The Company thus owed a small amount of FICA and FUTA taxes on the back wages paid to him even when those wages were allocated back to 1987.

from "wages" any remuneration "paid to [an] individual by [an] employer during [a] calendar year" that exceeds "remuneration . . . equal to $7,000 . . . paid to [such] individual by [such] employer during [the] calendar year."

Both sides in this controversy have offered plausible interpretations of Congress' design. We set out next the parties' positions and explain why we ultimately defer to the Internal Revenue Service's reasonable, consistent, and longstanding interpretation of the FICA and FUTA provisions in point. Under that interpretation, wages must be taxed according to the year they are actually paid.

A

In the Government's view, the text of the controlling FICA and FUTA tax provisions explicitly instructs that employment taxes shall be computed by applying the tax rate and wage base in effect when wages are actually paid. In particular, the Government calls attention to the statute's constant references to *wages paid during a calendar year* as the touchstone for determining the applicable tax rate and wage base. 26 U.S.C. Sec. 3111(a) (setting Social Security tax rates for "wages paid during" particular calendar years); Sec. 3121(a) (defining Social Security wage base in terms of "remuneration . . . paid . . . during the calendar year"); Sec. 3301 (setting FUTA tax rate as a percentage of "wages . . . paid . . . during the calendar year"); Sec. 3306(b)(1) (defining FUTA wage base in terms of "remuneration . . . paid . . . during any calendar year"). The meaning of this language, the Government contends, is plain: Wages are taxed according to the calendar year they are in fact paid, regardless of when they should have been paid.

In support of this reading, the Government observes that Congress chose the words in the current statute specifically to replace language in the original 1935 Social Security Act providing that FICA and FUTA tax rates applied to wages paid or received "with respect to *employment during the calendar year*." Social Security Act (1935 Act), Secs. 801, 804, 901, 49 Stat. 636–637, 639 (emphasis added). The Treasury Department had interpreted this 1935 language to mean that wages are taxed at "the rate in effect *at the time of the performance of the services* for which the wages were paid." Treas. Regs. 91, Arts. 202, 302 (1936) (emphasis added). In 1939, Congress amended the 1935 Act to provide that FICA and FUTA tax rates would no longer apply on the basis of when services were performed, but would instead apply "with respect to *wages paid during the calendar yea[r]*." Social Security Act Amendments of 1939 (1939 Amendments), Secs. 604, 608, 53 Stat. 1383, 1387 (emphasis added). This 1939 language remains essentially unchanged in the current FICA and FUTA tax provisions, 26 U.S.C. Secs. 3111(a) and 3301.

Acknowledging that the 1939 Amendments established a "wages paid" rule for FICA and FUTA taxation, the Company nevertheless argues that *Social Security Bd. v. Nierotko*, 327 U.S. 358 (1946), undermines the Government's plain language argument. According due weight to our precedent, we agree.

In *Nierotko*, the National Labor Relations Board had ordered the reinstatement of a wrongfully discharged employee with "back pay" covering wages lost during the period from February 1937 to September 1939. *Id.*, at 359. The employer paid the award in July 1941. *Id.*, at 359–360. The primary question presented and aired in the Court's opinion was whether backpay for a time in which the employee was not on the job should nevertheless count as "wages" in determining the employee's eligibility for Social Security benefits. *Id.*, at 359. Notwithstanding the contrary view of the Social Security Board and the Bureau of Internal Revenue, the Court held that backpay covering the wrongful discharge period met the definition of "wages" in the 1935 Act. *Id.*, at 360–370.

In the final two paragraphs of the *Nierotko* opinion, the Court took up the question of how the backpay award should be allocated for purposes of determining the worker's eligibility for benefits. As originally enacted, the Social Security Act extended benefits to persons over 65 who had earned at least $2,000 in wages in each of any five years after 1936. 1935 Act, Secs. 201(a), 210(c), 49 Stat. 622, 625. In 1939, however, Congress introduced a new scheme, which remains in place today, tying eligibility for benefits to the number of calendar-year "quarters of coverage" accumulated by an individual. 1939 Amendments, Secs. 209(g), (h), 53 Stat. 1376–1377 (codified at 42 U.S.C. Secs. 413(a)(2), 414). Section 209(g) defined a "quarter of coverage" as either "a calendar quarter in which the individual has been paid not less than $50 in wages" or any quarter except the first "where an individual has been paid in a calendar year $3,000 or more in wages." 53 Stat. 1377.

*Nierotko* swiftly dispatched the question whether "'back pay' must be allocated as wages . . . to the 'calendar quarters' of the year in which the money would have been earned, if the employee had not been wrongfully discharged." 327 U.S., at 370. Rejecting the Government's argument that such allocation was impermissible because the 1939 Amendments to the benefits scheme refer to "'wages' to be 'paid' in certain 'quarters,'" *id.*, at 370, and n. 25 (citing *id.*, at 362, n. 7 (citing Sec. 209(g))), the Court concluded: "If, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods when the regular wages were not paid as usual." *Id.*, at 370.

Although the allocation question in *Nierotko* was a secondary issue addressed summarily by the Court, we think the Company is correct that *Nierotko* undercuts the plain meaning argument urged by the Government here. *Nierotko* found no conflict between an allocation-back rule for backpay and the language in Sec. 209(g) tying benefits eligibility to the number of calendar quarters "in which" a minimum amount of "wages" "has been paid." The Court's allocation holding for benefits eligibility purposes, which the Government does not urge us to overrule, Tr. of Oral Arg. 9, thus turned on an implicit construction of Sec. 209(g)'s terms — "wages" "paid" "in" "a calendar quarter" — to include "regular wages" that should have been paid but "were not paid as usual," 327 U.S., at 370. Given this construction of Sec. 209(g), now codified in 42 U.S.C. Sec. 413(a)(2), we cannot say that the FICA and FUTA provisions prescribing tax rates based on *wages paid during a calendar year*, codified in 26 U.S.C. Secs. 3111(a), 3301, have a plain meaning that precludes allocation of backpay to the year it should have been paid. Cf. *Hilton v. South Carolina Public*

*Railways Comm'n*, 502 U.S. 197, 205 (1991) ("*stare decisis* is most compelling" where "a pure question of statutory construction" is involved).

B

From here, we part ways with the Company. Although we agree that *Nierotko* blocks the Government's argument that the "wages paid" formulation in 26 U.S.C. Secs. 3111(a) and 3301 has a dispositively plain meaning, we reject the Company's next contention. Because *Nierotko* read the 1939 "wages paid" language for benefits eligibility purposes to accommodate an allocation-back rule for backpay, the Company urges, the identical 1939 "wages paid" language for tax purposes must be read the same way. We do not agree that the latter follows from the former like the night, the day.

*Nierotko* dealt specifically and only with Social Security benefits eligibility, not with taxation. The Court's allocation holding in *Nierotko* in all likelihood reflected concern that the benefits scheme created in 1939 would be disserved by allowing an employer's wrongdoing to reduce the quarters of coverage an employee would otherwise be entitled to claim toward eligibility. No similar concern underlies the tax provisions. Although Social Security taxes are used to pay for Social Security benefits in the aggregate, there is no direct relation between taxes and benefits at the level of an individual employee. As the Company itself acknowledges, "Social Security tax 'contributions,' unlike private pension contributions, do not create in the contributor a property right to benefits against the government, and wages rather than [tax] contributions are the statutory basis for calculating an individual's benefits." Brief for Respondent 14.

*Nierotko* thus does not compel symmetrical construction of the "wages paid" language in the discrete taxation and benefits eligibility contexts. Although we generally presume that "identical words used in different parts of the same act are intended to have the same meaning," *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932), the presumption "is not rigid," and "the meaning [of the same words] well may vary to meet the purposes of the law," *ibid.* Cf. Cook, "Substance" and "Procedure" in the Conflict of Laws, 42 Yale L. J. 333, 337 (1933) ("The tendency to assume that a word which appears in two or more legal rules, and so in connection with more than one purpose, has and should have precisely the same scope in all of them . . . has all the tenacity of original sin and must constantly be guarded against."). The benefits scheme delineated in Title 42 would "no doubt" be set awry without an allocation-back rule for back wages, notwithstanding "accounting difficulties." *Nierotko*, 327 U.S. at 370. But that surely cannot be said for the taxation scheme described in Title 26, where Congress' evident concern was not worker eligibility for benefits, but fiscal administrability.[12]

The 1939 Amendments adopting the "wages paid" rule for taxation reflected Congress' worry that, as tax rates increase from year to year, "difficulties and confusion" would attend the taxation of wages payable in one year, but not actually paid until another year. S. Rep. No. 734, 76th Cong., 1st Sess., 75–76; see also H.R. Rep. No. 728, 76th Cong., 1st Sess., 57–58. Congress understood that an employee's annual compensation may be "based on a percentage of profits, or on future royalties, the amount of which cannot be determined until long after the close of the year." S. Rep. No. 734, 76th Cong., 1st Sess., at 75. Requiring employers to "estimate unascertained amounts and pay taxes and contributions on that basis" would "cause a burden on employers and administrative authorities alike." *Id.*, at 75–76. Congress correctly anticipated that "[t]he placing of [FICA and FUTA] tax[es] on the 'wages paid' basis [would] relieve this situation." *Id.*, at 76. "Under the amendment the rate applicable would be the rate in effect at the time that the wages are paid and received without reference to the rate which was in effect at the time the services were performed." H.R. Rep. No.728, *supra*, at 58.

As an additional ground for construing the tax and benefits provisions *in pari materia*, the Company insists that Congress incorporated *Nierotko's* treatment of backpay into the tax provisions when it amended the Social Security Act shortly after *Nierotko* was decided. Prior to 1946, the FICA and FUTA wage bases had been defined in terms of remuneration "paid . . . with respect to employment during" a given year. 1935 Act, Sec. 811(a), 49 Stat. 639 (FICA); 1939 Amendments, Sec. 606, 53 Stat. 1383 (FUTA). Paralleling the 1939 Amendments to the tax rate provisions, Congress in 1946 established the current "wages paid" rule for identifying the wages that compose the FICA and FUTA wage bases in a given year. Social Security Act Amendments of 1946 (1946 Amendments), Secs. 412, 414, 60 Stat. 989-991 (codified at 26 U.S.C. Secs. 3121(a), 3306(b)(1)). The 1946 law amended Sec. 209(a), which defines the Social Security wage base for purposes of benefits calculation, by adopting the "wages paid" language already present in Sec. 209(g), the provision construed in *Nierotko*. Sec. 414, 60 Stat. 990–991. Congress also used identical "wages paid" language in redefining the FICA and FUTA wage bases for tax purposes. Sec. 412, 60 Stat. 989. Relying on the presumption that Sec. 209(a), as amended, incorporated *Nierotko's* construction of Sec. 209(g), see *Cannon v. University of Chicago*, 441 U.S. 677, 696–699 (1979), and observing that Congress redefined the wage bases for taxation to "confor[m] with the changes in section 209(a)," S. Rep. No. 1862, 79th Cong., 2d Sess., 36 (1946); H.R. Rep. No. 2447, 79th Cong., 2d Sess., 35 (1946), the Company urges that the amended benefits and tax provisions codified *Nierotko's* backpay allocation rule.

We are unpersuaded. Even assuming that the benefits provision, Sec. 209(a), is properly construed as incorporating *Nierotko's* reading of Sec. 209(g), we think the "confor[mity]" Congress sought to achieve between the tax and benefits provisions, S. Rep. No. 1862, *supra*, at 36; H.R.

[12] In determining that "accounting difficulties" were "not . . . insuperable" to its allocation holding, *Nierotko* noted that "'back pay' is now treated distributively" under Sec. 119 of the Revenue Act of 1943. 327 U.S. at 370, and n. 26. Section 119 provided that backpay exceeding 15 percent of gross income may be allocated to earlier periods for income tax purposes if such allocation would reduce the taxpayer's liability. Sec. 119(a), 58 Stat. 39. But Congress eliminated the 1943 backpay allocation rule in 1964, see Pub. L. 88-272, Sec. 232(a), 78 Stat. 107, leaving behind the principle "too firmly embedded in the income tax law to permit of any question," that "payments of compensation are income to a taxpayer on a cash basis in the year of receipt, as distinguished from the year in which the compensation is earned," 2 J. Mertens, Law of Federal Income Taxation Sec. 12.42, p. 179 (1973). The symmetry urged by the Company in construing the tax and benefits provisions of FICA and FUTA thus comes only at the expense of asymmetry in the collection of income taxes and employment taxes.

Rep. No. 2447, *supra*, at 35, had nothing to do with *Nierotko's* treatment of backpay. The Committee Reports make clear that Congress' purpose in amending the FICA and FUTA wage bases was to define the "yardstick" for measuring "wages" as "*the amount paid during the calendar year . . . , without regard to the year in which the employment occurred.*" S. Rep. No. 1862, *supra*, at 35 (emphasis added); H.R. Rep. No. 2447, *supra*, at 35 (emphasis added). It is with respect to this rule — measuring "wages" based on "the amount paid during the calendar year" — that Congress sought conformity between the Title 26 tax provisions and the Title 42 benefits provision. See S. Rep. No. 1862, *supra*, at 36 (tax wage base), 37 (benefits wage base); H.R. Rep. No. 2447, *supra*, at 35 (tax wage base), 36 (benefits wage base). Far from indicating an intent to codify *Nierotko*, those Reports suggest that Congress, if it considered *Nierotko* at all, considered it an exception to the general rule for measuring "wages" in a given year.[13] Because the concern that animates *Nierotko's* treatment of backpay in the benefits context has no relevance to the tax side, *supra* at 10–11, it makes no sense to attribute to Congress a desire for conformity not only with respect to the general rule for measuring "wages," but also with respect to *Nierotko's* backpay exception.

C

Were the Company to rely solely on arguments for symmetry in statutory construction, we would be inclined to conclude, given *Nierotko's* lack of concern with taxation, that the tax provisions themselves, informed by legislative purpose, require back wages to be taxed according to the year they are actually paid. But the Company has one more arrow in its quiver.

Apart from its arguments for symmetry, the Company contends that the Government's refusal to allocate back wages to the year they should have been paid creates inequities in taxation and incentives for strategic behavior that Congress did not intend. This contention is not without force. Under the Government's rule, an employee who should have been paid $100,000 in 1986, but is instead paid $50,000 in 1986 and $50,000 in backpay in 1994, would owe more tax than if she had been paid the full $100,000 due in 1986. Conversely, a wrongdoing employer who should have paid an employee $50,000 in each of five years covered by a $250,000 backpay award would pay only one year's worth of employment taxes (limited by the annual ceilings on taxable wages) in the year the award is actually paid. The Government's rule thus appears to exempt some wages that should be taxed and to tax some wages that should be exempt.

Applying the Government's rule to other provisions of the Code produces similar anomalies. Section 3121(a)(4), for example, exempts disability benefits from FICA tax if paid by an employer to an employee more than six months after the employee worked for the employer. 26 U.S.C. Sec. 3121(a)(4). Disability benefits included in a backpay award would be exempt from FICA tax if the employee had not worked for the employer for six months prior to the backpay award, even if the benefits should have been paid within six months after the employee stopped working for the employer. According to the Company, such results amount to tax windfalls, and invite employers wrongfully to withhold pay or benefits in order to reap the advantages of a strategically timed payment. See Brief for Respondent 33–40 (additional examples of windfalls and avoidance schemes). These outcomes may be avoided, the Company argues, by construing the tax provisions to require taxation of back wages according to the year the wages should have been paid.

It is, of course, true that statutory construction "is a holistic endeavor" and that the meaning of a provision is "clarified by the remainder of the statutory scheme . . . [when] only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Sav. Assn. of Tex. v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371 (1988). The Company's examples leave little doubt that the Government's rule generates a degree of arbitrariness in the operation of the tax statutes. But in *Nierotko's* context, an inflexible rule allocating backpay to the year it is actually paid would never work to the employee's advantage; it could inure *only* to the detriment of the employee, counter to the thrust of the benefits eligibility provisions.[14] In this case, by contrast, there is no comparable structural unfairness in taxation. The Government's rule sometimes disadvantages the taxpayer, as in this case. Other times it works to the disadvantage of the fisc, as the Company's examples show. The anomalous results to which the Company points must be considered in light of Congress' evident interest in reducing complexity and minimizing administrative confusion within the FICA and FUTA tax schemes. See *supra* at 11–12. Given the practical administrability concerns that underpin the tax provisions, we cannot say that the Government's rule is incompatible with the statutory scheme. The most we can say is that Congress intended the tax provisions to be both efficiently administrable and fair, and that this case reveals the tension that sometimes exists when Congress seeks to meet those twin aims.

D

Confronted with this tension, "we do not sit as a committee of revision to perfect the administration of the tax laws." *United States v. Correll*, 389 U.S. 299, 306–307 (1967). Instead, we defer to the Commissioner's regulations as long as

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[13] Indeed, the contemporaneous understanding of the Commissioner of Internal Revenue was that the 1946 Amendments supplanted *Nierotko's* allocation rule for backpay. See Letter from Joseph D. Nunan, Jr., Commissioner of Internal Revenue, to Social Security Administration, Bureau of Old-Age and Survivors Insurance (Mar. 6, 1947) ("The *Nierotko* decision requiring your Agency to make an allocation of the back pay award to prior periods was rendered on the basis of the law in effect at that time. The Social Security Act Amendments of 1946, having been enacted subsequent to the date of the *Nierotko* decision, must be interpreted in the light of the language contained in such Amendments and the Congressional intent.") (available in Lodging for Respondent, Exh. F). Nevertheless, for benefits eligibility and calculation purposes, the Social Security Administration (SSA) by regulation continues to apply the *Nierotko* rule to "[b]ack pay under a statute," 20 CFR Sec. 404.1242(b) (2000) (such backpay "is allocated to the periods of time in which it should have been paid if the employer had not violated the statute"), while declining to apply *Nierotko* to "[b]ack pay not under a statute," Sec. 404.1242(c) ("This back pay cannot be allocated to prior periods of time, but must be reported by the employer for the period in which it is paid.").

[14] The SSA has interpreted its regulation governing "[b]ack pay under a statute," 20 CFR Sec. 404.1242(b) (2000), to allow the employee to choose whether to allocate the back pay to the year it is paid or to the year it should have been paid. Social Security Administration, Reporting Back Pay and Special Wage Payments to the Social Security Administration 2, Pub. 957 (Sept. 1997).

they "implement the congressional mandate in some reasonable manner." *Id.*, at 307. "We do this because Congress has delegated to the [Commissioner], not to the courts, the task of prescribing all needful rules and regulations for the enforcement of the Internal Revenue Code." *National Muffler Dealers Assn., Inc. v. United States*, 440 U.S. 472, 477 (1979) (citing *Correll*, 389 U.S. at 307 (citing 26 U.S.C. Sec. 7805(a))). This delegation "helps guarantee that the rules will be written by 'masters of the subject' . . . who will be responsible for putting the rules into effect." 440 U.S., at 477 (quoting *United States v. Moore*, 95 U.S. 760, 763 (1878)).

The Internal Revenue Service has long maintained regulations interpreting the FICA and FUTA tax provisions. In their current form, the regulations specify that the employer tax "attaches *at the time that the wages are paid* by the employer," 26 CFR Sec. 31.3111–3 (2000) (emphasis added), and "is computed by applying to the wages paid by the employer the rate in effect *at the time such wages are paid*," Sec. 31.3111–2(c) (emphasis added); see Secs. 31.3301–2, –3(b) (same for FUTA). Echoing the language in 26 U.S.C. Secs. 3111(a) (FICA tax) and 3301 (FUTA tax), these regulations have continued unchanged in their basic substance since 1940. See T.D. 6516, 25 Fed. Reg. 13032 (1960); Treas. Regs. 107 (as amended by T.D. 5566, 1947–2 Cum. Bull. 148); Treas. Regs. 106 (as amended by T.D. 5566, 1947–2 Cum. Bull. 148); Treas. Regs. 106, Secs. 402.301–.303, 402.401–.403 (1940). Cf. *National Muffler*, 440 U.S. at 477 ("A regulation may have particular force if it is a substantially contemporaneous construction of the statute by those presumed to have been aware of congressional intent.").

Although the regulations, like the statute, do not specifically address backpay, the Internal Revenue Service has consistently interpreted them to require taxation of back wages according to the year the wages are actually paid, regardless of when those wages were earned or should have been paid. Rev. Rul. 89–35, 1989–1 Cum. Bull. 280; Rev. Rul. 78–336, 1978–2 Cum. Bull. 255. We need not decide whether the Revenue Rulings themselves are entitled to deference. In this case, the Rulings simply reflect the agency's longstanding interpretation of its own regulations. Because that interpretation is reasonable, it attracts substantial judicial deference. *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512 (1994). We do not resist according such deference in reviewing an agency's steady interpretation of its own 61-year-old regulation implementing a 62-year-old statute. "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Cottage Savings Assn. v. Commissioner*, 499 U.S. 554, 561 (1991) (citing *Correll*, 389 U.S., at 305–306).

* * * *

In line with the text and administrative history of the relevant taxation provisions, we hold that, for FICA and FUTA tax purposes, back wages should be attributed to the year in which they are actually paid. Accordingly, the judgment of the United States Court of Appeals for the Sixth Circuit is reversed.

*It is so ordered.*

**SUPREME COURT OF THE UNITED STATES**

No. 00-203

UNITED STATES, PETITIONER *v.* CLEVELAND INDIANS BASEBALL COMPANY

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

[April 17, 2001]

JUSTICE SCALIA, concurring in the judgment.

If I believed that the text of the tax statutes addressed the issue before us, I might well find for the respondent, giving that text the same meaning the Court found it to have in the benefits provisions of the Social Security Act. See *Social Security Bd. v. Nierotko*, 327 U.S. 358, 370, and n. 25 (1946). The Court's principal reason for assigning the identical language a different meaning in the present case — leaving aside statements in testimony and Committee Reports that I have no reason to believe Congress was aware of — is that tax assessments do not present the equitable considerations implicated by the potential arbitrary decrease of benefits in *Nierotko*. See *ante*, at 10–11. But the Court acknowledges that departing from *Nierotko* will produce arbitrary variations in tax liability. See *ante*, at 15–16. As between an immediate arbitrary increase in tax liability and a deferred arbitrary decrease in benefits, I cannot say the latter is the greater inequity. The difference is at least not so stark as to cause me to regard the two regulatory schemes as different in kind, which I would insist upon before giving different meanings to identical statutory texts.

In fact, however, I do not think that the text of the FICA and FUTA provisions, 26 U.S.C. Secs. 3111(a), 3111(b), 3301, addresses the issue we face today. Those provisions, which direct that taxes shall be assessed against "wages paid" during the calendar year, would be controlling if the income we had before us were "wages" within the normal meaning of that term; but it is not. The question we face is whether *damages awards compensating an employee for lost wages* should be regarded for tax purposes as wages paid when the award is received, or rather as wages paid when they would have been paid but for the employer's unlawful actions. (The parties have stipulated that the damages awards should be regarded as taxable "wages paid" of some sort, see also *Social Security Bd. v. Nierotko*, *supra*, at 364–370.) The proper treatment of such damages awards is an issue the statute does not address, and hence it is an issue left to the reasonable resolution of the administering agency, here the Internal Revenue Service. In *Nierotko*, which we decided at a time when it was common for courts to fill statutory gaps that would now be left to the agency, we provided one rule for purposes of the benefits provisions. The Internal Revenue Service has since provided another rule for purposes of the tax provisions. Both rules are reasonable; neither is compelled; and neither involves a direct application of the statutory term "wages paid" which would require (or at least strongly suggest) a uniform result. I therefore concur in the Court's judgment deferring to the Government's regulations.

# Part IV. Items of General Interest

## Foundations Status of Certain Organizations

## Announcement 2001–79

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

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

113 Calhoun Street Foundation, Inc., Charleston, SC
Advanced Community Educators, Inc., Decatur, GA
Aenon Evangelical Ministry, Trevose, PA
African-American Heritage Foundation, Inc., Stone Mountain, GA
African American Women Empowerment, Inc., Riviera Beach, FL
American Defense Coalition, Mt. Pleasant, SC
American Dream Career Museum Company, Mountaintop, PA
American Patriotic Charities, Inc., Augusta, GA
Atlanta Technical Assistant Organization, Inc., Atlanta, GA
Autism Society of North Carolina, Inc., Raleigh, NC
Bankhead Courts RMC, Inc., Atlanta, GA
Barefoot Childrens Society, Inc., High Point, NC
Barnwell County Hospital Foundation, Barnwell, SC
BBAM Community and Economic Development Corporation, Tupelo, MS
Believers Outreach Ministries, Inc., Los Alamitos, CA
Blackburn Elementary School Parent Teacher Organization, Newton, NC
Boys & Girls Club of Toombs Co., Inc., Vidalia, GA
British & International Sailors Society, Mt. Pleasant, SC
Brothers II Residential Center, Valdosta, GA
Cabrailsong School of Vocal Arts, Columbia, SC
Callie Clark Seales Scholarship Fund, Sumter, SC
Cape Cod Waves Girls Ice Hockey, Inc., Osterville, MA
Cape Sportsmans Society, Inc., Columbia, SC
Carolinas Volunteer Auxiliary, Inc., Florence, SC
Carpenters for Christ International, Fair Play, SC
Casa Bonita Housing, Inc., A Non-Profit Public Benefit Corporation, Stockton, CA
Cause for Paws, Inc., Woodstock, GA
Chapss, Inc., Douglasville, GA
Cherokee Clean & Beautiful Commission, Inc., Canton, GA
Chiefs Athletic Scholarship Fund, Inc., N. Myrtle Beach, SC
Circle of Reflection Enterprises, Inc., Atlanta, GA
Community Interactions, Inc., Metuchen, NJ
Community Service Group Foundation, James Island, SC
Cross Cultural Institute of America, Inc., Spartansburg, SC
CSRA Breastfeeding Coalition, Clearwater, SC
CSRA Share and Care Foundation, Inc., Washington, GA
Dekalb M.R. Homes II, Inc., Atlanta, GA
Disadvantaged Childrens Education Fund, Inc., Greensboro, GA
Eastern Orangeburg County Enterprise Community, Holly Hill, SC
Education Zone Network, Detroit, MI
Ethnographic and Environmental Science Institute, Berkeley, CA
Family Assistance Management Service, Inc., Charleston, SC
Family Health Institute, Lanham, MD
Family Life Education Center, Inc., An Alternative to Child Abuse & Negl., Cedartown, GA
Feline Refuge, Mt. Pleasant, SC
Fertile Ground, Inc., Atlanta, GA
Filmmakers of Color Actors of Color, Inc., Atlanta, GA
Fold, Inc., Asheville, NC
Forum to Stop Family Violence in Clayton County, Inc., Decatur, GA
Fowler Middle School, Tigard, OR
Genessential, Inc., Stone Mountain, GA
Georgia Art Education Association, Inc., Marietta, GA
Give Us Hope, Inc., Norcross, GA
Golden Bells of Atlanta, Norcross, GA
Good Horseman Foundation, Pine Lake, GA
Gospel Sound Ministries, Florence, SC
Grady Graves Annex, Inc., Atlanta, GA
Greater Atlanta Family Center, Inc., Decatur, GA
Greater Bethanyvine City Outreach Community Service Ministry, Inc., Atlanta, GA
Healthy Kids of North Carolina, Inc., Raleigh, NC
Helping Youth Pursue Excellence, Inc., Atlanta, GA
Historical Society of Forsyth County, Inc., Cumming, GA
Housing Ideas, Inc., Atlanta, GA
Institute for Human Development, Inc., Detroit, MI
International Hope Foundation, West Palm Beach, FL
Invaders for Christ, Inc., Union City, GA
Itawa Retreat Center, Inc., Roswell, GA
Jericho Road Ministries, Longview, TX
Jones County Senior Citizens, Inc., Gray, GA
Judah Team Ministries, Inc., Smyrna, GA
Justice for Children, Summerville, SC
Life Signs, Inc., Pelion, SC
Listen Up-A Drug Prevention and Education Company, College Park, GA
Live, Inc., Atlanta, GA
Live & Learn Counseling Center, Inc., Decatur, GA
Love in Action Ministries, Inc., Atlanta, GA
Lower Sampson Development Corp., Willard, NC
Mazzei Foundation, Inc., Tulsa, OK
Metro Outreach Project, Inc., Atlanta, GA
Midlands Foundation for Scholastic Success, Columbia, SC
Midlands Wellness and Recreation Institute, Swansea, SC
Mike Muth Basketball Scholarship Fund, Inc., Williamston, SC

Miss-Lou Mental Health Association, Natchez, MS
Mississippi Housing & Community Services, Inc., Jackson, MS
Mt. Olive Housing, Inc., Myrtle Beach, SC
Naresh C. Jain Foundation, Buena Park, CA
Nathaniel House Personal Care Home, Atlanta, GA
Nevada Testing Institute, Inc., North Las Vegas, NV
New Atlanta Early Learning Center, Inc., Atlanta, GA
New Dance Company of San Joaquin Valley, Stockton, CA
New Directions Development Corporation, Inc., Atlanta, GA
New Tyler Child Enrichment Center, Incorporated, Memphis, TN
New York Retirees Association of Georgia, Inc., Decatur, GA
North Carolina Indian Community Development Corporation, Raleigh, NC
North Carolina Peace Corps Association, Durham, NC
Onesimus Foundation, Inc., Atlanta, GA
Operation Dignity, Inc., Decatur, GA
Options for Living-East One, Inc., Albany, GA
Options for Living-East Two, Inc., Albany, GA
Pain Foundation, Kansas City, MO
Palmetto Baseball League, Inc., Columbia, SC
Palmetto Girls Soccer Association, Columbia, SC
Partners Advancing the Community, Inc., Hogansville, GA
Peaceworks, Charleston, SC
Peachstate Football Officials Association, Atlanta, GA
Progressive Columbia, Inc., Atlanta, GA
Project Adopt, Inc., Stone Mountain, GA
Rabun County Real Life Crusade, Inc., Clayton, GA
Raduium Springs Foundation, Inc., Albany, GA
Recovery Center Foundation, Hilton Head Island, SC
Reidville Historical Society, Reidville, SC
Reins of Life Academy, Inc., Springfield, GA
Renewed Life, Inc., Blythewood, SC
Residents Working for Georgia, Inc., Macon, GA
Rippavilla, Inc., Columbia, TN
Rock County Family Coordinating Council, Luverne, MN
Save Our Swamp, Inc., Conway, SC
S.C. Center for the Book, Columbia, SC
Shandon Baptist Church Foundation, Columbia, SC
Share International, Inc., Atlanta, GA
Somali Community Services of Seattle, Seattle, WA
South Carolina Affiliate of the American Geriatric Society, Rock Hill, SC
South Carolina Amateur Sports, Inc., Columbia, SC
Southern Hispanic Resource Center, Inc., Jonesboro, GA
Southwest Atlanta Community Partnership, Inc., Atlanta, GA
St. Benedicts Society, Inc., Atlanta, GA
Star of Hope, Inc., New Orleans, LA
Stars of Heaven, Inc., Ellenwood, GA
Sumter Bluegrass Series, Inc., Manning, SC
Systas 4 Systas, Inc., East Orange, NJ
Tattnall Band Boosters, Inc., Reidsville, GA
Tenn-Vest, Incorporated, Memphis, TN
Tiger Band Booster Club, Smithville, TX
Tri-Community Collaborative, Inc., Atlanta, GA
Troup Shelter for Abused & Neglected Children, LaGrange, KY
Urban Youth Enrichment Concepts, Inc., Atlanta, GA
Village Museum, McClellanville, SC
Waccamaw High School Athletic Booster Club, Inc., Pawleys Island, SC
Wando High School Band Boosters, Mt. Pleasant, SC
Washington County Golden Hawks Athletic Association, Inc., Sandersville, GA
Wee-Love, Inc., Ladson, SC
William Henry Waldon Jr., Outreach Ministry, Inc., Atlanta, GA
Wings of Love, Atlanta, GA
Word of Truth Community Housing Association, Detroit, MI

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

## New Backup Withholding Rate for Amounts Paid After August 6, 2001

## Announcement 2001–80

### Purpose

This announcement is to advise payers about a reduction in the backup withholding rate authorized by section 3406(a)(1) of the Internal Revenue Code. Section 101(c)(10) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16) reduced the rate for backup withholding on reportable payments.

### New Backup Withholding Rate

Effective for amounts paid after August 6, 2001, payers should backup withhold at a reduced rate of 30.5%.

For amounts paid after December 31, 2001, the backup withholding rate will be further reduced to 30%.

### New Rate Not Reflected in *2000* Products

The backup withholding rate shown in the December 2000 revision of the following products is incorrect for amounts paid after August 6, 2001.

**Tax Forms.**

- Instructions for the Requester of Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY
- Instructions for Form W-8BEN
- Instructions for Form W-8ECI
- Instructions for Form W-8EXP
- Instructions for Form W-8IMY
- Form W-9, Request for Taxpayer Identification Number and Certification
- Instructions for the Requester of Form W-9

The Instructions for the Requester of Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY, and the separate instructions for Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY will be revised in August 2001 to reflect the new rates.

Form W-9 and the Instructions for the Requester of Form W-9 will be revised in December 2001 to reflect the new backup withholding rate for amounts paid after December 31, 2001.

**Technical publications.**

- Publication 17, *Your Federal Income Tax*
- Publication 225, *Farmer's Tax Guide*
- Publication 505, *Tax Withholding and Estimated Tax*
- Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*
- Publication 542, *Corporations*
- Publication 550, *Investment Income and Expenses*
- Publication 583, *Starting a Business and Keeping Records*
- Publication 1212, *List of Original Issue Discount Instruments*

The 2001 version of these publications will show the new backup withholding rate for amounts paid after December 31, 2001.

**New Rate Not Reflected in *2001* Products**

The backup withholding rate shown in the 2001 version of the following products is incorrect for amounts paid after August 6, 2001.

- Form W-2G, *Certain Gambling Winnings*
- Instructions for Form 1042-S
- Form 1099-DIV, *Dividends and Distributions*
- Form 1099-G, *Certain Government and Qualified State Tuition Program Payments*
- Form 1099-INT, *Interest Income*
- Form 1099-OID, *Original Issue Discount*
- Form 1099-MISC, *Miscellaneous Income*
- Form 1099-PATR, *Taxable Distributions Received From Cooperatives*
- Instructions for Forms 1099, 1098, 5498, and W-2G

The 2002 version of these forms and instructions will show the new backup withholding rate for amounts paid after December 31, 2001.

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

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

**Low-income housing credit; satisfactory bond; "bond factor" amounts for the period July through September 2001.** This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2001.

## Rev. Rul. 2001–37

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

Rev. Proc. 99–11, 1999–1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period July through September 2001.

Table 1
Rev. Rul. 2001–37
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

| | Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Month of Disposition | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 |
| Jul ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 70.27 | 71.68 | 72.99 | 74.30 | 75.75 | 77.30 |
| Aug ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 70.09 | 71.49 | 72.80 | 74.10 | 75.55 | 77.10 |
| Sep ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 69.91 | 71.31 | 72.61 | 73.91 | 75.36 | 76.91 |

Table 1 (cont'd)
Rev. Rul. 2001–37
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

| | Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year | | | |
|---|---|---|---|---|
| Month of Disposition | 1998 | 1999 | 2000 | 2001 |
| Jul ’01 | 79.07 | 80.80 | 82.36 | 83.98 |
| Aug ’01 | 78.86 | 80.60 | 82.19 | 83.98 |
| Sep ’01 | 78.67 | 80.41 | 82.05 | 83.98 |

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98–3, 1998–1 C.B. 248, and Rev. Rul. 2001–2, 2001–2 I.R.B. 255. For dispositions occurring during the period January through March 2001, see Rev. Rul. 2001–10, 2001–10 I.R.B. 755. For dispositions during the period April through June 2001, see Rev. Rul. 2001–19, 2001–18 I.R.B. 1143.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran at (202) 622-3040 (not a toll-free call).

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## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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

The adjusted applicable federal long-term rate is set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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## Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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## Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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## Section 679.—Foreign Trusts Having One or More United States Beneficiaries

*26 CFR 1.679–2: Trusts treated as having a U. S. beneficiary.*

## T. D. 8955

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Foreign Trusts That Have U.S. Beneficiaries

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 679 of the Internal Revenue Code relating to transfers of property by U.S. persons to foreign trusts having one or more United States beneficiaries. The final regulations affect United States persons who transfer property to foreign trusts.

DATES: *Effective Date*: These regulations are effective July 20, 2001.

*Applicability Date*: For dates of applicability, see §1.679–7.

FOR FURTHER INFORMATION CONTACT: Willard W. Yates at (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

On August 7, 2000, the IRS and Treasury published a notice of proposed rulemaking (REG–209038–89, 2000–34 I.R.B. 191) in the **Federal Register** (65 FR 48185) inviting comments relating to the treatment of U.S. persons who transfer property to foreign trusts that have one or more U.S. beneficiaries. Comments responding to the notice of proposed rulemaking were received and a public hearing was held on November 8, 2000. After consideration of all of the comments, the proposed regulations are adopted as revised by this Treasury decision. The revisions are discussed below.

**Explanation of Provisions**

*Comments Relating to §1.679–2: Trusts Treated as Having a U.S. Beneficiary*

A. *Benefit to a U.S. Person*

Under §1.679–2(a)(1) of the proposed regulations, a foreign trust that has received property from a U.S. transferor is treated as having a U.S. beneficiary unless during the taxable year of the U.S. transferor both of the following tests are satisfied: (i) no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, either directly or indirectly, a U.S. person; and (ii) if the trust is terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of, either directly or indirectly, a U.S. person.

Section 1.679–2(a)(2)(i) of the proposed regulations provides that, for purposes of applying these tests, income or corpus is considered to be paid or accumulated to or for the benefit of a U.S. person during a taxable year of the U.S. transferor if during that year, directly or indirectly, income may be distributed to, or accumulated for the benefit of a U.S. person, or corpus may be distributed to, or held for the future benefit of, a U.S. person. This determination is made without regard to whether income or corpus is actually distributed to a U.S. person during that year, and without regard to whether a U.S. person's interest in the trust income or corpus is contingent on a future event. The proposed regulations provide a narrow exception with respect to certain contingent beneficiaries whose interests in the trust are so remote as to be negligible.

One commenter suggests that §1.679–2(a)(2) of the proposed regulations (specifically, *Example 5* of §1.679–2(a)(2)(iii)) is overly broad. The commenter suggests that a foreign trust should not be treated as having a U.S. beneficiary where the trust's only asset consists of stock of a foreign corporation, the trust will terminate one year after the death of a U.S. transferor, whereupon distributions of corpus or income may be made to a U.S. person, and the trust receives no income from the corporation during the term of its existence. The commenter argues that because the foreign trust receives no income from the foreign corporation during the trust's existence, the U.S. person's status as a beneficiary provides the U.S. person with nothing of value and, therefore, the foreign trust should not be treated as having a U.S. beneficiary.

The commenter's argument overlooks the clear legislative intent underlying section 679 that a foreign trust will be treated as having a U.S. beneficiary even in situations where there exists only the possibility of distribution of income or corpus to or the accumulation of corpus for the benefit of a U.S. person. H.R. Rep. No. 658, 94th Cong., 1st Sess., at 210 (1975). The fact that a foreign trust holds an asset, such as the stock of a foreign corporation, that produces no income during the term of the trust's existence is of no import for purposes of determining whether the trust will be treated as having a U.S. beneficiary. The determining factor in such a situation is that the trust holds corpus for the future benefit of a U.S. person, regardless of whether the corpus consists of stock with respect to which no dividends have been paid or some other asset that produces no current income. Accordingly, the final regulations adopt the rule of the proposed regulations.

B. *Records and Documents*

Section 1.679–2(a)(4) of the proposed regulations provides that a trust may be treated as having a U.S. beneficiary by reference, *inter alia*, to written and oral agreements and understandings not contained in the trust document, and to whether the terms of the trust instrument are actually or reasonably expected to be disregarded by the parties to the trust. A commenter states that this rule creates new and unclear rules for purposes of determining whether an arrangement constitutes a trust for Federal income tax purposes.

The determination as to whether an arrangement will be treated as a trust is made pursuant to the rules set forth in §301.7701–4 of the regulations. The regulations under section 679 address only the determination of whether a foreign trust will be treated as having a U.S. beneficiary. The final regulations are not intended to provide factors in addition to the rules of §301.7701–4 for purposes of determining whether an arrangement constitutes a trust for federal income tax purposes.

C. *Trusts Acquiring a U.S. Beneficiary*

The proposed regulations anticipate situations where the beneficiary of a foreign trust may change. Section 1.679–2(c)(1) of the proposed regulations provides that if a foreign trust is not treated as having a U.S. beneficiary (within the meaning of §1.679–2(a)) but subsequently is treated as having a U.S. beneficiary, the U.S. transferor is treated as having additional income in the first taxable year of the U.S. transferor in which the trust is treated as having a U.S. beneficiary. The amount of the additional income is equal to the trust's undistributed net income, as defined in section 665(a), at the end of the U.S. transferor's immediately preceding taxable year and is subject to the rules of section 668, providing for an interest charge on accumulation distributions from foreign trusts.

A commenter suggests that the rule treating the U.S. transferor as having additional income in the first year the foreign trust acquires the U.S. beneficiary exceeds the authority of section 679, noting that in most cases the transferor will not have received any income from the trust.

Section 1.679–2(c)(1) of the proposed regulations follows closely the legislative history underlying section 679 regarding the U.S. transferor's recognition of additional income. The legislative history provides that the amount of the additional income shall be the foreign trust's undistributed net income, *i.e.*, accumulated income that would be taxable to a beneficiary upon distribution, as of the close of the immediately preceding taxable year. H.R. Rep. No. 658, 94th Cong., 1st Sess., at 211, Fn. 13 (1975). In short, the legislative history provides that the U.S. transferor's additional income shall receive the same treatment as accumulation distributions to beneficiaries of a foreign trust. Accumulated income distributions to beneficiaries of foreign trusts are subject to the interest charge provided for in section 668. Accordingly, the provision for additional income in §1.679–2(c)(1) of the final regulations, as well as the application of the interest charge provided for in section 668, are necessary to carry out the legislative purpose of section 679. The rule of the proposed regulations is adopted by the final regulations without change.

*Comments Relating to §1.679–3: Transfers*

A. *Indirect Transfers - Principal Purpose of Tax Avoidance*

Section 1.679–3(a) of the proposed regulations broadly defines the term *transfer* as any direct, indirect, or constructive transfer by a U.S. person to a foreign trust. Section 1.679–3(c) of the proposed regulations provides rules for determining when there is an indirect transfer. Under §1.679–3(c)(1) of the proposed regulations, a transfer to a foreign trust by any person to whom a U.S. person transfers property (referred to as an intermediary) is treated as an indirect transfer by a U.S. person if the transfer is made pursuant to a plan one of the principal purposes of which is the avoidance of U.S. tax. Section 1.679–3(c)(2) of the proposed regulations deems a transfer to have been made pursuant to such a plan if certain conditions are present.

The deemed-principal-purpose test of §1.679–3(c)(2) of the proposed regulations is similar to the deemed-principal-purpose test in §1.643(h)–1(a) of the regulations, which concerns distributions from foreign trusts to U.S. persons through intermediaries, except that the presumption in the proposed regulations applies without regard to the period of time between the transfer from the U.S. person to the intermediary and from the intermediary to the foreign trust. In contrast, the deemed-principal-purpose test of §1.643(h)–1(a)(2)(ii) applies only if property is distributed to the U.S. person during the period beginning 24 months before and ending 24 months after the intermediary's receipt of property from the foreign trust. A commenter suggests that a similar time limit should be provided in §1.679–3(c)(2) with respect to outbound transfers.

In the context of section 643(h), Treasury and the IRS weighed the potential for abuse in that area against the possible adverse effect that the deemed-principal-purpose test could have on legitimate transactions, and concluded that a time limitation in §1.643(h)–1(a)(2) was appropriate. However, Treasury and the IRS believe the potential for abuse is greater in the case of outbound transfers to foreign trusts than in the case of inbound trust distributions to U.S. beneficiaries. Congress enacted section 679 in order to prevent the tax-free accumulation of income earned by foreign trusts over long periods of time that provided foreign trusts with an unwarranted advantage over domestic trusts. H.R. Rep. No. 658, 94th Cong., 1st Sess., at 207 (1975). Providing for a time limitation to the application of §1.679–3(c) could allow for easy circumvention of Congress' purpose in enacting section 679. Treasury and the IRS recognize that some transfers that were not intended to avoid U.S. tax may come within the presumption in the absence of a specific time limit. However, under such circumstances §1.679–3(c)(2)(ii) provides taxpayers with a way to rebut the application of the deemed-principal-purpose test. Therefore, the final regulations do not include a time limitation to the application of §1.679–3(c)(2)(i).

B. *Indirect Transfers - Corporate Distributions*

One commenter asked about the application of the indirect transfer rules set forth in §1.679–3(c) of the proposed regulations to successive corporate distributions up a chain of wholly-owned corporations to an ultimate shareholder that is a foreign trust. The commenter expressed concern that, if one of the lower-tier corporations were a domestic corporation, §1.679–3(c) of the proposed regulations could potentially treat the distributions as an indirect transfer from the domestic corporation to the foreign trust that would be subject to the general rule of §1.679–1.

Even if the distributions were characterized as an indirect transfer from a domestic corporation to a foreign trust under §1.679–3(c), the indirect transfer would generally be treated as a transfer for fair market value under the final sentence of §1.679–4(b)(1) and would therefore be excepted from the general rule of §1.679–1 pursuant to §1.679–4(a)(4). Therefore, no special rules have been added to the final regulations to address this situation.

C. *Transfers to Entities Owned by Foreign Trusts*

Section 1.679–3(f) of the proposed regulations provides specific rules regarding transfers by a U.S. person to an entity owned by a foreign trust if the U.S. person is related to the foreign trust. The transfer is treated as a transfer from the U.S. person to the foreign trust, followed by a transfer from the foreign trust to the entity owned by the foreign trust, unless the U.S. person demonstrates to the satisfaction of the Commissioner that the transfer to the entity is properly attributable to the U.S. person's ownership interest in the entity. A commenter noted potential conflicts with this rule and judicial doctrines concerning constructive corporate distributions.

Section 1.679–3(f) is not intended to override judicial doctrines concerning constructive corporate distributions. For example, if judicial doctrines would recharacterize a direct transfer of property by a domestic corporation to an entity owned by a foreign trust as a constructive dividend of the property to the domestic corporation's shareholder followed by a constructive transfer of the property by that shareholder to the foreign trust and a constructive contribution by the foreign trust to the entity owned by the foreign trust, then those judicial doctrines would apply (and §1.679–3(f) would not apply) to the transaction.

*Comments Relating to §1.679–4: Exceptions to General Rule - Transfers to Trusts Described in Section 501(c)(3)*

Section 1.679–4(a)(3) of the proposed regulations provides an exception to the general rule of §1.679–1 for transfers to a foreign trust that has already received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3), provided that the letter has been neither revoked nor modified. Commenters questioned the requirement that a foreign trust obtain a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). They assert that the requirement may interfere with a U.S. person's ability to make contributions to a foreign charitable entity that may not be familiar with U.S. tax laws and may not have any reason to obtain a determination letter from the IRS. They suggest that the final regulations require only that the U.S. transferor disclose to the IRS, at such time and in such manner as the IRS may provide, that the transfer has been made and that the transferor believes the transferee is an organization described in section 501(c)(3).

In response to commenters' concerns, the final regulations eliminate the requirement that the foreign trust receive a ruling or determination letter from the IRS recognizing the trust's tax-exempt status under section 501(c)(3). The final regulations provide instead that the general rule of §1.679–1 does not apply to any transfer of property to a foreign trust that is described in section 501(c)(3). However, taxpayers should be aware that, under Notice 97–34 (1997–1 C.B. 422), the U.S. transferor has a reporting obligation on Form 3520 with respect to such a transfer, unless the foreign trust has received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). Moreover, if the IRS subsequently determines that the foreign trust is not described in section 501(c)(3), the exception will not apply for any taxable year of the U.S. transferor, and the U.S. transferor may be subject to interest and penalties, if applicable.

*Clarification Regarding Section 958*

The final regulations clarify the language of §1.958–1(b) of the proposed regulations with respect to persons who are treated as owners under sections 671 through 679 of any portion of a foreign trust that includes the stock of a foreign corporation.

**Special Analyses**

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

**Drafting Information**

The principal author of these final regulations is Willard W. Yates of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.679–1 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–2 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–3 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–4 also issued under 26 U.S.C. 643(a)(7), 679(a)(3) and 679(d).

Section 1.679–5 also issued under 26 U.S.C. 643(a)(7) and 679(d).

Section 1.679–6 also issued under 26 U.S.C. 643(a)(7) and 679(d). * * *

Par. 2. Sections 1.679–0, 1.679–1, 1.679–2, 1.679–3, 1.679–4, 1.679–5, 1.679–6, and 1.679–7 are added under the undesignated center heading "Grantors and Others Treated as Substantial Owners" to read as follows:

*§1.679–0 Outline of major topics.*

This section lists the major paragraphs contained in §§1.679–1 through 1.679–7 as follows:

*§1.679–1 U.S. transferor treated as owner of foreign trust.*

(a) In general.
(b) Interaction with sections 673 through 678.
(c) Definitions.
(1) U.S. transferor.
(2) U.S. person.
(3) Foreign trust.
(4) Property.
(5) Related person.
(6) Obligation.
(d) Examples.

*§1.679–2 Trusts treated as having a U.S. beneficiary.*

(a) Existence of U.S. beneficiary.
(1) In general.
(2) Benefit to a U.S. person.
(i) In general.
(ii) Certain unexpected beneficiaries.
(iii) Examples.
(3) Changes in beneficiary's status.
(i) In general.
(ii) Examples.
(4) General rules.
(i) Records and documents.
(ii) Additional factors.
(iii) Examples.
(b) Indirect U.S. beneficiaries.
(1) Certain foreign entities.
(2) Other indirect beneficiaries.
(3) Examples.
(c) Treatment of U.S. transferor upon foreign trust's acquisition or loss of U.S. beneficiary.
(1) Trusts acquiring a U.S. beneficiary.
(2) Trusts ceasing to have a U.S. beneficiary.
(3) Examples.

*§1.679–3 Transfers.*

(a) In general.
(b) Transfers by certain trusts.
(1) In general.
(2) Example.
(c) Indirect transfers.
(1) Principal purpose of tax avoidance.
(2) Principal purpose of tax avoidance deemed to exist.
(3) Effect of disregarding intermediary.
(i) In general.
(ii) Special rule.
(iii) Effect on intermediary.
(4) Related parties.
(5) Examples.
(d) Constructive transfers.
(1) In general.
(2) Examples.
(e) Guarantee of trust obligations.
(1) In general.
(2) Amount transferred.
(3) Principal repayments.
(4) Guarantee.
(5) Examples.
(f) Transfers to entities owned by a foreign trust.
(1) General rule.
(2) Examples.

*§1.679–4 Exceptions to general rule.*

(a) In general.
(b) Transfers for fair market value.
(1) In general.
(2) Special rule.
(i) Transfers for partial consideration.
(ii) Example.
(c) Certain obligations not taken into account.
(d) Qualified obligations.
(1) In general.
(2) Additional loans.
(3) Obligations that cease to be qualified.
(4) Transfers resulting from failed qualified obligations.
(5) Renegotiated loans.
(6) Principal repayments.
(7) Examples.

*§1.679–5 Pre-immigration trusts.*

(a) In general.
(b) Special rules.
(1) Change in grantor trust status.
(2) Treatment of undistributed income.
(c) Examples.

*§1.679–6 Outbound migrations of domestic trusts.*

(a) In general.
(b) Amount deemed transferred.

(c) Example.

*§1.679–7 Effective dates.*

(a) In general.
(b) Special rules.

*§1.679–1 U.S. transferor treated as owner of foreign trust.*

(a) *In general*. A U.S. transferor who transfers property to a foreign trust is treated as the owner of the portion of the trust attributable to the property transferred if there is a U.S. beneficiary of any portion of the trust, unless an exception in §1.679–4 applies to the transfer.

(b) *Interaction with sections 673 through 678*. The rules of this section apply without regard to whether the U.S. transferor retains any power or interest described in sections 673 through 677. If a U.S. transferor would be treated as the owner of a portion of a foreign trust pursuant to the rules of this section and another person would be treated as the owner of the same portion of the trust pursuant to section 678, then the U.S. transferor is treated as the owner and the other person is not treated as the owner.

(c) *Definitions*. The following definitions apply for purposes of this section and §§1.679–2 through 1.679–7:

(1) *U.S. transferor*. The term *U.S. transferor* means any U.S. person who makes a transfer (as defined in §1.679–3) of property to a foreign trust.

(2) *U.S. person*. The term *U.S. person* means a United States person as defined in section 7701(a)(30), a nonresident alien individual who elects under section 6013(g) to be treated as resident of the United States, and an individual who is a dual resident taxpayer within the meaning of §301.7701(b)–7(a) of this chapter.

(3) *Foreign trust*. Section 7701(a)(31)(B) defines the term *foreign trust*. See also §301.7701–7 of this chapter.

(4) *Property*. The term *property* means any property including cash.

(5) *Related person*. A person is a *related person* if, without regard to the transfer at issue, the person is—

(i) A grantor of any portion of the trust (within the meaning of §1.671–2(e)(1));

(ii) An owner of any portion of the trust under sections 671 through 679;

(iii) A beneficiary of the trust; or

(iv) A person who is related (within the meaning of section 643(i)(2)(B)) to any grantor, owner or beneficiary of the trust.

(6) *Obligation*. The term *obligation* means any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other evidence of indebtedness, and, to the extent not previously described, any annuity contract.

(d) *Examples*. The following examples illustrate the rules of paragraph (a) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s father, who is a resident alien, *D* is *A*'s uncle, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Interaction with section 678*. *A* creates and funds *FT*. *FT* may provide for the education of *B* by paying for books, tuition, room and board. In addition, *C* has the power to vest the trust corpus or income in himself within the meaning of section 678(a)(1). Under paragraph (b) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred to *FT* by *A* and *C* is not treated as the owner thereof.

*Example 2. U.S. person treated as owner of a portion of FT*. *D* creates and funds *FT* for the benefit of *B*. *D* retains a power described in section 676 and §1.672(f)–3(a)(1). *A* transfers property to *FT*. Under sections 676 and 672(f), *D* is treated as the owner of the portion of *FT* attributable to the property transferred by *D*. Under paragraph (a) of this section, *A* is treated as the owner of the portion of *FT* attributable to the property transferred by *A*.

*§1.679–2 Trusts treated as having a U.S. beneficiary.*

(a) *Existence of U.S. beneficiary*—(1) *In general*. The determination of whether a foreign trust has a U.S. beneficiary is made on an annual basis. A foreign trust is treated as having a U.S. beneficiary unless during the taxable year of the U.S. transferor—

(i) No part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, directly or indirectly, a U.S. person; and

(ii) If the trust is terminated at any time during the taxable year, no part of the income or corpus of the trust could be paid to or for the benefit of, directly or indirectly, a U.S. person.

(2) *Benefit to a U.S. person*—(i) *In general*. For purposes of paragraph (a)(1) of this section, income or corpus may be paid or accumulated to or for the benefit of a U.S. person during a taxable year of the U.S. transferor if during that year, directly or indirectly, income may be distributed to, or accumulated for the benefit of, a U.S. person, or corpus may be distributed to, or held for the future benefit of, a U.S. person. This determination is made without regard to whether income or corpus is actually distributed to a U.S. person during that year, and without regard to whether a U.S. person's interest in the trust income or corpus is contingent on a future event.

(ii) *Certain unexpected beneficiaries*. Notwithstanding paragraph (a)(2)(i) of this section, for purposes of paragraph (a)(1) of this section, a person who is not named as a beneficiary and is not a member of a class of beneficiaries as defined under the trust instrument is not taken into consideration if the U.S. transferor demonstrates to the satisfaction of the Commissioner that the person's contingent interest in the trust is so remote as to be negligible. The preceding sentence does not apply with respect to persons to whom distributions could be made pursuant to a grant of discretion to the trustee or any other person. A class of beneficiaries generally does not include heirs who will benefit from the trust under the laws of intestate succession in the event that the named beneficiaries (or members of the named class) have all deceased (whether or not stated as a named class in the trust instrument).

(iii) *Examples*. The following examples illustrate the rules of paragraphs (a)(1) and (2) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Distribution of income to U.S. person*. *A* transfers property to *FT*. The trust instrument provides that all trust income is to be distributed currently to *B*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 2. Income accumulation for the benefit of a U.S. person*. In 2001, *A* transfers property to *FT*. The trust instrument provides that from 2001 through 2010, the trustee of *FT* may distribute trust income to *C* or may accumulate the trust income. The trust instrument further provides that in 2011, the trust will terminate and the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust assets must be distributed to *C*. Because it is possible that income may be accumulated in each year, and that the accumulated income ultimately may be distributed to *B*, a U.S. person, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through 2011. This result applies even though no U.S. person may receive distributions from the trust during the tax years 2001 through 2010.

*Example 3. Corpus held for the benefit of a U.S. person*. The facts are the same as in *Example 2*, except that from 2001 through 2011, all trust income must be distributed to *C*. In 2011, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*, in the trustee's discretion. If the trust terminates unexpectedly prior to 2011, all trust corpus must be distributed to *C*. Because during each of *A*'s tax years from 2001 through 2011 trust corpus is held for possible future distribution to *B*, a U.S. person, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of those years. This result applies even though no U.S. person may receive distributions from the trust during the tax years 2001 through 2010.

*Example 4. Distribution upon U.S. transferor's death*. *A* transfers property to *FT*. The trust instrument provides that all trust income must be distributed currently to *C* and, upon *A*'s death, the trust will terminate and the trustee may distribute the trust corpus to either or both of *B* and *C*. Because *B* may receive a distribution of corpus upon the termination of *FT*, and *FT* could terminate in any year, *FT* is treated as having a U.S. beneficiary in the year of the transfer and in subsequent years.

*Example 5. Distribution after U.S. transferor's death*. The facts are the same as in *Example 4*, except the trust instrument provides that the trust will not terminate until the year following *A*'s death. Upon termination, the trustee may distribute the trust assets to either or both of *B* and *C*, in the trustee's discretion. All trust assets are invested in the stock of *X*, a foreign corporation, and *X* makes no distributions to *FT*. Although no U.S. person may receive a distribution until the year after *A*'s death, and *FT* has no realized income during any year of its existence, during each year in which *A* is living corpus may be held for future distribution to *B*, a U.S. person. Thus, under paragraph (a)(1) of this section *FT* is treated as having a U.S. beneficiary during each of *A*'s tax years from 2001 through the year of *A*'s death.

*Example 6. Constructive benefit to U.S. person*. *A* transfers property to *FT*. The trust instrument provides that no income or corpus may be paid directly to a U.S. person. However, the trust instrument provides that trust corpus may be used to satisfy *B*'s legal obligations to a third party by making a payment directly to the third party. Under paragraphs (a)(1) and (2) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 7. U.S. person with negligible contingent interest*. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *C*, and upon *C*'s death, all corpus is to be distributed to whomever of *C*'s three children is then living. All of *C*'s children are nonresident aliens. Under the laws of intestate succession that would apply to *FT*, if all of *C*'s children are deceased at the time of *C*'s death, the corpus would be distributed to *A*'s heirs. *A*'s living relatives at the time of the transfer consist solely of two brothers and two nieces, all of whom are nonresident aliens, and two first cousins, one of whom, *E*, is a U.S. citizen. Although it is possible under certain circumstances that *E* could receive a corpus distribution under the applicable laws of intestate succession, for each year the trust is in existence *A* is able to demonstrate to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that *E*'s contingent interest in *FT* is so remote as to be negligible. Provided that paragraph (a)(4) of this section does not require a different result, *FT* is not treated as having a U.S. beneficiary.

*Example 8. U.S. person with non-negligible contingent interest*. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. Under the laws of intestate succession that would apply to *FT*, *B* and *C* would share equally in the trust corpus if *D* is not living at the time of *A*'s death. *A* is unable to demonstrate to the satisfaction of the Commissioner that *B*'s contingent interest in the trust is so remote as to be negligible. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

*Example 9. U.S. person as member of class of beneficiaries*. *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *D*, *A*'s uncle, who is a nonresident alien, and upon *A*'s death, the corpus is to be distributed to *D* if he is then living. If *D* is not then living, the corpus is to be distributed to *D*'s descendants. *D*'s grandson, *E*, is a resident alien. Under paragraph (a)(2)(ii) of this section, *FT* is treated as having a U.S. beneficiary as of the year of the transfer.

*Example 10. Trustee's discretion in choosing beneficiaries*. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of, any person who is pursuing the academic study of ancient Greek, in the trustee's discretion. Because it is possible that a U.S. person will receive distributions of income or corpus, or will have income accumulated for his benefit, *FT* is treated as having a U.S. beneficiary. This result applies even if, during a tax year, no distributions or accumulations are actually made to or for the benefit of a U.S. person. *A* may not invoke paragraph (a)(2)(ii) of this section because a U.S. person could benefit pursuant to a grant of discretion in the trust instrument.

*Example 11. Appointment of remainder beneficiary*. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute current income to C, or may accumulate income, and, upon termination of the trust, trust assets are to be distributed to *C*. However, the trust instrument further provides that *D*, *A*'s uncle, may appoint a different remainder beneficiary. Because it is possible that a U.S. person could be named as the remainder beneficiary, and because corpus could be held in each year for the future benefit of that U.S. person, *FT* is treated as having a U.S. beneficiary for each year.

*Example 12. Trust not treated as having a U.S. beneficiary*. *A* transfers property to *FT*. The trust instrument provides that the trustee may distribute income and corpus to, or accumulate income for the benefit of *C*. Upon termination of the trust, all income and corpus must be distributed to *C*. Assume that paragraph (a)(4) of this section is not applicable under the facts and circumstances and that A establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Because no part of the income or corpus of the trust may be paid or accumulated to or for the benefit of, either directly or indirectly, a U.S. person, and if the trust is terminated, no part of the income or corpus of the trust could be paid to or for the benefit of, either directly or indirectly, a U.S. person, *FT* is not treated as having a U.S. beneficiary.

*Example 13. U.S. beneficiary becomes non-U.S. person*. In 2001, *A* transfers property to *FT*. The trust instrument provides that, as long as *B* remains a U.S. resident, no distributions of income or corpus may be made from the trust to *B*. The trust instrument further provides that if *B* becomes a nonresident alien, distributions of income (including previously accumulated income) and corpus may be made to him. If *B* remains a U.S. resident at the time of *FT*'s termination, all accumulated income and corpus is to be distributed to *C*. In 2007, *B* becomes a nonresident alien and remains so thereafter. Because income may be accumulated during the years 2001 through 2007 for the benefit of a person who is a U.S. person during those years, *FT* is treated as having a U.S. beneficiary under paragraph (a)(1) of this section during each of those years. This result applies even though *B* cannot receive distributions from *FT* during the years he is a resident alien and even though *B* might remain a resident alien who is not entitled to any distribution from *FT*. Provided that paragraph (a)(4) of this section does not require a different result and that *A* establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no other U.S. persons are reasonably expected to benefit from the trust, *FT* is not treated as having a U.S. beneficiary under paragraph (a)(1) of this section during tax years after 2007.

(3) *Changes in beneficiary's status*—(i) *In general*. For purposes of paragraph (a)(1) of this section, the possibility that a person that is not a U.S. person could become a U.S. person will not cause that person to be treated as a U.S. person for purposes of paragraph (a)(1) of this section until the tax year of the U.S. transferor in which that individual actually becomes a U.S. person. However, if a person who is not a U.S. person becomes a U.S. person for the first time more than 5 years after the date of a transfer to the foreign trust by a U.S. transferor, that person is not treated as a U.S. person for purposes of applying paragraph (a)(1) of this section with respect to that transfer.

(ii) *Examples*. The following examples illustrate the rules of paragraph (a)(3) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Non-U.S. beneficiary becomes U.S. person*. In 2001, *A* transfers property to *FT*. The trust instrument provides that all income is to be distributed currently to *C* and that, upon the termination of *FT*, all corpus is to be distributed to *C*. Assume that paragraph (a)(4) of this section is not applicable under the facts and circumstances and that *A* establishes to the satisfaction of the Commissioner under paragraph (a)(2)(ii) of this section that no U.S. persons are reasonably expected to benefit from the trust. Under paragraph (a)(3)(i) of this section, *FT* is not treated as having a U.S. beneficiary during the tax years of *A* in which *C* remains a nonresident alien. If *C* first becomes a resident alien in 2004, *FT* is treated as having a U.S. beneficiary commencing in that year under paragraph (a)(3) of this section. See paragraph (c) of this section regarding the treatment of *A* upon *FT*'s acquisition of a U.S. beneficiary.

*Example 2. Non-U.S. beneficiary becomes U.S. person more than 5 years after transfer*. The facts are the same as in *Example 1*, except *C* first becomes a resident alien in 2007. *FT* is treated as not having a U.S. beneficiary under paragraph (a)(3)(i) of this section with respect to the property transfer by *A*. However, if *C* had previously been a U.S. person during any prior period, the 5-year exception in paragraph (a)(3)(i) of this section would not apply in 2007 because it would not have been the first time *C* became a U.S. person.

(4) *General rules*—(i) *Records and documents*. Even if, based on the terms of the trust instrument, a foreign trust is not treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the trust may nevertheless be treated as having a U.S. beneficiary pursuant to paragraph (a)(1) of this section based on the following—

(A) All written and oral agreements and understandings relating to the trust;

(B) Memoranda or letters of wishes;

(C) All records that relate to the actual distribution of income and corpus; and

(D) All other documents that relate to the trust, whether or not of any purported legal effect.

(ii) *Additional factors*. For purposes of determining whether a foreign trust is treated as having a U.S. beneficiary within the meaning of paragraph (a)(1) of this section, the following additional factors are taken into account—

(A) If the terms of the trust instrument allow the trust to be amended to benefit a U.S. person, all potential benefits that could be provided to a U.S. person pursuant to an amendment must be taken into account;

(B) If the terms of the trust instrument do not allow the trust to be amended to benefit a U.S. person, but the law applicable to a foreign trust may require payments or accumulations of income or corpus to or for the benefit of a U.S. person (by judicial reformation or otherwise), all potential benefits that could be provided to a U.S. person pursuant to the law must be taken into account, unless the U.S. transferor demonstrates to the satisfaction of the Commissioner that the law is not reasonably expected to be applied or invoked under the facts and circumstances; and

(C) If the parties to the trust ignore the terms of the trust instrument, or if it is reasonably expected that they will do so, all benefits that have been, or are reasonably expected to be, provided to a U.S. person must be taken into account.

(iii) *Examples*. The following examples illustrate the rules of paragraph (a)(4) of this section. In these examples, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, *C* is *A*'s daughter, who is a nonresident alien, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Amendment pursuant to local law*. *A* creates and funds *FT* for the benefit of *C*. The terms of *FT* (which, according to the trust instrument, cannot be amended) provide that no part of the income or corpus of *FT* may be paid or accumulated during the taxable year to or for the benefit of any U.S. person, either during the existence of *FT* or at the time of its termination. However, pursuant to the applicable foreign law, *FT* can be amended to provide for additional beneficiaries, and there is an oral understanding between *A* and the trustee that *B* can be added as a beneficiary. Under paragraphs (a)(1) and (a)(4)(ii)(B) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 2. Actions in violation of the terms of the trust*. *A* transfers property to *FT*. The trust instrument provides that no U.S. person can receive income or corpus from *FT* during the term of the trust or at the termination of *FT*. Notwithstanding the terms of the trust instrument, a letter of wishes directs the trustee of *FT* to provide for the educational needs of *B*, who is about to begin college. The letter of wishes contains a disclaimer to the effect that its contents are only suggestions and recommendations and that the trustee is at all times bound by the terms of the trust as set forth in the trust instrument. Under paragraphs (a)(1) and (a)(4)(ii)(C) of this section, *FT* is treated as having a U.S. beneficiary.

(b) *Indirect U.S. beneficiaries*—(1) *Certain foreign entities*. For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of—

(i) A controlled foreign corporation, as defined in section 957(a);

(ii) A foreign partnership, if a U.S. person is a partner of such partnership; or

(iii) A foreign trust or estate, if such trust or estate has a U.S. beneficiary (within the meaning of paragraph (a)(1) of this section).

(2) *Other indirect beneficiaries*. For purposes of paragraph (a)(1) of this section, an amount is treated as paid or accumulated to or for the benefit of a U.S. person if the amount is paid to or accumulated for the benefit of a U.S. person through an intermediary, such as an agent or nominee, or by any other means where a U.S. person may obtain an actual or constructive benefit.

(3) *Examples*. The following examples illustrate the rules of this paragraph (b). Unless otherwise noted, *A* is a resident alien. *B* is *A*'s son and is a resident alien. *FT* is a foreign trust. The examples are as follows:

*Example 1. Trust benefitting foreign corporation*. *A* transfers property to *FT*. The beneficiary of *FT* is *FC*, a foreign corporation. *FC* has outstanding solely 100 shares of common stock. *B* owns 49 shares of the *FC* stock and *FC2*, also a foreign corporation, owns the remaining 51 shares. *FC2* has outstanding solely 100 shares of common stock. *B* owns 49 shares of *FC2* and nonresident alien individuals own the remaining 51 *FC2* shares. *FC* is a controlled foreign corporation (as defined in section 957(a), after the application of section 958(a)(2)). Under paragraphs (a)(1) and (b)(1)(i) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 2. Trust benefitting another trust*. *A* transfers property to *FT*. The terms of *FT* permit current distributions of income to *B*. *A* transfers property to another foreign trust, *FT2*. The terms of *FT2* provide that no U.S. person can benefit either as to income or corpus, but permit current distributions of income to *FT*. Under paragraph (a)(1) of this section, *FT* is treated as having a U.S. beneficiary and, under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT2* is treated as having a U.S. beneficiary.

*Example 3. Trust benefitting another trust after transferor's death*. *A* transfers property to *FT*. The terms of *FT* require that all income from *FT* be accumulated during *A*'s lifetime. In the year following *A*'s death, a share of *FT* is to be distributed to *FT2*, another foreign trust, for the benefit of *B*. Under paragraphs (a)(1) and (b)(1)(iii) of this section, *FT* is treated as having a U.S. beneficiary beginning with the year of *A*'s transfer of property to *FT*.

*Example 4. Indirect benefit through use of debit card*. *A* transfers property to *FT*. The trust instrument provides that no U.S. person can benefit either as to income or corpus. However, *FT* maintains an account with *FB*, a foreign bank, and *FB* issues a debit card to *B* against the account maintained by *FT* and *B* is allowed to make withdrawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

*Example 5. Other indirect benefit*. *A* transfers property to *FT*. *FT* is administered by *FTC*, a foreign trust company. *FTC* forms *IBC*, an international business corporation formed under the laws of a foreign jurisdiction. *IBC* is the beneficiary of *FT*. *IBC* maintains an account with *FB*, a foreign bank. *FB* issues a debit card to *B* against the account maintained by *IBC* and *B* is allowed to make withdrawals. Under paragraphs (a)(1) and (b)(2) of this section, *FT* is treated as having a U.S. beneficiary.

(c) *Treatment of U.S. transferor upon foreign trust's acquisition or loss of U.S. beneficiary—(1) Trusts acquiring a U.S. beneficiary*. If a foreign trust to which a U.S. transferor has transferred property is not treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) for any taxable year of the U.S. transferor, but the trust is treated as having a U.S. beneficiary (within the meaning of paragraph (a) of this section) in any subsequent taxable year, the U.S. transferor is treated as having additional income in the first such taxable year of the U.S. transferor in which the trust is treated as having a U.S. beneficiary. The amount of the additional income is equal to the trust's undistributed net income, as defined in section 665(a), at the end of the U.S. transferor's immediately preceding taxable year and is subject to the rules of section 668, providing for an interest charge on accumulation distributions from foreign trusts.

(2) *Trusts ceasing to have a U.S. beneficiary*. If, for any taxable year of a U.S. transferor, a foreign trust that has received a transfer of property from the U.S. transferor ceases to be treated as having a U.S. beneficiary, the U.S. transferor ceases to be treated as the owner of the portion of the trust attributable to the transfer beginning in the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary (unless the U.S. transferor is treated as an owner thereof pursuant to sections 673 through 677). The U.S. transferor is treated as making a transfer of property to the foreign trust on the first day of the first taxable year following the last taxable year of the U.S. transferor during which the trust was treated as having a U.S. beneficiary. The amount of the property deemed to be transferred to the trust is the portion of the trust attributable to the prior transfer to which paragraph (a)(1) of this section applied. For rules regarding the recognition of gain on transfers to foreign trusts, see section 684.

(3) *Examples*. The rules of this paragraph (c) are illustrated by the following examples. *A* is a resident alien, *B* is *A*'s son, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Trust acquiring U.S. beneficiary*. (i) In 2001, *A* transfers stock with a fair market value of $100,000 to *FT*. The stock has an adjusted basis of $50,000 at the time of the transfer. The trust instrument provides that income may be paid currently to, or accumulated for the benefit of, *B* and that, upon the termination of the trust, all income and corpus is to be distributed to *B*. At the time of the transfer, *B* is a nonresident alien. *A* is not treated as the owner of any portion of *FT* under sections 673 through 677. *FT* accumulates a total of $30,000 of income during the taxable years 2001 through 2003. In 2004, *B* moves to the United States and becomes a resident alien. Assume paragraph (a)(4) of this section is not applicable under the facts and circumstances.

(ii) Under paragraph (c)(1) of this section, *A* is treated as receiving an accumulation distribution in the amount of $30,000 in 2004 and immediately transferring that amount back to the trust. The accumulation distribution is subject to the rules of section 668, providing for an interest charge on accumulation distributions.

(iii) Under paragraphs (a)(1) and (3) of this section, beginning in 2005, *A* is treated as the owner of the portion of *FT* attributable to the stock transferred by *A* to *FT* in 2001 (which includes the portion attributable to the accumulated income deemed to be retransferred in 2004).

*Example 2. Trust ceasing to have U.S. beneficiary*. (i) The facts are the same as in *Example 1*. In 2008, *B* becomes a nonresident alien. On the date *B* becomes a nonresident alien, the stock transferred by *A* to *FT* in 2001 has a fair market value of $125,000 and an adjusted basis of $50,000.

(ii) Under paragraph (c)(2) of this section, beginning in 2009, *FT* is not treated as having a U.S. beneficiary, and *A* is not treated as the owner of the portion of the trust attributable to the prior transfer of stock. For rules regarding the recognition of gain on the termination of ownership status, see section 684.

*§1.679–3 Transfers.*

(a) *In general*. A transfer means a direct, indirect, or constructive transfer.

(b) *Transfers by certain trusts*—(1) *In general*. If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Example*. The following example illustrates this paragraph (b):

*Example*. In 2001, *A*, a U.S. citizen, creates and funds *DT*, a domestic trust. *A* has the power to revest absolutely in himself the title to the property in *DT* and is treated as the owner of *DT* pursuant to section 676. In 2004, *DT* transfers property to *FT*, a foreign trust. *A* is treated as having transferred the property to *FT* in 2004 for purposes of this section.

(c) *Indirect transfers*—(1) *Principal purpose of tax avoidance*. A transfer to a foreign trust by any person (intermediary) to whom a U.S. person transfers property is treated as an indirect transfer by a U.S. person to the foreign trust if such transfer is made pursuant to a plan one of the principal purposes of which is the avoidance of United States tax.

(2) *Principal purpose of tax avoidance deemed to exist*. For purposes of paragraph (c)(1) of this section, a transfer is deemed to have been made pursuant to a plan one of the principal purposes of which was the avoidance of United States tax if—

(i) The U.S. person is related (within the meaning of paragraph (c)(4) of this section) to a beneficiary of the foreign trust, or has another relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the U.S. transferor would make a transfer to the foreign trust; and

(ii) The U.S. person cannot demonstrate to the satisfaction of the Commissioner that—

(A) The intermediary has a relationship with a beneficiary of the foreign trust that establishes a reasonable basis for concluding that the intermediary would make a transfer to the foreign trust;

(B) The intermediary acted independently of the U.S. person;

(C) The intermediary is not an agent of the U.S. person under generally applicable United States agency principles; and

(D) The intermediary timely complied with the reporting requirements of section 6048, if applicable.

(3) *Effect of disregarding intermediary*—(i) *In general*. Except as provided in paragraph (c)(3)(ii) of this section, if a transfer is treated as an indirect transfer pursuant to paragraph (c)(1) of this section, then the intermediary is treated as an agent of the U.S. person, and the property is treated as transferred to the foreign trust by the U.S. person in the year the property is transferred, or made available, by the intermediary to the foreign trust. The fair market value of the property transferred is determined as of the date of the transfer by the intermediary to the foreign trust.

(ii) *Special rule*. If the Commissioner determines, or if the taxpayer can demonstrate to the satisfaction of the Commissioner, that the intermediary is an agent of the foreign trust under generally applicable United States agency principles, the property will be treated as transferred to the foreign trust in the year the U.S. person transfers the property to the intermediary. The fair market value of the property transferred will be determined as of the date of the transfer by the U.S. person to the intermediary.

(iii) *Effect on intermediary*. If a transfer of property is treated as an indirect transfer under paragraph (c)(1) of this section, the intermediary is not treated as having transferred the property to the foreign trust.

(4) *Related parties*. For purposes of this paragraph (c), a U.S. transferor is treated as related to a U.S. beneficiary of a foreign trust if the U.S. transferor and the beneficiary are related for purposes of section 643(i)(2)(B), with the following modifications—

(i) For purposes of applying section 267 (other than section 267(f)) and section 707(b)(1), "at least 10 percent" is used instead of "more than 50 percent" each place it appears; and

(ii) The principles of section 267(b)(10), using "at least 10 percent" instead of "more than 50 percent," apply to determine whether two corporations are related.

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

*Example 1. Principal purpose of tax avoidance*. *A*, a U.S. citizen, creates and funds *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. In 2004, *A* decides to transfer an additional 1000X to the foreign trust. Pursuant to a plan with a principal purpose of avoiding the application of section 679, A transfers 1000X to *I*, a foreign person. *I* subsequently transfers 1000X to *FT*. Under paragraph (c)(1) of this section, *A* is treated as having made a transfer of 1000X to *FT*.

*Example 2. U.S. person unable to demonstrate that intermediary acted independently*. *A*, a U.S. citizen, creates and funds *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. On July 1, 2004, *A* transfers XYZ stock to *D*, *A*'s uncle, who is a nonresident alien. *D* immediately sells the XYZ stock and uses the proceeds to purchase ABC stock. On January 1, 2007, *D* transfers the ABC stock to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that *D* acted independently of *A* in making the transfer to FT. Under paragraph (c)(1) of this section, *A* is treated as having transferred the ABC stock to *FT*. Under paragraph (c)(3) of this section, *D* is treated as an agent of *A*, and the transfer is deemed to have been made on January 1, 2007.

*Example 3. Indirect loan to foreign trust*. *A*, a U.S. citizen, previously created and funded *FT*, a foreign trust, for the benefit of *A*'s children, who are U.S. citizens. On July 1, 2004, *A* deposits 500X with *FB*, a foreign bank. On January 1, 2005, *FB* loans 450X to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, pursuant to paragraph (c)(2) of this section, that *FB* has a relationship with *FT* that establishes a reasonable basis for concluding that *FB* would make a loan to *FT* or that *FB* acted independently of *A* in making the loan. Under paragraph (c)(1) of this section, *A* is deemed to have transferred 450X directly to *FT* on January 1, 2005. Under paragraph (c)(3) of this section, *FB* is treated as an agent of *A*. For possible exceptions with respect to qualified obligations of the trust, and the treatment of principal repayments with respect to obligations of the trust that are not qualified obligations, see §1.679–4.

*Example 4. Loan to foreign trust prior to deposit of funds in foreign bank*. The facts are the same as in *Example 3*, except that *A* makes the 500X deposit with *FB* on January 2, 2005, the day after *FB* makes the loan to *FT*. The result is the same as in *Example 3*.

(d) *Constructive transfers*—(1) *In general*. For purposes of paragraph (a) of this section, a constructive transfer includes any assumption or satisfaction of a foreign trust's obligation to a third party.

(2) *Examples*. The rules of this paragraph (d) are illustrated by the following examples. In each example, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

*Example 1. Payment of debt of foreign trust*. *FT* owes 1000X to *Y*, an unrelated foreign corporation, for the performance of services by *Y* for *FT*. In satisfaction of *FT*'s liability to *Y*, *A* transfers to *Y* property with a fair market value of 1000X. Under paragraph (d)(1) of this section, *A* is treated as having made a constructive transfer of the property to *FT*.

*Example 2. Assumption of liability of foreign trust*. *FT* owes 1000X to *Y*, an unrelated foreign corporation, for the performance of services by *Y* for *FT*. *A* assumes *FT*'s liability to pay *Y*. Under paragraph (d)(1) of this section, *A* is treated as having made a constructive transfer of property with a fair market value of 1000X to *FT*.

(e) *Guarantee of trust obligations*—(1) *In general*. If a foreign trust borrows money or other property from any person who is not a related person (within the meaning of §1.679–1(c)(5)) with respect to the trust (lender) and a U.S. person (U.S. guarantor) that is a related person with respect to the trust guarantees (within the meaning of paragraph (e)(4) of this section) the foreign trust's obligation, the U.S. guarantor is treated for purposes of this section as a U.S. transferor that has made a transfer to the trust on the date of the guarantee in an amount determined under paragraph (e)(2) of this section. To the extent this paragraph causes the U.S. guarantor to be treated as having made a transfer to the trust, a lender that is a U.S. person shall not be treated as having transferred that amount to the foreign trust.

(2) *Amount transferred*. The amount deemed transferred by a U.S. guarantor described in paragraph (e)(1) of this section is the guaranteed portion of the adjusted issue price of the obligation (within the meaning of §1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273–1(c)).

(3) *Principal repayments*. If a U.S. person is treated under this paragraph (e) as having made a transfer by reason of the guarantee of an obligation, payments of principal to the lender by the foreign trust with respect to the obligation are taken into account on and after the date of the payment in determining the portion of the trust attributable to the property deemed transferred by the U.S. guarantor.

(4) *Guarantee*. For purposes of this section, the term guarantee—

(i) Includes any arrangement under which a person, directly or indirectly, assures, on a conditional or unconditional basis, the payment of another's obligation;

(ii) Encompasses any form of credit support, and includes a commitment to make a capital contribution to the debtor or otherwise maintain its financial viability; and

(iii) Includes an arrangement reflected in a comfort letter, regardless of whether the arrangement gives rise to a legally enforceable obligation. If an arrangement is contingent upon the occurrence of an event, in determining whether the arrangement is a guarantee, it is assumed that the event has occurred.

(5) *Examples*. The rules of this paragraph (e) are illustrated by the following examples. In all of the examples, *A* is a U.S. resident and *FT* is a foreign trust. The examples are as follows:

*Example 1. Foreign lender*. *X*, a foreign corporation, loans 1000X of cash to *FT* in exchange for *FT*'s obligation to repay the loan. *A* guarantees the repayment of 600X of *FT*'s obligation. Under paragraph (e)(2) of this section, *A* is treated as having transferred 600X to *FT*.

*Example 2. Unrelated U.S. lender*. The facts are the same as in *Example 1*, except *X* is a U.S. person that is not a related person within the meaning of §1.679–1(c)(5). The result is the same as in *Example 1*.

(f) *Transfers to entities owned by a foreign trust*—(1) *General rule*. If a U.S. person is a related person (as defined in §1.679–1(c)(5)) with respect to a foreign trust, any transfer of property by the U.S. person to an entity in which the foreign trust holds an ownership interest is treated as a transfer of such property by the U.S.

person to the foreign trust followed by a transfer of the property from the foreign trust to the entity owned by the foreign trust, unless the U.S. person demonstrates to the satisfaction of the Commissioner that the transfer to the entity is properly attributable to the U.S. person's ownership interest in the entity.

(2) *Examples*. The rules of this paragraph (f) are illustrated by the following examples. In all of the examples, *A* is a U.S. citizen, *FT* is a foreign trust, and *FC* is a foreign corporation. The examples are as follows:

*Example 1. Transfer treated as transfer to trust*. *A* creates and funds *FT*, which is treated as having a U.S. beneficiary under §1.679–2. *FT* owns all of the outstanding stock of *FC*. *A* transfers property directly to *FC*. Because *FT* is the sole shareholder of *FC*, *A* is unable to demonstrate to the satisfaction of the Commissioner that the transfer is properly attributable to *A*'s ownership interest in *FC*. Accordingly, under this paragraph (f), *A* is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. Under §1.679–1(a), *A* is treated as the owner of the portion of *FT* attributable to the property treated as transferred directly to *FT*. Under §1.367(a)–1T(c)(4)(ii), the transfer of property by *FT* to *FC* is treated as a transfer of the property by *A* to *FC*.

*Example 2. Transfer treated as transfer to trust*. The facts are the same as in *Example 1*, except that *FT* is not treated as having a U.S. beneficiary under §1.679–2. Under this paragraph (f), *A* is treated as having transferred the property to *FT*, followed by a transfer of such property by *FT* to *FC*. *A* is not treated as the owner of *FT* for purposes of §1.679–1(a). For rules regarding the recognition of gain on the transfer, see section 684.

*Example 3. Transfer not treated as transfer to trust*. *A* creates and funds *FT*. *FC* has outstanding solely 100 shares of common stock. *FT* owns 50 shares of *FC* stock, and *A* owns the remaining 50 shares. On July 1, 2001, *FT* and *A* each transfer 1000X to FC. *A* is able to demonstrate to the satisfaction of the Commissioner that *A*'s transfer to *FC* is properly attributable to *A*'s ownership interest in *FC*. Accordingly, under this paragraph (f), *A*'s transfer to *FC* is not treated as a transfer to *FT*.

*§1.679–4 Exceptions to general rule.*

(a) *In general*. Section 1.679–1 does not apply to—

(1) Any transfer of property to a foreign trust by reason of the death of the transferor;

(2) Any transfer of property to a foreign trust described in sections 402(b), 404(a)(4), or 404A;

(3) Any transfer of property to a foreign trust described in section 501(c)(3) (without regard to the requirements of section 508(a)); and

(4) Any transfer of property to a foreign trust to the extent the transfer is for fair market value.

(b) *Transfers for fair market value*—(1) *In general*. For purposes of this section, a transfer is for fair market value only to the extent of the value of property received from the trust, services rendered by the trust, or the right to use property of the trust. For example, rents, royalties, interest, and compensation paid to a trust are transfers for fair market value only to the extent that the payments reflect an arm's length price for the use of the property of, or for the services rendered by, the trust. For purposes of this determination, an interest in the trust is not property received from the trust. For purposes of this section, a distribution to a trust with respect to an interest held by such trust in an entity other than a trust or an interest in certain investment trusts described in §301.7701–4(c) of this chapter, liquidating trusts described in §301.7701–4(d) of this chapter, or environmental remediation trusts described in §301.7701–4(e) of this chapter is considered to be a transfer for fair market value.

(2) *Special rule—(i) Transfers for partial consideration*. For purposes of this section, if a person transfers property to a foreign trust in exchange for property having a fair market value that is less than the fair market value of the property transferred, the exception in paragraph (a)(4) of this section applies only to the extent of the fair market value of the property received.

(ii) *Example*. This paragraph (b) is illustrated by the following example:

*Example*. *A*, a U.S. citizen, transfers property that has a fair market value of 1000X to *FT*, a foreign trust, in exchange for 600X of cash. Under this paragraph (b), §1.679–1 applies with respect to the transfer of 400X (1000X less 600X) to *FT*.

(c) *Certain obligations not taken into account*. Solely for purposes of this section, in determining whether a transfer by a U.S. transferor that is a related person (as defined in §1.679–1(c)(5)) with respect to the foreign trust is for fair market value, any obligation (as defined in §1.679–1(c)(6)) of the trust or a related person (as defined in §1.679–1(c)(5)) that is not a qualified obligation within the meaning of paragraph (d)(1) of this section shall not be taken into account.

(d) *Qualified obligations*—(1) *In general*. For purposes of this section, an obligation is treated as a qualified obligation only if—

(i) The obligation is reduced to writing by an express written agreement;

(ii) The term of the obligation does not exceed five years (for purposes of determining the term of an obligation, the obligation's maturity date is the last possible date that the obligation can be outstanding under the terms of the obligation);

(iii) All payments on the obligation are denominated in U.S. dollars;

(iv) The yield to maturity is not less than 100 percent of the applicable Federal rate and not greater that 130 percent of the applicable Federal rate (the applicable Federal rate for an obligation is the applicable Federal rate in effect under section 1274(d) for the day on which the obligation is issued, as published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter));

(v) The U.S. transferor extends the period for assessment of any income or transfer tax attributable to the transfer and any consequential income tax changes for each year that the obligation is outstanding, to a date not earlier than three years after the maturity date of the obligation (this extension is not necessary if the maturity date of the obligation does not extend beyond the end of the U.S. transferor's taxable year for the year of the transfer and is paid within such period); when properly executed and filed, such an agreement is deemed to be consented to for purposes of §301.6501(c)–1(d) of this chapter; and

(vi) The U.S. transferor reports the status of the loan, including principal and interest payments, on Form 3520 for every year that the loan is outstanding.

(2) *Additional loans*. If, while the original obligation is outstanding, the U.S. transferor or a person related to the trust (within the meaning of §1.679–1(c)(5)) directly or indirectly obtains another obligation issued by the trust, or if the U.S. transferor directly or indirectly obtains another obligation issued by a person related to the trust, the original obligation is deemed to have the maturity date of any such subsequent obligation in determining whether the term of the original obligation exceeds the specified 5-year term. In addition, a series of obligations issued and repaid by the trust (or a person

related to the trust) is treated as a single obligation if the transactions giving rise to the obligations are structured with a principal purpose to avoid the application of this provision.

(3) *Obligations that cease to be qualified*. If an obligation treated as a qualified obligation subsequently fails to be a qualified obligation (*e.g.*, renegotiation of the terms of the obligation causes the term of the obligation to exceed five years), the U.S. transferor is treated as making a transfer to the trust in an amount equal to the original obligation's adjusted issue price (within the meaning of §1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273–1(c)) as of the date of the subsequent event that causes the obligation to no longer be a qualified obligation. If the maturity date is extended beyond five years by reason of the issuance of a subsequent obligation by the trust (or person related to the trust), the amount of the transfer will not exceed the issue price of the subsequent obligation. The subsequent obligation is separately tested to determine if it is a qualified obligation.

(4) *Transfers resulting from failed qualified obligations*. In general, a transfer resulting from a failed qualified obligation is deemed to occur on the date of the subsequent event that causes the obligation to no longer be a qualified obligation. However, based on all of the facts and circumstances, the Commissioner may deem a transfer to have occurred on any date on or after the issue date of the original obligation. For example, if at the time the original obligation was issued, the transferor knew or had reason to know that the obligation would not be repaid, the Commissioner could deem the transfer to have occurred on the issue date of the original obligation.

(5) *Renegotiated loans*. Any loan that is renegotiated, extended, or revised is treated as a new loan, and any transfer of funds to a foreign trust after such renegotiation, extension, or revision under a preexisting loan agreement is treated as a transfer subject to this section.

(6) *Principal repayments*. The payment of principal with respect to any obligation that is not treated as a qualified obligation under this paragraph is taken into account on and after the date of the payment in determining the portion of the trust attributable to the property transferred.

(7) *Examples*. The rules of this paragraph (d) are illustrated by the following examples. In the examples, *A* and *B* are U.S. residents and *FT* is a foreign trust. The examples are as follows:

*Example 1. Demand loan*. *A* transfers 500X to *FT* in exchange for a demand note that permits *A* to require repayment by *FT* at any time. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679–1 applies with respect to the full 500X transfer to *FT*.

*Example 2. Private annuity*. *A* transfers 4000X to *FT* in exchange for an annuity from the foreign trust that will pay *A* 100X per year for the rest of *A*'s life. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because *FT*'s obligation to *A* could remain outstanding for more than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679–1 applies with respect to the full 4000X transfer to *FT*.

*Example 3. Loan to unrelated foreign trust*. *B* transfers 1000X to *FT* in exchange for an obligation of the trust. The term of the obligation is fifteen years. *B* is not a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because *B* is not a related person, the fair market value of the obligation received by *B* is taken into account for purposes of determining whether *B*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section, even though the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section.

*Example 4. Transfer for an obligation with term in excess of 5 years*. *A* transfers property that has a fair market value of 5000X to *FT* in exchange for an obligation of the trust. The term of the obligation is ten years. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Because the term of the obligation is greater than five years, the obligation is not a qualified obligation within the meaning of paragraph (d)(1) of this section and, pursuant to paragraph (c) of this section, it is not taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section. Accordingly, §1.679–1 applies with respect to the full 5000X transfer to *FT*.

*Example 5. Transfer for a qualified obligation*. The facts are the same as in *Example 4,* except that the term of the obligation is 3 years. Assuming the other requirements of paragraph (d)(1) of this section are satisfied, the obligation is a qualified obligation and its adjusted issue price is taken into account for purposes of determining whether *A*'s transfer is eligible for the fair market value exception of paragraph (a)(4) of this section.

*Example 6. Effect of subsequent obligation on original obligation*. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for an obligation that satisfies the requirements of paragraph (d)(1) of this section. *A* is a related person (as defined in §1.679–1(c)(5)) with respect to *FT*. Two years later, *A* transfers an additional 2000X to *FT* and receives another obligation from *FT* that has a maturity date four years from the date that the second obligation was issued. Under paragraph (d)(2) of this section, the original obligation is deemed to have the maturity date of the second obligation. Under paragraph (a) of this section, *A* is treated as having made a transfer in an amount equal to the original obligation's adjusted issue price (within the meaning of §1.1275–1(b)) plus any accrued but unpaid qualified stated interest (within the meaning of §1.1273–1(c)) as of the date of issuance of the second obligation. The second obligation is tested separately to determine whether it is a qualified obligation for purposes of applying paragraph (a) of this section to the second transfer.

### *§1.679–5 Pre-immigration trusts.*

(a) *In general*. If a nonresident alien individual becomes a U.S. person and the individual has a residency starting date (as determined under section 7701(b)(2)(A)) within 5 years after directly or indirectly transferring property to a foreign trust (the original transfer), the individual is treated as having transferred to the trust on the residency starting date an amount equal to the portion of the trust attributable to the property transferred by the individual in the original transfer.

(b) *Special rules*—(1) *Change in grantor trust status*. For purposes of paragraph (a) of this section, if a nonresident alien individual who is treated as owning any portion of a trust under the provisions of subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, subsequently ceases to be so treated, the individual is treated as having made the original transfer to the foreign trust immediately before the trust ceases to be treated as owned by the individual.

(2) *Treatment of undistributed income*. For purposes of paragraph (a) of this section, the property deemed transferred to the foreign trust on the residency starting date includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred. Undistributed net income for periods before the individual's residency starting date is taken into account only for purposes of determining the amount of the property deemed transferred.

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

*Example 1. Nonresident alien becomes resident alien*. On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. On January 1, 2006, *A* becomes a resident of the United States within the meaning of section 7701(b)(1)(A) and has a residency starting date of January 1, 2006, within the meaning of section 7701(b)(2)(A). Under paragraph (a) of this section, *A* is treated as a U.S. transferor and is deemed to transfer the property to *FT* on January 1, 2006. Under paragraph (b)(2) of this section, the property deemed transferred to *FT* on January 1, 2006, includes the undistributed net income of the trust, as defined in section 665(a), attributable to the property originally transferred.

*Example 2. Nonresident alien loses power to revest property*. On January 1, 2002, *A*, a nonresident alien individual, transfers property to a foreign trust, *FT*. *A* has the power to revest absolutely in himself the title to such property transferred and is treated as the owner of the trust pursuant to sections 676 and 672(f). On January 1, 2008, the terms of *FT* are amended to remove *A*'s power to revest in himself title to the property transferred, and *A* ceases to be treated as the owner of *FT*. On January 1, 2010, *A* becomes a resident of the United States. Under paragraph (b)(1) of this section, for purposes of paragraph (a) of this section *A* is treated as having originally transferred the property to *FT* on January 1, 2008. Because this date is within five years of *A*'s residency starting date, *A* is deemed to have made a transfer to the foreign trust on January 1, 2010, his residency starting date. Under paragraph (b)(2) of this section, the property deemed transferred to the foreign trust on January 1, 2010, includes the undistributed net income of the trust, as defined in section 665(a), attributable to the property deemed transferred.

*§1.679–6 Outbound migrations of domestic trusts.*

(a) *In general*. Subject to the provisions of paragraph (b) of this section, if an individual who is a U.S. person transfers property to a trust that is not a foreign trust, and such trust becomes a foreign trust while the U.S. person is alive, the U.S. individual is treated as a U.S. transferor and is deemed to transfer the property to a foreign trust on the date the domestic trust becomes a foreign trust.

(b) *Amount deemed transferred*. For purposes of paragraph (a) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property previously transferred. Undistributed net income for periods prior to the migration is taken into account only for purposes of determining the portion of the trust that is attributable to the property transferred by the U.S. person.

(c) *Example*. The following example illustrates the rules of this section. For purposes of the example, *A* is a resident alien, *B* is *A*'s son, who is a resident alien, and *DT* is a domestic trust. The example is as follows:

*Example. Outbound migration of domestic trust*. On January 1, 2002, *A* transfers property to *DT*, for the benefit of *B*. On January 1, 2003, *DT* acquires a foreign trustee who has the power to determine whether and when distributions will be made to *B*. Under section 7701(a)(30)(E) and §301.7701–7(d)(ii)(A) of this chapter, *DT* becomes a foreign trust on January 1, 2003. Under paragraph (a) of this section, *A* is treated as transferring property to a foreign trust on January 1, 2003. Under paragraph (b) of this section, the property deemed transferred to the trust when it becomes a foreign trust includes undistributed net income, as defined in section 665(a), attributable to the property deemed transferred.

*§1.679–7 Effective dates.*

(a) *In general*. Except as provided in paragraph (b) of this section, the rules of §§1.679–1, 1.679–2, 1.679–3, and 1.679–4 apply with respect to transfers after August 7, 2000.

(b) *Special rules*. (1) The rules of §1.679–4(c) and (d) apply to an obligation issued after February 6, 1995, whether or not in accordance with a preexisting arrangement or understanding. For purposes of the rules of §1.679–4(c) and (d), if an obligation issued on or before February 6, 1995, is modified after that date, and the modification is a significant modification within the meaning of §1.1001–3, the obligation is treated as if it were issued on the date of the modification. However, the penalty provided in section 6677 applies only to a failure to report transfers in exchange for obligations issued after August 20, 1996.

(2) The rules of §1.679–5 apply to persons whose residency starting date is after August 7, 2000.

(3) The rules of §1.679–6 apply to trusts that become foreign trusts after August 7, 2000.

Par. 3. In §1.958–1, the first sentence of paragraph (b) is revised to read as follows:

*§1.958–1 Direct and indirect ownership of stock.*

* * * * *

(b) * * * For purposes of paragraph (a)(2) of this section, stock owned, directly or indirectly, by or for a foreign corporation, foreign partnership, foreign trust (within the meaning of section 7701(a)(31)) described in sections 671 through 679, or other foreign trust or foreign estate (within the meaning of section 7701(a)(31)) shall be considered as being owned proportionately by its shareholders, partners, grantors or other persons treated as owners under sections 671 through 679 of any portion of the trust that includes the stock, or beneficiaries, respectively. * * *

* * * * *

**§1.958–2 [Amended]**

Par. 4. In §1.958–2, paragraph (c)(1)(ii)(*b*) is amended by removing the language "678" and adding "679" in its place.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved July 9, 2001.

Mark Weinberger,
*Assistant Secretary of*
*the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on July 19, 2001, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2001, 66 F.R. 37886)

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## Section 684.—Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates

*26 CFR 1.684–1: Recognition of gain on transfers to certain foreign trusts and estates.*

## T.D. 8956

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Part 1

## Recognition of Gain on Certain Transfers to Certain Foreign Trusts and Estates

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 684 of the Internal Revenue Code relating to recog-

nition of gain on certain transfers to certain foreign trusts and estates. The regulations affect United States persons who transfer property to foreign trusts and estates.

DATES: *Effective Date*: These regulations are effective July 20, 2001.

*Applicability Date*: These regulations are applicable to transfers of property to foreign trusts and foreign estates after August 7, 2000.

FOR FURTHER INFORMATION CONTACT: Karen A. Rennie-Quarrie, (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains final regulations relating to the Income Tax Regulations (CFR part 1) under section 684 of the Internal Revenue Code (Code). On August 7, 2000, Treasury and the IRS published a notice of proposed rulemaking (REG–108522–00, 2000–34 I.R.B. 187) in the **Federal Register** (65 FR 48198) under section 684 of the Code relating to gain recognition on transfers of property by U.S. persons to foreign trusts and estates. Comments responding to the notice of proposed rulemaking were received and a public hearing was held on November 8, 2000. After consideration of all comments, the proposed regulations are adopted as final regulations as revised by this Treasury decision.

**Explanation of Provisions**

I. *Comments and Changes to §1.684–1: Recognition of Gain on Transfers to Certain Foreign Trusts and Estates*

Under the proposed regulations, a U.S. person who transfers property to a foreign trust or estate generally must recognize gain immediately even if deferral might otherwise be permitted under another provision of the Code.

One commenter questioned the authority for the conclusion in §1.684–1(d) *Example 4* that a U.S. person must recognize gain immediately upon the transfer of appreciated property to a foreign trust in exchange for a private annuity. The general rule in section 684(a) provides, in part, that the transfer to the foreign trust is treated as a sale or exchange for an amount equal to the fair market value of the property transferred and the transferor must recognize the gain in the property, except as provided in regulations. The language of section 684(a) does not provide for any deferral of this gain. Moreover, the legislative history of former section 1491 (the predecessor of section 684 regarding transfers of property by U.S. persons to foreign trusts) makes it clear that Congress did not look favorably upon deferral in the context of transfers to foreign trusts in exchange for private annuities: "The committee believes that any policy in favor of permitting deferral of tax in private annuity transactions should not apply to a private annuity transaction with a foreign trust." S. Rep. No. 94–938, at 217, n.5 (1976). Therefore, Treasury and the IRS do not believe it would be appropriate to adopt regulations that would permit deferral in such a case. The final regulations retain *Example 4* without modification.

II. *Comments and Changes to §1.684–2: Transfers*

The proposed regulations define the term *transfer* broadly to mean any direct, indirect, or constructive transfer. Section 1.684–2(e) of the proposed regulations provides that if any portion of a foreign trust is treated as owned by a U.S. person and such portion ceases to be treated as owned by such U.S. person, the U.S. person is treated as having transferred the assets of such portion to a foreign trust immediately before the trust is no longer treated as owned by the U.S. person. Section 1.684–2(e)(2) *Example 2* illustrates this rule in the case of the death of the grantor.

One commenter questioned the authority for the position that death is a transfer to which section 684 applies. Section 684(a) expressly applies to "*any* transfer of property by a United States person to a foreign estate or trust" (emphasis added). Section 679 also generally applies to transfers of property by U.S. persons to foreign trusts. In the case of section 679, however, section 679(a)(2)(A) specifically excepts transfers by reason of death from the application of the general rule of section 679. This exception implies that Congress believed that, unless otherwise excepted, a transfer by reason of death would be a transfer to which section 679 applied. Because Congress provided no exception in section 684 for transfers by reason of death, it follows that section 684 applies to such transfers. Additional support for this conclusion is found in the information reporting rules in section 6048(a)(3)(A)(ii), which provides that a "reportable event" includes "the transfer of any money or property (directly or indirectly) to a foreign trust by a United States person, *including a transfer by reason of death*" (emphasis added). Although section 684 generally applies to transfers by reason of death, §1.684–3(c) provides an exception to the general rule of gain recognition in the case of certain transfers at death.

One commenter requested guidance concerning a transfer of property by a domestic trust (that is not treated as owned by another person) to a foreign trust as a result of the testamentary exercise of a limited power of appointment with respect to the domestic trust. Treasury and the IRS believe that, under general principles regarding limited powers of appointment, the domestic trust, and not the holder of the limited power of appointment, is the transferor of the property. Accordingly, the domestic trust must recognize gain under the general rule of §1.684–1(a) unless an exception applies. The final regulations do not include any special rules for such transfers.

One commenter asked about the interaction of §1.684–2(d) and §1.684–2(e) in the context of an actual transfer of property from a foreign trust that is treated as owned by a U.S. person to either a foreign charitable organization or a U.S. charity. Under §1.684–2(d) of the proposed regulations, if any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner. Under §1.684–2(e) of the proposed regulations, if a portion of a foreign trust that is treated as owned by a U.S. person ceases to be treated as owned by the U.S. person, the U.S. person is treated as having transferred the assets of that portion of the trust to a foreign trust immediately before such portion is no longer treated as owned by the U.S. person.

The commenter noted that §1.684–2(e) of the proposed regulation could be read to apply in situations where a portion of a foreign trust ceases to be treated as owned by a U.S. person because of an actual transfer of property from the trust. The final regulations clarify that §1.684–2(e) does not apply (and that §1.684–2(d) may apply) when any portion of a trust ceases to be owned by a U.S. person by reason of an actual transfer of property from the trust. As a result, the general rule of gain recognition under §1.684–1(a) would not apply to an actual transfer by a foreign trust that is treated as owned by a U.S. person to a foreign charitable trust that meets the requirements of §1.684–3(b), or to a U.S. charity, even if the transfer causes the portion of the trust to cease to be owned by the U.S. person.

III. *Comments and Changes to §1.684–3: Exceptions to the General Rule of Gain Recognition*

Section 1.684–3(a) of the proposed regulations provides that a U.S. person who transfers property to a foreign trust is not required to recognize gain on the transfer to the extent that any person is treated as the owner of the trust under section 671. One commenter questioned whether the term *any person* includes foreign persons. Although not specifically addressed in the final regulations, it is understood that the term *any person* includes foreign as well as U.S. persons.

Section 1.684–3(b) of the proposed regulations provides an exception for transfers to a foreign trust that has already received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3), provided that the letter has been neither revoked nor modified. Commenters questioned the requirement that a foreign trust obtain a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). They assert that the requirement may interfere with a U.S. person's ability to make contributions to a foreign charitable entity that may not be familiar with U.S. tax laws and may not have any reason to obtain a determination letter from the IRS. They suggest that the final regulations require only that the U.S. transferor disclose to the IRS, at such time and in such manner as the IRS may provide, that the transfer has been made and that the U.S. transferor believes the transferee is an organization described in section 501(c)(3).

In response to commenters' concerns, the final regulations eliminate the requirement that the foreign trust receive a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). The final regulations provide, instead, that the general rule of gain recognition does not apply to any transfer of property to a foreign trust that is described in section 501(c)(3) (without regard to the requirements of section 508(a)). However, taxpayers should be aware that, under Notice 97–34 (1997–1 C.B. 422), the U.S. transferor has a reporting obligation on Form 3520 with respect to such a transfer, unless the foreign trust has received a ruling or determination letter from the IRS recognizing the trust's tax exempt status under section 501(c)(3). Moreover, if the IRS subsequently determines that the foreign trust is not described in section 501(c)(3), the exception will not apply and the U.S. transferor will be required to recognize gain as of the time of the original transfer, and may be subject to interest and penalties, if applicable.

Section 1.684–3(c) of the proposed regulations provides an exception for transfers of property by reason of the death of the U.S. transferor if both of the following requirements are satisfied: (1) the property is included in the U.S. transferor's gross estate for Federal estate tax purposes, and (2) the basis of the property in the hands of the foreign trust is determined under section 1014(a). One commenter questioned whether section 684 would apply in the case of an individual who is a U.S. person for income tax purposes, but a non-domiciliary for estate tax purposes, with the result that the property of the individual would be entitled to a step-up in basis, but would not be included in the individual's gross estate. The final regulations eliminate the requirement that the property be included in the U.S. transferor's gross estate and allow the exception to apply as long as the basis of the property in the hands of the foreign trust is determined under section 1014(a).

Another commenter requested that the final regulations confirm that section 1032 applies to provide for nonrecognition of gain on issuer stock transferred to a foreign trust. The commenter noted that under former section 1491, no excise tax was imposed on a transfer of stock by a foreign corporation to a foreign trust if the corporation was not required to recognize gain on the transfer under section 1032. See Notice 97–18 (1997–1 C.B. 389, Sec. II.A.1). In response to this comment, §1.684–3(e) of the final regulations provides a new exception for transfers of stock (including treasury stock) by a domestic corporation to a foreign trust if the domestic corporation is not required to recognize gain on the transfer under section 1032.

Commenters also suggested that contributions by U.S. persons to foreign compensatory trusts described in sections 402(b), 404(a)(4), or 404A should be exempt from gain recognition under section 684. Treasury and the IRS have considered the proposed exception but do not believe it is consistent with the intended purpose of section 684. Accordingly, the final regulations do not include an exception for transfers to foreign compensatory trusts. However, the exception for transfers of stock to which section 1032 would apply may be available in appropriate cases for transfers of stock of a domestic parent company to a foreign compensatory trust set up by a foreign subsidiary.

Another commenter requested an exception for transfers of life insurance contracts to foreign trusts. The commenter noted that the proceeds of life insurance contracts do not generally give rise to any taxable gain if held by a U.S. individual or trust. Congress has recognized that life insurance contracts might be used to effectuate inappropriate outbound transfers of property. As part of the repeal of section 1491 in 1997, Congress enacted section 1035(c), which provides regulatory authority to deny the nonrecognition treatment given to exchanges of life insurance contracts under section 1035(a) where the exchange has the effect of transferring property to any person other than a U.S. person. Public Law 105–34, §1131(b)[(c)](1). Because of the potential for abuse and the lack of a compelling reason for creating an exception for offshore transfers of life insurance contracts, Treasury and the IRS have concluded that such an exception is not warranted.

IV. *Comments and Changes to §1.684–4: Outbound Migration of Domestic Trusts*

Section 1.684–4 of the proposed regulation provides that if a U.S. person transfers property to a domestic trust and, for any reason, the domestic trust becomes a foreign trust, the domestic trust will be deemed to have transferred all of its assets to a foreign trust and the domestic trust must immediately recognize gain. The proposed regulations do, however, incorporate the relief for inadvertent migrations that is set forth in §301.7701–7(d)(2).

One commenter suggested that the final regulations should extend the inadvertent migration rules of §301.7701–7(d)(2) to apply to §301.7701–7(f), which deals with the election by certain trusts to remain domestic trusts. Under §301.7701–7(d)(2), in the event of an inadvertent change in any person that has the power to make a substantial decision of the trust that would cause the domestic or foreign residency of the trust to change (*e.g.*, an inadvertent change from a U.S. trustee to a foreign trustee by reason of the U.S. trustee's death), the trust is allowed 12 months to make necessary changes to avoid a change in the trust's residency (*e.g.*, the replacement of the foreign successor trustee with a U.S. successor trustee). The commenter suggests that a trust with an election in force under §301.7701–7(d)(2) should be allowed a similar amount of time to make necessary changes if a U.S. trustee is inadvertently replaced by a foreign trustee.

The final regulations do not include such a rule. Under §301.7701–7(f), a trust generally can elect to remain a domestic trust if it was in existence on August 20, 1996, and it was treated as a domestic trust on August 19, 1996. Section 301.7701–7(f)(4)(ii) provides that such an election terminates if subsequent changes are made to the trust that result in the trust no longer having any reasonable basis for being treated as a domestic trust under section 7701(a)(30) prior to its amendment by the Small Business Job Protection Act of 1996 (SBJP Act), Pub. L. 104–188, 110 Stat. 1755. Whereas the "control test" of section 7701(a)(30)(E)(ii), as enacted by the SBJP Act, contains a relatively bright-line test for purposes of determining a trust's status, thereby necessitating the inadvertent migration rule of §301.7701–7(d)(2), the determination of domestic or foreign status prior to the SBJP Act was governed by less objective criteria.

Under pre-SBJP Act law, an inadvertent short-term replacement of a domestic trustee by a foreign trustee would not necessarily cause a change in the trust's status. Accordingly, a specific inadvertent migration rule for §301.7701–7(f) is not appropriate. Instead, as set forth in §301.7701–7(f)(4)(ii), an election under §301.7701–7(f) will not be terminated unless the trust has no reasonable basis for being treated as a domestic trust under pre-SBJP Act law.

**Special Analyses**

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

**Drafting Information**

The principal author of these regulations is Karen A. Rennie-Quarrie of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

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

Section 1.684–1 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–2 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–3 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–4 also issued under 26 U.S.C. 643(a)(7) and 684(a).

Section 1.684–5 also issued under 26 U.S.C. 643(a)(7) and 684(a). * * *

Par. 2. Sections 1.684–1, 1.684–2, 1.684–3, 1.684–4 and 1.684–5 are added under the undesignated centerheading "Miscellaneous" to read as follows:

*§1.684–1 Recognition of gain on transfers to certain foreign trusts and estates.*

(a) *Immediate recognition of gain*—(1) *In general*. Any U.S. person who transfers property to a foreign trust or foreign estate shall be required to recognize gain at the time of the transfer equal to the excess of the fair market value of the property transferred over the adjusted basis (for purposes of determining gain) of such property in the hands of the U.S. transferor unless an exception applies under the provisions of §1.684–3. The amount of gain recognized is determined on an asset-by-asset basis.

(2) *No recognition of loss*. Under this section a U.S. person may not recognize loss on the transfer of an asset to a foreign trust or foreign estate. A U.S. person may not offset gain realized on the transfer of an appreciated asset to a foreign trust or foreign estate by a loss realized on the transfer of a depreciated asset to the foreign trust or foreign estate.

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

(1) *U.S. person*. The term *U.S. person* means a United States person as defined in section 7701(a)(30), and includes a nonresident alien individual who elects under section 6013(g) to be treated as a resident of the United States.

(2) *U.S. transferor*. The term *U.S. transferor* means any U.S. person who makes a transfer (as defined in §1.684–2) of property to a foreign trust or foreign estate.

(3) *Foreign trust*. Section 7701(a)(31)(B) defines foreign trust. See also §301.7701–7 of this chapter.

(4) *Foreign estate*. Section 7701(a)(31)(A) defines foreign estate.

(c) *Reporting requirements*. A U.S. person who transfers property to a foreign trust or foreign estate must comply with the reporting requirements under section 6048.

(d) *Examples*. The following examples illustrate the rules of this section. In all examples, *A* is a U.S. person and *FT* is a foreign trust. The examples are as follows:

*Example 1. Transfer to foreign trust*. *A* transfers property that has a fair market value of 1000X to *FT*. *A*'s adjusted basis in the property is 400X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes gain at the time of the transfer equal to 600X.

*Example 2. Transfer of multiple properties*. *A* transfers property Q, with a fair market value of 1000X, and property R, with a fair market value of 2000X, to *FT*. At the time of the transfer, *A*'s adjusted basis in property Q is 700X, and *A*'s adjusted basis in property R is 2200X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes the 300X of gain attributable to property Q. Under paragraph (a)(2) of this section, *A* does not recognize the 200X of loss attributable to property R, and may not offset that loss against the gain attributable to property Q.

*Example 3. Transfer for less than fair market value*. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for 400X of cash. *A*'s adjusted basis in the property is 200X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. Under paragraph (a)(1) of this section, *A* recognizes gain at the time of the transfer equal to 800X.

*Example 4. Exchange of property for private annuity*. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for *FT*'s obligation to pay *A* 50X per year for the rest of *A*'s life. *A*'s adjusted basis in the property is 100X. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. *A* is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though *A* might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code.

*Example 5. Transfer of property to related foreign trust in exchange for qualified obligation*. *A* transfers property that has a fair market value of 1000X to *FT* in exchange for *FT*'s obligation to make payments to *A* during the next four years. *FT* is related to *A* as defined in §1.679–1(c)(5). The obligation is treated as a qualified obligation within the meaning of §1.679–4(d), and no person is treated as owning any portion of *FT*. *A*'s adjusted basis in the property is 100X. *A* is required to recognize gain equal to 900X immediately upon transfer of the property to the trust. This result applies even though *A* might otherwise have been allowed to defer recognition of gain under another provision of the Internal Revenue Code. Section 1.684–3(d) provides rules relating to transfers for fair market value to unrelated foreign trusts.

*§1.684–2 Transfers.*

(a) *In general*. A transfer means a direct, indirect, or constructive transfer.

(b) *Indirect transfers*—(1) *In general*. Section 1.679–3(c) shall apply to determine if a transfer to a foreign trust or foreign estate, by any person, is treated as an indirect transfer by a U.S. person to the foreign trust or foreign estate.

(2) *Examples*. The following examples illustrate the rules of this paragraph (b). In all examples, *A* is a U.S. citizen, *FT* is a foreign trust, and *I* is *A*'s uncle, who is a nonresident alien. The examples are as follows:

*Example 1. Principal purpose of tax avoidance*. *A* creates and funds *FT* for the benefit of *A*'s cousin, who is a nonresident alien. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. In 2004, *A* decides to transfer additional property with a fair market value of 1000X and an adjusted basis of 600X to *FT*. Pursuant to a plan with a principal purpose of avoiding the application of section 684, *A* transfers the property to *I*. *I* subsequently transfers the property to *FT*. Under paragraph (b) of this section and §1.679–3(c), *A* is treated as having transferred the property to *FT*.

*Example 2. U.S. person unable to demonstrate that intermediary acted independently*. *A* creates and funds *FT* for the benefit of *A*'s cousin, who is a nonresident alien. *FT* has no U.S. beneficiary within the meaning of §1.679–2, and no person is treated as owning any portion of *FT*. On July 1, 2004, *A* transfers property with a fair market value of 1000X and an adjusted basis of 300X to *I*, a foreign person. On January 1, 2007, at a time when the fair market value of the property is 1100X, *I* transfers the property to *FT*. *A* is unable to demonstrate to the satisfaction of the Commissioner, under §1.679–3(c)(2)(ii), that *I* acted independently of *A* in making the transfer to *FT*. Under paragraph (b) of this section and §1.679–3(c), *A* is treated as having transferred the property to *FT*. Under paragraph (b) of this section and §1.679–3(c)(3), *I* is treated as an agent of *A*, and the transfer is deemed to have been made on January 1, 2007. Under §1.684–1(a), *A* recognizes gain equal to 800X on that date.

(c) *Constructive transfers*. Section 1.679–3(d) shall apply to determine if a transfer to a foreign trust or foreign estate is treated as a constructive transfer by a U.S. person to the foreign trust or foreign estate.

(d) *Transfers by certain trusts*—(1) *In general*. If any portion of a trust is treated as owned by a U.S. person, a transfer of property from that portion of the trust to a foreign trust is treated as a transfer from the owner of that portion to the foreign trust.

(2) *Examples.* The following examples illustrate the rules of this paragraph (d). In all examples, *A* is a U.S. person, *DT* is a domestic trust, and *FT* is a foreign trust. The examples are as follows:

*Example 1. Transfer by a domestic trust*. On January 1, 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis of 200X to *DT*. *A* retains the power to revoke *DT*. On January 1, 2003, *DT* transfers property which has a fair market value of 500X and an adjusted basis of 100X to *FT*. At the time of the transfer, *FT* has no U.S. beneficiary as defined in §1.679–2 and no person is treated as owning any portion of *FT*. *A* is treated as having transferred the property to *FT* and is required to recognize gain of 400X, under §1.684–1, at the time of the transfer by *DT* to *FT*.

*Example 2. Transfer by a foreign trust*. On January 1, 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis of 200X to *FT1*. At the time of the transfer, *FT1* has a U.S. beneficiary as defined in §1.679–2 and *A* is treated as the owner of *FT1* under section 679. On January 1, 2003, *FT1* transfers property which has a fair market value of 500X and an adjusted basis of 100X to *FT2*. At the time of the transfer, *FT2* has no U.S. beneficiary as defined in §1.679–2 and no person is treated as owning any portion of *FT2*. *A* is treated as having transferred the property to *FT2* and is required to recognize gain of 400X, under §1.684–1, at the time of the transfer by *FT1* to *FT2*.

(e) *Deemed transfers when foreign trust no longer treated as owned by a U.S. person*—(1) *In general*. If any portion of a foreign trust is treated as owned by a U.S. person under subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, and such portion ceases to be treated as owned by that person under such subpart (other than by reason of an actual transfer of property from the trust to which §1.684–2(d) applies), the U.S. person shall be treated as having transferred, immediately before (but on the same date that) the trust is no longer treated as owned by that U.S. person, the assets of such portion to a foreign trust.

(2) *Examples*. The following examples illustrate the rules of this paragraph (e). In all examples, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

*Example 1. Loss of U.S. beneficiary.* (i) On January 1, 2001, *A* transfers property, which has a fair market value of 1000X and an adjusted basis of 400X, to *FT*. At the time of the transfer, *FT* has a U.S. beneficiary within the meaning of §1.679–2, and *A* is treated as owning *FT* under section 679. Under §1.684–3(a), §1.684–1 does not cause *A* to recognize gain at the time of the transfer.

(ii) On July 1, 2003, *FT* ceases to have a U.S. beneficiary as defined in §1.679–2(c) and as of that date neither *A* nor any other person is treated as owning any portion of *FT*. Pursuant to §1.679–2(c)(2), if *FT* ceases to be treated as having a U.S. beneficiary, *A* will cease to be treated as owner of *FT* beginning on the first day of the first taxable year following the last taxable year in which there was a U.S. beneficiary. Thus, on January 1, 2004, *A* ceases to be treated as owner of *FT*. On that date, the fair market value of the property is 1200X and the adjusted basis is 350X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* on January 1, 2004, and must recognize 850X of gain at that time under §1.684–1.

*Example 2. Death of grantor.* (i) The initial facts are the same as in paragraph (i) of *Example 1*.

(ii) On July 1, 2003, *A* dies, and as of that date no other person is treated as the owner of *FT*. On that date, the fair market value of the property is 1200X, and its adjusted basis equals 350X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* immediately before his death, and generally is required to recognize 850X of gain at that time under §1.684–1. However, an exception may apply under §1.684–3(c).

*Example 3. Release of a power*. (i) On January 1, 2001, *A* transfers property that has a fair market value of 500X and an adjusted basis of 200X to *FT*. At the time of the transfer, FT does not have a U.S. beneficiary within the meaning of §1.679–2. However, *A* retains the power to revoke the trust. *A* is treated as the owner of the trust under section 676 and, therefore, under §1.684–3(a), *A* is not required to recognize gain under §1.684–1 at the time of the transfer.

(ii) On January 1, 2007, *A* releases the power to revoke the trust and, as of that date, neither *A* nor any other person is treated as owning any portion of FT. On that date, the fair market value of the property is 900X, and its adjusted basis is 200X. Under paragraph (e)(1) of this section, *A* is treated as having transferred the property to *FT* on January 1, 2007, and must recognize 700X of gain at that time.

(f) *Transfers to entities owned by a foreign trust*. Section 1.679–3(f) provides rules that apply with respect to transfers of property by a U.S. person to an entity in which a foreign trust holds an ownership interest.

### *§1.684–3 Exceptions to general rule of gain recognition.*

(a) *Transfers to grantor trusts*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property by a U.S. person to a foreign trust to the extent that any person is treated as the owner of the trust under section 671. Section 1.684–2(e) provides rules regarding a subsequent change in the status of the trust.

(b) *Transfers to charitable trusts*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property to a foreign trust that is described in section 501(c)(3) (without regard to the requirements of section 508(a)).

(c) *Certain transfers at death*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property by reason of death of the U.S. transferor if the basis of the property in the hands of the foreign trust is determined under section 1014(a).

(d) *Transfers for fair market value to unrelated trusts*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of property for fair market value to a foreign trust that is not a related foreign trust as defined in §1.679–1(c)(5). Section 1.671–2(e)(2)(ii) defines fair market value.

(e) *Transfers to which section 1032 applies*. The general rule of gain recognition under §1.684–1 shall not apply to any transfer of stock (including treasury stock) by a domestic corporation to a foreign trust if the domestic corporation is not required to recognize gain on the transfer under section 1032.

(f) *Certain distributions to trusts*. For purposes of this section, a transfer does not include a distribution to a trust with respect to an interest held by such trust in an entity other than a trust or an interest in certain investment trusts described in §301.7701–4(c) of this chapter, liquidating trusts described in §301.7701–4(d) of this chapter, or environmental remediation trusts described in §301.7701–4(e) of this chapter.

(g) *Examples*. The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen and *FT* is a foreign trust. The examples are as follows:

*Example 1. Transfer to owner trust*. In 2001, *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *FT*. At the time of the transfer, *FT* has a U.S. beneficiary within the meaning of §1.679–2, and *A* is treated as owning *FT* under section 679. Under paragraph (a) of this section, §1.684–1 does not cause *A* to recognize gain at the time of the transfer. See §1.684–2(e) for rules that may require *A* to recognize gain if the trust is no longer owned by *A*.

*Example 2. Transfer of property at death: Basis determined under section 1014(a)*. (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retained the power to revoke *FT*, thus, the value of all property owned by *FT* at *A*'s death is includible in *A*'s gross estate for U.S. estate tax purposes. Pursuant to paragraph (c) of this section, *A* is not required to recognize gain under §1.684–1 because the basis of the property in the hands of the foreign trust is determined under section 1014(a).

*Example 3. Transfer of property at death: Basis not determined under section 1014(a).* (i) The initial facts are the same as *Example 1*.

(ii) *A* dies on July 1, 2004. The fair market value at *A*'s death of all property transferred to *FT* by *A* is 1500X. The basis in the property is 400X. *A* retains no power over *FT*, and *FT*'s basis in the property transferred is not determined under section 1014(a). Under §1.684–2(e)(1), *A* is treated as having transferred the property to *FT* immediately before his death, and must recognize 1100X of gain at that time under §1.684–1.

*Example 4. Transfer of property for fair market value to an unrelated foreign trust*. *A* sells a house with a fair market value of 1000X to *FT* in exchange for a 30-year note issued by *FT*. *A* is not related to *FT* as defined in §1.679–1(c)(5). *FT* is not treated as owned by any person. Pursuant to paragraph (d) of this section, *A* is not required to recognize gain under §1.684–1.

### *§1.684–4 Outbound migrations of domestic trusts.*

(a) *In general*. If a U.S. person transfers property to a domestic trust, and such trust becomes a foreign trust, and neither trust is treated as owned by any person under subpart E of part I of subchapter J, chapter 1 of the Internal Revenue Code, the trust shall be treated for purposes of this section as having transferred all of its assets to a foreign trust and the trust is required to recognize gain on the transfer under §1.684–1(a). The trust must also comply with the rules of section 6048.

(b) *Date of transfer*. The transfer described in this section shall be deemed to occur immediately before, but on the same date that, the trust meets the definition of a foreign trust set forth in section 7701(a)(31)(B).

(c) *Inadvertent migrations*. In the event of an inadvertent migration, as defined in §301.7701–7(d)(2) of this chapter, a trust may avoid the application of this section by complying with the procedures set forth in §301.7701–7(d)(2) of this chapter.

(d) *Examples*. The following examples illustrate the rules of this section. In all examples, *A* is a U.S. citizen, *B* is a U.S. citizen, *C* is a nonresident alien, and *T* is a trust. The examples are as follows:

*Example 1. Migration of domestic trust with U.S. beneficiaries*. *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust, for the benefit of *A*'s children who are also U.S. citizens. *B* is the trustee of *T*. On January 1, 2001, while *A* is still alive, *B* resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701–7(d) of this chapter, *T* becomes a foreign trust. *T* has U.S. beneficiaries within the meaning of

§1.679–2 and *A* is, therefore, treated as owning *FT* under section 679. Pursuant to §1.684–3(a), neither *A* nor *T* is required to recognize gain at the time of the migration. Section 1.684–2(e) provides rules that may require *A* to recognize gain upon a subsequent change in the status of the trust.

*Example 2. Migration of domestic trust with no U.S. beneficiaries*. *A* transfers property which has a fair market value of 1000X and an adjusted basis equal to 400X to *T*, a domestic trust for the benefit of *A*'s mother who is not a citizen or resident of the United States. *T* is not treated as owned by another person. *B* is the trustee of *T*. On January 1, 2001, while *A* is still alive, B resigns as trustee and *C* becomes successor trustee under the terms of the trust. Pursuant to §301.7701–7(d) of this chapter, *T* becomes a foreign trust, *FT*. *FT* has no U.S. beneficiaries within the meaning of §1.679–2 and no person is treated as owning any portion of *FT*. *T* is required to recognize gain of 600X on January 1, 2001. Paragraph (c) of this section provides rules with respect to an inadvertent migration of a domestic trust.

*§1.684–5 Effective date*

Sections 1.684–1 through 1.684–4 apply to transfers of property to foreign trusts and foreign estates after August 7, 2000.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved July 9, 2001.

Mark Weinberger,
*Assistant Secretary of*
*the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on July 19, 2001, 8:45 a.m., and published in the issue of the Federal Register for July 20, 2001, 66 F.R. 37897)

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

## Section 809.—Reduction in Certain Deductions of Mutual Life Insurance Companies

*26 CFR 1.809–9: Computation of the differential earnings rate and the recomputed differential earnings rate.*

**Mutual life insurance companies; differential earnings rate.** The differential earnings rate for 2000 and the recomputed differential earnings rate for 1999 are set forth for use by mutual life insurance companies to compute their income tax liabilities for 2000.

## Rev. Rul. 2001–33

This revenue ruling contains the differential earnings rate for 2000 and the recomputed differential earnings rate for 1999. Under § 809 of the Internal Revenue Code, mutual life insurance companies use these rates in computing their federal income tax liability for taxable years beginning in 2000. This revenue ruling also contains the figures on which the determinations of these rates are based. Notice 2001–24, 2001–12 I.R.B. 912, contained tentative determinations of these rates.

Section 809(a) provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under § 808 for policyholder dividends is reduced (but not below zero) by the "differential earnings amount." Any excess of the differential earnings amount over the amount of the deduction allowable under § 808 is taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of § 807. The "differential earnings amount" for any taxable year is the amount equal to the product of (a) the life insurance company's average equity base for the taxable year multiplied by (b) the "differential earnings rate" for that taxable year. The "differential earnings rate" for the taxable year is the excess of (a) the "imputed earnings rate" for the taxable year over (b) the "average mutual earnings rate" for the second calendar year preceding the calendar year in which the taxable year begins. The "imputed earnings rate" for any taxable year is the amount that bears the same ratio to 16.5 percent as the "current stock earnings rate" for the taxable year bears to the "base period stock earnings rate."

Section 809(f) provides that, in the case of any mutual life insurance company, if the "recomputed differential earnings amount" for any taxable year exceeds the differential earnings amount for that taxable year, the excess is included in life insurance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for that taxable year, the excess is allowed as a life insurance deduction for the succeeding taxable year. The "recomputed differential earnings amount" for any taxable year is an amount calculated in the same manner as the differential earnings amount for that taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

The stock earnings rates and mutual earnings rates taken into account under § 809 generally are determined by dividing statement gain from operations by the average equity base. For this purpose, the term "statement gain from operations" means "the net gain or loss from operations required to be set forth in the annual statement, determined without regard to federal income taxes, and ... properly adjusted for realized capital gains and losses...." *See* § 809(g)(1). The term "equity base" is defined as an amount determined in the manner prescribed by regulations equal to surplus and capital increased by the amount of nonadmitted financial assets, the excess of the amount of statutory reserves over the amount of tax reserves, the sum of certain other reserves, and 50 percent of any policyholder dividends (or other similar liability) payable in the following taxable year. *See* § 809(b)(2), (3), (4), (5), and (6). Section 1.809–10 of the Income Tax Regulations provides that the equity base includes both the asset valuation reserve and the interest maintenance reserve for taxable years ending after December 31, 1991.

Section 1.809–9(a) of the regulations provides that neither the differential earnings rate under § 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under § 809(f)(3) may be less than zero.

Rev. Rul. 99–3, 1999–1 C.B. 313, provides that a life insurance subsidiary of a mutual holding company is not a mutual life insurance company for which the deduction for policyholder dividends is reduced pursuant to §§ 808(c)(2) and 809.

For purposes of § 809, the differential earnings rate for 2000 and the rate used to calculate the recomputed differential earnings amount for 1999 (the recomputed differential earnings rate for 1999), and the figures on which these two rates are based are set forth in Table 1.

Rev. Rul. 2001–33 Table 1

Determination of Rates To Be Used For Taxable Years Beginning in 2000

| | |
|---|---|
| Differential earnings rate for 2000 | 0 |
| Recomputed differential earnings rate for 1999 | 0 |
| Imputed earnings rate for 1999 | 15.815 |
| Imputed earnings rate for 2000 | 15.358 |
| Base period stock earnings rate | 18.221 |
| Current stock earnings rate for 2000 | 16.960 |
| Stock earnings rate for 1997 | 19.321 |
| Stock earnings rate for 1998 | 15.836 |
| Stock earnings rate for 1999 | 15.724 |
| Average mutual earnings rate for 1998 | 16.011 |
| Average mutual earnings rate for 1999 | 16.164 |

DRAFTING INFORMATION

The principal author of this revenue ruling is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Ms. Hossofsky at (202) 622-3477 (not a toll-free number).

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## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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

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

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for August 2001.

## Rev. Rul. 2001–36

This revenue ruling provides various prescribed rates for federal income tax purposes for August 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2001–36 TABLE 1

Applicable Federal Rates (AFR) for August 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| *Short-Term* | | | | |
| AFR | 3.94% | 3.90% | 3.88% | 3.87% |
| 110% AFR | 4.34% | 4.29% | 4.27% | 4.25% |
| 120% AFR | 4.73% | 4.68% | 4.65% | 4.64% |
| 130% AFR | 5.13% | 5.07% | 5.04% | 5.02% |
| *Mid-Term* | | | | |
| AFR | 4.99% | 4.93% | 4.90% | 4.88% |
| 110% AFR | 5.49% | 5.42% | 5.38% | 5.36% |
| 120% AFR | 6.01% | 5.92% | 5.88% | 5.85% |
| 130% AFR | 6.51% | 6.41% | 6.36% | 6.33% |
| 150% AFR | 7.54% | 7.40% | 7.33% | 7.29% |
| 175% AFR | 8.82% | 8.63% | 8.54% | 8.48% |
| *Long-Term* | | | | |
| AFR | 5.72% | 5.64% | 5.60% | 5.57% |
| 110% AFR | 6.30% | 6.20% | 6.15% | 6.12% |
| 120% AFR | 6.88% | 6.77% | 6.71% | 6.68% |
| 130% AFR | 7.46% | 7.33% | 7.26% | 7.22% |

REV. RUL. 2001–36 TABLE 2

Adjusted AFR for August 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| Short-term adjusted AFR | 3.01% | 2.99% | 2.98% | 2.97% |
| Mid-term adjusted AFR | 3.83% | 3.79% | 3.77% | 3.76% |
| Long-term adjusted AFR | 4.94% | 4.88% | 4.85% | 4.83% |

REV. RUL. 2001–36 TABLE 3

Rates Under Section 382 for August 2001

| | |
|---|---|
| Adjusted federal long-term rate for the current month | 4.94% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 5.01% |

REV. RUL. 2001–36 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for August 2001

| | |
|---|---|
| Appropriate percentage for the 70% present value low-income housing credit | 8.25% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.54% |

REV. RUL. 2001–36 TABLE 5

Rate Under Section 7520 for August 2001

| | |
|---|---|
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | 6.0% |

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of August 2001. See Rev. Rul. 2001–36, page 119.

# Part III. Administrative, Procedural, and Miscellaneous

## Extension of Relief Relating to Application of Nondiscrimination Rules for Certain Church Plans and Governmental Plans

## Notice 2001–46

**I. PURPOSE**

This notice provides relief from the application of the nondiscrimination requirements of the Internal Revenue Code for certain church and governmental plans.

In particular, this notice extends the effective date of regulations under §§ 401(a)(4), 401(a)(5), 401(l), and 414(s) of the Internal Revenue Code for nonelecting church plans until further notice, but in no case earlier than the first plan year beginning on or after January 1, 2003.

In addition, this notice provides that certain governmental plans shall be deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) of the Code until the first day of the first plan year beginning on or after January 1, 2003. In accordance with this relief, the regulations relating to these provisions do not apply until plan years beginning on or after that date. This relief is available with respect to governmental plans within the meaning of § 414(d) other than plans of State and local governments or political subdivisions, agencies or instrumentalities thereof.

**II. BACKGROUND**

**A. Church Plans**

Section 414(e)(1) of the Code provides in general that the term "church plan" means a plan established and maintained for its employees (and their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under § 501. Pursuant to § 410(d), a church or convention or association of churches that maintains any church plan may make an election under § 410(d) to have certain Code provisions relating to participation, vesting, and funding, etc., apply to such church plan as if such provisions did not contain an exclusion for church plans. A church plan for which such an election has not been made (a "nonelecting church plan") is not subject to these provisions.

Notice 2001–9, 2001–4 I.R.B. 375, provided that the regulations under §§ 401(a)(4), 401(a)(5), 401(l) and 414(s) would apply for nonelecting church plans in plan years beginning on or after January 1, 2002. For plan years beginning before that effective date, nonelecting church plans must be operated in accordance with a reasonable, good faith interpretation of these statutory provisions.

**B. Governmental Plans**

Section 414(d) of the Code provides that the term "governmental plan" means a plan established and maintained for its employees by the government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing. The term "governmental plan" also includes any plan to which the Railroad Retirement Act of 1935 or 1937 (the "Act") applies and which is financed by contributions under that Act and any plan of an international organization which is exempt from taxation by reason of the International Organizations Immunities Act (59 Stat. 669).

Section 1505 of the Taxpayer Relief Act of 1997 ("TRA '97") generally provides that the nondiscrimination rules do not apply to State and local governmental plans. In particular, § 1505 amended the Code to provide that §§ 401(a)(3), 401(a)(4), and 401(a)(26) shall not apply to such plans. Section 1505 of TRA '97 amended § 401(k) of the Code to provide that State and local governmental plans shall be treated as meeting the requirements of § 401(k)(3). In addition, § 1505(a)(3) of TRA '97 amended § 410(c) of the Code to provide that governmental plans shall be treated as meeting the requirements of § 410 for purposes of § 401(a). This amendment to § 410(c), by its terms, is not limited to State and local governmental plans but applies to all governmental plans within the meaning of § 414(d).

Notice 2001–9 provided that governmental plans, other than plans maintained by State or local governments or political subdivisions or instrumentalities thereof, would be deemed to satisfy §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) of the Internal Revenue Code until the first day of the first plan year beginning on or after January 1, 2002. The notice also provided that the regulations relating to these provisions would not apply until plan years beginning on or after that date.

**III. EXTENSION OF EFFECTIVE DATE OF NONDISCRIMINATION REGULATIONS FOR NON-ELECTING CHURCH PLANS**

The regulations under §§ 401(a)(4), 401(a)(5), 401(l), and 414(s) shall not apply to nonelecting church plans until further notice, but in no case earlier than the first plan year beginning on or after January 1, 2003. Nonelecting church plans must be operated in accordance with a reasonable, good faith interpretation of these statutory provisions until the time such notice is provided.

**IV. EXTENSION OF RELIEF RELATING TO APPLICATION OF NONDISCRIMINATION RULES FOR CERTAIN GOVERNMENTAL PLANS**

Under the relief provided by this notice, governmental plans within the meaning of § 414(d), other than those maintained by State or local governments or political subdivisions, agencies or instrumentalities thereof, shall be treated as satisfying the requirements of §§ 401(a)(4), 401(a)(26), 401(k)(3), and 401(m) until the first plan year beginning on or after January 1, 2003. In accordance with this relief, the regulations under §§ 401(a)(4), 401(a)(26), 401(m), 410(b) and 414(s), and the regulations implementing § 401(k)(3), shall apply to governmental plans described in this section IV only for plan years beginning on or after January 1, 2003.

**V. EFFECT ON OTHER DOCUMENTS**

Notice 2001–9 is modified.

**DRAFTING INFORMATION**

The principal author of this notice is Diane S. Bloom of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Bloom may be reached at (202) 283-9888. These telephone numbers are not toll-free.

# Part IV. Items of General Interest

## Additional Model Amendment for Retirement Plans for Proposed Regulations under Section 401(a)(9)

## Announcement 2001–82

Proposed regulations under section 401(a)(9) of the Internal Revenue Code, relating to required minimum distributions from retirement plans, were published in the Federal Register on January 17, 2001 (the 2001 Proposed Regulations) and in the Internal Revenue Bulletin at 2001–11 I.R.B. 865. The preamble to the 2001 Proposed Regulations states that taxpayers may rely on regulations under § 401(a)(9) that were proposed in 1987 (the 1987 Proposed Regulations) or the 2001 Proposed Regulations for determining required minimum distributions for calendar year 2001 and subsequent calendar years prior to the effective date of the final regulations.

The preamble to the 2001 Proposed Regulations contains a model amendment that qualified plan sponsors can adopt if they wish to apply the 2001 Proposed Regulations in making all required minimum distributions for 2001 and subsequent calendar years prior to the effective date of the final regulations. After publication in the Federal Register, the model amendment was republished in Announcement 2001–18, 2001–10 I.R.B. 791, with minor corrections, and appeared (as corrected) in the preamble to the 2001 Proposed Regulations (REG–130477–00; REG–130481–00, 2001–11 I.R.B. 865).

This announcement responds to concerns by qualified plan sponsors that intended to use the 2001 Proposed Regulations for distributions for 2001 but made required minimum distributions for 2001 under the 1987 Proposed Regulations prior to the date on which the plan began operating under the 2001 Proposed Regulations. Qualified plan sponsors may adopt the alternative model amendment provided below in order to allow required minimum distributions made for 2001 prior to the date on which the plan began operating under the 2001 Proposed Regulations to be made under the 1987 Proposed Regulations. Required minimum distributions made on or after the effective date of the amendment for 2001 will be made under the 2001 Proposed Regulations. The alternative model amendment also provides that, if the total amount of 2001 required minimum distributions made to a participant prior to the date on which the plan began operating in accordance with the 2001 Proposed Regulations are equal to or greater than the required minimum distributions determined under the 2001 Proposed Regulations, then no additional distributions are required for that participant for 2001 on or after such date. If the total amount of required minimum distributions made to a participant for 2001 prior to the date on which the plan began operating under the 2001 Proposed Regulations are less than the amount determined under the 2001 Proposed Regulations, then required minimum distributions for 2001 following such date will be determined so that the total amount of required minimum distributions for 2001 for that participant is the amount determined under the 2001 Proposed Regulations.

The model amendment described above is as follows:

> With respect to distributions under the Plan made on or after ***[SPECIFY DATE ON WHICH THE PLAN BEGAN OPERATING IN ACCORDANCE WITH THE 2001 PROPOSED REGULATIONS]*** for calendar years beginning on or after January 1, 2001, the Plan will apply the minimum distribution requirements of section 401(a)(9) of the Internal Revenue Code in accordance with the regulations under section 401(a)(9) that were proposed on January 17, 2001 (the 2001 Proposed Regulations), notwithstanding any provision of the Plan to the contrary. If the total amount of required minimum distributions made to a participant for 2001 prior to ***[SPECIFY DATE ON WHICH THE PLAN BEGAN OPERATING IN ACCORDANCE WITH THE 2001 PROPOSED REGULATIONS]*** are equal to or greater than the amount of required minimum distributions determined under the 2001 Proposed Regulations, then no additional distributions are required for such participant for 2001 on or after such date. If the total amount of required minimum distributions made to a participant for 2001 prior to ***[SPECIFY DATE ON WHICH THE PLAN BEGAN OPERATING IN ACCORDANCE WITH THE 2001 PROPOSED REGULATIONS]*** are less than the amount determined under the 2001 Proposed Regulations, then the amount of required minimum distributions for 2001 on or after such date will be determined so that the total amount of required minimum distributions for 2001 is the amount determined under the 2001 Proposed Regulations. This amendment shall continue in effect until the last calendar year beginning before the effective date of the final regulations under section 401(a)(9) or such other date as may be published by the Internal Revenue Service.

A plan sponsor that made required minimum distributions for 2001 under the 1987 Proposed Regulations prior to the date during 2001 that it began operating under the 2001 Proposed Regulations must amend its plan in accordance with the model amendment set forth above. The above model amendment may be used only if it is effective on a date in 2001 when the plan begins to operate in accordance with the 2001 Proposed Regulations. The original model amendment contained in Announcement 2001–18 is available for plans that follow the 2001 Proposed Regulations for determining required minimum distributions for 2001 for the entire calendar year 2001 or, if first effective after 2001, for later calendar years prior to the effective date of the final regulations.

In order for a qualified plan sponsor to use either model amendment, it must adopt the amendment prior to the end of the plan's GUST remedial amendment period. Revenue Procedure 2000–27, 2000–26 I.R.B. 1272, extends the GUST remedial amendment period for most plans until the end of the first plan year beginning on or after January 1, 2001.

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

## Section 807.—Rules for Certain Reserves

**Insurance companies; prevailing mortality and morbidity tables.** The prevailing mortality and morbidity tables for contracts issued since 1999 are set forth for use by insurance companies to compute their reserves.

## Rev. Rul. 2001–38

For purposes of section 807(d)(5) of the Internal Revenue Code, this ruling clarifies and supplements the schedule of prevailing commissioners' standard tables of mortality and morbidity set forth in Part I of Rev. Rul. 92–19, 1992–1 C.B. 227. This information is to be used by insurance companies in computing their reserves for (1) life insurance and supplementary total and permanent disability benefits, (2) individual annuities and pure endowments, and (3) group annuities and pure endowments.

**Schedule of Prevailing Commissioners' Standard Tables — Products Issued In 1992–2000 Inclusive.**

TABLES[1]

| Year [2] | Life Insurance and Supplementary Total and Permanent Disability Benefits | | | Individual Annuities and Pure Endowments | Group Annuities and Pure Endowments |
|---|---|---|---|---|---|
| | ***Ordinary Contracts*** | | *Industrial* | | |
| | *Life* | *Disability* | *Policies* | | |
| 1992 | | | | | |
| 1993 | | | | | |
| 1994 | | | | | |
| 1995 | | | | | |
| 1996 | | | | | |
| 1997 | | | | | |
| 1998 | | | | | |
| 1999 | | | | Annuity 2000 Mortality Table | 94 GAR |
| 2000 | | | | | |

**NOTES TO THE SCHEDULE OF PREVAILING COMMISSIONERS' TABLES**

1. Stated in the schedule is the most recent mortality table permitted as of January 1 of the year for valuation of policies of the specified type issued in that year under the valuation laws of at least 26 states. For policies issued prior to 1992, please refer to Rev. Rul. 92–19, 1992–1 C.B. 227 which clarified and supplemented Rev. Rul. 87–26, 1987–1 C.B. 158.

   The abbreviations used stand for the following mortality tables:

   Annuity 2000 Mortality Table:
   
   The Annuity 2000 Mortality Table is an individual, mortality table and is a sex distinct table. This table is not applicable to contracts based on settlements of various forms of claims pertaining to court settlements or out of court settlements from tort actions, settlements involving similar actions such as worker compensation claims or settlements of long term disability claims where a temporary or life annuity has been used in lieu of continuing disability payment. For these contracts, the 1983 Table "a" should be used.

   94 GAR: 1994 Group Annuity Reserving Table
   
   The 94 GAR is a sex-distinct table to determine the reserves for a group.

2. The year indicated is the first year the table may be used for federal income tax purposes. Section 807(d)(5)(A) states that the specified table may be used as the prevailing table from the beginning of the calendar year in which the table becomes prevailing. The former table, however, may be used as the prevailing table for that calendar year and three subsequent years. Rev. Rul. 87–26.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 92–19 is supplemented by the addition to Part I of that ruling of the commissioners' standard tables of mortality and morbidity under § 807 for certain insurance products issued after January 1, 1999. Parts II, III, and IV are not affected by this ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Sumit Mitra of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact either him or Donald J. Drees, Jr. at (202) 622-3970 (not a toll-free call).

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## Section 1504(d).—Subsidiary Formed To Comply With Foreign Law

**U.S. corporation; wholly-owned Mexican subsidiary treated as a domestic corporation.** This ruling obsoletes Rev. Rul. 70–379 (1970–2 C.B. 179) relating to U.S. corporations electing under section 1504(d) of the Code to treat its wholly-owned Mexican subsidiary as a domestic corporation for the purpose of filing consolidated returns.

## Rev. Rul. 2001–39

This revenue ruling obsoletes Rev. Rul. 70–379 (1970–2 C.B. 179).

Rev. Rul. 70–379 concluded that a U.S. corporation may elect under section 1504(d) of the Internal Revenue Code (the "Code") to treat its wholly-owned Mexican subsidiary as a domestic corporation for the purpose of filing consolidated returns because the subsidiary was organized under the laws of Mexico solely to comply with Mexican law as to title and operation of property in Mexico. Because the U.S. parent corporation could not directly own Mexican real estate under Mexican law, organization of the Mexican subsidiary was necessary in order to comply with Mexican law relating to the title of real estate.

The rationale underlying Rev. Rul. 70–379 was based, in part, upon Mexican law and legal authorities that interpreted Article 27 of the Mexican Constitution to prohibit direct ownership of Mexican real estate by certain non-Mexican residents. In particular, it was based on Article 34 of the Mexican Nationality and Naturalization Law, and the Official Declarations of the Secretariat of Foreign Relations, issued January 7, 1936, representing an official interpretation of Article 27 of the Mexican Constitution.

Since the publication of Rev. Rul. 70–379, the Mexican legal interpretations on which the ruling were based have been subject to considerable revision. Most significantly for purposes of Rev. Rul. 70–379, Article 10A of the Mexican Foreign Investment Law of 1993, as amended effective December 25, 1996 ("1996 Amendment"), now allows direct foreign ownership of real estate in certain circumstances. As a result, after the effective date of the 1996 Amendment, a U.S. corporation in these circumstances does not meet the requirements for an election under section 1504(d) to treat its wholly-owned Mexican subsidiary as a domestic corporation for the purpose of filing consolidated returns because organization of such subsidiary would not be necessary to comply with Mexican law as to the title and operation of property in Mexico. Accordingly, the IRS is obsoleting Rev. Rul. 70–379, and taxpayers may not rely upon it on or after December 25, 1996 (the effective date of the 1996 Amendment). Application of section 1504(d) in circumstances other than those addressed by the 1996 Amendment continues to require an assessment of the status of the relevant Mexican law with respect to Mexican real estate holdings.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70–379, 1970–2 C.B. 179, is obsoleted effective December 25, 1996.

DRAFTING INFORMATION

The principal author of this revenue ruling is Kenneth Allison of the Associate Chief Counsel (International) (CC:INTL:Br4). For further information regarding this revenue ruling, contact Mr. Allison at (202) 622-3860 (not a toll-free call).

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## Section 6075.—Time for Filing Estate and Gift Tax Returns

*26 CFR 20.6075–1: Returns; time for filing estate tax return.*

## T.D. 8957

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Parts 20 and 602

## Estate Tax Return; Form 706, Extension To File

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the filing of an application for an automatic 6-month extension of time to file an estate tax return (Form 706). The final regulations provide guidance to executors of decedents' estates on how to properly file the application for the automatic extension.

DATES: *Effective Date*: These regulations are effective July 25, 2001.

*Applicability Date*: For dates of applicability, see §§20.6075–1 and 20.6081–1(e).

FOR FURTHER INFORMATION CONTACT: Mary Berman at (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Paperwork Reduction Act**

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1707. The collection of information in these final regulations is in §20.6081–1. To receive an extension of time to file an estate tax return, the executor of a decedent's estate must file Form 4768, "*Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes.*" This information is required to obtain a benefit (an automatic 6-month extension of time to file an estate tax return). The collection of information is mandatory if the extension is requested. The likely respondents are executors of decedents' estates.

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

The reporting burden contained in §20.6081–1 is reflected in the burden of Form 4768.

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

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

**Background**

On October 20, 2000, the IRS published in the Federal Register (65 FR 63025) a notice of proposed rulemaking (REG–106511–00, 2000–45 I.R.B. 465) relating to the filing of an application for an automatic 6-month extension of time to file Form 706, "*United States Estate (and Generation-Skipping Transfer) Tax Return.*" This document adopts final regulations with respect to that notice of proposed rulemaking. Written comments were received with respect to the proposed regulations, and a public hearing was held on January 24, 2001. A summary of the principal comments received is provided below.

In general, under the proposed regulations the executor of a decedent's estate is allowed an automatic 6-month extension of time to file Form 706 beyond the 9 months provided for by section 6075(a). The application for the automatic extension must be submitted on Form 4768. The application must be filed with the IRS on or before the date prescribed by section 6075(a) for filing the Form 706, and it must include an estimate of the full amount of tax due.

The proposed regulations refer to "the person who is required to file the return" as the person who may request an extension of time to file. Since §20.6018–2 of the Estate Tax Regulations requires that the return be filed jointly by all executors in situations in which there is more than one executor, one commentator pointed out that "the person who is required to file the return" could be interpreted as meaning that all executors must sign the request for an extension of time to file in situations in which there is more than one executor.

Also, the Treasury Department and the IRS recognize that "the person who is required to file the return" may be interpreted to mean that only an executor may sign a request for an extension to file. However, as indicated on Form 4768, the request may be signed by an attorney, certified public accountant, or enrolled agent authorized by the executor, or by an authorized agent holding a power of attorney.

In response to the comment, the quoted language in the proposed regulations has been deleted from the final regulations. Also, the Form 4768 will be revised to clarify that it is only necessary for one executor to sign the request for an extension of time to file in situations in which there is more than one executor.

Two commentators suggested that the final regulations clearly provide that payment of the tax is not a prerequisite to obtaining an extension of time to file, and that an extension of time to file does not operate to extend the time for payment of the tax. In response to this suggestion, the final regulations provide that, if an extension of time to file has been obtained but no extension of time to pay has been granted, interest will be due on the tax not paid by the due date and the estate will be subject to all applicable late payment penalties.

One commentator suggested that, in addition to the automatic 6-month extension of time to file, the regulations provide an automatic extension of time to pay. The commentator suggested that the executor be required to pay an amount equal to the executor's "best estimate" of the ultimate tax due and receive an automatic extension of time to pay any excess. The Treasury Department and the IRS believe that a standard incorporating an executor's "best estimate" would be difficult to administer, and the suggestion has not been adopted.

One commentator suggested that the regulations provide the criteria to be used in approving or denying requests for extensions of time to file that do not qualify for the automatic 6-month extension. This suggestion has not been adopted. The Treasury Department and the IRS believe that the circumstances surrounding requests for extensions of time to file that do not qualify for the automatic 6-month extension generally present factual issues and questions warranting the broad discretion of the IRS office responsible for granting or denying the extension of time.

**Special Analysis**

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

**Drafting Information**

The principal author of these regulations is Mary Berman, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR parts 20 and 602 are amended as follows:

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

Paragraph 1. The authority citation for part 20 is amended by adding an entry in numerical order to read in part as follows:

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

Section 20.6081–1 also issued under 26 U.S.C. 6081(a). * * *

Par. 2. Section 20.6075–1 is revised to read as follows:

*§20.6075–1 Returns; time for filing estate tax return.*

The estate tax return required by section 6018 must be filed on or before the due date. The due date is the date on or before which the return is required to be filed in accordance with the provisions of section 6075(a) or the last day of the period covered by an extension of time as provided in §20.6081–1. The due date, for a decedent dying after December 31, 1970, is, unless an extension of time for filing has been obtained, the day of the ninth calendar month after the decedent's death numerically corresponding to the day of the calendar month on which death occurred. However, if there is no numerically corresponding day in the ninth month, the last day of the ninth month is the due date. For example, if the decedent dies on July 31, 2000, the estate tax return and tax payment must be made on or before April 30, 2001. When the due date falls on Saturday, Sunday, or a legal holiday, the due date for filing the return is the next succeeding day that is not Saturday, Sunday, or a legal holiday. For the definition of a legal holiday, see section 7503 and §301.7503–1 of this chapter. As to additions to the tax in the case of failure to file the return or pay the tax within the prescribed time, see section 6651 and §301.6651–1 of this chapter. For rules with respect to the right to elect to have the property valued as of a date or dates subsequent to the decedent's death, see section 2032 and §20.2032–1, and section 7502 and §301.7502–1 of this chapter. This section applies to estates of decedents dying after August 16, 1954.

Par. 3. Section 20.6081–1 is revised to read as follows:

*§20.6081–1 Extension of time for filing the return.*

(a) *Procedures for requesting an extension of time for filing the return*. A request for an extension of time to file the return required by section 6018 must be made by filing Form 4768, "*Application for Extension of Time To File a Return and/or Pay U. S. Estate (and Generation-Skipping Transfer) Taxes*." Form 4768 must be filed with the Internal Revenue Service office designated in the application's instructions (except as provided in §301.6091–1(b) of this chapter for hand-carried documents). Form 4768 must include an estimate of the amounts of estate and generation-skipping transfer tax liabilities with respect to the estate.

(b) *Automatic extension*. An estate will be allowed an automatic 6-month extension of time beyond the date prescribed in section 6075(a) to file Form 706, "*United States Estate (and Generation-Skipping Transfer) Tax Return*," if Form 4768 is filed on or before the due date for filing Form 706 and in accordance with the procedures under paragraph (a) of this section.

(c) *Extension for good cause shown*. In its discretion, the Internal Revenue Service may, upon the showing of good and sufficient cause, grant an extension of time to file the return required by section 6018 in certain situations. Such an extension may be granted to an estate that did not request an automatic extension of time to file Form 706 prior to the due date under paragraph (b) of this section, to an estate or person that is required to file forms other than Form 706, or to an executor who is abroad and is requesting an additional extension of time to file Form 706 beyond the 6-month automatic extension. Unless the executor is abroad, the extension of time may not be for more than 6 months beyond the filing date prescribed in section 6075(a). To obtain such an extension, Form 4768 must be filed in accordance with the procedures under paragraph (a) of this section and must contain a detailed explanation of why it is impossible or impractical to file a reasonably complete return by the due date. Form 4768 should be filed sufficiently early to permit the Internal Revenue Service time to consider the matter and reply before what otherwise would be the due date of the return. Failure to file Form 4768 before that due date may indicate negligence and constitute sufficient cause for denial of the extension. If an estate did not request an automatic extension of time to file Form 706 under paragraph (b) of this section, Form 4768 must also contain an explanation showing good cause for not requesting the automatic extension.

(d) *Filing the return*. A return as complete as possible must be filed before the expiration of the extension period. The return thus filed will be the return required by section 6018(a), and any tax shown on the return will be the amount determined by the executor as the tax referred to in section 6161(a)(2), or the amount shown as the tax by the taxpayer upon the taxpayer's return referred to in section 6211(a)(1)(A). The return cannot be amended after the expiration of the extension period although supplemental information may subsequently be filed that may result in a finally determined tax different from the amount shown as the tax on the return.

(e) *Payment of the tax*. An extension of time for filing a return does not operate to extend the time for payment of the tax. See §20.6151–1 for the time for payment of the tax, and §§20.6161–1 and 20.6163–1 for extensions of time for payment of the tax. If an extension of time to file a return is obtained, but no extension of time for payment of the tax is granted, interest will be due on the tax not paid by the due date and the estate will be subject to all applicable late payment penalties.

(f) *Effective date*. This section applies to estates of decedents dying after August 16, 1954, except for paragraph (b) of this section which applies to estate tax returns due after July 25, 2001.

PART 602—OMB CONTROL UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by revising the entry for 20.6081–1 to read as follows:

*§602.101 OMB Control numbers.*

* * * * *

(b) * * *

| CFR part or section where identified and described | Current OMB control No. |
|---|---|
| * * * * * | |
| 20.6081–1 | 1545–0015 |
| | 1545–0181 |
| | 1545–1707 |
| * * * * * | |

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved July 17, 2001.

Mark Weinberger,
*Assistant Secretary*
*of the Treasury.*

(Filed by the Office of the Federal Register on July 24, 2001, 8:45 a.m., and published in the issue of the Federal Register for July 25, 2001, 66 F.R. 38544)

# Part III. Administrative, Procedural, and Miscellaneous

## Basis Shifting Tax Shelter

## Notice 2001–45

The Internal Revenue Service and the Treasury Department have become aware of a type of transaction, described below, that is being used by taxpayers for the purpose of generating losses or reducing income or gains. This Notice alerts taxpayers and their representatives that the tax benefits purportedly generated by such transactions are not properly allowable for federal income tax purposes. This Notice also alerts taxpayers, their representatives, and promoters of such transactions of certain responsibilities that may arise from participating in such transactions.

FACTS

The transaction involves the use of the attribution rules of § 318 of the Internal Revenue Code and § 1.302–2(c) of the Income Tax Regulations to increase the basis of stock owned by a taxpayer (the "Taxpayer") that claims a loss upon disposition of that stock. In the transaction, there is a redemption of stock that is owned by a person (other than the Taxpayer) that is not subject to U.S. tax or is otherwise indifferent to the Federal income tax consequences of the redemption. Purportedly as a result of the application of the attribution rules of § 318, the redemption of stock is claimed to be a dividend under § 301 rather than a payment in exchange for stock under § 302(a). A variety of devices, often including options, is employed to treat the redeemed shareholder as owning stock in the redeeming corporation owned or treated as owned by the Taxpayer under the attribution rules of § 318. The attribution of ownership of such shares purportedly prevents the redemption of stock from reducing the redeemed shareholder's ownership interest in the redeeming corporation, thereby causing the redemption to be treated as a dividend.

As a result of the redemption, the Taxpayer takes the position that under § 1.302–2(c) all or a portion of the basis of the redeemed stock is added to the basis of stock in the redeeming corporation that the Taxpayer owns. The Taxpayer then sells the stock and claims a loss.

Variations on the transaction include (1) the use of the transaction to reduce income or gain (rather than generate loss) and (2) the transfer of the stock (the basis of which was purportedly increased by reason of the redemption) to an entity in a carryover basis exchange, followed by either a sale of the entity interest or a sale of the stock by the entity.

ANALYSIS

Section 302(a) provides that if a corporation redeems its stock and § 302(b)(1), (2), (3), or (4) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the redeemed stock. Under § 302(b)(1), a redemption distribution will be subject to § 302(a) if, based on the facts and circumstances, the redemption distribution is not essentially equivalent to a dividend. *See* § 1.302–2(b). Section 302(b)(2) provides that a distribution in redemption of stock will be subject to § 302(a) if the distribution is substantially disproportionate with respect to the redeeming shareholder. Under § 302(b)(3), § 302(a) will apply to a distribution in redemption of stock if the redemption is in complete redemption of all of the stock of the corporation owned by the redeeming shareholder.

For purposes of determining whether a distribution in redemption of stock is treated as a sale or exchange of stock, all steps that are part of a single, pre–arranged plan are taken into account. *See Zenz v. Quinlivan*, 213 F.2d 914 (6th Cir. 1954). Section 302(d) provides that if § 302(a) does not apply, the distribution will be treated as a distribution subject to § 301. Section 302(c)(1) provides that, in determining whether the provisions of § 302(b) are satisfied, the attribution rules of § 318 shall apply. Section 301(c)(1) provides that the portion of the distribution that is a dividend shall be included in the redeemed shareholder's gross income.

Section 1.302–2(c) provides that when an amount received in a redemption of stock is treated as a distribution of a dividend, "proper adjustment" of the basis of the remaining stock will be made with respect to the stock redeemed. *Example 2* of § 1.302–2(c) illustrates a proper adjustment where the entire amount received in redemption of the stock held by one spouse is treated as a dividend because the redeemed spouse is treated as owning stock held by the other spouse. In that example, the basis of the stock of the nonredeemed spouse is properly increased by the basis of the stock of the redeemed spouse.

It is the position of the Service and the Treasury that such an adjustment is not proper in every case in which the redeemed shareholder retains no stock in the redeeming corporation. The example in the regulations is premised on the concept that an adjustment is appropriate where the redeemed spouse is required to include the full redemption proceeds as a dividend in gross income that is subject to U.S. tax and such spouse retains no stock to which the basis of the redeemed stock could attach.

The Service intends to disallow losses claimed (or to increase taxable income or gains) in the transactions described in this Notice to the extent a taxpayer derives a tax benefit that is attributable to stock basis purportedly shifted from the redeemed shares. Depending on the facts of the particular case, reasons for disallowance may include, but are not limited to, the following: (1) the redemption does not result in a dividend (and consequently there is no basis shift) because, viewing the transaction as a whole, the redemption results in a reduction of interest in the redeeming corporation to which § 302(b) applies; (2) the basis shift is not a "proper adjustment" as contemplated by § 1.302–2(c); and (3) there is no attribution of stock ownership or basis shift because the steps taken to achieve those results are transitory and serve no purpose other than tax avoidance.

In addition, the Service may impose penalties on participants in these transactions, or, as applicable, on persons who participate in the promotion or reporting of these transactions, including the accuracy-related penalty under § 6662, the return preparer penalty under § 6694, the promoter penalty under § 6700, and the aiding and abetting penalty under § 6701.

Transactions that are the same as, or substantially similar to, those described in this Notice are identified as "listed transactions" for purposes of § 1.6011–4T (b)(2) of the Temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the Temporary Procedure and Administration Regulations. *See also* § 301.6112–1T, A–4. It should be noted that, independent of their classification as "listed transactions" for purposes of §§ 1.6011–4T(b)(2) and 301.6111–2T(b)(2), such transactions may already be subject to the tax shelter registration and list maintenance requirements of §§ 6111 and 6112 under the regulations issued in February 2000 (§§ 301.6111–2T and 301.6112–1T, A–4), as well as the regulations issued in 1984 and amended in 1986 (§§ 301.6111–1T and 301.6112–1T, A–3). Persons required to register these tax shelters who have failed to register the shelters may be subject to the penalty under § 6707(a), and to the penalty under § 6708(a) if the requirements of § 6112 are not satisfied.

The Service and Treasury recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the type of transaction described in this Notice. We advise these taxpayers to take prompt action to file amended returns.

The principal authors of this Notice are Theresa Abell and Lisa Leong of the Office of Associate Chief Counsel (Corporate). For further information regarding this Notice, contact Ms. Abell at (202) 622-7700 or Ms. Leong at (202) 622-7530 (not toll-free calls).

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## Weighted Average Interest Rate Update

## Notice 2001–48

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for June 2001 is 5.67 percent.

The following rates were determined for the plan years beginning in the month shown below.

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---|---|---|---|---|
| July | 2001 | 5.80 | 5.22 to 6.09 | 5.22 to 6.38 |

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283-9702 (not a toll-free number).

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**NOTE:**

**Following is a list of related instructions and forms for filing Form 1042–S Magnetically/Electronically:**

- **2001 Instructions for Form 1042–S**
- **Form 4419 – Application for Filing Information Returns Magnetically/Electronically**
- **Form 4804 – Transmittal of Information Returns Reported Magnetically**
- **Form 8508 – Request for Waiver From Filing Information Returns on Magnetic Media (Forms W-2, W-2G, 1042–S, 1098, 1099, 5498, and 8027)**
- **Form 8809 – Request for Extension of Time To File Information Returns (Forms W-2, W-2G, 1042–S, 1098, 1099, 5498, and 8027)**
- **Notice 210 – Preparation Instructions for Media Labels**
- **Publication 515 – Withholding of Tax on Nonresident Aliens and Foreign Corporations (for general information and explanation of tax law associated with Form 1042–S)**
- **Publication 901 – U.S. Tax Treaties**

The Internal Revenue Service, Martinsburg Computing Center, encourages filers to make copies of the blank forms in the back of this publication for future use. *These forms can also be obtained by calling 1-800-TAX-FORM (1-800-829-3676). You can also download forms and publications from the IRS Web Site at* ***www.irs.gov.***

## Rev. Proc. 2001–40

Use this Revenue Procedure to prepare Tax Year *2001* and prior year information returns for submission to Internal Revenue Service (IRS) using any of the following:

– Magnetic Tape
– Tape Cartridge
– 8mm, 4mm, and Quarter Inch Cartridges (QIC)
– 3 1/2-Inch Diskette
– Electronic Filing

### Attention! Important Notice:

**FORM 1042–S PROCESSING AND PUBLICATION 1187 HAVE UNDERGONE MAJOR REVISIONS. THE RECORD FORMAT AND PROCESSING PROCEDURES ARE VERY DIFFERENT FROM PREVIOUS YEARS. PLEASE READ THIS ENTIRE PUBLICATION CAREFULLY.** Persons or businesses required to file Form 1042–S magnetically or electronically may be subject to penalties for failure to file or include correct information if they do not follow the instructions in this Revenue Procedure.

### Table of Contents

## Part A. General

Revenue Procedures are generally revised annually to reflect legislative and form changes. Comments concerning this Revenue Procedure, or suggestions for making it more helpful, can be addressed to:

Internal Revenue Service
Martinsburg Computing Center
Attn: Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

## Sec. 1. Purpose

**.01** The purpose of this Revenue Procedure is to provide the specifications for filing Form 1042–S magnetically or electronically, using 1/2-inch 9-track tape, IBM 3480, 3490, 3490E, *3590, 3590E* or AS400 compatible tape cartridges (including 4mm, 8mm & QIC), or 3 1/2-inch diskette with IRS. **IRS/MCC has discontinued processing 8-inch and 5 1/4-inch diskettes and the mainframe electronic filing system. In addition, IRS/MCC will no longer process 1/2-inch 9-track magnetic tape beginning in calendar year 2003 for tax year 2002. The previously used IRP-BBS (Bulletin Board System) has also been replaced**. The new electronic filing system is known as FIRE (Filing Information Returns Electronically). When using the Revenue Procedure for filing prior year returns, reformat required information from prior years to fit the updated specifications. This Revenue Procedure must be used to prepare current and prior year information returns **filed beginning January 1, 2002, and received by IRS/MCC or postmarked by December 31, 2002.**

**.02** Generally, the box numbers on the paper Form 1042–S correspond with the fields used to file magnetically/electronically; however, if discrepancies occur, the instructions in this Revenue Procedure govern.

**.03** This Revenue Procedure supersedes Rev. Proc. 98–44 published as Publication 1187, Specifications for Filing Form 1042–S, Foreign Person's U.S. Source Income Subject to Withholding, Magnetically or Electronically.

**.04** Refer to Part A, Sec. 17, for definitions of terms used in this publication.

**.05** Specifications for filing Forms W-2, Wage and Tax Statements, magnetically/electronically are available from the Social Security Administration (SSA) **only**. Filers can call 1-800-SSA-6270 to obtain the phone number of the SSA Employer Service Liaison Officer for their area.

**.06** IRS/MCC does **not** process Forms W-2. Paper **and/or** magnetic media for Forms W-2 must be sent to SSA. IRS/MCC does, however, process waiver requests (Form 8508) and extension of time to file requests (Form 8809) for Forms W-2 and requests for an extension of time to provide the employee copies of Forms W-2.

**.07** The following Revenue Procedures and publications provide more detailed filing procedures for certain information returns:

**(a)** 2001 Instructions for Form 1042–S.

**(b)** Rev. Proc. 84–33, 1984–1 C.B. 502, regarding the optional method for agents to report and deposit backup withholding.

**(c)** Publication 1179, Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 1042–S, 5498, and W–2G.

**(d)** Publication 1239, Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically.

**(e)** Publication 1220 (Rev. 7–*2001*), Specifications for Filing Forms 1098, 1099, 5498, and W-2G, Magnetically or Electronically.

**(f)** Publication 1245, Specifications for Filing Form W-4, Employee's Withholding Allowance Certificate, Magnetically or Electronically.

## Sec. 2. Nature of Changes—Current Year (Tax Year *2001*)

**.01 Due to the issuance of final regulations to Internal Revenue Code (IRC) Section 1441, effective January 1, 2001, this publication is completely revised for Tax Year *2001*. Because of this comprehensive revision, changes are not emphasized by the use of italics as in the past. Major changes are listed below, however, filers must read the publication in its entirety for Form 1042–S to be filed correctly, magnetically or electronically.**

**.02** IRS/MCC will no longer return problem media in need of replacement. See Part A, Sec. 12. Filers will receive Form 9267, Media Tracking Slip, a listing of errors, and a letter detailing the problem(s) encountered during processing. Filers will be expected to send replacement media within the prescribed time frame**.** This makes it **imperative** that filers maintain backup copies and/or recreate capabilities for their information return files. All references to returning media for replacement were deleted.

**.03** Major changes were implemented for the processing of Form 1042–S. See Part A, Sec.12.03 for a complete listing of errors that will result in a request for a replacement file.

**.04** Validity, consistency, and related math error checks within individual "Q" Records will no longer be conducted as part of IRS/MCC's processing. This processing will be performed by the IRS Service Center. See Part A, Sec. 13.

**.05** The guidelines for corrected returns have been updated to reflect record and format changes. See Part A, Sec. 14.

**.06** Beginning in calendar year 2003 for Tax Year 2002, IRS/MCC will no longer accept 9-track tape for filing Form 1042–S. See Part B, Sec. 2, Tape Specifications.

**.07** The record layout and record sequence have changed. A Reconciliation "C" Record was added, and the End of Transmission "F" Record has replaced the "Y" Record. A file will consist of records in the following sequence:

Transmitter "T" Record,
Withholding Agent "W" Record,
Recipient "Q" Record(s),
Reconciliation "C" Record, and
End of Transmission "F" Record.

Multiple sets of the Withholding Agent "W" Record, the Recipient "Q" Record(s), and the Reconciliation "C" Record may be included within the file in that sequence. However, the file must contain only one Transmitter "T" Record (at the beginning of the file) and one End of Transmission "F" Record (at the end of the file). The record length has changed to 780 fixed positions. Block size must not exceed 23,400 tape positions. See Part B.

**.08** A Reconciliation "C" Record has been added to summarize the number of "Q" Records and income amounts reported in the Recipient "Q" Records for a specific Withholding Agent "W" Record. See Part B, Reconciliation "C" Record.

**.09** The final record on a file has been changed to End of Transmission "F" Record. See Part B, End of Transmission "F" Record.

**.10** Filers **must** read the record format for each type of record very carefully. There have been numerous changes, additions, and deletions to the elements in each record.

## Sec. 3. Where To File and How to Contact the IRS, Martinsburg Computing Center

**.01** All information returns filed magnetically or electronically are processed at IRS/MCC. Files containing information returns and requests for IRS magnetic media and electronic filing information should be sent to the following address:

IRS-Martinsburg Computing Center
Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

**.02** **All** requests for an extension of time to file information returns with IRS/MCC or to the recipients, and requests for undue hardship waivers filed on Form 8508, should be sent to the following address:

IRS-Martinsburg Computing Center
Information Reporting Program
**Attn: Extension of Time Coordinator**
240 Murall Drive
**Kearneysville, WV 25430**

**.03** The telephone numbers for magnetic media inquiries or electronic submissions are:

**304-263-8700 - Call Site or *email at*** <u>*mccirp@irs.gov*</u>

**304-267-3367 - TDD (Telecommunication Device for the Deaf)**

**304-264-5602 - Fax Machine**

**Electronic Filing – FIRE System**

**304-262-2400**
********(**These are not toll-free telephone numbers.**)********

**TO OBTAIN FORMS:**

**1-800-TAX-FORM (1-800-829-3676)**

**www.irs.gov – IRS Web Site access to forms**

**.04** The 2001 Instructions for Form 1042–S have been included in the Publication 1187 for your convenience. The Form 1042–T is used only to transmit Copy A of **paper** Form 1042–S. If filing paper returns, follow the mailing instructions on Form 1042–T and submit the paper returns to the Internal Revenue Service Center, Philadelphia, PA 19255.

**.05** Requests for paper Form 1042–S and publications related to magnetic media/electronic filing should be made by calling the IRS toll-free number **1-800-TAX-FORM (1-800-829-3676)** or via the IRS Web Site at **www.irs.gov.**

**.06** Questions pertaining to magnetic media filing of Forms W-2 **must** be directed to the Social Security Administration (SSA). Filers can call 1-800-SSA-6270 to obtain the phone number of the SSA Employer Service Liaison Officer for their area.

**.07** Filers **should not** contact IRS/MCC if they have received a penalty notice and need additional information or are requesting an abatement of the penalty. A penalty notice contains an IRS representative's name and/or phone number for contact purposes; or, the filer may be instructed to respond in writing to the address provided. IRS/MCC does **not** issue penalty notices and does **not** have the authority to abate penalties. For penalty information, refer to the Penalty section of the 2001 Instructions for Form 1042–S.

**.08** A taxpayer or authorized representative may request a copy of a tax return, including Form W-2 filed with a return, by submitting Form 4506, Request for Copy or Transcript of Tax Form, to IRS. This form may be obtained by calling **1-800-TAX-FORM (1-800-829-3676)**. For any questions regarding this form, call 1-800-829-1040.

**.09** The Information Reporting Program Call Site answers both magnetic media and tax law questions relating to the filing of information returns (Forms 1096, 1098, 1099, 5498, 8027, W-2G, and W-4). The Call Site also answers magnetic media questions related to Form 1042–S as well as tax law and paper filing related questions about Forms W-2 and W-3. They also handle inquiries dealing with backup withholding and reasonable cause requirements due to missing and incorrect taxpayer identification numbers. The Call Site is located at IRS/MCC and operates in conjunction with the Information Reporting Program. The Call Site provides service to the payer community (financial institutions, employers, and other transmitters of information returns). Recipients of information returns (payees) should continue to contact 1-800-829-1040 or other numbers specified in the tax return instructions with any questions on how to report information on their tax returns. The Call Site accepts calls from all areas of the country. The number to call is **304-263-8700** or Telecommunications Device for the Deaf **(TDD) 304-267-3367.** These are not toll-free numbers. *You can also reach the Call Site via email at mccirp@irs.gov*. Hours of operation for the Call Site are Monday through Friday, 8:30 a.m. to 4:30 p.m. Eastern time. The Call Site is in operation throughout the year to handle the questions of payers, transmitters, and employers. Due to the high demand for assistance at the end of January and February, it is advisable to call as soon as possible to avoid these peak filing seasons.

☞**Note: This call site does not answer tax law questions concerning the requirements for withholding of tax on payments of U.S. source income to foreign persons under Chapter 3 of the Code. If you need such assistance, you may call 215-516-2000 (not a toll-free number) or write to: Philadelphia Internal Revenue Service, International Section, P.O. Box 920, Bensalem, PA 19020-8518.**

## Sec. 4. Filing Requirements

**.01** The regulations under section 6011(e)(2)(A) of the Internal Revenue Code provide that any person, including a corporation, partnership, individual, estate, and trust, who is required to file 250 or more information returns must file such returns magnetically/electronically. Withholding agents who meet the threshold of 250 or more Forms1042–S are required to submit their information electronically or magnetically.

☞**Note: Even though filers with less than 250 information returns are not required to submit the information returns magnetically or electronically and may submit them on paper, IRS encourages filers to transmit those information returns magnetically or electronically**.

**.02** These requirements apply separately to both originals and corrections filed magnetically/electronically.

**.03** All filing requirements that follow apply individually to each reporting entity as defined by its separate taxpayer identification number (TIN) [social security number (SSN), employer identification number (EIN), IRS individual taxpayer identification number (ITIN), or Qualified Intermediary Employer Identification Number (QI-EIN)]. For example, if a corporation with several branches or locations uses the same EIN, the corporation must aggregate the total volume of returns to be filed for that EIN and apply the filing requirements to each type of return accordingly.

**.04** Filers who are required to submit their information returns on magnetic media may choose to submit their documents by electronic filing. IRS/MCC has one method for filing information returns electronically; see Part C.

**.05** The above requirements do not apply if the filer establishes hardship (see Part A, Sec. 5).

## Sec. 5. Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media

**.01** If a filer is required to file on magnetic media but fails to do so (or fails to file electronically in lieu of magnetic media filing) and does not have an approved waiver on record, the filer will be subject to a penalty of $50 per return in excess of 250. For penalty information, refer to the Penalty section of the 2001 Instructions for Form 1042–S.

**.02** If filers are required to file original or corrected returns on magnetic media, but such filing would create a hardship, they may request a waiver from these filing requirements by submitting Form 8508, Request for Waiver From Filing Information Returns on Magnetic Media, to IRS/MCC.

**.03** Even though a filer may submit as many as 249 corrections on paper, IRS encourages magnetically or electronically submitted corrections. Once the 250 threshold has been met, filers are required to submit any returns of 250 or more magnetically or electronically. However, if a waiver for original documents is approved, any corrections for the same type of returns will be covered under this waiver.

**.04** Generally, only the withholding agent may sign the Form 8508. A transmitter may sign if given power of attorney; however, a letter signed by the withholding agent stating this fact must be attached to the Form 8508.

**.05** A transmitter must submit a separate Form 8508 for each withholding agent. Do not submit a list of withholding agents.

**.06** All information requested on the Form 8508 must be provided to IRS for the request to be processed.

**.07** The waiver, if approved, will provide exemption from magnetic media filing for the current tax year only. Withholding agents may not apply for a waiver for more than one tax year at a time; application must be made each year a waiver is necessary.

**.08** Form 8508 may be photocopied or computer-generated as long as it contains all the information requested on the original form.

**.09** Filers are encouraged to submit Form 8508 to IRS/MCC at least 45 days before the due date of the returns.

**.10** File Form 8508 for the W-2 series of forms with IRS/MCC, not SSA.

**.11** Waivers are evaluated on a case-by-case basis and are approved or denied based on criteria set forth in the regulations under section 6011(e) of the Internal Revenue Code. The transmitter must allow a minimum of 30 days for IRS/MCC to respond to a waiver request.

**.12** If a waiver request is approved, the transmitter should keep the approval letter on file. The transmitter should not send a copy of the approved waiver to the service center where the paper returns are filed.

**.13** An approved waiver from filing information returns on magnetic media does not provide exemption from all filing. The withholding agent must timely file Form 1042–S on acceptable paper forms with the Philadelphia Service Center.

## Sec. 6. Vendor List

**.01** IRS/MCC prepares a list of vendors who support magnetic media or electronic filing. The Vendor List (Pub. 1582) contains the names of service bureaus that will produce files on the prescribed types of magnetic media or via electronic filing. It also contains the names of vendors who provide software packages for filers who wish to produce magnetic media or electronic files on their own computer systems. This list is compiled as a courtesy and in no way implies IRS/MCC approval or endorsement.

**.02** If filers meeting the filing requirements engage a service bureau to prepare media on their behalf, the filers should be careful not to report duplicate data, which may cause penalty notices to be generated.

**.03** The Vendor List, Publication 1582, may be updated in print every other year. The most recently printed copy will be available by contacting IRS/MCC at 304-263-8700 or by letter (see Part A, Sec. 3). The Vendor List is also available on the IRS Web Site at **www.irs.gov**.

**.04** A vendor who offers a software package, has the ability to produce magnetic media for customers, or has the capability to electronically file information returns, and would like to be included on the list, must submit a written request to IRS/MCC. The request should include:

**(a)** Company name,
**(b)** Address (include city, state, and ZIP code),
**(c)** Telephone number (include area code),
**(d)** Contact person,
**(e)** Type(s) of service provided (e.g., service bureau and/or software),
**(f)** Type(s) of media offered (e.g., magnetic tape, tape cartridge, 3 1/2-inch diskette, or electronic filing),
**(g)** Type(s) of return(s).

## Sec. 7. Form 4419, Application for Filing Information Returns Magnetically/Electronically

**.01** Transmitters are required to submit Form 4419, Application for Filing Information Returns Magnetically/Electronically, to request authorization to file information returns with IRS/MCC. A single Form 4419 may be filed.

**EXCEPTIONS**
**An additional Form 4419 is required for filing each of the following types of returns:**
**Forms 1098, 1099, 5498, W-2G, 8027, and Questionable W-4.**

| FORM | TITLE | EXPLANATION |
|---|---|---|
| 1098, 1099, 5498<br>W-2G | Various types of information returns | Payments subject to reporting requirements under Code Section 6011(e)(2)(A), including interest, dividends, royalties, pensions and annuities, gambling winnings, and compensation for personal services. |
| 8027 | Employer's Annual Information Return of Tip Income and Allocated Tips | Receipts from operations where tipping is customary. Used by employers to report employees' tips or allocated tips. |
| Questionable W-4<br>(See **Note**) | Employee's Withholding Allowance Certificate | Forms received during the quarter from employees still employed at the end of the quarter who claim<br>**(a)** More than 10 withholding allowances, or<br>**(b)** Exempt status and wages normally would be more than $200 a week. |

☛**Note: Employers are not required to send other Forms W-4 unless notified to do so by the IRS**.

**.02** Magnetic tape, tape cartridge, diskette, and electronically-filed returns may not be submitted to IRS/MCC until the application has been approved. Please read the instructions on the back of Form 4419 carefully. A Form 4419 is included in the Publication 1187 for the filer's use. This form may be photocopied. Additional forms may be obtained by calling **1-800-TAX-FORM (1-800-829-3676)**. The form is also available on the IRS Web Site at **www.irs.gov**.

**.03** Upon approval, a five-character alpha/numeric Transmitter Control Code (TCC) beginning with the digits **"22"** will be assigned and included in an approval letter. The TCC **must** be coded in the Transmitter "T" Record. If a transmitter uses more than one TCC to file, each TCC must be reported on separate media or in separate transmissions if filing electronically. Please make sure you submit your magnetic media files using the correct TCC.

**.04** When revisions occur, a Publication 1187 containing the current Revenue Procedure, forms, and instructions will be sent to the attention of the contact person indicated on Form 4419.

**.05** If **any** of the information (name, TIN, or address) on the Form 4419 changes, please notify IRS/MCC in writing so the IRS/MCC database can be updated. However, a change in the method by which information returns are being submitted is not information which needs to be updated (e.g., tape to disk). The transmitter should include the TCC in all correspondence.

**.06** Form 4419 may be submitted anytime during the year; however, it **must** be submitted to IRS/MCC at least 30 days before the due date of the return(s) for current year processing. This will allow IRS/MCC the minimum amount of time necessary to process and respond to applications. In the event that computer equipment or software is not compatible with IRS/MCC, a waiver may be requested to file returns on paper documents.

**.07** IRS/MCC encourages transmitters who file for multiple withholding agents to submit one application and to use the assigned TCC for all withholding agents.

**.08** If a withholding agent's files are prepared by a service bureau, the withholding agent may not need to submit an application to obtain a TCC. Some service bureaus will produce files, code their own TCC on the media, and send it to IRS/MCC for the withholding agent. Other service bureaus will prepare magnetic media and return the media to the withholding agent for submission to IRS/MCC. These service bureaus may require the withholding agent to obtain a TCC to be coded in the Transmitter "T" Record. Withholding agents should contact their service bureaus for further information.

**.09** Once a transmitter is approved to file magnetically or electronically, it is not necessary to reapply each year **unless**:

**(a)** The withholding agent has discontinued filing magnetically or electronically for two consecutive years; the withholding agent's TCC may have been reassigned by IRS/MCC. Withholding agents who are aware that the TCC assigned will no longer be used are requested to notify IRS/MCC so these numbers may be reassigned; **or**

**(b)** The withholding agent's magnetic media files were transmitted in the past by a service bureau using the service bureau's TCC, but now the withholding agent has computer equipment compatible with that of IRS/MCC and wishes to prepare his or her own files. The withholding agent must request a TCC by filing Form 4419.

**.10** One Form 4419 may be submitted regardless of how many types of media or methods are used to file the return. Multiple TCCs will only be issued to withholding agents with multiple TINs. Only one TCC will be issued per TIN unless the filer has checked the application for the following forms in addition to the Form 1042–S: Forms 1098, 1099, 5498, W-2G, 8027, and/or W-4. A separate TCC will be assigned for these forms.

**.11** Approval to file does not imply endorsement by IRS/MCC of any computer software or of the quality of tax preparation services provided by a service bureau or software vendor.

## Sec. 8. Test Files

**.01** IRS/MCC strongly encourages all magnetic media or electronic filers to submit a test for 2001. The test file must consist of a sample of each type of record:

**(a)** Transmitter "T" Record
**(b)** Withholding Agent "W" Record
**(c)** Multiple Recipient "Q" Records **(at least 20)**
**(d)** Reconciliation "C" Record
**(e)** End of Transmission "F" Record

**.02** Use the Test Indicator **"TEST**" (upper case) in Field Positions 195–198 of the "T" Record to show this is a test file.

**.03** IRS/MCC will check the file to ensure it meets the specifications of this Revenue Procedure. For current filers, sending a test file will provide the opportunity to ensure their software reflects all programming changes required for TY2001.

**.04** Tests should be sent to IRS/MCC between December 1, 2001, and February 15, 2002. Tests must be received at MCC by February 15, 2002, in order to be processed.

**.05** For tests filed on magnetic tape, tape cartridge, 8mm, 4mm, and quarter inch cartridge, and 3 1/2-inch diskette, the transmitter must include the signed Form 4804 in the same package with the corresponding magnetic media. Mark the "TEST" box in Block 1 on the form. Also, mark "TEST" on the external media label.

**.06** IRS/MCC will send a letter of acknowledgment to indicate the test results for magnetic media with documentation identifying the fatal errors. Resubmission of magnetic media test files must be received by IRS/MCC no later than February 15. See Part C, Sec. 5.03, for information on electronic test results.

**.07** Magnetic media will not be returned to filers.

☛**Note: Validity, consistency, and related math error checks within individual "Q" Records will no longer be conducted as part of MCC's testing procedures.**

## Sec. 9. Filing of Information Returns Magnetically and Retention Requirements

**.01** Form 4804, Transmittal of Information Returns Reported Magnetically, or a computer-generated substitute, must accompany **all** magnetic media shipments.

**.02** IRS/MCC allows for the use of computer-generated substitutes for Form 4804. The substitutes must contain all information requested on the original forms including the affidavit and signature line. Photocopies are acceptable but an original signature is required. When using computer-generated forms, be sure to mark very clearly which tax year is being reported. This will eliminate a phone communication from IRS/MCC to question the tax year.

**.03** Multiple types of media may be submitted in a shipment. However, submit a separate Form 4804 for each type of media.

**.04** Current and prior year data may be submitted in the same shipment; however, each tax year must be on separate media, and a separate Form 4804 must be prepared to clearly indicate each tax year.

**.05** Filers who have prepared their information returns in advance of the due date are encouraged to submit this information to IRS/MCC no earlier than January 1 of the year the return is due.

**.06** Do not report duplicate information. If a filer submits returns magnetically/electronically, identical paper documents must not be filed. This may result in erroneous penalty notices.

**.07** Form 4804 may be signed by the withholding agent or the transmitter, service bureau, paying agent, or disbursing agent (all hereafter referred to as agent) on behalf of the payer. Failure to sign the affidavit on Form 4804 may delay processing or could result in IRS/MCC requesting a replacement file. An agent may sign the Form 4804 if the agent has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under state law and adds the caption "FOR: (name of withholding agent/payer)."

**.08** Although an authorized agent may sign the affidavit, the withholding agent is responsible for the accuracy of the Form 4804 and the returns filed. The withholding agent will be liable for penalties for failure to comply with filing requirements.

**.09** A self-adhesive external media label, created by the filer, must be affixed to each piece of magnetic media. For instructions on how to prepare an external media label, refer to Notice 210 in the forms section of this publication.

**.10** On the outside of the shipping container, affix or attach a label which reads **"IRB Box ___of___"** reflecting the number of containers in the shipment. (Filers can create a label with this information or cut out one of the labels on the special label page provided in this publication.) If there is only one container, mark the outside as Box 1 of 1. For multiple containers, include the sequence (for example, Box 1 of 3, 2 of 3, 3 of 3).

**.11** When submitting magnetic files include the following:

**(a)** A **signed** Form 4804;

**(b)** External media label (created by filer) affixed to magnetic media;

**(c)** IRB Box _____ of ______ outside label.

**.12** IRS/MCC will not pay for or accept "Cash-on-Delivery" or "Charge to IRS" shipments of tax information that an individual or organization is legally required to submit.

**.13** Withholding agents should retain a copy of the information returns filed with IRS or have the ability to reconstruct the data for at least 3 years from the due date of the returns. Whenever backup withholding is imposed, a 4-year retention is required.

## Sec. 10. Due Dates

**.01** The due dates for filing paper returns with IRS also apply to magnetic media. Filing of Form 1042–S is on a calendar year basis.

**.02** Form 1042–S filed magnetically must be submitted to IRS/MCC postmarked on or before March 15.

**.03** If any due date falls on a Saturday, Sunday, or legal holiday, the return or statement is considered timely if filed or furnished on the next day that is not a Saturday, Sunday, or legal holiday.

**.04** Magnetic media returns postmarked by the United States Postal Service (USPS) on or before March 15, and delivered by United States mail to IRS/MCC after the due date, are treated as timely under the "timely mailing as timely filing" rule. Notice 97–26, 1997–1 C.B. 413, provides rules for determining the date that is treated as the postmark date. A similar rule applies to items delivered by private delivery services (PDSs) designated by the IRS. A PDS must be designated by the IRS before it will qualify for the timely mailing rule. (See **Note**.) Notice 99–41, 1999–2 C.B. 325, provides the list of designated PDSs. Designation is effective until the IRS issues a revised list. For items delivered by a non-designated PDS, the actual date of receipt by IRS/MCC will be used as the filing date. For items delivered by a designated PDS, but through a type of service not designated in Notice 99–41, the actual date of receipt by IRS/MCC will be used as the filing date.

☛**Note: Due to security regulations at MCC, the Internal Revenue police officers will not accept media from PDSs or couriers from 3:00 p.m. to 11:00 p.m., seven days a week, and 11:00 p.m. to 7:00 a.m., Saturday and Sunday.**

**.05** Statements to recipients must be mailed on or before March 15.

## Sec. 11. Extensions of Time

**.01** An extension of time to file may be requested for Form 1042–S.

**.02** Form 8809, Request for Extension of Time To File Information Returns, should be submitted to IRS/MCC at the address listed in .06 of this section. This form may be used to request an extension of time to file information returns submitted on paper, magnetically or electronically.

**.03** Requesting an extension of time for multiple withholding agents (50 or less) may be done by submitting Form 8809 and attaching a list of the withholding agent's names and associated EIN or QI-EIN, if applicable. The listing must be attached to ensure an extension is recorded for all withholding agents**.** Form 8809 may be computer-generated or photocopied. Be sure that all the pertinent information is included.

**.04** Requests for an extension of time to file for more than 50 withholding agents must be submitted magnetically or electronically. Transmitters requesting an extension of time for 10 to 50 withholding agents are encouraged to file magnetically or electronically. The request may be filed on tape, tape cartridge, 3 1/2-inch diskette, or electronically. (See Part D, Sec. 3, for the record format.)

**.05** If a filer does not have an IRS/MCC assigned Transmitter Control Code (TCC), a Form 4419, Application for Filing Information Returns Magnetically/Electronically, **must** be submitted to obtain a TCC. The TCC must be used to submit an extension request magnetically/electronically.

**.06** All requests for an extension of time filed on Form 8809 or filed magnetically on tape, tape cartridge, or 3 1/2-inch diskette should be sent using the following address*:*

IRS-Martinsburg Computing Center
Information Reporting Program
**Attn: Extension of Time Coordinator**
240 Murall Drive
Kearneysville, WV 25430

**.07** Requests for extensions of time for multiple withholding agents will be responded to with one approval letter, accompanied by a list of withholding agents covered under that approval.

**.08** Transmitters should submit Form 8809 as soon as it is apparent that a 30-day extension is needed. It will take a minimum of 30 days for IRS/MCC to respond to an extension request. Under certain circumstances, a request for an extension of time could be denied. When a denial letter is received, any additional or necessary information may be resubmitted within 20 days.

**.09** Form 8809 must be postmarked no later than the due date of the return for which an extension is requested. If requesting an extension of time to file several types of forms, use one Form 8809; however, the Form 8809 must be postmarked no later than the earliest due date. For example, if requesting an extension of time to file both Forms 1099–INT and 1042–S, submit Form 8809 postmarked on or before February 28.

**.10** If an additional extension of time is needed, a second Form 8809 must be filed by the initial extended due date. Check line 7 on the form to indicate that an additional extension is being requested. A second 30-day extension will be approved only in cases of extreme hardship or catastrophic event. **If requesting a second 30-day extension of time, submit the information return files as soon as prepared. Do not wait for MCC's response to your second extension request.**

**.11** If an extension request is approved, the approval letter should be kept on file. The approval letter or copy of the approval letter for an extension of time should **not** be sent to IRS/MCC with the magnetic media file or to the service center where the paper returns are filed.

**.12** Request an extension for only the current tax year.

**.13** The extension request must be signed by the withholding agent or a person who is duly authorized to sign a return, statement, or other document for the withholding agent.

**.14** Failure to properly complete and sign the Form 8809 may cause delays in processing the request or result in a denial. Carefully read and follow the instructions on the back of the Form 8809.

**.15** Form 8809 may be obtained by calling **1-800-TAX-FORM (1-800-829-3676).** The form is also available on the IRS Web Site at **www.irs.gov**. A copy of the Form 8809 is also provided in the back of Publication 1187.

**.16** Request an extension of time to furnish the statements to recipients of Form 1042–S by submitting a letter to IRS/MCC at the address listed in .06 of this section. The letter should contain the following information:

**(a)** Withholding Agent name,
**(b)** TIN,
**(c)** Address,
**(d)** Type of return,
**(e)** Specify that the extension request is to provide statements to recipients,
**(f)** Reason for delay, and
**(g)** Signature of withholding agent or person duly authorized.

Requests for an extension of time to furnish the statements to recipients for Forms 1042–S, 1098, 1099, 5498, W-2G, and W-2 series are not automatically approved; however, if approved, generally an extension will allow a maximum of 30 additional days from the due date to furnish the statements to the recipients. The request must be postmarked by the date on which the statements are due to the recipients.

☛**Note: The due date for the Form 1042 is March 15. To request an extension of time to file Form 1042, submit Form 2758 to the Internal Revenue Service, Philadelphia, PA 19255.**

## Sec. 12. Processing of Information Returns Magnetically at IRS/MCC

**.01** All data received at IRS/MCC for processing will be given the same protection as individual income tax returns (Form 1040). IRS/MCC will process the data and determine if the records are formatted and coded according to this Revenue Procedure.

**.02 If the data is formatted incorrectly, IRS/MCC will request a replacement file in writing. When IRS/MCC requests a replacement file, it is because we encountered errors (not limited to format) and were unable to process the media. Filers will receive a Media Tracking Slip (Form 9267) and letter detailing the reason(s) their media could not be processed. It is imperative that filers maintain backup copies and/or recreate capabilities for their information return files.**

- A **replacement** is an information return file sent by the filer **at the request of IRS/MCC** because of errors encountered while processing the filer's original submission. After necessary changes have been made, the file must be resubmitted for processing along with the Media Tracking Slip (Form 9267) which was included in the correspondence from IRS/MCC. Filers should never send anything to IRS/MCC marked "Replacement" unless IRS/MCC has requested a replacement file in writing or via the FIRE System.

**.03** The following list of errors are considered fatal processing errors and will cause IRS/MCC to request a replacement file:

**(a) Pre-processing Errors:**
Damaged Media
Media Type Invalid/Missing
Invalid Record Length (**MUST** be 780 positions)
Invalid Block Size (**can not** exceed 23,400)

**(b) Processing Errors:**
Invalid Tax Year
Transmitter Control Code Invalid/Missing (**MUST** begin with **"22")**
No Transmitter Record ("T" Record)
No Withholding Agent Record ("W" Record)
No Recipient Record ("Q" Record)
No Reconciliation Record ("C" Record)
No End of Transmission Record ("F" Record)
Records are not in proper sequence (e.g., T, W, Q, C, F)
No data entered in "W" Record
No data entered in "Q" Record
No data entered in "C" Record
Count of "Q" Records missing in "C" Record
Total "Q" Record count differs from count indicated in "C" Record
Total Gross Amount Paid missing in "C" Record
Total U.S. Tax Withheld missing in "C" Record
Total Gross Amount in "Q" Records differs from amount indicated in "C" Record
Total U.S. Tax Withheld amount in "Q" Records differs from amount indicated in "C" Record

**.04** Magnetic media files must be corrected and returned with the Media Tracking Slip (Form 9267) to IRS/MCC within 45 days from the date of the letter. Refer to Part C, Section 6, for procedures for correcting files submitted electronically. A penalty for failure to file correct information returns by the due date will be assessed if the files are not corrected and replaced within the 45 days **or if IRS/MCC requests replacement files more than two times.** A penalty for intentional disregard of the filing requirements will be assessed if a replacement file is not received. (For penalty information, refer to the Penalty section of the 2001 Instructions for Form 1042–S.)

**.05** A letter identifying errors encountered will be provided. It is the responsibility of the transmitter to check the entire replacement file for errors before resubmitting.

**.06** IRS/MCC will not return magnetic media. Therefore, if the transmitter wants proof that IRS/MCC received a shipment, the transmitter should select a service with tracking capabilities or one that will provide proof of delivery.

**.07** IRS/MCC will work with filers as much as possible to assist with processing problems.

## Sec. 13. Validation of Information Returns at IRS Service Center

**.01** The accuracy of data reported on Form 1042–S will now be reviewed and validated at the IRS Service Center. All fields indicated as **"Required"** in the record layouts in Part B must contain valid information. If the Service identifies an error, you will be notified by telephone or in writing to provide correct information.

**.02 Know your recipient!**

**.03** The tax rate entered must be a valid tax rate based on the Internal Revenue Code or on a valid treaty article. The valid treaty rate is based on the recipient's country of residence for tax purposes. The rate selected must be justified by the appropriate treaty.

**.04** The Gross Income amount field must reflect pretax income. The Gross Income amount is the total income paid before any deduction of tax at source.

**.05** If a qualified intermediary is acting as such, either as a withholding agent or as a recipient, the TIN reported must be a QI-EIN and must begin with "98".

**.06** Country Codes used must be valid codes taken from the Country Code Table. Generally, the use of "OC" or "UC" will generate an error condition. If a recipient is claiming treaty benefits, the Country Code can never be "OC" or "UC".

**.07** If a recipient is an "Unknown Recipient" or "Withholding Rate Pool", an address is not required. These are the only two situations where a street address is not required.

**.08** A U.S. TIN for a recipient is now generally required, particularly for most treaty benefits. The exceptions are very limited and are listed in the 2001 Instructions for Form 1042–S.

**.09** Apply the following formula to determine U.S. Federal Tax Withheld (field positions 48–59 of the "Q" Record). All field positions described below are in the "Q" Record.

| *Income Codes (15 – 19)* | *All other Income Codes* |
|---|---|
| Gross Income Paid (6–17) | Gross Income Paid (6–17) |
| − Withholding Allowance (18–29) | × Tax Rate (42–45) |
| = Net Income Amount (30–41) | = U.S. Federal Tax Withheld (48–59) |
| × Tax Rate (42–45) | |
| = U.S. Federal Tax Withheld (48–59) | |

**.10** If the Recipient Code is 20 (Unknown Recipient), the tax rate should be 30%.

**.11** When making a payment to an international organization (e.g., United Nations) or a tax exempt organization under IRC 501(a), use Country Code "OC". Use "UC" only when you have an "Unknown Recipient".

**.12** When using Exemption Code 4, the Recipient Country of Residence Code for Tax Purposes MUST be a VALID treaty country (e.g., if tax resident of Northern Ireland, use United Kingdom). Do not use Exemption Code 4 unless a reduction or exemption of tax is based on a treaty claim.

**.13** Generally, payments under Income Codes 06 and 08 are not exempt from withholding; however, certain exceptions apply. See the 2001 Instructions for Form 1042–S.

**.14** If the type of income is from gambling winnings (Income Code 28) or is not specified (Income Code 50), the tax rate must generally be 30%. This type of income is only exempt from withholding at source if the exemption is based on a tax treaty that has an "Other Income" article.

**.15** If Income Code 20 (Earnings as Artist or Athlete) is used, the Recipient Code must be 09. Do not use Recipient Code 01 (Individual), 02 (Corporation), or 03 (Partnership). Generally, the tax rate cannot be zero even if a treaty may apply.

**.16** When paying scholarship and fellowship grants (Income Code 15), the Recipient's Country of Residence for Tax Purposes must be identified and cannot be "OC" or "UC". Grants that are exempt under Code Section 117, while no longer required, may be reported on Form 1042–S.

☛**Note: Grants that are exempt under Code 117 include only amounts provided for tuition, fees, books, and supplies to a qualified student. Amounts provided for room and board can only be exempted under a tax treaty and must be reported on Form 1042–S whether exempt from tax or not.**

**.17** If a student is receiving compensation (Income Code 19) or a teacher or a researcher is receiving compensation (Income Code 18), all or part of which is exempted from tax under a tax treaty, the Country of Residence for Tax Purposes must be identified and cannot be "OC" or "UC".

## Sec. 14. Voided and Corrected Returns

**.01** A corrected record must always have a corresponding voided record submitted prior to or in association with the corrected record.

**.02** To provide clarification of the correction process for Form 1042–S, the following definitions have been provided:

**(a)** A void record is an information return (Form 1042–S) submitted by the transmitter to delete a previously filed incorrect original return. A void record must be a duplicate of the original successfully processed return with the exception of a Return Type Indicator of "1" (1 = Void) in field position 2 of the "W" and "Q" Records. The voided "Q" Record can be filed with or without a corresponding correction record. For example, a Form 1042–S was submitted, and it should have been prepared as a Form 1099. A "Q" Record with the original Form 1042–S information would be filed with a Return Type Indicator of "1" (1 = Void) in field position 2. In this instance, a corresponding "Q" Record coded as a correction would **NOT** be necessary.

**(b)** A correction is an information return (Form 1042–S) submitted by the transmitter to correct a return that was successfully processed by IRS/MCC, but contained erroneous information. A Return Type Indicator of "2" (2 = Corrected) in field position 2 of the "W" and "Q" Records identifies a correction record**. A corrected record must always have a corresponding voided record submitted prior to or in association with the corrected record**.

**.03** The magnetic media filing requirement of information returns of 250 or more applies separately to both original and corrected returns.

| | |
|---|---|
| | If a withholding agent has 100 Forms 1042–S to be corrected, they can be |
| **E** | filed on paper because they fall under the 250 threshold. However, |
| **X** | if the withholding agent has 300 Forms 1042–S to be corrected, they must be |
| **A** | filed magnetically or electronically because they exceed the 250 threshold. |
| **M** | If for some reason a withholding agent cannot file the 300 corrections on |
| **P** | magnetic media, to avoid penalties, a request for a waiver must be submitted |
| **L** | before filing on paper. If a waiver is approved for original documents, any |
| **E** | corrections for the same type of return will be covered under this waiver. |

**.04** Corrections should be filed **as soon as possible**. Corrections filed after August 1 may be subject to the maximum penalty of $50 per return. Corrections filed by August 1 may be subject to a lesser penalty. For information on penalties, refer to the Penalty section of the 2001 Instructions for Form 1042–S. However, if a withholding agent discovers errors after August 1, it is still required to file corrections or the withholding agent will be subject to a penalty for intentional disregard of the filing requirements. If a record is incorrect, all fields on that record must be completed with the correct information**.** Submit corrections only for the returns filed in error. Do not submit the entire file. Furnish corrected statements to recipients as soon as possible.

**.05** Corrected returns must be identified on the Form 4804 and the external media label by indicating "Correction".

☞**Note: Do not include original returns and corrected returns on the same media or in the same electronic file.**

**.06** If filers discover that certain information returns were omitted on their original file, they must not code these documents as corrections. The file must be coded and submitted as an original file.

**.07** Prior year data, original and corrected, **must** be filed according to the requirements of this Revenue Procedure. If submitting prior year corrections, use the record format for the current year and submit on separate media. However, use the actual year designation of the correction in Field Positions 2–5 of the "T" Record. If filing electronically, a separate transmission must be made for each tax year.

**.08** In general, filers should submit corrections for returns filed within the last 3 calendar years.

**.09** All paper returns, whether original or corrected, must be filed with Philadelphia Service Center.

**.10** Form 4804 must be submitted with corrected files submitted magnetically.

**.11** The "Q" Record provides a 20-position field (positions 72–91) for the recipient's account number assigned by the withholding agent. This number will help identify the appropriate incorrect return if more than one return is filed for a particular payee. This number should appear on the initial return and on the corrected return in order to identify and process the correction properly. **Do not enter a TIN in this field.**

**.12** The record sequence for filing corrections is the same as for original returns.

**.13** Following is a chart showing the steps to be taken for voiding and correcting Form 1042–S:

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**Guidelines for Filing Corrected Returns Magnetically/Electronically**

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**Transaction 1: Identify incorrect returns (void process)**

The record sequence for filing corrections is the same as for original returns. Create the file in the following order exactly the same as the original transmission:

- **(a)** Transmitter "T" Record
- **(b)** Withholding Agent "W" Record with a Return Type Indicator of "1" (1 = Void) in field position 2
- **(c)** Recipient "Q" Record (s) with the exact information as submitted originally; however, place a Return Type Indicator of "1" (1 = Void) in field position 2 of the "Q" Record (See **Note**)
- **(d)** Prepare a Reconciliation "C" Record summarizing the preceding voided "Q" Records. (See sample format below.)

☞**Note: A voided "Q" Record may or may not have a corresponding corrected "Q" Record.**

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**Transaction 2: Report the correct information (correction process)**

If possible, on the same media or electronic submission prepare:

- **(a)** Withholding Agent "W" Record with a Return Type Indicator of "2" (2 = Corrected) in field position 2
- **(b)** Recipient "Q" Record(s) with the correct information. Place a "2" (2 = Corrected) in field position 2 of the "Q" Record
- **(c)** Prepare a Reconciliation "C" Record summarizing the preceding corrected "Q" Records
- **(d)** Prepare an End of Transmission "F" Record.

☞**Note: Each corrected "Q" Record MUST have a corresponding voided "Q" Record submitted prior to or in association with the corresponding correction record.**

**Sample data sequence for void/correction records submitted in the same file:**

"T" Record
"W" Record coded for voided records
"Q" Record coded as void
"Q" Record coded as void
"Q" Record coded as void
"Q" Record coded as void
"Q" Record coded as void
"C" Record to summarize voided records
"W" Record coded for corrected records
"Q" Record coded as corrected records
"Q" Record coded as corrected
"Q" Record coded as corrected
"C" Record to summarize corrected records
"F" Record

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**.14** For information, on when an amended Form 1042 is required, refer to Pub. 515, Withholding of Tax on Nonresident Aliens and Foreign Corporations.

## Sec. 15. Taxpayer Identification Number (TIN)

**.01** Section 6109 of the Internal Revenue Code establishes the general requirements under which a person is required to furnish a TIN to the person obligated to file the information return.

**.02** The Withholding Agent must provide its EIN or QI-EIN, if appropriate, in the "W" Record and "T" Record if the Withholding Agent is also the transmitter.

**.03** A recipient TIN (SSN, ITIN, EIN, QI-EIN) must be provided on every "Q" Record when:

**(a)** Tax rate is less than 30% (See the 2001 Instructions for Form 1042–S for exceptions)
**(b)** Income is effectively connected
**(c)** Recipient claims tax treaty benefits (generally)
**(d)** Recipient is a Qualified Intermediary
**(e)** An NRA individual claiming exemption from withholding on independent personal services
**(f)** Other situations may apply, see Publication 515

**.04** The recipient's TIN and name combination are used to associate information returns reported to IRS/MCC with corresponding information on recipients' tax returns. It is imperative that **correct** Taxpayer Identification Numbers (TINs) for recipients be provided to IRS/MCC. **DO NOT enter hyphens or alpha characters.** Entering all zeros, ones, twos, etc., will have the effect of an incorrect TIN.

**.05** The withholding agent and recipient names with associated TINs should be consistent with the names and TINs used on other tax returns.

☞**Note: For 2001 and future years, SSNs and ITINs are no longer valid for withholding agents to use. A withholding agent must have a valid EIN and/or QI-EIN.**

## Sec. 16. Effect on Paper Returns and Statements to Recipients

**.01** Magnetic/electronic reporting of Form 1042–S eliminates the need to submit paper documents to the IRS. **CAUTION: DO NOT send Copy A of the paper forms to IRS for any forms filed on magnetic media or electronically.** This will result in duplicate filing.

**.02** Withholding agents are responsible for providing statements to the recipients as outlined in the 2001 Instructions for Form 1042–S. Refer to those instructions for filing Form 1042–S on paper with the IRS and furnishing statements to recipients.

**.03** Statements to recipients should be clear and legible. If the official IRS form is not used, the filer must adhere to the specifications and guidelines in Publication 1179, Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 1042–S, 5498, and W–2G.

**.04** The address for filing paper Forms 1042–S and Form 1042 is: Internal Revenue Service Center, Philadelphia, PA 19255. **DO NOT** send paper Forms 1042–S or 1042 to IRS/MCC.

## Sec. 17. Definition of Terms

| **Element** | **Description** |
|---|---|
| Asynchronous Protocols | This type of data transmission is most often used by microcomputers, PCs and some minicomputers.<br>Asynchronous transmissions transfer data at arbitrary time intervals using the start-stop method. Each character transmitted has its own start bit and stop bit. |
| b̸ | Denotes a blank position. Enter blank(s) when this symbol is used (do not enter the letter "b"). This appears in numerous areas throughout the record descriptions. |
| Beneficial Owner | The beneficial owner of income is, generally, the person who is required under U.S. tax principles to include the income in gross income on a tax return. For additional information and special conditions see Definitions in the 2001 Instructions for Form 1042–S. |
| Correction | A correction is an information return submitted by the transmitter to correct an information return that was previously submitted to and processed by IRS/MCC, but contained erroneous information. A corrected record must always have a corresponding voided record submitted prior to or in association with the corrected record. |
| Employer Identification Number (EIN) | A nine-digit number assigned by IRS for Federal tax reporting purposes. |

| Element | Description |
|---|---|
| Electronic Filing | Submission of information returns using switched telecommunications network circuits. These transmissions use modems, dial-up phone lines, and asynchronous protocols. See Parts A and C of this publication for specific information on electronic filing. |
| File | For purposes of this Revenue Procedure, a file consists of one Transmitter "T" Record at the beginning of the file, a Withholding Agent "W" Record, followed by the Recipient "Q" Record(s), a Reconciliation "C" Record summarizing the number of preceding "Q" Records and total of preceding money fields. Follow with any additional "W", "Q", and "C" Record sequences as needed. The last record on the file will be the End of Transmission "F" Record. Nothing should be reported after the End of Transmission "F" Record. A file format diagram is located at the end of Part E, Miscellaneous Information just before the mail labels. |
| Filer | Person (may be withholding agent and/or transmitter) submitting information returns to IRS. |
| FIRE | Filing Information Returns Electronically (FIRE) is the method for submitting Forms 1042–S electronically to IRS/MCC. See Part C. |
| Filing Year | The calendar year in which the information returns are being submitted to IRS. |
| Flow–Through Entity | A flow-through entity is a foreign partnership (other than a withholding foreign partnership), or a foreign simple or grantor trust (other than a withholding foreign trust). For any payments for which a reduced rate of withholding under an income tax treaty is claimed, any entity is considered to be a flow-through entity if it is considered to be fiscally transparent under IRC Section 894 with respect to the payment by an interest holder's jurisdiction. |
| Foreign Person | A foreign person includes a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust, a foreign estate, and any other person that is not a U.S. person. The term also includes a foreign branch or office of a U.S. financial institution or U.S. clearing organization if the foreign branch is a Qualified Intermediary. Generally, a payment to a U.S. branch of a foreign person is a payment to a foreign person. |
| Gross Income | Gross income includes income from all sources, except certain items expressly excluded by statute. Gross income is the starting point for computing adjusted gross income and taxable income. |
| IRS Individual Taxpayer Identification Number (ITIN) | A nine-digit number issued by IRS to individuals who are required to have a U.S. taxpayer identification number for tax purposes but are not eligible to obtain a social security number (SSN). |
| Information Return | The vehicle for withholding agents to submit required tax information about a recipient to IRS. For this Revenue Procedure, it is information about a foreign person's U.S. source income subject to withholding, and the information return is Form 1042–S. |
| Intermediary | An intermediary is a person that acts as a custodian, broker, nominee, or otherwise as an agent for another person, regardless of whether that other person is the beneficial owner of the amount paid, a flow-through entity, or another intermediary. |
| ISDN - Integrated Services Digital Network | ISDN's basic service is Basic Rate Interface (BRI) which is made up of two 64Kbps B channels and one 16Kbps D channel. If both channels are combined into one, called bonding, the total data rate becomes 128Kbps and is 4 1/2 times the bandwidth of a 28.8 modem. |

| Element | Description |
|---|---|
| Magnetic Media | For this Revenue Procedure, the term magnetic media refers to 9-track magnetic tape; IBM 3480, 3490, 3490E, *3590, 3590E* or AS400 compatible tape cartridge; 8mm, 4mm, and QIC (Quarter Inch Cartridge) cartridge or 3 1/2-inch diskette. |
| Media Tracking Slip | Form 9267 accompanies correspondence sent by IRS/MCC requesting a replacement file due to incorrect format or certain errors encountered when trying to process the media. **This form must be returned with the replacement file**. |
| Nonqualified Intermediary (NQI) | A Nonqualified Intermediary is any intermediary that is not a U.S. person and that is not a Qualified Intermediary. |
| Payer | A payer is the person for whom the withholding agent acts as a paying agent pursuant to an agreement whereby the withholding agent agrees to withhold and report a payment. |
| Presumption Rules | The presumption rules are those rules prescribed under Chapter 3 and Chapter 61 of the Internal Revenue Code that a withholding agent must follow to determine the status of a beneficial owner as a U.S. or foreign person when it cannot reliably associate a payment with valid documentation. |
| Pro-Rata Basis Reporting | If the withholding agent has agreed that an NQI may provide information allocating a payment to its account holders under the provisions of Regulations section 1.1441–1(e)(3)(iv)(D), and the NQI fails to allocate the payment in a withholding rate pool to the specific recipients in the pool, the withholding agent must file a Form 1042–S for each recipient on a pro-rata basis. |
| Qualified Intermediary (QI) | A Qualified Intermediary is an intermediary that is a party to a withholding agreement with the IRS, in which it agrees to comply with the relevant terms of Chapter 3 and 61 of the Internal Revenue Code. |
| Qualified Intermediary Employer Identification Number (QI-EIN) | A nine-digit number assigned by IRS to a QI for Federal tax reporting purposes. A QI-EIN should be used only when the QI is not filing on its own behalf. |
| Recipient | Person (nonresident alien individual, fiduciary, foreign partnership, foreign corporation, Qualified Intermediary, Withholding Rate Pool, or other foreign entity) that receives payments from a withholding agent as a beneficial owner or as a qualified intermediary acting on behalf of a beneficial owner. A non-qualified intermediary can not be a recipient. |
| Replacement File | A replacement file is an information return file sent by the filer **at the request of IRS/MCC** because of certain errors encountered while processing the filer's original submission. |
| Service Bureau | Person or organization with whom the withholding agent has a contract to prepare and/or submit information return files to IRS/MCC. A parent company submitting data for a subsidiary is not considered a service bureau. |
| Social Security Number (SSN) | A nine-digit number assigned by Social Security Administration to an individual for wage and tax reporting purposes. |
| Special Character | Any character that is **not** a numeric, an alpha, or a blank. |
| Taxpayer Identification Number (TIN) | Refers to either an Employer Identification Number (EIN), Social Security Number (SSN), IRS Individual Taxpayer Identification Number (ITIN), or a Qualified Intermediary Employer Identification Number (QI-EIN). |

| Element | Description |
|---|---|
| Tax Year | The year in which payments were made by a withholding agent to a recipient. |
| Transmitter | Refers to the person or organization submitting file(s) magnetically/electronically. The transmitter may be the payer, agent of the payer, or withholding agent. |
| Transmitter Control Code (TCC) | A five-character alpha/numeric number assigned by IRS/MCC to the transmitter prior to filing magnetically or electronically. An application Form 4419 must be filed with IRS/MCC to receive this number. This number is inserted in the Transmitter “T” Record (field positions 190–194) of the file and **must** be present before the file can be processed. Transmitter Control Codes assigned to 1042–S filers will always begin with **“22”.** |
| Unknown Recipient | For this Revenue Procedure, an unknown recipient is a recipient for which no documentation has been received by a withholding agent or intermediary or for which documentation received can not be reliably associated. An unknown recipient is always subject to withholding at the maximum applicable rate. |
| Vendor | Vendors include service bureaus that produce information return files on the prescribed types of magnetic media or via electronic filing for withholding agents. Vendors also include companies that provide software for those who wish to produce their own media or electronic files. |
| Void | A void record is used in the correction process of Form 1042–S. For purposes of this Revenue Procedure, a void record is submitted by the transmitter to delete a previously filed incorrect original Form 1042–S. A void record must be a duplicate of the original successfully processed record with the exception of a “1” in field position 2 of the “W” and “Q” Records. |
| Withholding Agent | Any person, U.S. or foreign, that has control, receipt, or custody of an amount subject to withholding or who can disburse or make payments of an amount subject to withholding. The withholding agent may be an individual, corporation, partnership, trust, association, or any other entity. The term withholding agent also includes, but is not limited to, a qualified intermediary, a nonqualified intermediary, a withholding foreign partnership, a withholding foreign trust, a flow-through entity, a U.S. branch of a foreign insurance company or foreign bank that is treated as a U. S. person, and an authorized foreign agent. A person may be a withholding agent even if there is no requirement to withhold from a payment or even if another person has already withheld the required amount from a payment. |
| Withholding Foreign Partnership | A foreign partnership or trust that has entered into a withholding or Withholding Foreign Trust agreement with the IRS in which it agrees to assume primary withholding responsibility for all payments that are made to it for its partners, beneficiaries, or owners. |

## Sec. 18. State Abbreviations

**.01** The following state and U.S. territory abbreviations are to be used when developing the state code portion of address fields. This table provides state and territory abbreviations.

| State | Code | State | Code | State | Code |
|---|---|---|---|---|---|
| Alabama | AL | Louisiana | LA | Ohio | OH |
| Alaska | AK | Maine | ME | Oklahoma | OK |
| American Samoa | AS | Maryland | MD | Oregon | OR |
| Arizona | AZ | Massachusetts | MA | Pennsylvania | PA |

| State | Code | State | Code | State | Code |
|---|---|---|---|---|---|
| Arkansas | AR | Michigan | MI | Puerto Rico | PR |
| California | CA | Minnesota | MN | Rhode Island | RI |
| Colorado | CO | Mississippi | MS | South Carolina | SC |
| Connecticut | CT | Missouri | MO | South Dakota | SD |
| Delaware | DE | Montana | MT | Tennessee | TN |
| District of Columbia | DC | Nebraska | NE | Texas | TX |
| Florida | FL | Nevada | NV | Utah | UT |
| Georgia | GA | New Hampshire | NH | Vermont | VT |
| Guam | GU | New Jersey | NJ | Virginia | VA |
| Hawaii | HI | New Mexico | NM | (U.S.) Virgin Islands | VI |
| Idaho | ID | New York | NY | Washington | WA |
| Illinois | IL | North Carolina | NC | West Virginia | WV |
| Indiana | IN | North Dakota | ND | Wisconsin | WI |
| Iowa | IA | Northern | | Wyoming | WY |
| Kansas | KS | Mariana Islands | MP | | |
| Kentucky | KY | | | | |

**.02** When reporting APO/FPO addresses use the following format:

**EXAMPLE**:

| | |
|---|---|
| Payee Name | PVT Willard J. Doe |
| Mailing Address | Company F, PSC Box 100 |
| | 167 Infantry REGT |
| Payee City | APO (or FPO) |
| Payee State | AE, AA, or AP***** |
| Payee ZIP Code | 098010100 |

*****AE is the designation for ZIPs beginning with 090–098, AA for ZIP 340, and AP for ZIPs 962–966.

## Part B. Magnetic Media Specifications

## Sec. 1. General

**.01** The specifications contained in this part of the Revenue Procedure define the <u>required</u> format and content of the records to be included in the magnetic media/electronic file. Do not deviate from this format.

**.02** Transmitters must be consistent in the use of recording modes and density on files. If the media does not meet these specifications, IRS/MCC will request a replacement file. Filers are encouraged to submit a test prior to submitting the actual file. Contact IRS/MCC for further information at 304-263-8700.

**.03** Regardless of the type of media used or if returns are filed electronically, the record length must be 780 positions.

## Sec. 2. Tape Specifications

☞**Note:** ***Beginning in calendar year 2003 for Tax Year 2002, IRS/MCC will no longer accept 9-track tape for filing Form 1042–S.***

**.01** IRS/MCC can process most magnetic tape files if the following specifications are followed:

**(a)** 9-track EBCDIC (Extended Binary Coded Decimal Interchange Code) with:

**(1)** Odd parity,

**(2)** A density of 1600 or 6250 BPI,

**(3)** If transmitters use UNISYS Series 1100, they must submit an interchange tape.

**(b)** 9-track ASCII (American Standard Coded Information Interchange) with:

**(1)** Odd parity,

**(2)** A density of 1600 or 6250 BPI.

Transmitters should be consistent in the use of recording codes and density on files.

**.02** All compatible tape files must have the following characteristics: Type of tape - 1/2-inch (12.7 mm) wide, computer-grade magnetic tape on reels of up to 2,400 feet (731.52 m) within the following specifications:

**(a)** Tape thickness: 1.0 or 1.5 mils and

**(b)** Reel diameter: 10 1/2-inch (26.67 cm), 8 1/2-inch (21.59 cm), 7-inch (17.78 cm), or 6-inch.

**.03** The tape records defined in this Revenue Procedure may be blocked subject to the following:

**(a)** A block **must not** exceed 23,400 tape positions.

**(b)** If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks.**

**(c)** All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 780.

**(d)** Records may not span blocks.

**.04** Labeled or unlabeled tapes may be submitted.

**.05** For the purposes of this Revenue Procedure the following must be used:

Tape Mark:

**(a)** Signifies the physical end of the recording on tape.

**(b)** For even parity, use BCD configuration 001111 (8421).

**(c)** May follow the header label and precede and/or follow the trailer label.

**.06** IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but **must** end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

## Sec. 3. Tape Cartridge Specifications

**.01** In most instances, IRS/MCC can process tape cartridges that meet the following specifications:

**(a)** Must be IBM 3480, 3490, 3490E, 3590, 3590E or AS400 compatible.

**(b)** Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

**(1)** Tape cartridges will be 1/2-inch tape contained in plastic cartridges which are approximately 4-inches by 5-inches by 1-inch in dimension.

**(2)** Magnetic tape will be chromium dioxide particle based 1/2-inch tape.

**(3)** Cartridges must be 18-track, 36-track, 128-track, or 256-track parallel (See **Note**).

**(4)** Cartridges will contain 37,871 CPI or 75,742 CPI (characters per inch).

**(5)** Mode will be full function.

**(6)** The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.

**(7)** Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used.

**.02** The tape cartridge records defined in this Revenue Procedure may be blocked subject to the following:

**(a)** A block **must not** exceed 23,400 tape positions.

**(b)** If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks**.

**(c)** All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 780.

**(d)** Records may not span blocks.

**.03** Tape cartridges may be labeled or unlabeled.

**.04** For the purposes of this Revenue Procedure, the following must be used:

Tape Mark:

**(a)** Signifies the physical end of the recording on tape.

**(b)** For even parity, use BCD configuration 001111 (8421).

**(c)** May follow the header label and precede and/or follow the trailer label.

☛**Note: Filers should indicate on the external media label and transmittal Form 4804 whether the cartridge is 18-track, 36-track, 128-track or 256-track.**

## Sec. 4. 8mm, 4mm, and Quarter-Inch Cartridge Specifications

**.01** In most instances, IRS/MCC can process 8mm tape cartridges that meet the following specifications:

**(a)** Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

**(1)** Created from an AS400 operating system only.

**(2)** 8mm (.315-inch) tape cartridges will be 2 1/2-inch by 3 3/4-inch.

**(3)** The 8mm tape cartridges must meet the following specifications:

| **Tracks** | **Density** | **Capacity** |
|---|---|---|
| 1 | 20 (43245 BPI) | 2.3 Gb |
| 1 | 21 (45434 BPI) | 5 Gb |

**(4)** Mode will be full function.

**(5)** Compressed data is not acceptable.

**(6)** Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used. However, IRS/MCC encourages the use of EBCDIC. This information must appear on the external media label affixed to the cartridge.

**(7)** A file may consist of more than one cartridge; however, no more than 250,000 documents may be transmitted per file or per cartridge. The filename, for example, 1042TAX, will contain a three digit extension. The extension will indicate the sequence of the cartridge within the file (e.g., 1 of 3, 2 of 3, and 3 of 3 will appear in the header label as 1042TAX.001, 1042TAX.002, and 1042TAX.003 on each cartridge of the file). The Transmitter "T" Record must only appear on the first cartridge. The End of Transmission "F" Record should be placed only on the last cartridge for files containing multiple cartridges.

**.02** The 8mm (.315-inch) tape cartridge records defined in this Revenue Procedure may be blocked subject to the following:

**(a)** A block **must not** exceed 23,400 tape positions.

**(b)** If the use of blocked records would result in a short block, the last block of the file may be filled with 9s or truncated.

**(c)** All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 780.

**(d)** Various COPY commands have been successful; however, the **SAVE OBJECT COMMAND** is not acceptable.

**(e)** Extraneous data following the "F" Record will result in IRS/MCC requesting a replacement file.

**(f)** Records may not span blocks.

**(g)** No more than 250,000 documents per cartridge and per file.

☛**Note:** ***Advanced Metal Evaporated (AME) cartridges are not acceptable.***

**.03** For faster processing, IRS/MCC encourages transmitters to use header labeled cartridges. 1042TAX may be used as a suggested filename.

**.04** For the purposes of this Revenue Procedure, the following must be used:

Tape Mark:

**(a)** Signifies the physical end of the recording on tape.

**(b)** For even parity, use BCD configuration 001111 (8421).

**(c)** May follow the header label and precede and/or follow the trailer label.

**.05** If extraneous data follows the End of Transmission "F" Record, IRS/MCC will request a replacement file. Therefore, IRS/MCC encourages transmitters to use blank tape cartridges, rather than cartridges previously used, in the preparation of data when submitting information returns.

**.06** IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but must end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

**.07** 4mm (.157-inch) cassettes are now acceptable with the following specifications:

**(a)** 4mm cassettes will be 2 1/4-inch by 3-inch.

**(b)** The tracks are 1 (one).

**(c)** The density is 19 (61000 BPI).

**(d)** The typical capacity is DDS (DAT data storage) at 1.3 Gb (60 meter) or 2 Gb (90 meter), or DDS-2 at 4Gb (120 meter).

**(e)** The general specifications for 8mm cartridges also apply to the 4mm cassettes.

☛**Note: 4mm cassettes with a capacity of DDS-3 (125 meter) are not acceptable.**

**.08** Various Quarter-Inch Cartridges (QIC) (1/4-inch) are also acceptable.

**(a)** QIC cartridges will be 4″ by 6″ .

**(b)** QIC cartridges must meet the following specifications:

| Size | Tracks | Density | Capacity |
|---|---|---|---|
| QIC-24 | 8/9 | 5 (8000 BPI) | 45Mb or 60Mb |
| QIC-120 | 15 | 15 (10000 BPI) | 120Mb or 200Mb |
| QIC-150 | 18 | 16 (10000 BPI) | 150Mb or 250Mb |
| QIC-525 | 26 | 17 (16000 BPI) | 525Mb |
| QIC-1000 | 30 | 21 (36000 BPI) | 1Gb |
| QIC-2Gb | 42 | 34 (40640 BPI) | 2Gb |

**(c)** The general specifications that apply to 8mm cartridges also apply to QIC cartridges.

## Sec. 5. 3 1/2-Inch Diskette Specifications

**IRS/MCC has discontinued processing 5 1/4-inch diskettes. Filers must use other methods to submit Form 1042–S magnetically/electronically.**

**.01** To be compatible, a diskette file must meet the following specifications:

**(a)** 3 1/2-inches in diameter.

**(b)** Data must be recorded in standard ASCII code.

**(c)** Records must be a fixed length of 780 bytes per record.

**(d)** Delimiter character commas (,) must not be used.

**(e)** Positions 779 and 780 of each record have been reserved for use as carriage return/line feed (cr/lf) characters, if applicable.

**(f)** Filename of 1042TAX must be used. Do not enter any other data in this field. If a file will consist of more than one diskette, the filename 1042TAX will contain a three-digit extension. This extension will indicate the sequence of the diskettes within the file. For example, if the file consists of three diskettes, the first diskette will be named 1042TAX.001, the second will be 1042TAX.002, and the third will be 1042TAX.003. The first diskette, 1042TAX.001 will begin with a "T" Record and the third diskette, 1042TAX.003 will have an "F" Record at the end of the file.

**(g)** A diskette will not contain multiple files as defined in Part A, Section 17. A file may have only **ONE** Transmitter "T" Record.

**(h)** Failure to comply with instructions will result in IRS/MCC requesting a replacement file.

**(i)** Diskettes must meet one of the following specifications:

| Capacity | Tracks | Sides/Density | Sector Size |
|---|---|---|---|
| 1.44 mb | 96tpi | hd | 512 |
| 1.44 mb | 135tpi | hd | 512 |

**.02** IRS/MCC encourages transmitters to use blank or currently formatted diskettes when preparing files. If extraneous data follows the End of Transmission "F" Record, IRS/MCC will request a replacement file.

**.03** IRS/MCC will **only** accept 3 1/2-inch diskettes created using MS-DOS.

✒**Notes: IRS no longer has the capability to process non-MS-DOS compatible diskettes.**

**3 1/2-inch diskettes created on a System 36 or AS400 are not acceptable.**

**.04** Transmitters should check media for viruses before submitting it to IRS/MCC.

## Sec. 6. Transmitter "T" Record

**.01** This record identifies the entity preparing and transmitting the file. The transmitter and the withholding agent may be the same, but they need not be.

**.02** The first record of a file **MUST** be a Transmitter "T" Record (preceded only by header labels). The "T" Record must appear on each tape and cartridge; otherwise a replacement file may be requested.

**.03** The "T" Record is a fixed length of 780 positions.

**.04** All alpha characters entered in the "T" Record must be upper case.

✒**Note 1: For all fields marked Required, the transmitter must provide the information described under Description and Remarks. If required fields are not completed in accordance with these instructions, IRS will contact you to request correct information. For those fields not marked Required, a transmitter must allow for the field, but may be instructed to enter blanks or zeroes in the indicated media position(s) and for the indicated length. All records have a fixed length of 780 positions.**

✒**Note 2: A copy of the 2001 Instructions for Form 1042–S is included at the end of this publication. These instructions should be used for the proper coding of each field in this record where applicable. The Instructions are updated each year as required.**

### Record Name: Transmitter "T" Record

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 1 | Record Type | 1 | **Required.** Enter **"T".** |
| 2–5 | Tax Year | 4 | **Required**. Enter year for which income and withholding are being reported. |

## Record Name: Transmitter "T" Record (continued)

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 6–14 | Transmitter's Taxpayer Identification Number (TIN) | 9 | **Required.** Enter the Taxpayer Identification Number of the Transmitter. This can be a Social Security Number (SSN), IRS Individual Taxpayer Identification Number (ITIN), Employer Identification Number (EIN), or Qualified Intermediary Number (QI-EIN). **DO NOT ENTER blanks, hyphens or alpha characters**. A TIN consisting of all the same digits (e.g., 111111111) is not acceptable. |
| 15–54 | Transmitter Name | 40 | **Required.** Enter name of transmitter of file. Abbreviate if necessary to fit 40-character limit. Omit punctuation if possible. Left-justify and blank fill. |

☛**Note: Do not use special characters in names or addresses that are unique to a language other than English. For example, å = A, æ = A, ű = U, Ǿ = O, ň = N, etc.**

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 55–94 | Transmitter Address | 40 | **Required.** Enter full mailing address of the transmitter. This will include number, street, and apartment or suite number (P.O. Box can be used if mail is not delivered to street address). Abbreviate as needed to fit 40-character limit. Omit punctuation if possible. Left-justify and blank fill. |
| 95–114 | City | 20 | **Required**. Enter the city or town (or other locality name) of transmitter. If applicable, enter APO or FPO only. Left-justify and blank fill. |
| 115–116 | State Code | 2 | **Required if U.S. Transmitter.** Enter only the two-alpha State Code. **DO NOT spell out the state name. See State Code Table Part A, Sec. 18.** |
| 117–118 | Province Code | 2 | **Required if Foreign Country Code is "CA" (Canada).** Enter only the two-alpha character Province Code as shown in the Province Code table. **DO NOT spell out the Province Name. If foreign country other than Canada, blank fill.** |

| Province Code | Province |
|---|---|
| AB | Alberta |
| BC | British Columbia |
| LB | Labrador |
| MB | Manitoba |
| NB | New Brunswick |
| NF | Newfoundland |
| NS | Nova Scotia |
| NT | Northwest Territories |
| ON | Ontario |
| PE | Prince Edward Island |
| PQ | Quebec |
| SK | Saskatchewan |
| YK | Yukon Territory |

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 119–120 | Country Code | 2 | **Required if Foreign Transmitter. If Country Code is present, State Code field MUST be blank**. Enter only the two-alpha Country Code from the Country Code table. **DO NOT spell out the Country Name.** |

☛**Note 1: COUNTRY CODES: The list of country codes provided in the 2001 Instructions for Form 1042-S includes all internationally recognized country codes and must be used to ensure the proper coding of the Country Code field. This list is updated each year as required.**

☛**Note 2: Do not enter U.S. in the Country Code field. Enter the code for the country of which the recipient claims residency under that country's tax laws. Enter "OC" (other country) only when the country of residence does not appear on the list or the payment is made to an international organization.**

☛**Note 3: Enter "UC" (unknown country) only if the payment is to an unknown recipient. If you are making a payment to a QI or QI withholding rate pool, enter the country code of the QI.**

## Record Name: Transmitter "T" Record (continued)

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 121–129 | Postal Zip Code | 9 | **Required if U.S. address.** Enter up to nine numeric characters for all U.S. addresses (including territories, possessions and APO/FPO). **Conditional for foreign addresses.** Enter the foreign postal code. Left-justify and zero fill the remaining positions. DO NOT use hyphens. |
| 130–169 | Contact Name | 40 | **Required**. Enter the name of the person to contact if any questions should arise with the transmission. |
| 170–189 | Contact Telephone Number | 20 | **Required**. Enter the contact person's telephone number, and extension, if applicable. If foreign, provide appropriate codes for overseas calls. Left-justify. |
| 190–194 | Transmitter Control Code (TCC) | 5 | **Required.** Enter the five-character alpha/numeric TCC assigned ONLY for Form 1042–S reporting. (The first two numbers will always be **22**). |
| 195–198 | Test Indicator | 4 | **Required if this is a test file.** Enter the word "TEST". Otherwise enter blanks. |
| 199–778 | Reserved | 580 | Blank fill. |
| 779–780 | Blank or Carriage Return Line Feed | 2 | **Required.** Enter blanks or carriage return line feed (CR/LF) characters. |

## Transmitter "T" Record Layout

| Record Type | Tax Year | Transmitter's TIN | Transmitter Name | Transmitter Address | City | State Code | Province Code |
|---|---|---|---|---|---|---|---|
| 1 | 2–5 | 6–14 | 15–54 | 55–94 | 95–114 | 115–116 | 117–118 |

| Country Code | Postal Zip Code | Contact Name | Contact Telephone Number | TCC | Test Indicator | Reserved | Blank or Carriage Return Line Feed |
|---|---|---|---|---|---|---|---|
| 119–120 | 121–129 | 130–169 | 170–189 | 190–194 | 195–198 | 199–778 | 779–780 |

## Sec. 7. Withholding Agent "W" Record

**.01** The "W" Record identifies the Withholding Agent.

**.02** Enter a "W" Record after the initial "T" Record on the file followed by the Recipient "Q" Records, and a Reconciliation "C" Record.

**.03** Several "W" Records for different Withholding Agents may appear on the same Transmitter's File.

**.04** Each "W" Record is a fixed length of 780 positions.

**.05** All alpha characters entered in the "W" Record must be upper case.

☛**Note 1: For all fields marked Required, the transmitter must provide the information described under Description and Remarks. If required fields are not completed in accordance with these instructions, IRS will contact you to request correct information. For those fields not marked Required, a transmitter must allow for the field, but may be instructed to enter blanks or zeroes in the indicated media position(s) and for the indicated length. All records have a fixed length of 780 positions.**

☛**Note 2: A copy of the 2001 Instructions for Form 1042-S is included at the end of this publication. These instructions should be used for the proper coding of each field in this record where applicable. The list of country codes in the instructions includes all recognized country codes and MUST be used for coding. The instructions are updated each year as required.**

## Record Name: Withholding Agent "W" Record

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 1 | Record Type | 1 | **Required.** Enter **"W".** |
| 2 | Return Type Indicator | 1 | **Required.** Enter the one position value below to identify whether the record is Original, Void or Corrected.<br>Values are:<br>• 0 (Zero) = Original<br>• 1 = Void<br>• 2 = Corrected |
| 3 | Pro Rata Basis Reporting | 1 | **Required.** Enter the one position value below to identify if reporting on a Pro Rata Basis.<br>Values are:<br>• 0 (Zero) = Not Pro Rata<br>• 1 = Pro Rata Basis Reporting |
| 4–12 | Withholding Agent's EIN | 9 | **Required.** Enter the nine-digit Employer Identification Number of the Withholding Agent. Do **NOT** enter blanks, hyphens or alpha characters. An EIN consisting of all the same digits (e.g., 111111111) is not acceptable. Do **NOT** enter the recipient's TIN in this field. |

✒**Note: See 2001 Instructions for Form 1042–S to determine when a Qualified Intermediary must provide its QI-EIN in this field.**

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 13 | Withholding Agent's EIN Indicator | 1 | **Required.** Enter the Withholding Agent's EIN indicator from the following values:<br>• 1 = EIN<br>• 2 = QI-EIN |
| 14–53 | Withholding Agent's Name Line-1 | 40 | **Required.** Enter the Withholding Agent's Name as established when filing for the EIN or QI-EIN which appears in position 4–12 of the "W" Record. Left-justify and blank fill. |

✒**Note: Do not use special characters in names or addresses that are unique to a language other than English. For example, å = A, æ = A, ű = U, Ǿ= O, ň = N, etc.**

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 54–93 | Withholding Agent's Name Line-2 | 40 | Enter supplementary withholding agent's name information; otherwise enter blanks. Use this line for additional names (e.g., partners or joint owners), for trade names, stage names, aliases or titles. Also use this line for "care of" or "via". Valid characters are alpha, numeric, blank, ampersand (&), hyphen (-), comma (,), and the percent (%). The percent [% (used as "in care of")] is valid in the first position only. |
| 94–133 | Withholding Agent's Name Line-3 | 40 | See above. |
| 134–173 | Withholding Agent's Street Line-1 | 40 | **Required.** Enter the mailing address of the withholding agent. Street address should include number, street, and apartment or suite number (or P.O. Box if mail is not delivered to street address). Abbreviate as needed. Left-justify and blank fill. |
| 174–213 | Withholding Agent's Street Line-2 | 40 | Enter supplementary withholding agent street address information. Otherwise blank fill. |
| 214–253 | Withholding Agent's City | 40 | **Required.** Enter the city or town (or other locality name). Enter APO or FPO only if applicable. Left-justify and blank fill. |
| 254–255 | Withholding Agent's State Code | 2 | **Required if U.S. Withholding Agent.** Enter the two-character State Code abbreviation. If not a U.S. state, territory or APO/FPO identifiers, blank fill. **Do not use any of the two character Country Codes in the State Code Field.** |

## Record Name: Withholding Agent “W” Record (continued)

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 256–257 | Withholding Agent’s Province Code | 2 | **Required if Foreign Country Code is “CA” (Canada).** Enter only the two-alpha character Province Code as shown in the Province Code Table. See “T” record positions 117–118 for Province Code Table. **DO NOT spell out the Province Name. If foreign country other than Canada, blank fill.** |
| 258–259 | Withholding Agent’s Country Code | 2 | Enter only the two-alpha Country Code from the Country Code Table. **DO NOT spell out the Country Name.** |

**☞Note 1: COUNTRY CODES: The list of country codes provided in the 2001 Instructions for Form 1042–S includes all internationally recognized country codes and MUST be used to ensure the proper coding of the Country Code field. This list is updated each year as required.**

**☞Note 2: Do not enter U.S. in the Country Code field. Enter the code for the country of which the recipient claims residency under that country’s tax laws. Enter “OC” (other country) only when the country of residence does not appear on the list or the payment is made to an international organization.**

**☞Note 3: Enter “UC” (unknown country) only if the payment is to an unknown recipient. If you are making a payment to a QI or QI withholding rate pool, enter the country code of the QI.**

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 260–268 | Postal Zip Code | 9 | **Required if U.S. address.** Enter up to nine numeric characters for all U.S. addresses (including territories, possessions and APO/FPO). **Conditional for foreign addresses**. Enter the foreign postal code. Left-justify and zero fill the remaining positions. DO NOT use hyphens. |
| 269–272 | Tax Year | 4 | **Required.** Enter the four-digit year of the calendar year for which income and withholding are being reported. All recipient “Q” Records must report payments for this year only. Different tax years may not appear on the same file. |
| 273–292 | Withholding Agent’s Phone Number and Extension | 20 | **Required.** Enter the Withholding Agent’s telephone number and extension, if applicable. If foreign, provide appropriate codes for overseas call. Left-justify. |
| 293 | Final Return Indicator | 1 | **Required.** Enter the one position value below to indicate whether you will be filing Forms 1042–S in the future.<br>• 0 (Zero) = will be filing<br>• 1 = will not be filing |
| 294–778 | Reserved | 485 | Blank fill. |
| 779–780 | Blank or Carriage Return Line Feed | 2 | **Required.** Enter blanks or carriage return line feed characters (CR/LF). |

## Withholding Agent “W” Record Layout

| Record Type | Return Type Indicator | Pro Rata Basis Reporting | Withholding Agent’s EIN | Withholding Agent’s EIN Indicator | Withholding Agent’s Name Line 1 | Withholding Agent’s Name Line 2 |
|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4–12 | 13 | 14–53 | 54–93 |

| Withholding Agent’s Name Line 3 | Withholding Agent’s Street-1 | Withholding Agent’s Street-2 | Withholding Agent’s City | Withholding Agent’s State Code | Withholding Agent’s Province Code | Withholding Agent’s Country Code |
|---|---|---|---|---|---|---|
| 94–133 | 134–173 | 174–213 | 214–253 | 254–255 | 256–257 | 258–259 |

### Withholding Agent "W" Record Layout (continued)

| Postal Zip Code | Tax Year | Withholding Agent's Phone Number and Extension | Final Return Indicator | Reserved | Blank or Carriage Return Line Feed |
|---|---|---|---|---|---|
| 260–268 | 269–272 | 273–292 | 293 | 294–778 | 779–780 |

## Sec. 8. Recipient "Q" Record

**.01** The "Q" Record contains name and address information for the Recipient of Income, Non-Qualified Intermediary or Flow-Through Entity if appropriate, Payer, and all data concerning the income paid and tax withheld that is required to be reported under U.S. law. Each Recipient "Q" Record is treated as if it were a separate Form 1042–S.

**.02** Since the "Q" Record is restricted to one type of income and one tax rate, under certain circumstances it may be necessary to write more than one "Q" Record for the same recipient. Failure to provide multiple Recipient "Q" Records when necessary will generate math computation errors during processing. This will result in IRS contacting you for correct information.

**.03** Following are some of the circumstances when more than one "Q" Record for a recipient would be required:

**(a)** Different types of income. For example, Recipient X derived income from Capital Gains (Income Code 09) and Industrial Royalties (Income Code 10). A separate "Q" Record must be reported for each Income Code, providing Gross Income Paid and U.S. Federal Tax Withheld pertaining to that Income Code.

**(b)** Change in Country Code during the year. For example, the Withholding Agent received notification via Form W–8BEN that the recipient's country of residence for tax purposes changed from country X to country Y. A separate "Q" Record must be reported for each Country Code providing Gross Income Paid, Tax Rate, U.S. Federal Tax Withheld and Exemption Code, if any. The amounts reported must be based on each country.

**(c)** Change in a country's tax treaty rate during the year. For example, effective April 1, country X changes its tax treaty rate from 10% to 20%. A separate "Q" Record must be reported for each of the tax rates. Provide the Gross Income Paid, Tax Rate, and U.S. Federal Tax Withheld under each tax rate.

**.04** All recipient "Q" Records for a particular Withholding Agent must be written after the corresponding Withholding Agent "W" Record, followed by a Reconciliation "C" Record, and before the "W" Record for another Withholding Agent begins.

**.05** All alpha characters entered in the "Q" Record must be upper case.

**.06** Report income and tax withheld in whole dollars only. Round up or down as appropriate. **DO NOT** enter cents.

**✒Note 1: For all fields marked Required, the transmitter must provide the information described under Description and Remarks. If required fields are not completed in accordance with these instructions, IRS will contact you to request the correct information. For those fields not marked Required, a transmitter must allow for the field, but may be instructed to enter blanks or zeroes in the indicated media position(s) and for the indicated length. All records have a fixed length of 780 positions.**

**✒Note 2: A copy of the 2001 Instructions for Form 1042–S is included at the end of this publication. These instructions should be used for the proper coding of each field in this record where applicable. The list of country codes in the instructions includes all recognized country codes and MUST be used for coding. The instructions are updated each year as required.**

### Record Name: Recipient "Q" Record

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 1 | Record Type | 1 | **Required.** Enter **"Q"**. |
| 2 | Return Type Indicator | 1 | **Required.** Enter the one position value below to identify whether the record is Original, Void, or Corrected. Values are:<br>• 0 (Zero) = Original<br>• 1 = Void<br>• 2 = Corrected |
| 3 | Pro Rata Basis Reporting | 1 | **Required.** Enter the one position value below to identify whether reporting Pro Rata Basis.<br>Values are:<br>• 0 (Zero) = Not Pro Rata<br>• 1 = Pro Rata Basis Reporting |

## Record Name: Recipient "Q" Record (continued)

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 4–5 | Income Code | 2 | **Required.** Enter the two-position value EXACTLY as it appears from the income code table. The Income Code must accurately reflect the type of income paid. DO NOT enter blanks or 00 (zeroes). |
| **☛Note: The Income Code list has been expanded for TY2001. Refer to the 2001 Instructions for Form 1042–S for more information.** | | | |
| 6–17 | Gross Income | 12 | **Required.** Enter the gross income amount in whole dollars only (do not enter cents). An income amount of zero cannot be shown. Right-justify. |
| 18–29 | Withholding Allowance | 12 | **Used with Income Code 15 or 16 ONLY.** Enter the withholding allowance amount in whole dollars only (do not enter cents). Right-justify and zero fill. Otherwise enter blanks. |
| 30–41 | Net Income | 12 | **Required if Dollar Amount is Entered in Withholding Allowance Field**. Enter the net income in whole dollars only (do not enter cents). An amount other than zero **must** be shown. Right-justify and zero fill. Otherwise enter blanks. |
| 42–45 | Tax Rate | 4 | **Required.** Enter the correct Tax Rate applicable to the income in gross income field or net income field, as appropriate. Enter the Tax Rate as a 2-digit whole number and 2-digit decimal (e.g. Enter 39.6% as 3960). See Note below. |
| **☛Note: The correct Tax Rate must be entered, even if withholding was at a lesser rate. See the 2001 Instructions for Form 1042–S.** | | | |
| 46–47 | Exemption Code | 2 | **Required.**<br>• If the tax rate entered is 0%, enter the appropriate exemption code "01" through "09" from the 2001 Instructions for Form 1042–S.<br>• If the tax rate entered is 1% through 30%, enter "00".<br>• If the tax rate entered is 31% or higher, blank fill. DO NOT enter "00".<br>See the 2001 Instructions for Form 1042–S for circumstances under which Exemption Code "99" must be used. |
| **☛Note: If an incorrect amount of tax was withheld, report the amount that was actually withheld and use the correct tax treaty rate in field positions 42–45.** | | | |
| 48–59 | U. S. Tax Withheld | 12 | **Required.** Enter the U.S. Federal tax withheld amount in whole dollars only (do not enter cents). Right-justify and zero fill. |
| 60–71 | Amount Repaid | 12 | This field should be completed only if:<br>• you repaid a recipient an amount that was over-withheld and you are going to reimburse yourself by reducing, by the amount of tax actually repaid, the amount of any deposit made for a payment period in the calendar year following calendar year of withholding. |
| 72–91 | Recipient Account Number | 20 | Enter the account number assigned by the withholding agent to the recipient. Do not enter the recipient's U.S. or foreign TIN. If account numbers are NOT assigned, then blank fill. This field may contain numeric, alpha characters, blanks or hyphens. Left-justify and blank fill. |
| 92–93 | Recipient Code | 2 | **Required.** Enter the appropriate Recipient Code. Refer to the expanded list of appropriate codes in the 2001 Instructions for Form 1042–S. No other codes or values are valid. |
| 94–133 | Recipient's Name Line-1 | 40 | **Required.** Provide the complete name of the recipient. If the recipient has a U.S. TIN, enter the name as established when applying for the TIN. See 2001 Instructions for Form 1042–S for specifics on "Unknown Recipient" and "Withholding Rate Pool". Valid characters are alpha, numeric, ampersand (&), hyphen (-), comma (,), or blank. Left-justify and blank fill. |

## Record Name: Recipient "Q" Record (continued)

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|

☛**Note 1: A Non-Qualified Intermediary (NQI) can NEVER be entered as the recipient.**

☛**Note 2: Do not use special characters in names or addresses that are unique to a language other than English. For example, å = A, æ = A, ű = U, Ǿ= O, ň = N, etc.**

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 134–173 | Recipient's Name Line-2 | 40 | Enter supplementary recipient name information including titles; otherwise enter blanks. Use this line for additional names (e.g., partners or joint owners), for trade names, stage names, aliases or titles. Also use this line for "care of" or "via". Valid characters are alpha, numeric, blank, ampersand (&), hyphen (-), comma (,), and the percent (%). The percent [% (use as "in care of")] is valid in the first position only. |
| 174–213 | Recipient's Name Line-3 | 40 | See above. |
| 214–253 | Recipient's Street Line-1 | 40 | **Required.** Enter the mailing address of the recipient. Street address should include number, street, apartment, or suite number (or P.O. Box if mail is not delivered to street address). Abbreviate as needed. Left-justify and blank fill. |
| 254–293 | Recipient's Street Line-2 | 40 | Enter supplementary recipient street address information; otherwise blank fill. |
| 294–333 | Recipient's City | 40 | **Required.** Enter the city or town (or other locality name). Enter APO or FPO only, if applicable. Left-justify and blank fill. |
| 334–335 | Recipient's State | 2 | **Required if U.S. address.** Enter the two-character State Code abbreviation. If no U.S. state, territory or APO/FPO identifier is applicable then blank fill. **Do not use any of the two-character Country Codes in the State Code Field.** |
| 336–337 | Recipient's Province Code | 2 | **Required if Foreign Country Code is "CA" (Canada).** Enter only the two-alpha character Province Code as shown in the Province Code Table. See "T" record positions 117–118 for Province Code Table. **DO NOT spell out the Province Name. If foreign country other than Canada, blank fill.** |
| 338–339 | Recipient's Country Code | 2 | **Required.** Enter the two-character Country Code abbreviation, if applicable. |
| 340–348 | Postal Zip Code | 9 | Enter up to nine numeric characters for all U.S. addresses (including territories, possessions and APO/FPO). For foreign addresses, enter the foreign postal code. Enter this code in the left most position and zero fill the remaining positions. **DO NOT** use hyphens. Left-Justify. |

☛**Note 1: COUNTRY CODES: The list of country codes provided in the 2001 Instructions for Form 1042–S includes all internationally recognized country codes and MUST be used to ensure the proper coding of the Country Code field. This list is updated each year as required.**

☛**Note 2: Do not enter U.S. in the Country Code field. Enter the code for the country of which the recipient claims residency under that country's tax laws. Enter "OC" (other country) <u>only</u> when the country of residence does not appear on the list or the payment is made to an international organization.**

☛**Note 3: Enter "UC" (unknown country) <u>only</u> if the payment is to an unknown recipient. If you are making a payment to a QI or QI withholding rate pool, enter the country code of the QI.**

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 349–357 | Recipient's U.S. TIN | 9 | **Required.** Enter the recipient's nine-digit U.S. Taxpayer Identification Number (TIN). **DO NOT** enter hyphens or alpha characters. If TIN is not required under regulations, blank fill. |

☛**Note: U.S. TINs are now required for most recipients. See 2001 Instructions for Form 1042–S.**

## Record Name: Recipient "Q" Record (continued)

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 358 | Recipient's U.S. TIN Type | 1 | **Required.** Enter the recipient's U.S. TIN type indicator from the following values:<br>• 1 = SSN/ITIN<br>• 2 = EIN<br>• 3 = QI-EIN<br>See 2001 Instructions for Form 1042–S for exceptions. |
| 359–398 | Recipient's Country of Residence for Tax Purposes | 40 | **Required.** Enter the complete name of the recipient's country of residence for tax purposes in which the recipient claims residency under that country's tax law. |
| 399–400 | Recipient's Country of Residence Code for Tax Purposes | 2 | **Required.** Enter the two-character Country Code for which the recipient is a resident for tax purposes and on which the tax treaty benefits are based. The rate of tax withheld is determined by this code. |
| 401–440 | NQI/FLW-THR Name Line-1 | 40 | Provide the complete name of the NQI/FLW-THR Entity. It is very important that the complete name of the NQI/FLW-THR entity be provided. Valid characters are alpha, numeric, ampersand (&), hyphen (-), comma (,), or blank. Left-justify and blank fill. **See note below**. |
| 441–480 | NQI FLW-THR Name Line-2 | 40 | Enter supplementary information; otherwise enter blanks. Use this line for additional names (e.g., partners or joint owners), for trade names, stage names, aliases or titles. Also use this line for "care of" or "via". Valid characters are alpha, numeric, blank, ampersand (&), hyphen (-), comma (,), and the percent (%). The percent [% (used as "in care of")] is valid in the first position only. |
| 481–520 | NQI/FLW-THR Name Line-3 | 40 | See above. |
| 521–522 | Reserved | 2 | Enter blanks. |
| 523–562 | NQI/FLW-THR Street Line 1 | 40 | Enter the mailing address of the NQI/FLW-THR entity. Street address should include number, street, apartment, or suite number (or P.O. Box if mail is not delivered to street address). Abbreviate as needed. Left-justify and blank fill. |
| 563–602 | NQI/FLW-THR Street Line 2 | 40 | Enter supplementary NQI/FLW-THR entity street address information; otherwise; blank fill. |
| 603–642 | NQI/FLW-THR City | 40 | Enter the city or town (or other locality name). Left-justify and blank fill. |
| 643–644 | Reserved | 2 | Enter blanks. |
| 645–646 | NQI/FLW-THR Province Code | 2 | Enter the two-alpha character Province Code abbreviation, if applicable. See "T" record positions 117–118. |
| 647–648 | NQI/FLW-THR Country Code | 2 | Enter the two-character Country Code abbreviation, where the NQI/FLW-THR is located. |
| 649–657 | NQI/FLW-THR Postal Code | 9 | Enter up to nine numeric characters for all U.S. addresses (including territories and possessions). Left-justify and zero fill. |
| 658–666 | NQI/FLW-THR U.S. TIN | 9 | Enter the NQI/FLW-THR nine-digit U.S. Taxpayer Identification Number (TIN). Do NOT enter hyphens or alpha characters. |

✒**Note: All NQI/FLW-THR fields are REQUIRED if the NQI/FLW-THR entity is involved in the payment structure.**

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 667–706 | Payer's Name | 40 | Enter the name of the Payer of Income if different from the Withholding Agent. Abbreviate as needed. If Withholding Agent and Payer are the same, blank fill. |

| Record Name: Recipient "Q" Record (continued) | | | |
|---|---|---|---|
| **Field Positions** | **Field Title** | **Length** | **Description and Remarks** |
| 707–715 | Payer's U.S. TIN | 9 | Enter the Payer's U.S. Taxpayer Identification Number if there is an entry in the Payer Name Field; otherwise leave blank. |
| 716–727 | State Income Tax Withheld | 12 | If State Tax has been withheld, enter that amount, in whole dollars (do not enter cents). Right-justify and zero fill. If no entry, zero fill. |
| 728–737 | Payer's State Tax Number | 10 | Enter the employer's state I.D. number assigned by the state. |
| 738–739 | State Code | 2 | Enter the two-character State Code abbreviation. |
| 740–760 | Special Data Entries | 21 | This field may be used for the filer's own purposes, (e.g., Do Not Mail). If this field is not used, enter blanks. |
| 761–778 | Reserved | 18 | Enter blanks. |
| 779–780 | Blank or Carriage Return Line Feed | 2 | Enter blanks or carriage return line feed (CR/LF) characters. |

## Recipient "Q" Record Layout

| Record Type | Return Type Indicator | Pro Rata Basis Reporting | Income Code | Gross Income | Withholding Allowance | Net Income | Tax Rate | Exemption Code |
|---|---|---|---|---|---|---|---|---|
| 1 | 2 | 3 | 4–5 | 6–17 | 18–29 | 30–41 | 42–45 | 46–47 |

| U.S. Tax Withheld | Amount Repaid | Recipient Account Number | Recipient Code | Recipient's Name Line 1 | Recipient's Name Line 2 | Recipient's Name Line 3 | Recipient's Street Line 1 |
|---|---|---|---|---|---|---|---|
| 48–59 | 60–71 | 72–91 | 92–93 | 94–133 | 134–173 | 174–213 | 214–253 |

| Recipient's Street Line 2 | Recipient's City | Recipient's State | Recipient's Province Code | Recipient's Country Code | Postal Zip Code | Recipient's U. S. TIN | Recipient's U. S. TIN Type |
|---|---|---|---|---|---|---|---|
| 254–293 | 294–333 | 334–335 | 336–337 | 338–339 | 340–348 | 349–357 | 358 |

| Recipient's Country of Residence for Tax Purposes | Recipient's Country of Residence Code for Tax Purposes | NQI/FLW-THR Name Line 1 | NQI/FLW-THR Name Line 2 | NQI/FLW-THR Name Line 3 | Reserved |
|---|---|---|---|---|---|
| 359–398 | 399–400 | 401–440 | 441–480 | 481–520 | 521–522 |

| NQI/FLW-THR Street Line 1 | NQI/FLW-THR Street Line 2 | NQI/FLW-THR City | Reserved | NQI/FLW-THR Province Code |
|---|---|---|---|---|
| 523–562 | 563–602 | 603–642 | 643–644 | 645–646 |

### Recipient "Q" Record Layout (continued)

| NQI/FLW-THR Country Code | NQI/FLW-THR Postal Code | NQI/FLW-THR U.S. TIN | Payer's Name | Payer's U.S. TIN | State Income Tax Withheld | Payer's State Tax Number |
|---|---|---|---|---|---|---|
| 647–648 | 649–657 | 658–666 | 667–706 | 707–715 | 716–727 | 728–737 |

| State Code | Special Data Entries | Reserved | Blank or Carriage Return Line Feed |
|---|---|---|---|
| 738–739 | 740–760 | 761–778 | 779–780 |

## Sec. 9. Reconciliation "C" Record

**.01** The "C" Record is a fixed record length of 780 positions and all positions listed are required. The "C" Record is a summary of the number of "Q" Records for each Withholding Agent, Gross Amount Paid, and Total U.S. Tax Withheld.

**.02** This record will be written after the last "Q" Record filed for a given withholding agent. For each "W" Record and group of "Q" Records on the file, there must be a corresponding "C" Record.

**.03** All alpha characters entered in the "C" Record must be upper case.

### Record Name: Reconciliation "C" Record

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 1 | Record Type | 1 | **Required.** Enter "C". |
| 2–9 | Total "Q" Records | 8 | **Required.** Enter the total number of "Q" Records for this withholding agent. |
| 10–15 | Blank | 6 | Enter blanks. |
| 16–30 | Total Gross Amount Paid | 15 | **Required.** Enter the total gross income amount in whole dollars (do not enter cents). An income amount other than zero must be shown. Right-justify and zero fill. |
| 31–45 | Total U. S. Tax Withheld | 15 | **Required.** Enter the total U.S. Federal tax withheld amount in whole dollars (do not enter cents). Right-justify and zero fill. |
| 46–778 | Reserved | 733 | Blank fill. |
| 779–780 | Blank or Carriage Return Line Feed | 2 | Enter blanks or carriage return line feed (CR/LF) characters. |

### Reconciliation "C" Record Layout

| Record Type | Total "Q" Records | Blank | Total Gross Amount Paid | Total U. S. Tax Withheld | Reserved | Blank or Carriage Return Line Feed |
|---|---|---|---|---|---|---|
| 1 | 2–9 | 10–15 | 16–30 | 31–45 | 46–778 | 779–780 |

## Sec. 10. End of Transmission "F" Record

**.01** The "F" Record is a fixed record length of 780 positions and all positions listed are required. The "F" Record is a summary of the number of withholding agents and media count in the entire file.

**.02** This record will be written after the last "C" Record of the entire file. End the file with an End of Transmission "F" Record. Only a "C" Record may precede the "F" Record. The "F" Record may only be followed by a tape mark, a trailer label or a combination of both.

**.03** All alpha characters entered in the "F" Record must be upper case.

| Record Name: End of Transmission "F" Record | | | |
|---|---|---|---|
| **Field Positions** | **Field Title** | **Length** | **Description and Remarks** |
| 1 | Record Type | 1 | **Required.** Enter "F". |
| 2–4 | Withholding Agent Count | 3 | **Required.** Enter the total number of withholding agents on this file. This count must be the same as the total number of "W" records. Right-justify and zero fill. |
| 5–7 | Media Count | 3 | **Required.** Enter the total number of media for this transmission. Right-justify and zero fill. |
| 8–778 | Reserved | 771 | Blank fill. |
| 779–780 | Blank or Carriage Return Line Feed | 2 | **Required.** Enter blanks or carriage return line feed characters (CR/LF). |

## End of Transmission "F" Record Layout

| Record Type | Withholding Agent Count | Media Count | Reserved | Blank or Carriage Return Line Feed |
|---|---|---|---|---|
| 1 | 2–4 | 5–7 | 8–778 | 779–780 |

# Part C. Electronic Filing Specifications

## Sec. 1. Background

**01.** All electronic filing of information returns are received at IRS/MCC via the FIRE (Filing Information Returns Electronically) System. The FIRE System can be accessed via analog and ISDN BRI connections. The system is designed to support the electronic filing of information returns only. The telephone number for electronic filing is **(304-262-2400)**. Publications and forms are no longer available electronically from MCC. Users needing publications and forms will need to download them from the IRS Web Site at www.irs.gov or order them by calling 1-800-TAX-FORM (1-800-829-3676). IRS/MCC encourages the sending of test files, especially when extensive changes have occurred in processing procedures, format, or if you have never filed electronically. See Sec. 5 for testing procedures.

## Sec. 2. Advantages of Filing Electronically

Some of the advantages of filing electronically are as follows:

**(1)** Acknowledgment of files received.
**(2)** Results generally available within 20 workdays as to the acceptability of the data transmitted.
**(3)** Better customer service due to on-line availability of transmitter's files for research purposes.

## Sec. 3. General

**.01** Electronic filing of Form 1042–S, originals, corrections, and replacements of information returns is offered as an alternative to magnetic media (tape, tape cartridge, or diskette) or paper filing, but is not a requirement. Transmitters filing electronically will fulfill the magnetic media requirements for those withholding agents who are required to file magnetically. It may also be used by withholding agents who are under the filing threshold requirement, but would prefer to file their information returns electronically. If the original file was sent magnetically, but IRS/MCC requested a replacement file, the replacement may be transmitted electronically. Also, if the original file was submitted via magnetic media, any corrections may be transmitted electronically.

**.02** Files submitted to IRS/MCC electronically must be in standard ASCII code. No magnetic media or paper forms are to be submitted with the same information as the electronically submitted file.

**.03** If a request for an extension is approved, transmitters who file electronically will be granted an extension of time to file. Part A, Sec. 11, explains procedures for requesting extensions of time. Filers are encouraged to file their data as soon as possible.

**.04** The formats of the "T", "W", "Q", "C", and "F" Records are the same for electronically filed records as they are for magnetic media, and must be in standard ASCII code. For electronically filed documents, each transmission is considered a separate file; therefore, each transmission **must** begin with a Transmitter "T" Record and end with an End of Transmission (EOT) "F" Record.

## Sec. 4. Electronic Filing Approval Procedure

**.01** Filers must obtain, or already have, a Transmitter Control Code (TCC) assigned before submitting their files electronically. (Filers who currently have a TCC for magnetic media filing of Form 1042–S, beginning with "22", will not be assigned a second TCC for electronic filing.) Refer to Part A, Sec. 7, for information on how to obtain a TCC.

**.02** Once a TCC is obtained, electronic filers assign their own logon name, password and PIN (Personal Identification Number) and do not need prior or special approval. See Part C, Sec. 7.

**.03** For all passwords, it is the user's responsibility to remember the password and not allow the password to be compromised. Passwords are user assigned at first logon and are up to 8 alpha/numerics, which are case sensitive. However, if filers forget their password or *PIN*, call **304-263-8700** for assistance. The FIRE System requires users to change their passwords on a yearly basis.

☞**Note: Passwords are case sensitive.**

## Sec. 5. Test Files

**.01** Filers are not required to submit a test file; however, the submission of a test file is encouraged for all *new electronic filers to test hardware and software.* If filers wish to submit an electronic test file for Tax Year *2001* (returns to be filed in *2002*), it **must** be submitted to IRS/MCC **no earlier than** December 1, 2001, and **no later than** February 15, 2002.

**.02** If a filer encounters problems while transmitting the electronic test file, contact IRS/MCC for assistance.

**.03** Filers can verify the status of the transmitted test data by connecting to the electronic filing system at **304-262-2400**. This information will be available within 20 workdays after the transmission is received by IRS/MCC.

**.04** Form 4804 is no longer required for test files submitted electronically. See Part C, Sec. 7.

## Sec. 6. Electronic Submissions

**.01** Electronically filed information may be submitted to IRS/MCC 24 hours a day, 7 days a week. Technical assistance will be available Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern time by calling **304-263-8700**.

**.02 The FIRE System will be down from December 29, 2001, through January 7, 2002.** This allows IRS/MCC to update its system to reflect current year changes.

**.03** Data compression is encouraged when submitting information returns electronically. WinZip and PKZip are acceptable compression packages. UNIX COMPRESS may be acceptable; however, a test file is recommended to verify compatibility. IRS/MCC cannot accept self-extracting zip files or compressed files containing multiple files.

The time required to transmit information returns electronically will vary depending on the modem speed and the type of data compression used, if any. The time required to transmit a file can be reduced by as much as 95 percent by using software compression and hardware compression.

The following are transmission rates achieved in test uploads at MCC using compressed files. The transmission rates will vary depending on the modem speeds.

| Transmission Speed in bps | 1,000 Records | 10,000 Records | 100,000 Records |
|---|---|---|---|
| 19.2K | 34 Sec. | 6 Min. | 60 Min. |
| 56K | 20 Sec. | 3 1/2 Min. | 33 Min. |
| 128K (ISDN) | 8 Sec. | 1 Min. | 10 Min. |

**.04** Files submitted electronically will be assigned a unique filename by the *FIRE* System (the users may name files anything they choose from their end). The filename *assigned by the FIRE System* will consist of submission type [TEST, ORIG (original), CORR (correction), and REPL (replacement)], the filer's TCC and a four-digit number sequence. The sequence number will be incremented for every file sent. For example, if it is your first original file for the calendar year and your TCC is 22000, the IRS assigned filename would be ORIG.22000.0001. Record the filename.

**.05** If a file was submitted timely and is bad, the filer will receive a letter and listing detailing the reasons a replacement file is needed. The filer will have up to 45 days to transmit the first replacement file, and 30 days thereafter, if additional replacements are necessary.

**.06 Filers are advised not to resubmit an entire file if records were omitted from the original transmission. This will result in duplicate filing. A new file should be sent consisting of only those records that had not previously been submitted.**

**.07** The TCC (beginning with the numbers "22") in the Transmitter "T" Record must be the TCC used to transmit the file; otherwise, the file will be considered an error.

## Sec. 7. PIN Requirements

**.01** The Form 4804 is not required for electronic files. All new users will be prompted to create a PIN consisting of ten numerics when they are establishing their initial logon name and password effective 1/1/2002. All users having existing accounts will be prompted for a PIN assignment the first time they logon after 12/31/2001.

**.02** The PIN is required each time you send us a file electronically and is your permission to release the file. If you forget your PIN, please call us at 304-263-8700.

**.03** If the file is good, it is released for mainline processing 20 calendar days from receipt. You may contact us at 304-263-8700 within this 20-day period if there is some reason the file should not be released for further processing. If the file is bad, normal replacement procedures are followed.

## Sec. 8. Electronic Filing Specifications

**.01** The FIRE System is designed exclusively for the filing of Forms 1042–S, 1098, 1099, 5498, 8027, W-2G and W-4.

**.02** A transmitter must have a TCC before a file can be transmitted. A TCC assigned for magnetic media filing that begins with the numbers "22" should also be used for electronic filing.

**.03** The results of the electronic transmission will be available in the File Status area of the FIRE System within 20 workdays. It is the filer's responsibility to dial back to verify the acceptability of files submitted by checking the File Status area of the system. These reports will be available on the electronic system in 20 workdays after the transmission is received by IRS/MCC.

**.04** Connect to the FIRE System by dialing **304-262-2400.** This number supports analog connections from 1200bps to 56Kbps or ISDN BRI 128Kbps. The system can be accessed via Dial-up network/web browser *(see Part C, Sec. 9)* or communications software *(see Part C, Sec. 10)*. The Dial-up network/web browser (point-to-point) will provide an Internet-like look, however, it is not the Internet. If you do not have this capability, a text interface is provided that can be accessed via communication software such as Hyperterminal, Procomm, PCAnywhere, etc.

## Sec. 9. Dial-up Network/Browser Specifications (Web Interface)

**.01** The following are some general instructions (many of these may already be set by default in your software):

Dial-up network settings:

**(a)** Set dial-up server type to PPP
**(b)** Set network protocol to TCP/IP
**(c)** Disable software compression
**(d)** Disable PPP-LCP extensions

Browser settings:

**(a)** Browser must be capable of file uploads (i.e., Internet Explorer 4.0, Netscape 2.0 or higher)
**(b)** Enter the **URL** address of **http://10.225.224.2** after you have connected via dial-up. (Remember, this is a point-to-point connection, not the Internet.)

**.02** Due to the large number of communication products available, it is impossible to provide specific information on all software/hardware configurations. However, since most filers use Windows 95, 98, NT, 2000, or ME software or more current versions, the following instructions are geared toward those products:

**UPLOADING FILES WITH DIAL-UP NETWORKING/WEB BROWSER IN WINDOWS 95/98/NT/2000/ME**

**Tips**

(1) This is a point-to-point connection – not the Internet.
(2) Your browser must be capable of file uploads, i.e., Internet Explorer 4.0 or Netscape Navigator 2.0 or higher.
(3) If you currently access the Internet via a LAN or a PROXY server, you will need to disable those options in your browser and enable 'Connect to the Internet using a modem'.

Select **Programs**
**Accessories**
**Communications** (Windows 98)
**Dial-Up Networking**

<u>**First time connecting with Dial-Up Network**</u> (If you have logged on previously, skip to Subsequent Dial-up Network Connections.)

**The first time you dial-in, you will need to configure your Dial-Up Networking.**

Select **'Make new connection'**.
Type a descriptive name for the system you are calling.

Select your modem.
Click **'Next'**.
Enter area code **304** and telephone number **262-2400**.
Click **'Next'**.
When you receive a message that, you have successfully created a new Dial-Up Networking connection, click **'Finish'**.
Click **'Connect'** to dial. If you are prompted for a user name and password, complete according to local procedures; otherwise, click **'OK'**.
When you receive the message that you have connected to our system, click on your Web Browser **(remember, it is not connecting via the Internet – this is a point-to-point connection).**
In the URL Address enter **http://10.225.224.2** and press **ENTER**.

**<u>Subsequent Dial-Up Network connections</u>**

Click **'Connect'**.
If prompted for user name and password, complete according to local procedures; otherwise, click **'OK'**.
When you receive 'Connection Complete', click **'OK'**.
Click on your Web Browser **(remember, you are not connecting via the Internet)**.
In the URL Address enter **http://10.225.224.2** and press **ENTER**.

**<u>First time connection to the FIRE System</u>** (If you have logged on previously, skip to Subsequent Connections to the FIRE System.)

Click **'Create New Account'**.
Fill out the registration form and click **'Create'**.
Enter your **logon name** (most users logon with their first and last name).
Enter your **password** (the password is user assigned and is case sensitive).
Click **'Create'**.
If you receive the message 'account created', click **'OK'**.
Click **'Start the Fire Application'.**

**<u>Subsequent connections to the FIRE System</u>**

Click **'Log On'**.
Enter your **logon name** (most users logon with their first and last name).
Enter your **password** (the password is user assigned and is case sensitive).

At Menu Options:
Click **'Information Returns'**
Enter your **TCC:**
Enter your **EIN:**
Click **'Submit'**.

The system will then display the company name, address, city, state, ZIP code, contact and telephone number. This information will be used to contact or send any correspondence regarding this transmission. Update as appropriate and/or click **'Accept'**.

Click one of the following:
**Original File**
**Correction File**
**Test File**
**Replacement File** (if you select this option, select one of the following):
**FIRE Replacement** (file was originally transmitted on this system)
Click file to be replaced

**or**

**Magnetic Media Replacement File**
Enter the alpha character from Form 9267, Media Tracking Slip, that was returned with the correspondence requesting a replacement file.
Click **'Submit'**.

Enter the **drive/path/filename** of the file you want to upload or click **'Browse'** to locate the file.
Click **'Upload'**.

**When the upload is complete, the screen will display the total bytes received and the IRS assigned file name.**

If you have more files to upload for that TCC:
Click **'File Another'**; otherwise,
Click **'Back to Main Menu'**.

**It is your responsibility to check the acceptability of your file; therefore, be sure to dial back into the system in 20 business days.**

To check the acceptability of a previously submitted file:

At the Main Menu:
Click **'File Stats'**.
Enter your **TCC:**
Enter your **EIN:**
Click **'Search'**.

If 'Results' indicate:

**'File Good'** and you agree with the 'Count of Payees', you are finished with this file. (If you do not want the file processed, you must contact IRS/MCC within 10 days.)

**'File Bad'** - Correct the errors and resubmit the file as a 'replacement'.

**'Not Yet Processed'** - File has been received, but we do not have results available yet. Please check back in a few days.

Click on the desired file for a detailed report of your transmission.
When finished viewing your files, click on '**Main Menu**'.
Click **'Log Off'**.
Close your Web Browser.

**IMPORTANT**
**Go back into your Dial-Up Network and click 'hang-up'; otherwise, you may stay connected and incur unnecessary telephone charges.**

## Sec. 10. Communication Software Specifications (Text Interface)

**.01** Communications software settings must be:
- No parity
- Eight data bits
- One stop bit

**.02** Terminal Emulation must be VT100.

**.03** Due to the large number of communication products available, it is impossible to provide specific information on all software/hardware configurations. However, since most of our filers use Windows 95, 98 or NT software, the following instructions are geared toward those products (Procomm, PCAnywhere and many other communications packages are also acceptable and the product does not necessarily need to be Windows based.):

**Uploading Files Using Hyperterminal in Windows 95, 98 or NT**

Select **Programs**
**Accessories**
**Communications** (Windows 98)
**Hyperterminal**

The first time you log on, select **Hyperterminal**, **Hyperterm,** or **Hyperterm.exe**, whichever is available on your system. Thereafter, you can just select the icon that you have saved.

A box will appear titled **'Connection Description'**.
**Enter a name and choose an icon** for the connection:
Country Code: United States of America
Area Code: **304**
Phone Number: **262-2400**

**Connect Using: (default)**
(If you need to modify the phone number, select **File,** then **Properties** to enter defaults for the area code, phone numbers, and/or special access codes.)

Click on **'Dial'**.

A ‘Connect’ box will appear to show the status.

Once you have connected to the FIRE System, if you do not get a menu within a few seconds, press the **ENTER** key one time.

**First Time Logon**

When you have connected to the system, enter ‘**new**’ to create your logon name and password.
Complete the registration information and enter ‘**y**’ to create account.

**Logon Name and Password**

**Logon Name**: Enter a logon name. Most users enter their first and last name as the logon name.
**Password**: Enter a password of your choosing (1-8 alpha/numerics - case sensitive).
After entering the password, you will go to the Main Menu.

**Transferring Your Electronic File**

Enter ‘**A**’ for Electronic Filing.
After reading Information Notice, press **ENTER**.
Enter ‘**A**’ for Forms 1098, 1099, 5498, W-2G, 1042-S, 8027, and Questionable Forms W-4.
Press the Tab key to advance to TCC box; otherwise, enter ‘**E**’ to exit.
Enter your **TCC**:
Enter your **EIN**:

The system will then display the company name, address, city, state, ZIP code, and phone number. This information will be used to contact or send correspondence (if necessary) regarding this transmission. If you need to update, enter ‘**n**’ to change information; otherwise, enter ‘**y**’ to accept.

Select one of the following:
‘**A**’ for an Original file
‘**B**’ for a Replacement file
‘**C**’ for a Correction file
‘**D**’ for a Test file

**If you selected ‘B’ for a replacement file, select one of the following:**

‘**A**’ Replacement Files For This System
This option is to replace an original/correction file that was submitted electronically on this system but was bad and needs to be replaced. Select the file needing replaced.
‘**B**’ Magnetic media replacement files
Enter the alpha character from Form 9267, Media Tracking Slip, that was returned with the correspondence requesting a replacement file.

Choose one of the following protocols (Hyperterminal is normally set to Zmodem by default):
**X** - Xmodem
**Y** - Ymodem
**Z** - Zmodem (Zmodem will normally give you the fastest transfer rate.)

At this point, you must start the upload from your PC.
To send a file:
Go to the hyperterminal menu bar.
Click on **Transfer**.
Click on **Send file**.
A box will appear titled ‘Send File’.
Enter the drive/path/filename or click on **Browse** to locate your file.
Click on **Send**.

**When the upload is complete, the screen will display the total bytes received and the IRS assigned file name.**

Press **ENTER** to continue.
If you have more files to send for the same TCC/EIN, enter ‘**y**’; otherwise, enter ‘**n**’.

**It is your responsibility to check the acceptability of your file; therefore, be sure to dial back into the system in 20 business days.**

To check the acceptability of a previously submitted file:

At the Main Menu:
Enter '**B**' for file status.
Press the Tab key to advance to TCC box; otherwise, enter '**E**' to exit.
Enter your **TCC:**
Enter your **EIN:**
Choose the appropriate option.
Tab to appropriate file and press **ENTER**.

If 'Results' indicate:

**'File Good'** and you agree with the 'Count of Payees', you are finished with this file. (If you do not want the file processed, you must contact IRS/MCC within 10 days.)

**'File Bad'** - Correct the errors and resubmit the file as a replacement.

**'Not Yet Processed'** - File has been received, but results are not available. Please recheck in several days.

When you are finished, enter '**E**' from the 'Main Menu' to logoff.
Enter '**2**' to hang-up.

## Sec. 11. Modem Configuration

**.01** Hardware features

**(a)** Enable hardware flow control
**(b)** Enable modem error control
**(c)** Enable modem compression

## Sec. 12. Common Problems Associated with Electronic Filing

**.01** Refer to Part A, Section 18, for Major Problems Encountered with Form 1042–S magnetic/electronic files.
**.02** The following are the major non-format errors associated with electronic filing:

**1. Transmitter does not dial back to the electronic system to determine file acceptability.**

The results of your file transfer are posted to the FIRE System within 20 business days. It is your responsibility to verify file acceptability and, if the file contains errors, you can get an online listing of the errors. Date received and number of payee records are also displayed. (If you do not want the file processed, you must contact IRS/MCC within 10 days.)

**2. Transmitter uses wrong TCC.**

Use the TCC assigned for Form 1042–S filing only. This TCC will begin with a **"22".**

**3. Transmitter compresses several files into one.**

Only compress one file at a time. For example, if you have 10 uncompressed files to send, compress each file separately and send 10 separate compressed files.

**4. Transmitter sends a file and File Status indicates that the file is good, but the transmitter wants to send a replacement or correction file to replace the original/correction/replacement file.**

Once a file has been transmitted, you cannot send a replacement file unless File Status indicates the file is bad (20 business days after file was transmitted). If you do not want us to process the file, you must first contact us at 304-263-8700 to see if this is a possibility. However, this will count as a replacement. (See Part A, Sec. 16, for the definition of replacement.)

**5. Transmitter sends an original file that is good, then sends a correction file for the entire file even though there are only a few changes.**

The correction file, containing the proper coding, should only contain the records needing correction, not the entire file.

**6. File is formatted as EBCDIC.**

All files submitted electronically must be in standard ASCII code.

**.03** The following are the most common problems associated with connecting with dial-up networking/web browser:

**1. Transmitter is unable to connect to the FIRE System using dial-up networking.**

1. The user name and password should be blank when trying to connect unless it is needed for your system.

2. Windows 95/98: Disable 'enable software compression'.
3. Windows NT/2000: Disable both 'enable software compression' and 'enable PPP/LCP extensions'.
4. TCP/IP should be the only network protocol that is enabled.
(**Make sure you are using analog lines rather than digital**.)

**2. Transmitter is connecting using dial-up networking, but is unable to bring up the URL address using my web browser.**
1. Proxy server should be disabled for a dial-up connection.
2. Using a modem option should be selected.
3. The home page should either display **http://10.225.224.2** or be set to 'about:blank'.
4. The security level should be set at medium.
5. The option 'enable software compression' should be disabled under Dial-Up Networking.

**3. Transmitter clicks on 'start the FIRE application', but the logon screen is displayed again.**

Your browser must be set to receive 'cookies'.

**4. Transmitter is getting a menu when connecting with dial-up networking.**

The option 'pop-up a terminal window' should be disabled.

**5. Transmitter cannot find the browse button to upload file.**

If using Internet Explorer, you must have version 4.0 or higher. If using Netscape Navigator, it must be version 2.0 or higher. A patch is available that can be downloaded from Microsoft for users of Internet Explorer 3.02.

**6. The line is busy when dialed.**

We have enough lines available that you should not get this message. Check the phone number being dialed. It should be 304-262-2400. If you need a number such as an 8 or a 9 to access an outside line, make sure it is present. Also, some companies require an access code for long distance dialing.

**7. Transmitter is receiving the error message "Remote PPP Peer Not Responding."**

Disable 'enable PPP/LCP Extensions' in Dial-Up Networking

**.04** The following are the most common problems associated with connecting with hyperterminal:

**1. Transmitter is unable to connect using hyperterminal.**

1. If you need a number such as an 8 or a 9 to access an outside line, make sure it is present.
2. Set the terminal emulation to VT100.
3. Try lowering the modem speed.
4. Turn the modem off and then back on to reset it.

**Make sure you are using analog lines rather than digital**.

**2. Transmitter is getting the message 'annex command line interpreter.'**

Disconnect and try again. You may need to lower the modem speed if this happens several times in a row.

**3. When trying to logon, the cursor is not in the correct box, or the menus are distorted.**

Check the terminal emulation. It must be set to VT100. Also, verify that the data bits are set at 8, the stop bit is set at 1 and parity is set at None.

**4. Transmitter was able to connect and the menu is displayed, but is unable to type anything.**

Scroll lock cannot be turned on.

**5. When transmitter connects, the menus keep scrolling and display garbage characters.**

Make sure 'Use error control' and 'Compress data' are enabled under the Advanced Connection Settings.

**6. Transmitter receives message saying 'bad data packet' when the file is transmitting. What does this mean?**

Your modem is having problems sending the data, so it is re-trying to send it. Normally, if the transfer does not abort, the file will be sent successfully.

## Part D. Magnetic/Electronic Specifications For Extensions of Time

## Sec. 1. General

**.01** The specifications in Part D include the required 200-byte record format for extensions of time to file requests submitted magnetically or electronically. Also included are the instructions for the information that is to be entered in the record. **Filers are advised to read this section in its entirety to ensure proper filing.**

**.02** Only filers who have been assigned a Transmitter Control Code may request an extension of time magnetically or electronically. If you meet the threshold of more than 50 withholding agents when requesting an extension but are below the 250 documents threshold, you must still submit a Form 4419, Application for Filing Information Returns Magnetically/Electronically. Requests for extensions of time may be made for Forms 1098, 1099, 5498, W-2G, W-2, 1042–S and 8027.

**.03** For Tax Year *2001* (returns due to be filed in *2002*), transmitters requesting an extension of time to file for more than 50 withholding agents (not recipients) are required to file the extension request magnetically or electronically. Transmitters requesting an extension of time for 10 to 50 withholding agents (not recipients) are encouraged to file the request magnetically or electronically. The request may be filed on tape, tape cartridge, 3 1/2-inch diskette, or electronically.

**.04** For extension requests filed on magnetic media, the transmitter must mail the completed, signed Form 8809, Request for Extension of Time To File Information Returns, in the same package as the corresponding media or fax it to 304-264-5602. For extension requests filed electronically, the transmitter must fax the Form 8809 the same day the transmission is made.

**.05** Transmitters submitting an extension of time magnetically or electronically should not submit a list of withholding agents names and TINs with the Form 8809 since this information is included on the magnetic or electronic file. However, Line 6 of the Form 8809 must be completed with the total number of records included on the magnetic media or electronic file.

**.06** To be considered, an extension request must be postmarked or transmitted by the due date of the returns; otherwise, the request will be denied.

**.07** A magnetically-filed request for an extension of time should be sent using the following address:

IRS-Martinsburg Computing Center
Information Reporting Program
**Attn: Extension of Time Coordinator**
240 Murall Drive
Kearneysville, WV 25430

☛**Note: Due to the large volume of mail received by IRS/MCC and the time factor involved in processing the Form 8809, it is imperative that the attention line be present on all envelopes or packages containing Extension of Time (EOT) requests.**

**.08** Requests for extensions of time to file postmarked by the United States Postal Service on or before the due date of the returns, and delivered by United States mail to the IRS/MCC after the due date, are treated as timely under the "timely mailing as timely filing" rule. A similar rule applies to designated private delivery services (PDSs). See Part A, Sec. 10, for more information on PDSs. For requests delivered by a designated PDS, but through a non-designated service, the actual date of receipt by IRS/MCC will be used as the filing date.

**.09** Transmitters who submit their extension of time requests magnetically or electronically will receive a letter from IRS/MCC with an attached list of the withholding agents, based on information contained in the file, specifying approval and/or denial.

**.10** Do not submit tax year 2001 extensions of time to file requests on magnetic media before *January 1, 2002,* or electronically before *January 8, 2002*.

**.11** It will take a minimum of 30 days for IRS/MCC to respond to an extension request. Under certain circumstances, a request for an extension of time could be denied. In such cases, the transmitter receives a denial letter. When this denial letter is received, the transmitter has 20 days to provide the additional or necessary information and resubmit the extension request to IRS/MCC.

**.12** Each piece of magnetic media **must** have an external media label containing the following information:

**(a)** Transmitter name
**(b)** Transmitter Control Code (TCC)
**(c)** Tax year
**(d)** The words "Extension of Time"
**(e)** Record count

**.13** A request for an extension of time to file is not automatically granted. Approval or denial is dependent on information provided on the Form 8809. If the Form 8809 is not completed properly, processing may be delayed or the request may be denied.

**.14** If the first request for an extension of time to file was submitted magnetically or electronically, additional extension requests should be submitted in the same manner.

**.15** If an additional extension of time is needed, a second Form 8809 and file may be submitted before the end of the initial extension period with a postmark reflecting the date mailed. Line 7 on the form should be checked to indicate that the original extension has been received and the additional extension is being requested.

**.16** See Part A, Sec. 11, for complete information on requesting an extension of time to file information returns. If there are additional questions or concerns, contact IRS/MCC.

## Sec. 2. Magnetic Tape, Tape Cartridge, 8mm, 4mm, and QIC (Quarter-Inch Cartridge), 3 1/2-inch Diskette and Electronic Specifications

☛**Note:** ***Beginning in calendar year 2003 for Tax Year 2002, IRS/MCC will no longer process 9- track tapes***

**.01** Tape specifications are as follows:

**(a)** 9-track.

**(b)** EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) recording mode.

**(c)** 1600 or 6250 BPI.

**(d)** A block must not exceed 32,600 tape positions and must be a multiple of 200.

**(e)** Record length of 200 bytes.

**(f)** Labeled or unlabeled tapes may be submitted.

**.02** Tape cartridge specifications are as follows:

**(a)** Must be IBM 3480, 3490, *3590, 3590E* or AS400 compatible.

**(b)** Must meet American National Standard Institute (ANSI) standards and have the following characteristics:

**(1)** Tape cartridges will be 1/2-inch tape contained in plastic cartridges which are approximately 4-inches by 5-inches by 1-inch in dimension.

**(2)** Magnetic tape will be chromium dioxide particle based 1/2-inch tape.

**(3)** Cartridges will be 18-track or 36-track parallel. Indicate on the external media label if the tape cartridge is 18- or 36- track.

**(4)** Mode will be full function.

**(5)** The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.

**(6)** Either EBCDIC or ASCII.

**(c)** A block must not exceed 32,600 tape positions and must be a multiple of 200.

**(d)** Record length of 200 bytes.

**(e)** Labeled or unlabeled tape cartridges may be submitted.

**.03** 8mm, 4mm, and Quarter-Inch Cartridge Specifications:

**(a)** In most instances, IRS/MCC can process 8mm tape cartridges that meet the following specifications:

**(1)** Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

**(a)** Created from an AS400 operating system **only.**

**(b)** 8mm (.315-inch) tape cartridges will be 2 1/2-inch by *3 3/4-inch*.

**(c)** The 8mm tape cartridges must meet the following specifications:

| Tracks | Density | Capacity |
|---|---|---|
| 1 | 20 (43245 BPI) | *2.3* Gb |
| 1 | 21 (45434 BPI) | 5 Gb |

**(d)** Mode will be full function.

**(e)** **Compressed data is not acceptable.**

**(f)** Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used. However, IRS/MCC encourages the use of EBCDIC. This information must appear on the external media label affixed to the cartridge.

**(g)** A file may consist of more than one cartridge; however, no more than 250,000 documents may be transmitted per file or per cartridge. The filename, for example, IRSEOT, will contain a three digit extension. The extension will indicate the sequence of the cartridge within the file, 1 of 3, 2 of 3, or 3 of 3, and will appear in the header label IRSEOT.001, IRSEOT.002, and IRSEOT.003 on each cartridge of the file.

**(2)** The 8mm (.315-inch) tape cartridge records defined in this Revenue Procedure may be blocked subject to the following:

**(a)** A block must not exceed 32,600 tape positions.

**(b)** If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9's; however, the last block of the file may be filled with 9's or truncated. Do not pad a block with blanks.

**(c)** All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields which describe the length of the block or the logical records within a block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block which may be shorter (see item (b) above). The block length must be evenly divisible by 200.

**(d)** Various SAVE commands have been successful; however, the **SAVE OBJECT COMMAND is not acceptable.**

**(e)** Records may not span blocks.

☛**Note:** ***Advanced Metal Evaporated (AME) cartridges are not acceptable.***

**(3)** For faster processing, IRS/MCC encourages transmitters to use header labeled cartridges. IRSEOT may be used as a suggested filename.

**(4)** For the purposes of this Revenue Procedure, the following must be used:

Tape Mark:

**(a)** Signifies the physical end of the recording on tape.

**(b)** For even parity, use BCD configuration 001111 (8421).

**(c)** May follow the header label and precede and/or follow the trailer label.

**(5)** IRS/MCC can only read one data file on a tape. A data file is a group of records which may or may not begin with a tapemark, but must end with a trailer label. Any data beyond the trailer label cannot be read by IRS programs.

**(b)** 4mm (.157-inch) cassettes are now acceptable with the following specifications:

**(1)** 4mm cassettes will be 2 1/4-inch by 3-inch.

**(2)** The tracks are 1 (one).

**(3)** The density is 19 (61000 BPI).

**(4)** The typical capacity is DDS (DAT data storage) at 1.3 Gb or 2 Gb, or DDS-2 at 4 Gb.

**(5)** The general specifications for 8mm cartridges will also apply to the 4mm cassettes.

✒**Note: 4mm cassettes with a capacity of DDS-3 (125 meter) are not acceptable.**

**(c)** Various Quarter-Inch Cartridges (QIC) (1/4-inch) are also acceptable.

**(1)** QIC cartridges will be 4″ by 6″.

**(2)** QIC cartridges must meet the following specification:

| Size | Tracks | Density | Capacity |
|---|---|---|---|
| QIC-24 | 8/9 | 5 (8000 BPI) | 45Mb or 60Mb |
| QIC-120 | 15 | 15 (10000 BPI) | 120Mb or 200Mb |
| QIC-150 | 18 | 16 (10000 BPI) | 150Mb or 250Mb |
| QIC-525 | 26 | 17 (16000 BPI) | 525Mb |
| QIC-1000 | 30 | 21 (36000 BPI) | 1Gb |
| QIC-2Gb | 42 | 34 (40640 BPI) | 2Gb |

**(3)** The general specifications that apply to 8mm cartridges will also apply to QIC cartridges.

**.04** Diskette specifications are as follows:

**(a)** 3 1/2-inches in diameter.

**(b)** ASCII recording mode **only**. Additional specifications may be found in Part B, Sec. 5, of this Revenue Procedure.

**(c)** Record length of 200 bytes.

**(d)** Diskettes must be created using the MS-DOS operating system.

**(e)** Filename of IRSEOT must be used. No other filenames are acceptable. If a file will consist of more than one diskette, the filename IRSEOT will contain a three-digit extension. This extension will indicate the sequence of the diskettes within the file. For example, the first diskette will be named IRSEOT.001, the second diskette will be name IRSEOT.002, etc.

**(f)** Delimiter character commas (,) or quotes (") must not be used.

**(g)** Positions 199 and 200 of each record have been reserved for use as carriage return/line feed (cr/lf) characters, if applicable.

**.05** Electronic Filing specifications (See Note.)

(a) A transmitter must have a Transmitter Control Code (TCC).

(b) Filers can determine the acceptability of files submitted by checking the file status area of the system. These reports will be available on the electronic system within 5 business days if the Form 8809 is received timely by IRS/MCC.

✒**Note: See Part C, Electronic Filing Specifications, for detailed information on filing with IRS/MCC electronically.**

## Sec. 3. Record Layout

**.01** Positions 6 through 185 of the following record should contain information about the withholding agent for whom the extension of time to file is being requested. Do not enter transmitter information in these fields. **Only one TCC may be present in a file.**

### Record Layout for Extension of Time

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 1–5 | Transmitter Control Code | 5 | **Required.** Enter the five-digit Transmitter Control Code (TCC) issued by IRS. **Only one TCC per file is acceptable.** |

## Record Layout for Extension of Time (continued)

| Field Positions | Field Title | Length | Description and Remarks |
|---|---|---|---|
| 6–14 | Withholding Agent's TIN | 9 | **Required.** Must be the valid nine-digit EIN/SSN assigned to the withholding agent. **Do not enter blanks, hyphens or alpha characters.** All zeros, ones, twos, etc., will have the effect of an incorrect TIN. For foreign entities that are not required to have a TIN, this field may be blank; however, the Foreign Entity Indicator, position 187, **must** be set to "X." |
| 15–54 | Withholding Agent's Name | 40 | **Required.** Enter the name of the withholding agents whose TIN appears in positions 6–14. Left-justify information and fill unused positions with blanks. |
| 55–94 | Second Agent's Name | 40 | If additional space is needed, this field may be used to continue name line information (e.g., c/o First National Bank); otherwise, enter blanks. |
| 95–134 | Withholding Agent's Address | 40 | **Required.** Enter the agent's address. Street address should include number, street, apartment or suite number (or P.O. Box if mail is not delivered to a street address). |
| 135–174 | Withholding Agent's City | 40 | **Required.** Enter agent's city, town, or post office. |
| 175–176 | Withholding Agent's State | 2 | **Required.** Enter the agent's valid U.S. Postal Service state abbreviation. (Refer to Part A, Sec. 18.) |
| 177–185 | Withholding Agent's ZIP Code | 9 | **Required.** Enter agent's ZIP Code. If using a five-digit ZIP Code, left-justify information and fill unused positions with blanks. |
| 186 | Document Indicator | 1 | **Required.** Enter the document for which you are requesting an extension of time using the following code:<br>**Code** **Document**<br>4 1042–S |
| **DO NOT enter any other values in this field when requesting an extension for Form 1042–S.** | | | |
| 187 | Foreign Entity Indicator | 1 | Enter character "X" if the payer is a foreign entity. |
| 188–198 | Blank | 11 | **Enter blanks**. |
| 199–200 | Blank | 2 | **Enter blanks.** Diskette filers may code the ASCII carriage return/line feed (CR/LF) characters. |

## Extension of Time Record Layout

| Transmitter Control Code | Withholding Agent's TIN | Withholding Agent's Name | Second Withholding Agent's Name | Withholding Agent's Address | Withholding Agent's City | Withholding Agent's State |
|---|---|---|---|---|---|---|
| 1–5 | 6–14 | 15–54 | 55–94 | 95–134 | 135–174 | 175–176 |

| Withholding Agent's ZIP Code | Document Indicator | Foreign Entity Indicator | Blank | Blank or CR/LF |
|---|---|---|---|---|
| 177–185 | 186 | 187 | 188–198 | 199–200 |

## Part E. Miscellaneous Information

### Sec. 1. Addresses for Martinsburg Computing Center

To submit an application to file, correspondence, and magnetic media files, use the following:

IRS-Martinsburg Computing Center
Information Reporting Program
230 Murall Drive
Kearneysville, WV 25430

To submit magnetically filed and paper extension and waiver requests, use the following address:

IRS-Martinsburg Computing Center
Information Reporting Program
**Attn: Extension of Time Coordinator**
240 Murall Drive
Kearneysville, WV 25430

### Sec. 2. Telephone Numbers for Contacting IRS

**Between 8:30 a.m. and 4:30 p.m. Eastern Time**
**Monday through Friday**

**Information Reporting Program Call Site: 304-263-8700 or email at** mccirp@irs.gov

**Telecommunication Device for the Deaf (TDD): 304-267-3367**

**HOURS OF OPERATION – FIRE SYSTEM & FAX**
**24 HOURS A DAY**
**7 DAYS A WEEK**

**Electronic Filing via the FIRE System: 304-262-2400**

**Information Returns FAX Machine: 304-264-5602**

**Tax law inquiries concerning Chapter 3 Withholding: 215-516-2000**

**This is the end of Publication 1187 for Tax Year *2001*.**

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*26 CFR 601.05: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.*

## Rev. Proc. 2001–41

SECTION 1. PURPOSE

.01 This revenue procedure modifies Rev. Proc. 2001–2 (2001–1 I.R.B. 79) to clarify that Technical Advice will not be issued on frivolous issues and to provide a procedure for expedited review of denials of Technical Advice where the taxpayer requests Technical Advice on frivolous issues.

SECTION 2. MODIFICATIONS

.01 Section 3 of Rev. Proc. 2001–2, On What Issues May Technical Advice be Requested Under This Procedure, is modified by the addition of subsection .03 below, which provides that technical advice will not be issued on frivolous issues.

Technical advice will not be issued on frivolous issues. For purposes of this program, a "frivolous issue" is one without basis in fact or law, or that espouses a position which has been held by the courts to be frivolous or groundless. Examples of frivolous or groundless issues include, but are not limited to:

1. frivolous "constitutional" claims, such as claims that the requirement to file tax returns and pay taxes constitutes an unreasonable search barred by the Fourth Amendment; violates Fifth and Fourteenth Amendment protections of due process; violates Thirteenth Amendment protections against involuntary servitude; or is unenforceable because the Sixteenth Amendment does not authorize nonapportioned direct taxes or was never ratified;

2. claims that income taxes are voluntary, that the term "income" is not defined in the Internal Revenue Code, or that preparation and filing of income tax returns violates the Paperwork Reduction Act;

3. claims that tax may be imposed only on coins minted under a gold or silver standard or that receipt of Federal Reserve Notes does not cause an accretion to wealth;

4. claims that a person is not taxable on income because he or she falls within a class entitled to "repa-

ration claims" or an extra-statutory class of individuals exempt from tax, *e.g.*, "free-born" individuals;

5. claims that a taxpayer can refuse to pay taxes on the basis of opposition to certain governmental expenditures;

6. claims that taxes apply only to federal employees; only to residents of Puerto Rico, Guam, the U.S. Virgin Islands, the District of Columbia, or "federal enclaves"; or that the Internal Revenue Code imposes taxes on U.S. citizens and residents only on income derived from foreign based activities;

7. claims that wages or personal service income are not "income," are "nontaxable receipts," or "are a nontaxable exchange for labor;" or

8. other claims the courts have characterized as frivolous or groundless.

.02 Section 11 of Rev. Proc. 2001–2, How Does a Taxpayer Appeal a Director's or Area Director, Appeals', Decision not to Seek Technical Advice, is modified by adding subsection .05 below, which provides for expedited review procedures where the denial of technical advice is because the requested advice concerns frivolous issues.

Special procedures applicable to appeals regarding frivolous issues. If the request for technical advice concerns a "frivolous issue," as described in Section 3.03 of this Revenue Procedure, technical advice will not be given, and the examining officer or appeals officer will deny the taxpayer's request for referral. The taxpayer may appeal the decision of the examining officer or the appeals officer; however, if the territory manager or area director, appeals, determines that no technical advice will be sought, an expedited review procedure will be followed.

This expedited review procedure will consist of the following: 1) the territory manager or area director, appeals, will inform the appropriate official described in section 11.04 above (the Industry Director, LMSB; the Director, Field Compliance, SB/SE; the Director, Compliance, W&I; the Director, International, LMSB; the Director, Federal, State, and Local Governments; the Director, Tax Exempt Bonds; the Director, Indian Tribal Governments; or the Chief, Appeals) of the request for review and the basis for the denial, but will not forward the taxpayer's written request and statements, unless requested to do so by the official; 2) the field office or area office will not suspend action on the issue; 3) within 15 days, the official will notify the territory manager or area director, appeals, whether the proposed denial is approved or disapproved. The official may also determine that the expedited process is not warranted and request all of the information supplied by the taxpayer and allow suspension of action on the item while the denial is reviewed; and 4) the field office or area office will then notify the taxpayer of the result of the review of the denial.

SECTION 3. EFFECTIVE DATE

This revenue procedure is effective July 23, 2001, the date this revenue procedure was released to the news media.

SECTION 4. DRAFTING INFORMATION

The principal author of this revenue procedure is George Bowden of the Office of the Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue procedure, contact Mr. Bowden at 202-622-3400 (not a toll-free call).

# Part IV. Items of General Interest

## Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

## Announcement 2001–81

The name of an organization that no longer qualifies as an organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on August 13, 2001, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

WorldCare, Inc.
La Mesa, CA

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## Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organization listed below has recently filed a timely declaratory judgment suit under section 7428 of the Code, challenging revocation of it's status as an eligible donee under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

Career Guidance Foundation
San Diego, CA

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

## Section 355.—Distribution of Stock and Securities of a Controlled Corporation

*26 CFR 1.355–7T: Recognition of gain on certain distributions of stock or securities in connection with an acquisition.*

## T.D. 8960

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Part 1

## Guidance Under Section 355(e); Recognition of Gain on Certain Distributions of Stock or Securities in Connection With an Acquisition

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with an acquisition. Changes to the applicable law were made by the Taxpayer Relief Act of 1997. These temporary regulations affect corporations and are necessary to provide them with guidance needed to comply with these changes.

EFFECTIVE DATES: These temporary regulations are effective August 3, 2001.

FOR FURTHER INFORMATION CONTACT: Megan R. Fitzsimmons of the Office of Associate Chief Counsel (Corporate), (202) 622-7790 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Background

On January 2, 2001, the IRS and Treasury published in the **Federal Register** (66 FR 66) a notice of proposed rulemaking (REG–107566–00, 2001–3 I.R.B. 346) (the Proposed Regulations) under section 355(e) of the Internal Revenue Code of 1986. Section 355(e) provides that the stock of a controlled corporation will not be qualified property under section 355(c)(2) or 361(c)(2) if the stock is distributed as "part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation."

The Proposed Regulations provide guidance concerning the interpretation of the phrase "plan (or series of related transactions)." The Proposed Regulations generally provide that whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. They also set forth six safe harbors, the satisfaction of which would confirm that a distribution and an acquisition are not part of a plan.

A public hearing regarding the Proposed Regulations was held on May 15, 2001. In addition, written comments were received. A number of commentators have indicated that the lack of guidance under section 355(e) is hindering the ability to undertake acquisitions and divestitures. These commentators have requested that the IRS and Treasury provide immediate guidance pending the finalization of those regulations. In response to these requests, the IRS and Treasury are promulgating the Proposed Regulations as temporary regulations in this Treasury Decision. The temporary regulations are identical to the Proposed Regulations, except that the temporary regulations reserve section 1.355–7(e)(6) (suspending the running of any time period prescribed in the Proposed Regulations during which there is a substantial diminution of risk of loss under the principles of section 355(d)(6)(B)) and Example 7 of the Proposed Regulations (interpreting the term "similar acquisition" in the context of a situation involving multiple acquisitions).

The IRS and Treasury continue to study all of the comments received regarding the Proposed Regulations. The IRS and Treasury will continue to devote significant resources to analyzing the comments and, in the near future, expect to issue additional guidance regarding the interpretation of the phrase "plan (or series of related transactions)."

### Special Analyses

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

### Drafting Information

The principal author of these temporary regulations is Brendan P. O'Hara, Office of the Associate Chief Counsel (Corporate). However, other personnel from the Department of the Treasury and the IRS participated in their development.

* * * * *

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.355–7T also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355–0 is amended by revising the section heading and the introductory text and adding an entry for §1.355–7T to read in part as follows:

*§1.355–0 Outline of sections.*

In order to facilitate the use of §§1.355–1 through 1.355–7T, this section lists the major paragraphs in those sections as follows:

* * * * *

*§1.355–7T Recognition of gain on certain distributions of stock or securities in connection with an acquisition.*

(a) In general.
(b) Plan.
(c) Multiple acquisitions.
(d) Facts and circumstances.
(e) Operating rules.
(1) Reasonable certainty evidence of business purpose to facilitate an acquisition.
(2) Internal discussion evidence of business purpose.
(3) Hostile takeover defense.
(4) Effect of distribution on trading in stock.
(5) Consequences of section 355(e) disregarded for certain purposes.
(6) Substantial diminution of risk. [Reserved]
(f) Safe harbors.
(1) Safe Harbor I.
(2) Safe Harbor II.
(3) Safe Harbor III.
(4) Safe Harbor IV.
(5) Safe Harbor V.
(i) In general.
(ii) Special rules.
(6) Safe Harbor VI.
(g) Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests.
(1) Treatment of options.
(i) General rule.
(ii) Agreement, understanding, arrangement, or substantial negotiations to write an option.
(2) Instruments treated as options.
(3) Instruments generally not treated as options.
(i) Escrow, pledge, or other security agreements.
(ii) Compensatory options.
(iii) Options exercisable only upon death, disability, mental incompetency, or separation from service.
(iv) Rights of first refusal.
(v) Other enumerated instruments.
(h) Multiple controlled corporations.
(i) [Reserved]
(j) Valuation.
(k) Definitions.
(1) Agreement, understanding, arrangement, or substantial negotiations.
(2) Controlled corporation.
(3) Controlling shareholder.
(4) Established market.
(5) Five-percent shareholder.
(l) [Reserved]
(m) Examples.
(n) Effective date.

Par. 3. Section 1.355–7T is added to read as follows:

*§1.355–7T Recognition of gain on certain distributions of stock or securities in connection with an acquisition.*

(a) *In general*. Except as provided in section 355(e) and in this section, section 355(e) applies to any distribution—

(1) To which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) That is part of a plan (or series of related transactions) (referred to elsewhere in this section as "plan") pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation (Distributing) or any controlled corporation (Controlled).

(b) *Plan*. (1) Whether a distribution and an acquisition are part of a plan is determined based on all the facts and circumstances. In general, in the case of an acquisition after a distribution, the distribution and the acquisition are considered part of a plan if Distributing, Controlled, or any of their respective controlling shareholders intended, on the date of the distribution, that the acquisition or a similar acquisition occur in connection with the distribution. In general, in the case of an acquisition before a distribution, the acquisition and the distribution are considered part of a plan if Distributing, Controlled, or any of their respective controlling shareholders intended, on the date of the acquisition, that a distribution occur in connection with the acquisition.

(2) For purposes of paragraph (b)(1) of this section, the actual acquisition and the intended acquisition may be similar even though the identity of the person acquiring stock of Distributing or Controlled (acquirer), the timing of the acquisition or the terms of the actual acquisition are different from the intended acquisition. For example, in the case of a public offering or auction, the actual acquisition and the intended acquisition may be similar even though there are changes in the terms of the stock, the class of stock being offered, the size of the offering, the timing of the offering, the price of the stock, or the participants in the public offering or auction.

(c) *Multiple acquisitions*. All acquisitions of stock of Distributing or Controlled that are considered to be part of a plan with a distribution pursuant to paragraph (b) of this section will be aggregated for purposes of the 50-percent test of paragraph (a)(2) of this section.

(d) *Facts and circumstances*. (1) The facts and circumstances to be considered in demonstrating whether a distribution and an acquisition are part of a plan include, but are not limited to, the facts and circumstances specified in paragraphs (d)(2) and (3) of this section. The weight to be given each of the facts and circumstances depends on the particular case. Therefore, whether a distribution and an acquisition are part of a plan does not depend on the relative number of facts and circumstances present under paragraph (d)(2) of this section as compared to paragraph (d)(3) of this section.

(2) Among the facts and circumstances tending to show that a distribution and an acquisition are part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering or auction) after a distribution, Distributing or Controlled and the acquirer (or any of their respective controlling shareholders) discussed the acquisition or a similar acquisition by the acquirer before the distribution. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions. The existence of an agreement, understanding, arrangement or substantial negotiations at the time of the distribution is given substantial weight.

(ii) In the case of an acquisition (other than involving a public offering or auction) after a distribution, Distributing or Controlled and a potential acquirer (or any of their respective controlling shareholders) discussed an acquisition before the distribution and a similar acquisition by a different person occurred after the distribution. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions and the similarity of the acquisition actually occurring to the acquisition discussed before the distribution.

(iii) In the case of an acquisition involving a public offering or auction after a distribution, Distributing or Controlled (or any of their respective controlling shareholders) discussed the acquisition with an investment banker or other outside adviser before the distribution. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions.

(iv) In the case of an acquisition before a distribution, Distributing or Controlled and the acquirer (or any of their respective controlling shareholders) discussed a distribution before the acquisition. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions.

(v) In the case of an acquisition before a distribution, Distributing or Controlled and a potential acquirer (or any of their respective controlling shareholders) discussed a distribution before the acquisition and a similar acquisition by a different person occurred before the distribution. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions and the similarity of the acquisition actually occurring to the potential acquisition that was discussed.

(vi) In the case of an acquisition involving a public offering or auction before a distribution, Distributing or Controlled (or any of their respective controlling shareholders) discussed a distribution with an investment banker or other outside adviser before the acquisition. The weight to be accorded the discussions depends on the nature, extent, and timing of the discussions.

(vii) In the case of an acquisition either before or after a distribution, the distribution was motivated by a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled.

(viii) In the case of an acquisition either before or after a distribution, the acquisition and the distribution occurred within 6 months of each other or there was an agreement, understanding, arrangement, or substantial negotiations regarding the second transaction within 6 months after the first transaction. Also, in the case of an acquisition occurring after a distribution, there was an agreement, understanding, arrangement, or substantial negotiations regarding a similar acquisition at the time of the distribution or within 6 months thereafter.

(ix) In the case of an acquisition either before or after a distribution, the debt allocation between Distributing and Controlled made an acquisition of Distributing or Controlled likely in order to service the debt.

(3) Among the facts and circumstances tending to show that a distribution and an acquisition are not part of a plan are the following:

(i) In the case of an acquisition (other than involving a public offering or auction) after a distribution, neither Distributing nor Controlled and the acquirer or any potential acquirer (nor any of their respective controlling shareholders) discussed the acquisition or a similar acquisition before the distribution.

(ii) In the case of an acquisition involving a public offering or auction after a distribution, neither Distributing nor Controlled (nor any of their respective controlling shareholders) discussed the acquisition with an investment banker or other outside adviser before the distribution.

(iii) In the case of an acquisition after a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the distribution that resulted in the acquisition that was otherwise unexpected at the time of the distribution.

(iv) In the case of an acquisition (other than involving a public offering or auction) before a distribution, neither Distributing nor Controlled and the acquirer (nor any of their respective controlling shareholders) discussed a distribution before the acquisition. This paragraph (d)(3)(iv) does not apply if the acquisition occurred after the date of the public announcement of the planned distribution.

(v) In the case of an acquisition before a distribution, there was an identifiable, unexpected change in market or business conditions occurring after the acquisition that resulted in a distribution that was otherwise unexpected.

(vi) In the case of an acquisition either before or after a distribution, the distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled. The presence of a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled is relevant in determining the extent to which the distribution was motivated by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate the acquisition or a similar acquisition of Distributing or Controlled.

(vii) In the case of an acquisition either before or after a distribution, the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition or a similar acquisition (including a previously proposed similar acquisition that did not occur).

(e) *Operating rules*. The operating rules contained in this paragraph (e) apply for all purposes of this section.

(1) *Reasonable certainty evidence of business purpose to facilitate an acquisition*. (i) In the case of an acquisition after a distribution, if, at the time of the distribution, it was reasonably certain that before a date that is 6 months after the distribution an acquisition would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding an acquisition of Distributing or Controlled, the reasonable certainty is evidence of a business purpose to facilitate an acquisition of Distributing or Controlled.

(ii) In the case of an acquisition before a distribution, if the acquisition occurred after the date of the public announcement of the planned distribution, or if, at the time of the acquisition, it was reasonably certain that before a date that is 6 months after the acquisition the distribution would occur, an agreement, understanding, or arrangement would exist, or substantial negotiations would occur regarding the distribution, the public announcement or reasonable certainty is evidence of a business purpose to facilitate an acquisition of Distributing or Controlled.

(2) *Internal discussions evidence of business purpose*. The fact that internal discussions regarding an acquisition occurred may be indicative of the business purpose that motivated the distribution.

(3) *Hostile takeover defense*. If Distributing distributes Controlled stock intending, in whole or substantial part, to decrease the likelihood of the acquisition of Distributing or Controlled by separating it from another corporation that is likely to be acquired, Distributing will be treated as having a business purpose to facilitate the acquisition of the corporation that was likely to be acquired.

(4) *Effect of distribution on trading in stock*. The fact that the distribution made all or a part of the stock of Controlled available for trading or made Distributing or Controlled's stock trade more actively is not taken into account in determining whether the distribution and an acquisition of Distributing or Controlled stock were part of a plan.

(5) *Consequences of section 355(e) disregarded for certain purposes*. For purposes of determining the intentions of the relevant parties under this section, the consequences of the application of section 355(e), and the existence of any contractual indemnity by Controlled for tax resulting from the application of section 355(e) caused by an acquisition of Controlled, are disregarded.

(6) *Substantial diminution of risk*. [Reserved]

(f) *Safe harbors*—(1) *Safe Harbor I*. (i) A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(A) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution; and

(B) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate an acquisition of Distributing or Controlled.

(ii) For purposes of paragraph (f)(1)(i)(B) of this section, the presence of a business purpose to facilitate an acquisition of Distributing or Controlled is relevant in determining the extent to which the distribution was motivated by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate an acquisition of Distributing or Controlled.

(2) *Safe Harbor II*. A distribution and an acquisition occurring after the distribution will not be considered part of a plan if—

(i) The acquisition occurred more than 6 months after the distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition before a date that is 6 months after the distribution; and

(ii) The distribution was motivated in whole or substantial part by a corporate business purpose (within the meaning of §1.355–2(b)) to facilitate an acquisition or acquisitions of no more than 33 percent of the stock of Distributing or Controlled, and no more than 20 percent of the stock of the corporation (whose stock was acquired in the acquisition or acquisitions that motivated the distribution) was either acquired or the subject of an agreement, understanding, arrangement, or substantial negotiations before a date that is 6 months after the distribution.

(3) *Safe Harbor III*. If an acquisition occurs more than 2 years after a distribution and there was no agreement, understanding, arrangement, or substantial negotiations concerning the acquisition at the time of the distribution or within 6 months thereafter, the acquisition and the distribution are not part of a plan.

(4) *Safe Harbor IV*. If an acquisition occurs more than 2 years before a distribution, and there was no agreement, understanding, arrangement, or substantial negotiations concerning the distribution at the time of the acquisition or within 6 months thereafter, the acquisition and the distribution are not part of a plan.

(5) *Safe Harbor V*—(i) *In general*. An acquisition of Distributing or Controlled stock that is listed on an established market is not part of a plan if the acquisition is pursuant to a transfer between shareholders of Distributing or Controlled, neither of whom is a 5-percent shareholder. For purposes of the preceding sentence, the term 5-percent shareholder is defined in paragraph (k)(5) of this section, except that the corporation can rely on Schedules 13D and 13G (or any similar schedules) filed with the Securities and Exchange Commission to identify its 5-percent shareholders.

(ii) *Special rules*. (A) This paragraph (f)(5) does not apply to public offerings or redemptions.

(B) This paragraph (f)(5) does not apply to a transfer of stock by or to a person who, pursuant to a formal or informal understanding with other persons (the coordinating group), has joined in coordinated transfers of stock if, at any time during the period the understanding exists, the coordinating group owns, in the aggregate, 5 percent or more of the stock of the corporation whose stock is transferred (determined by vote or value) immediately before or after each transfer or at the time of the distribution. A principal element in determining if such an understanding exists is whether the investment decision of each person is based on the investment decision of 1 or more other existing or prospective shareholders.

(C) This paragraph (f)(5) does not apply to a transfer of stock by or to a person if the corporation the stock of which is being transferred knows, or has reason to know, that the person (or a coordinating group, treating it as a single person) intends to become a 5-percent shareholder at any time during the 4-year period beginning 2 years before the distribution.

(6) *Safe Harbor VI*. If stock of Distributing or Controlled is acquired by an employee or director of Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A), in connection with the performance of services as an employee or director for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) in a transaction to which section 83 applies, the acquisition is not an acquisition that is part of a plan as described in paragraph (b)(1) of this section.

(g) *Stock acquired by exercise of options, warrants, convertible obligations, and other similar interests*—(1) *Treatment of options*—(i) *General rule*. For purposes of this section, if stock of Distributing or Controlled is acquired pursuant to an option, the option will be treated as an agreement to acquire the stock on the date the option is written unless Distributing establishes that on the later of the date of the stock distribution or the writing of the option, the option was not more likely than not to be exercised. The determination of whether an option was more likely than not to be exercised is based on all the facts and circumstances, taking control premiums and minority and blockage discounts into account in determining the fair market value of stock underlying an option.

(ii) *Agreement, understanding, arrangement, or substantial negotiations to write an option*. If there is an agreement, understanding, or arrangement to write an option, the option will be treated as written on the date of the agreement, understanding, or arrangement. If an agreement, understanding, or arrangement to write an option is reached, or an option is written, more than 6 months but not more than 2 years after the distribution, and there were substantial negotiations regarding the writing of the option or the acquisition of the stock underlying the option before the end of the 6-month period beginning on the date of the distribution, the option will be treated as written within 6 months after the distribution.

(2) *Instruments treated as options*. For purposes of this paragraph (g), except to the extent provided in paragraph (g)(3) of this section, call options, warrants, convertible obligations, the conversion feature of convertible stock, put options, redemption agreements (including rights to cause the redemption of stock), any other instruments that provide for the right or possibility to issue, redeem, or transfer stock (including an option on an option), or any other similar interests are treated as options.

(3) *Instruments generally not treated as options*. For purposes of this paragraph (g), the following are not treated as options unless (in the case of paragraphs (g)(3)(i), (iii), and (iv) of this section) written, transferred (directly or indirectly), or listed with a principal purpose of avoiding the application of section 355(e) or this section.

(i) *Escrow, pledge, or other security agreements*. An option that is part of a security arrangement in a typical lending transaction (including a purchase money loan), if the arrangement is subject to customary commercial conditions. For this purpose, a security arrangement includes, for example, an agreement for holding stock in escrow or under a pledge or other security agreement, or an option to acquire stock contingent upon a default under a loan.

(ii) *Compensatory options*. An option to acquire stock in Distributing or Controlled with customary terms and conditions provided to an employee or director of Distributing, Controlled, or a person related to Distributing or Controlled under section 355(d)(7)(A), in connection with the performance of services as an employee or director for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed) and that immediately after the distribution and within 6 months thereafter—

(A) Is nontransferable within the meaning of §1.83–3(d); and

(B) Does not have a readily ascertainable fair market value as defined in §1.83–7(b).

(iii) *Options exercisable only upon death, disability, mental incompetency, or separation from service*. Any option entered into between shareholders of a corporation (or a shareholder and the corporation) that is exercisable only upon the death, disability, or mental incompetency of the shareholder, or, in the case of stock acquired in connection with the performance of services for the corporation or a person related to it under section 355(d)(7)(A) (and that is not excessive by reference to the services performed), the shareholder's separation from service.

(iv) *Rights of first refusal*. A *bona fide* right of first refusal regarding the corporation's stock with customary terms, entered into between shareholders of a corporation (or between the corporation and a shareholder).

(v) *Other enumerated instruments*. Any other instrument the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin. See § 601.601(d)(2) of this chapter.

(h) *Multiple controlled corporations*. Only the stock or securities of a controlled corporation in which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest as part of a plan involving the distribution of that corporation will be treated as not qualified property under section 355(e)(1) if—

(1) The stock or securities of more than 1 controlled corporation are distributed in distributions to which section 355 (or so much of section 356 as relates to section 355) applies; and

(2) One or more persons do not acquire, directly or indirectly, stock representing a 50-percent or greater interest in Distributing pursuant to a plan involving any of those distributions.

(i) [Reserved]

(j) *Valuation*. Except as provided in paragraph (g)(1)(i) of this section, for purposes of section 355(e) and this section, all shares of stock within a single class are considered to have the same value. Thus, control premiums and minority and blockage discounts within a single class are not taken into account.

(k) *Definitions*—(1) *Agreement, understanding, arrangement, or substantial negotiations*. Whether an agreement, understanding, or arrangement exists depends on the facts and circumstances. The parties do not necessarily have to have entered into a binding contract or have reached agreement on all terms to have an agreement, understanding, or arrangement. However, an agreement, understanding, or arrangement clearly exists if enforceable rights to acquire stock exist. In public offerings or auctions by Distributing or Controlled of Distributing or Controlled's stock, an agreement, understanding, arrangement, or substantial negotiations can exist even if the acquirer has not been specifically identified. The existence of such an agreement, understanding, arrangement, or substantial negotiations will be based on discussions with an investment banker or other outside adviser.

(2) *Controlled corporation*. For purposes of this section, a controlled corporation is a corporation the stock of which is distributed in a distribution to which section 355 (or so much of section 356 as relates to section 355) applies.

(3) *Controlling shareholder*. (i) A controlling shareholder of a corporation the stock of which is not listed on an established market is any person who, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)), possesses voting power in Distributing or Controlled representing a meaningful voice in the governance of the corporation.

(ii) A controlling shareholder of a corporation the stock of which is listed on an established market is a 5-percent shareholder who actively participates in the management or operation of the corporation.

(iii) For purposes of this section, a person is a controlling shareholder if that person meets the definition of controlling shareholder in this paragraph (k)(3) immediately before or immediately after the acquisition being tested.

(iv) If a distribution precedes an acquisition, Controlled's controlling shareholders immediately after the distribution are considered Controlled's controlling shareholders at the time of the distribution.

(4) *Established market*. An established market is—

(i) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(ii) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Act of 1934 (15 U.S.C. 78o–3); or

(iii) Any additional market that the Commissioner may designate in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

(5) *Five-percent shareholder*. A person will be considered a 5-percent shareholder of a corporation the stock of which is listed on an established market if the person owns, directly or indirectly, or together with related persons (as described in sections 267(b) and 707(b)) 5 percent or more of any class of stock of the corporation whose stock is transferred. A person is a 5-percent shareholder if the person meets the requirements of the preceding sentence immediately before or after each transfer. All options are treated as exercised for the purpose of determining whether the shareholder is a 5-percent shareholder.

(l) [Reserved]

(m) *Examples*. The following examples illustrate paragraphs (a) through (k) of this section. Throughout these examples, assume that Distributing (D) owns all of the stock of Controlled (C). Assume further that D distributes the stock of C in a distribution to which section 355 applies and to which section 355(d) does not apply. Unless otherwise stated, assume the corporations do not have controlling shareholders. No inference should be drawn from any example concerning whether any requirements of section 355 other than those of section 355(e) are satisfied. The examples are as follows:

*Example 1. Unwanted assets*. (i) D is in business 1. C is in business 2. D is relatively small in its industry. D wants to combine with X, a larger corporation also engaged in business 1. X and D begin negotiating for X to acquire D, but X does not want to acquire C. To facilitate the acquisition of D by X, D agrees to distribute all the stock of C *pro rata* before the acquisition. D and X enter into a binding contract for D to merge into X subject to several conditions. D distributes C and D merges into X one month later. As a result of the merger, D's former shareholders own less than 50 percent of the stock of X.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the merger of D into X are part of a plan. To determine whether the distribution of C and the merger of D into X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the merger of D into X are part of a plan: X and D discussed the acquisition before the distribution (paragraph (d)(2)(i) of this section), D was motivated by a business purpose to facilitate the merger (paragraph (d)(2)(vii) of this section), and the distribution and the merger occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). Because the merger was not only discussed, but was agreed to, before the distribution, the fact described in paragraph (d)(2)(i) of this section is given substantial weight.

(v) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(vi) The distribution of C and the merger of D into X are part of a plan under paragraph (b)(1) of this section.

*Example 2. Substituted acquirer*. (i) The facts are the same as in *Example 1,* except that after D distributes C, X is unable to fulfill one of the conditions of the merger agreement and the merger of D into X does not occur. Y, one of X's competitors, perceives this as an opportunity and begins discussing with D a merger into Y. Five months after D distributes C, D merges into Y. As a result of the merger, the D shareholders own less than 50 percent of the outstanding Y stock.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the merger of D into Y are part of a plan. To determine whether the distribution of C and the merger of D into Y are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the merger of D into Y are part of a plan: X, a potential acquirer, and D discussed an acquisition before the distribution and a similar acquisition by Y occurred (paragraph (d)(2)(ii) of this section), D was motivated by a business purpose to facilitate an acquisition similar to the merger with Y (paragraph (d)(2)(vii) of this section), and the distribution and the merger occurred within 6 months of each other (paragraph (d)(2)(viii) of this section).

(v) As in *Example 1,* none of the facts and circumstances listed in paragraph (d)(3) of this section exist in this case. Although a substituted acquirer acquired D, the merger of D into Y was similar to the negotiated merger of D into X.

(vi) The distribution of C and the merger of D into Y are part of a plan under paragraph (b)(1) of this section.

*Example 3. Public offering*. (i) D's managers, directors, and investment banker discuss the possibility of offering D stock to the public. They decide a public offering of 50 percent of D's stock with D as a stand alone corporation would be in D's best interest. To facilitate a stock offering by D of 50 percent of its stock, D distributes all the stock of C *pro rata* to D's shareholders. D issues new shares amounting to 50 percent of its stock to the public in a public offering 7 months after the distribution.

(ii) No Safe Harbor applies to this acquisition. Safe Harbor V, relating to public trading, does not apply to public offerings (paragraph (f)(5)(ii)(A) of this section).

(iii) The issue is whether the distribution of C and the public offering by D are part of a plan. To determine whether the distribution of C and the public offering by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) The following tends to show that the distribution of C and the public offering by D are part of a plan: D discussed the public offering with its investment banker before the distribution (paragraph (d)(2)(iii) of this section), D was motivated by a business purpose to facilitate the public offering (paragraph (d)(2)(vii) of this section), and there were substantial negotiations regarding the public offering within 6 months after the distribution (paragraph (d)(2)(viii) of this section).

(v) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(vi) The distribution of C and the public offering by D are part of a plan under paragraph (b)(1) of this section.

*Example 4. Public offering followed by unexpected opportunity*. (i) *Facts*. D's managers, directors, and investment banker discuss the possibility of offering C stock to the public. D decides to distribute C *pro rata* to D's shareholders solely to facilitate a 20 percent stock offering by C. To take advantage of favorable market conditions, C issues new shares amounting to 20 percent of its stock in a public offering 1 month before D distributes its remaining 80 percent of the C stock. The public offering documents disclose the intended distribution of C, which is expected to occur shortly after the public offering. At the time of the distribution, it is not reasonably certain that an acquisition will occur, an agreement, understanding, or arrangement concerning an acquisition will exist, or substantial negotiations concerning an acquisition will occur within 6 months. Two months after the distribution, C is approached unexpectedly regarding an opportunity to acquire X. Five months after the distribution, C acquires X in exchange for 40 percent of the C stock.

(ii) *Public offering*. (A) No Safe Harbor applies to the public offering. Safe Harbor V, related to public trading, does not apply to public offerings (paragraph (f)(5)(ii)(A) of this section).

(B) The issue is whether the 20 percent public offering by C and the distribution by D of the remaining C stock are part of a plan. To determine whether the distribution and the public offering are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the public offering are part of a plan: D discussed the distribution with its investment banker before the public offering (paragraph (d)(2)(vi) of this section), D was motivated by a business purpose to facilitate the public offering (paragraph (d)(2)(vii) of this section), and the public offering and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section).

(D) None of the facts and circumstances listed in paragraph (d)(3) of this section, tending to show that a distribution and an acquisition are not part of a plan, exist in this case.

(E) The public offering of C and the distribution of C are part of a plan under paragraph (b)(1) of this section.

(iii) *X acquisition*. (A) No Safe Harbor applies to the X acquisition.

(B) The issue is whether the distribution of C and the acquisition by C of X are part of a plan. To determine whether the distribution of C and the acquisition by C of X are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(C) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and acquisition by C of X are part of a plan: The distribution and the acquisition occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). The fact described in paragraph (d)(2)(vii) of this section does not exist in this case because D's business purpose was to facilitate the public offering and C's acquisition of X is not similar to that acquisition.

(D) Under paragraph (d)(3) of this section, the following tends to show that the distribution of C and the acquisition by C of X are not part of a plan: Neither D, C, nor their respective controlling shareholders discussed the acquisition of X or a similar acquisition with potential acquirers before the distribution (paragraph (d)(3)(i) of this section), D had a substantial business purpose for the distribution other than a business purpose to facilitate the acquisition of X or a similar acquisition (paragraph (d)(3)(vi) of this section), and the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition of X (paragraph (d)(3)(vii) of this section). The distribution was announced and accomplished to facilitate the 20 percent public offering by C. D and C were unaware of the opportunity to acquire X at the time of the distribution.

(E) Weighing the facts and circumstances, the acquisition by C of X and the distribution of C by D are not part of a plan under paragraph (b)(1) of this section.

(F) If C's acquisition of X had occurred more than 6 months after the distribution and had not been the subject of an agreement, understanding, arrangement, or substantial negotiations before the date that is 6 months after the distribution, Safe Harbor II would have applied to C's acquisition of X.

*Example 5. Hot market.* (i) D is a widely held corporation the stock of which is listed on an established market. D announces a distribution of C and distributes C *pro rata* to D's shareholders. By contract, C agrees to indemnify D for any imposition of tax under section 355(e) caused by the acts of C. The distribution is motivated by a desire to improve D's access to financing at preferred customer interest rates, which will be more readily available if D separates from C. At the time of the distribution, although D has not been approached by any potential acquirer of C, it is reasonably certain that within 6 months after the distribution either an acquisition of C will occur or there will be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C. Corporation Y acquires C in a merger described in section 368(a)(2)(E) within 6 months after the distribution. The C shareholders receive less than 50 percent of the stock of Y in the exchange.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the distribution of C and the acquisition of C by Y are part of a plan. To determine whether the distribution of C and the acquisition of C by Y are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) Under paragraph (d)(2) of this section, the following tends to show that the distribution of C and the acquisition of C by Y are part of a plan: The acquisition and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). In addition, the distribution may be motivated by a business purpose to facilitate the acquisition or a similar acquisition because there is evidence of a business purpose to facilitate an acquisition by reason of the fact that at the time of the distribution it was reasonably certain that an acquisition of C would occur or there would be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C within 6 months after the distribution (paragraphs (d)(2)(vii) and (e)(1)(i) of this section).

(v) Under paragraph (d)(3) of this section, the following tends to show that the distribution of C and the acquisition of C by Y are not part of a plan: Neither D, C, nor their respective controlling shareholders discussed the acquisition or a similar acquisition with Y or any other potential acquirers before the distribution (paragraph (d)(3)(i) of this section). Furthermore, D may be able to demonstrate that the distribution was motivated in whole or substantial part by a corporate business purpose other than a business purpose to facilitate the acquisition or a similar acquisition (paragraph (d)(3)(vi) of this section). D's stated purpose for the distribution (facilitating D's access to favorable financing) must be evaluated in light of the evidence of a business purpose to facilitate an acquisition. D also may be able to demonstrate that the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition (paragraph (d)(3)(vii) of this section).

(vi) Under paragraph (e)(5) of this section, the existence of the indemnity is irrelevant in analyzing whether the distribution and acquisition of C are part of a plan.

(vii) In determining whether the distribution of C and the acquisition of C by Y are part of a plan, one should consider the importance of D's stated business purpose for the distribution in light of the reasonable certainty that C would be acquired or there would be an agreement, understanding, arrangement, or substantial negotiations regarding an acquisition of C within 6 months after the distribution. If D's stated business purpose for the distribution is substantial even though the reasonable certainty that C would be acquired is evidence of a business purpose to facilitate an acquisition, and if D would have distributed C regardless of Y's acquisition of C, Y's acquisition of C and D's distribution of C are not part of a plan.

*Example 6. Unexpected opportunity*. (i) D, the stock of which is listed on an established market, announces that it will distribute all the stock of C *pro rata* to D's shareholders. At the time of the announcement, the distribution is motivated wholly by a corporate business purpose (within the meaning of §1.355–2(b)) other than a business purpose to facilitate an acquisition. After the announcement but before the distribution, widely held X becomes available as an acquisition target. There were no discussions between D and X before the announcement. D negotiates with and acquires X before the distribution. After the acquisition, X's former shareholders own 55 percent of D's stock. D distributes the stock of C *pro rata* within 6 months after the acquisition of X.

(ii) No Safe Harbor applies to this acquisition.

(iii) The issue is whether the acquisition of X by D and the distribution of C are part of a plan. To determine whether the distribution of C and the acquisition of X by D are part of a plan, D must consider all the facts and circumstances, including those described in paragraph (d) of this section.

(iv) Under paragraph (d)(2) of this section, the following tends to show that the acquisition of X by D and the distribution of C are part of a plan: The acquisition and the distribution occurred within 6 months of each other (paragraph (d)(2)(viii) of this section). Also, the distribution may be motivated by a business purpose to facilitate the acquisition or a similar acquisition because there is evidence of a business purpose to facilitate an acquisition by reason of the fact that the acquisition occurred after the public announcement of the planned distribution (paragraphs (d)(2)(vii) and (e)(1)(ii) of this section).

(v) Under paragraph (d)(3) of this section, D would assert that the following tends to show that the distribution of C and the acquisition of X by D are not part of a plan: The distribution was motivated by a corporate business purpose other than a business purpose to facilitate the acquisition or a similar acquisition (paragraph (d)(3)(vi) of this section), and the distribution would have occurred at approximately the same time and in similar form regardless of the acquisition (paragraph (d)(3)(vii) of this section). That D decided to distribute C and announced that decision before it became aware of the opportunity to acquire X suggests that the distribution would have occurred at approximately the same time and in similar form regardless of D's acquisition of X. X's lack of participation in the decision also helps establish that fact.

(vi) In determining whether the distribution of C and acquisition of X by D are part of a plan, one should consider the importance of D's business purpose for the distribution in light of D's opportunity to acquire X. If D can establish that the distribution continued to be motivated by the stated business purpose, and if D would have distributed C regardless of D's acquisition of X, then D's acquisition of X and D's distribution of C are not part of a plan.

*Example 7. Multiple acquisitions*. [Reserved]

(n) *Effective date*. This section applies to distributions occurring after August 3, 2001.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue*.

Approved July 26, 2001.

Mark A. Weinberger,
*Assistant Secretary*
*of the Treasury.*

(Filed by the Office of the Federal Register on August 2, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 3, 2001, 66 F.R. 40590)

## Section 2632.—Special Rules for Allocation of GST Exemption

*26 CFR 26.2632–1: Allocation of GST exemption.*

If a taxpayer does not elect on a timely filed gift tax return under section 2632(b) to have the automatic allocation of GST exemption rules not apply to direct skips, what procedure must the taxpayer follow to request an extension of time to make an election that the automatic allocation rules not apply? See Notice 2001–50, page 189.

*26 CFR 26.2632–1: Allocation of GST exemption.*

If a taxpayer does not elect on a timely filed gift tax return under section 2632(c) to have the automatic allocation of GST exemption rules not apply to indirect skips made after December 31, 2000, what procedure must the taxpayer follow to request an extension of time to make an election that the automatic allocation rules not apply? If a taxpayer does not elect on a timely filed gift tax return under section 2632(c)(5)(A)(ii) to treat a trust as a GST trust described in section 2632(c)(3)(B), what procedure must the taxpayer follow to request an extension of time to treat the trust as a GST trust? See Notice 2001–50, page 189.

## Section 2642.—Inclusion Ratio

*26 CFR 26.2642–2: Valuation.*

If a taxpayer does not allocate generation-skipping transfer exemption on a timely filed gift tax return with respect to a lifetime transfer under § 2642(b)(1) or on a timely filed estate tax return with respect to transfers at death under § 2642(b)(2), what procedure must the taxpayer follow to request an extension of time to make an allocation of the generation-skipping transfer exemption? See Notice 2001–50, page 189.

## Section 6103.—Confidentiality and Disclosure of Returns and Return Information

*26 CFR 301.6103(j)(5)–1: Disclosures of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities.*

## T.D. 8958

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Part 301

## Disclosures of Return Information to Officers and Employees of the Department of Agriculture for Certain Statistical Purposes and Related Activities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document provides a final regulation relating to the disclosure of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities. This regulation permits the IRS to disclose return information to the Department of Agriculture to structure, prepare, and conduct the Census of Agriculture.

DATES: *Effective Date*: This regulation is effective July 31, 2001.

*Applicability Date*: For dates of applicability of this regulation, see §301.6103 (j)(5)–1(d).

FOR FURTHER INFORMATION CONTACT: Stuart Murray, (202) 622-4580 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

On January 4, 2000, a temporary regulation (T.D. 8854, 2000–3 I.R.B. 306) relating to disclosure of return information to the Department of Agriculture was published in the **Federal Register** (65 FR 215). A notice of proposed rulemaking (REG–116704–99, 2000–3 I.R.B. 325) cross-referencing the temporary regulation was published in the **Federal Register** for the same day (65 FR 215). No public hearing was requested or held. No written or electronic comments responding to the notice of proposed rulemaking were received. Accordingly, the regulation proposed by REG–116704–99 is adopted by this Treasury decision without revision, and the corresponding temporary regulation is removed.

**Explanation of Provisions**

This regulation allows the IRS to disclose return information to the Department of Agriculture for purposes of the Census of Agriculture.

The disclosure of the specific items of return information identified in this regulation is necessary in order for the Department of Agriculture to accurately identify, locate, and classify, as well as properly process, information from agricultural businesses to be surveyed for the statutorily mandated Census of Agriculture.

**Special Analyses**

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

It is hereby certified that this regulation will not have a significant impact on a substantial number of small entities. This certification is based upon the fact that this regulation concerns the disclosure of return information by the IRS to the Department of Agriculture for purposes of the Census of Agriculture and does not require any action by or otherwise affect small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the temporary regulation and the notice of proposed rulemaking preceding this regulation were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

**Drafting Information**

The principal author of this regulation is Jennifer S. McGinty, formerly of the Office of the Associate Chief Counsel (Procedure & Administration), Disclosure & Privacy Law Division, IRS. However, other personnel from the IRS and Treasury Department participated in its development.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by removing the entry for 301.6103(j)(5)–1T and adding an entry in numerical order to read in part as follows:

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

Section 301.6103(j)(5)–1 also issued under 26 U.S.C. 6103(j)(5);* * *

Par. 2. Section 301.6103(j)(5)–1 is added to read as follows:

*§301.6103(j)(5)–1 Disclosures of return information to officers and employees of the Department of Agriculture for certain statistical purposes and related activities.*

(a) *General rule.* Pursuant to the provisions of section 6103(j)(5) of the Internal Revenue Code and subject to the requirements of paragraph (c) of this section, officers or employees of the Internal Revenue Service (IRS) will disclose return information to officers and employees of the Department of Agriculture to the extent, and for such purposes as may be, provided by paragraph (b) of this section.

(b) *Disclosure of return information to officers and employees of the Department of Agriculture.* (1) Officers or employees of the IRS will disclose the following return information for individuals, partnerships, and corporations with agricultural activity, as determined generally by industry code classification or the filing of returns for such activity, to officers and employees of the Department of Agriculture for purposes of, but only to the extent necessary in, structuring, preparing, and conducting, as authorized by chapter 55 of title 7, United States Code, the Census of Agriculture.

(2) From Form 1040/Schedule F—

(i) Taxpayer Identity Information (as defined in section 6103(b)(6) of the Internal Revenue Code);

(ii) Spouse's SSN;

(iii) Annual Accounting Period;

(iv) Principal Business Activity (PBA) Code;

(v) Sales of livestock and produce raised;

(vi) Taxable cooperative distributions;

(vii) Income from custom hire and machine work;

(viii) Gross income;

(ix) Master File Tax (MFT) Code;

(x) Document Locator Number (DLN);

(xi) Cycle Posted;

(xii) Final return indicator; and

(xiii) Part year return indicator.

(3) From Form 943—

(i) Taxpayer Identity Information;

(ii) Annual Accounting Period;

(iii) Total wages subject to Medicare taxes;

(iv) Master File Tax (MFT) Code;

(v) Document Locator Number (DLN);

(vi) Cycle Posted;

(vii) Final return indicator; and

(viii) Part year return indicator.

(4) From Form 1120 series—

(i) Taxpayer Identity Information;

(ii) Annual Accounting Period;

(iii) Gross receipts less returns and allowances;

(iv) PBA Code;

(v) Parent corporation Employer Identification Number, and related Name and PBA Code for entities with agricultural activity;

(vi) Master File Tax (MFT) Code;

(vii) Document Locator Number (DLN);

(viii) Cycle posted;

(ix) Final return indicator;

(x) Part year return indicator; and

(xi) Consolidated return indicator.

(5) From Form 851—

(i) Subsidiary Taxpayer Identity Information;

(ii) Annual Accounting Period;

(iii) Subsidiary PBA Code;

(iv) Parent Taxpayer Identity Information;

(v) Parent PBA Code;

(vi) Master File Tax (MFT) Code;

(vii) Document Locator Number (DLN); and

(viii) Cycle Posted.

(6) From Form 1065 series—

(i) Taxpayer Identity Information;

(ii) Annual Accounting Period;

(iii) PBA Code;

(iv) Gross receipts less returns and allowances;

(v) Net farm profit (loss);

(vi) Master File Tax (MFT) Code;

(vii) Document Locator Number (DLN);

(viii) Cycle Posted;

(ix) Final return indicator; and

(x) Part year return indicator.

(c) *Procedures and restrictions.* (1) Disclosure of return information by officers or employees of the IRS as provided by paragraph (b) of this section shall be made only upon written request designating, by name and title, the officers and employees of the Department of Agriculture to whom such disclosure is authorized, to the Commissioner of Internal Revenue by the Secretary of the Department of Agriculture and describing—

(i) The particular return information to be disclosed;

(ii) The taxable period or date to which such return information relates; and

(iii) The particular purpose for which the return information is to be used.

(2) No such officer or employee to whom return information is disclosed pursuant to the provisions of paragraph (b) of this section shall disclose such return information to any person, other than the taxpayer to whom such return information relates or other officers or employees of the Department of Agriculture whose duties or responsibilities require such disclosure for a purpose described in paragraph (b) of this section, except in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. If the IRS determines that the Department of Agriculture, or any officer or employee thereof, has failed to, or does not, satisfy the requirements of section 6103(p)(4) of the Internal Revenue Code or regulations or published procedures thereunder, the IRS may take such actions as are deemed necessary to ensure that such requirements are or shall be satisfied, including suspension of disclosures of return information otherwise authorized by section 6103(j)(5) and paragraph (b) of this section, until the IRS determines that such requirements have been or will be satisfied.

(d) *Effective date.* This section is applicable on July 31, 2001.

**§301.6103(j)(5)–1T [Removed]**

Par. 3. Section 301.6103(j)(5)–1T is removed.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

Approved July 20, 2001.

Mark Weinberger,
*Assistant Secretary of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on July 30, 2001, 8:45 a.m., and published in the issue of the Federal Register for July 31, 2001, 66 F.R. 39437)

## Section 6112.—Organizers and Sellers of Potentially Abusive Tax Shelters Must Keep Lists of Investors

*26 CFR 301.6112–1T: Requirements to maintain list of investors in potentially abusive tax shelters.*

Which transactions have been determined by the Internal Revenue Service to be tax avoidance transactions for purposes of § 6111(d)(1)(A) and are transactions for which promoters must maintain lists of investors pursuant to § 301.6112–1T? See Notice 2001–51, page 190.

## Section 6205.—Special Rules Applicable to Certain Employment Taxes

*26 CFR 31.6205–1: Adjustments of underpayments.*

## T.D. 8959

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 31

## Interest-Free Adjustments With Respect to Underpayments of Employment Taxes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

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

DATES: *Effective Date*: These regulations are effective August 1, 2001.

*Applicability Date*: These regulations are applicable with respect to notices of determination issued on or after March 19, 2001. Interest will be computed under the rule in this regulation on any claims for refund of interest pending on January 17, 2001. No inference is intended that the rule set forth in these final regulations is not current law.

FOR FURTHER INFORMATION CONTACT: Lynne Camillo (202) 622-6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains an amendment to the Employment Tax Regulations (26 CFR part 31) under section 6205. On January 17, 2001, the IRS published in the **Federal Register** (66 FR 3956) a notice of proposed rulemaking (REG–110374–00, 2001–12 I.R.B. 915) under section 6205 of the Internal Revenue Code relating to interest-free adjustments of employment tax underpayments. The notice proposed to amend §31.6205–1 of the employment tax regulations.

No written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. Accordingly, the proposed regulations are adopted as final regulations.

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

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

**Explanation of Provisions**

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

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

In Revenue Ruling 75–464 (1975–2 C.B. 474), the IRS further clarified the time for adjustments under section 6205. The ruling clarifies that employers can still make interest-free adjustments where the underpayment is discovered during an audit or examination (*i.e.*, where the employer has not independently ascertained

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

the underpayment). The ruling sets forth situations illustrating when an error is ascertained with respect to returns under audit by the IRS. Under the facts in the revenue ruling, an error is ascertained when the employer signs an *"Agreement to Adjustment and Collection of Additional Tax"*, Form 2504, either at the examination level or the appeals level, when the taxpayer pays the full amount due so as to file a refund claim (if paid prior to notice and demand), or at the conclusion of internal IRS appeal rights if no agreement is reached. Under the factual situations in Revenue Ruling 75–464, the employment taxes can be paid free of interest at the time the employer signs Agreement Form 2504 or at the time it pays the tax preparatory to filing a claim to contest the liability in court, after having exhausted all appeal rights within the IRS, provided the payment is made before the taxpayer receives notice and demand for payment.

The Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788), created new section 7436 of the Code which provides the Tax Court with jurisdiction to review determinations by the IRS that workers are employees for purposes of subtitle C of the Code, or that the organization for which services are performed is not entitled to relief from employment taxes under section 530. Section 7436(a) requires that the determination involve an actual controversy and that it be made as part of an examination. Subsequent to enactment of section 7436 of the Code, the IRS created a standard notice, the "Notice of Determination Concerning Worker Classification Under Section 7436" (notice of determination) to serve as the "determination" that is a prerequisite to invoking the Tax Court's jurisdiction under section 7436. Notice 98–43 (1998–2 C.B. 211).

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

Current IRS guidance provides for interest-free adjustments under section 6205 prior to assessment and notice and demand. Because of the prohibition on assessment for cases pending in the Tax Court, this creates a potential for inconsistent application of interest depending upon whether an employer files a claim in the Tax Court or in another court of Federal jurisdiction. The legislative history of section 7436 shows no intent to create an advantage for taxpayers who choose to litigate their cases in Tax Court as opposed to another court of Federal jurisdiction. H.R. No. 105–148, 105th Cong., 1st Sess., at 639–640 (1997). Taxpayers who choose to petition the Tax Court under section 7436 still have the benefit of all of the inherent advantages of litigating in the Tax Court, including the ability to obtain judicial review without prior payment of the additional tax the IRS has determined to be due.

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

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

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

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

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

**Special Analyses**

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

**Drafting Information**

The principal author of this final regulation is Lynne Camillo, Office of the Assistant Chief Counsel (Exempt Organizations/Employment Tax/Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Amendments to the Regulations**

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

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

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

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

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

*§31.6205–1 Adjustments of underpayments.*

(a) * * *

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

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

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

* * * * *

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved July 20, 2001.

Mark A. Weinberger,
*Assistant Secretary*
*of the Treasury.*

(Filed by the Office of the Federal Register on July 31, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2001, 66 F.R. 39638)

# Part III. Administrative, Procedural, and Miscellaneous

## Safe Harbor Under Which an Issue of Tax or Revenue Anticipation Bonds Will Not Be Treated as Outstanding Longer Than Is Reasonably Necessary to Accomplish the Governmental Purposes of the Bonds for Purposes of § 1.148–10(a)(4) of the Income Tax Regulations

## Notice 2001–49

Recent Internal Revenue Service examinations have identified a lack of clarity in regulations concerning when tax or revenue anticipation bonds will be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds for purposes of § 1.148–10(a)(4) of the Income Tax Regulations. Because of this lack of clarity in the regulations, the Internal Revenue Service announces that the issue of whether a tax or revenue anticipation bond is outstanding longer than necessary for purposes of § 1.148–10(a)(4) will be closed in any current examination, and will not be raised in any future examination, with respect to any issue of tax or revenue anticipation bonds that has a term of 2 years or less and was sold prior to August 3, 2001. This announcement has no effect on any other issue that may be identified in any current or future examination.

In addition, the Internal Revenue Service has determined that it is appropriate to provide a prospective safe harbor regarding the term of tax or revenue anticipation bonds. Therefore, attached is a proposed revenue procedure that sets forth a safe harbor under which an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds for purposes of § 1.148–10(a)(4).

Section 3 of the proposed revenue procedure provides that the safe harbor applies to an issue of tax or revenue anticipation bonds the proceeds of which qualify for a temporary period for restricted working capital expenditures under § 1.148–2(e)(3). Section 4 of the proposed revenue procedure provides that, for purposes of § 1.148–10(a)(4), an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of those bonds if the final maturity date of the issue is not later than the end of the applicable temporary period under § 1.148–2(e)(3)(i) or § 1.148–2(e)(3)(ii) for which proceeds of the issue qualify.

The proposed revenue procedure will apply to bonds sold after the date the revenue procedure is published in the Internal Revenue Bulletin in final form. However, issuers may rely on the proposed revenue procedure with respect to any issue of tax or revenue anticipation bonds that is sold before the effective date of the proposed revenue procedure and on or after August 3, 2001.

Comments are requested on the proposed revenue procedure. Comments may be submitted on or before November 18, 2001, to Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224, Attn: CC:ITA:RU (Notice 2001–49), Room 5226. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:ITA:RU (Notice 2001–49), Room 5226. Submissions may also be sent electronically via the Internet to the following e-mail address: notice.comments@m1.irscounsel.treas.gov.

The principal authors of this notice are Rose M. Weber and Timothy L. Jones of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of this notice. For further information regarding this notice, contact either Rose M. Weber or Timothy L. Jones at (202) 622-3980 (not a toll-free call).

*26 CFR 1.148–10: Anti-abuse rules and Authority of Commissioner.*
*(Also Part I, §§ 103, 148, 1.148–1, 148–2, 148–6)*

## Rev. Proc. 2001–XX

SECTION 1. PURPOSE

This revenue procedure sets forth a safe harbor under which an issue of tax or revenue anticipation bonds will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of the bonds for purposes of § 1.148–10(a)(4) of the Income Tax Regulations.

SECTION 2. BACKGROUND

01. Section 103(a) of the Internal Revenue Code of 1986 provides that, except as provided in section 103(b), gross income does not include interest on any state or local bond.

02. Section 103(b) provides that the exclusion described in section 103(a) does not apply to any arbitrage bond.

03. Section 148(a) provides that an arbitrage bond is any bond issued as part of an issue any portion of the proceeds of which are to be used directly or indirectly–

(1) to acquire higher yielding investments, or

(2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

04. Section 148(c)(1) provides that a bond will not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such bond is a part may be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which such issue was issued.

05. Section 1.148–2(e)(3)(i) of the Income Tax Regulations provides that the proceeds of an issue that are reasonably expected to be allocated to restricted working capital expenditures within 13 months after the issue date qualify for a temporary period of 13 months beginning on the issue date.

06. Section 1.148–2(e)(3)(ii) provides that if an issuer reasonably expects to use tax revenues arising from tax levies for a single fiscal year to redeem or retire an issue, and the issue matures by the earlier of 2 years after the issue date or 60 days after the last date for payment of those taxes without interest or penalty, the temporary period under § 1.148–2(e)(3)(i) is extended until the maturity date of the issue.

07. Section 1.148–1(b) provides that restricted working capital expenditures

are working capital expenditures that are subject to the proceeds-spent-last rule in § 1.148–6(d)(3)(i) and are ineligible for any exception to that rule.

08. Section 1.148–10(a)(1) provides that bonds of an issue are arbitrage bonds if an abusive arbitrage device under § 1.148–10(a)(2) is used in connection with the issue.

09. Section 1.148–10(a)(2) provides that any action is an abusive arbitrage device if the action has the effect of (i) enabling the issuer to exploit the difference between tax-exempt and taxable interest rates to obtain a material financial advantage and (ii) overburdening the tax-exempt bond market.

10. Section 1.148–10(a)(4) provides that an action overburdens the tax-exempt bond market if it results in issuing more bonds, issuing bonds earlier, or allowing bonds to remain outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds, based on all the facts and circumstances.

11. Under § 1.148–10(a)(4), one factor evidencing that bonds may remain outstanding longer than necessary is a term that exceeds the safe harbors against the creation of replacement proceeds under § 1.148–1(c)(4)(i)(B). This factor may be outweighed by other factors, however, such as long-term financial distress.

12. Section 1.148–1(c)(4)(i)(A) provides that certain replacement proceeds arise to the extent that the issuer reasonably expects as of the issue date that the term of the issue will be longer than is reasonably necessary for the governmental purposes of the issue and that there will be available amounts during the period that the issue remains outstanding longer than necessary. Whether an issue is outstanding longer than necessary is determined under § 1.148–10.

13. Section 1.148–1(c)(4)(i)(B)(1) provides a safe harbor against the creation of replacement proceeds under § 1.148–1(c)(4)(i)(A) for the portion of an issue that finances restricted working capital expenditures. This safe harbor is met if that portion is not outstanding longer than 2 years.

14. Section 1.148–1(c)(4)(i)(B)(2) provides a safe harbor against the creation of replacement proceeds under § 1.148–1(c)(4)(i)(A) for the portion of an issue (including a refunding issue) that finances or refinances capital projects. This safe harbor is met if that portion has a weighted average maturity that does not exceed 120 percent of the average reasonably expected economic life of the financed capital projects.

15. Section 1.148–10(d) contains examples illustrating the application of the anti-abuse rules of § 1.148–10. Example 2(i) describes a particular transaction in which an issue is deemed to have a longer weighted average maturity than necessary, notwithstanding that the issue satisfies the safe harbor against the creation of replacement proceeds in § 1.148–1(c)(4)(i)(B)(2).

SECTION 3. SCOPE

This revenue procedure applies to an issue of tax or revenue anticipation bonds the proceeds of which qualify for a temporary period for restricted working capital expenditures under § 1.148–2(e)(3).

SECTION 4. SAFE HARBOR

For purposes of § 1.148–10(a)(4), an issue of tax or revenue anticipation bonds within the scope of this revenue procedure will not be treated as outstanding longer than is reasonably necessary to accomplish the governmental purposes of those bonds if the final maturity date of the issue is not later than the end of the applicable temporary period under § 1.148–2(e)(3)(i) or § 1.148–2(e)(3)(ii) for which proceeds of the issue qualify. This revenue procedure does not apply to determine whether an issue of tax or revenue anticipation bonds meets the other requirements of section 148.

SECTION 5. ADVANCE RULINGS

The Service will consider requests for rulings on proposed issues of tax or revenue anticipation bonds that do not satisfy the safe harbor provided in section 4.

SECTION 6. EFFECTIVE DATE

This revenue procedure applies to tax or revenue anticipation bonds sold after August 20, 2001.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Rose M. Weber and Timothy L. Jones of Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in the development of this revenue procedure. For further information regarding this revenue procedure, contact Rose M. Weber or Timothy L. Jones at (202) 622-3980 (not a toll-free call).

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## Relief From Late Allocation of GST Exemption

## Notice 2001–50

PURPOSE

This notice provides guidance regarding requests for an extension of time to make an allocation of generation-skipping transfer (GST) exemption under § 2642(b)(1) and (2) of the Internal Revenue Code in view of the enactment of § 2642(g) by The Economic Growth and Tax Relief Reconciliation Act of 2001 (the Act). Pub. L. 107–16, § 564, 115 Stat. 91. This notice also provides guidance regarding requests for an extension of time to make elections under § 2632(b)(3) and § 2632(c)(5) as added by § 561(a) of the Act.

BACKGROUND

Section 2601 imposes a tax on every GST. Each individual is allowed a GST exemption that may be allocated to transfers that would be subject to the GST tax. In general, an individual's GST exemption may be allocated to transfers at any time on or before the due date for filing the federal estate tax return for the individual's estate under § 2632(a)(1).

For lifetime transfers, available GST exemption is automatically allocated to a direct skip under § 2632(b), and to indirect skips made after December 31, 2000, under § 2632(c), unless the individual elects out of the automatic allocation under § 2632(b)(3) and § 2632(c)(5), respectively. Under § 2632(c)(3)(A), an indirect skip is a transfer of property, subject to gift tax, to a GST trust as defined in § 2632(c)(3)(B). An individual may elect to treat any trust as a GST trust under § 2632(c)(5)(A)(ii).

Under § 26.2632–1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the election out of the automatic allocation for direct skips must be made on a timely filed federal gift tax return. The Treasury Department and the Internal Revenue Service will issue regulations providing that the election out of the automatic allocation for indirect skips and the election to treat any trust as a GST trust must also be made on a timely filed federal gift tax return.

Under § 2642(b)(1) and § 26.2642–2(a)(1), with respect to lifetime transfers, the value of the property to which the GST exemption is allocated is its value at the date of the transfer if the GST exemption is automatically allocated or is allocated on a timely filed federal gift tax return. Under § 2642(b)(3), if the allocation is not made on a timely filed gift tax return, the value of the property to which the exemption is allocated is its value on the effective date of the allocation as described in § 26.2642–2(a)(2).

Section 2642(b)(2) describes allocations with respect to transfers at death and provides that the value of property to which the GST exemption is allocated is its value as determined for estate tax purposes. The allocation of the GST exemption to transfers at death may be made by the executor at any time prior to the due date of the federal estate tax return under § 26.2632–1(a). Unused GST exemption that has not been allocated by the executor is automatically allocated to transfers at death and lifetime transfers for which no allocation had previously been made as prescribed in § 2632(e)(1).

Section 2642(g)(1)(A), added by § 564(a) of the Act, authorizes the Treasury Department to issue regulations prescribing the circumstances and procedures under which extensions of time will be granted to make an allocation of the GST exemption described in § 2642(b)(1) and (2) or to make an election under § 2632(b)(3) and (c)(5). Section 2642(g)(1)(B) provides that in determining whether to grant relief, the time for making the allocation or election is to be treated as if not expressly prescribed by statute. If an extension of time is granted to make the allocation, then the gift or estate tax value of the transfer to the trust is used to determine the allocation of the GST exemption. H.R. Conf. Rep. No. 84, 107th Cong., 1st Sess. 202 (2001). Under § 564(b) of the Act, the provisions of § 2642(g)(1) apply to requests for relief pending on, or filed after, December 31, 2000.

REQUESTS FOR RELIEF UNDER § 2642(g)(1)

Section 301.9100–3 of the Procedure and Administration Regulations provides the standards used to determine whether to grant an extension of time to make an election whose due date is prescribed by a regulation (and not expressly provided by statute). Under § 301.9100–1(b), a regulatory election includes an election whose due date is prescribed by a notice published in the Internal Revenue Bulletin. In accordance with § 2642(g)(1)(B), the time for allocating the GST exemption to lifetime transfers and transfers at death, the time for electing out of the automatic allocation rules, and the time for electing to treat any trust as a GST trust are to be treated as if not expressly prescribed by statute. Therefore, taxpayers may seek an extension of time to make an allocation described in § 2642(b)(1) or (b)(2) or an election described in § 2632(b)(3) or (c)(5) under the provisions of § 301.9100–3.

In general, under § 301.9100–3, relief will be granted if the taxpayer establishes to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith and that the grant of relief will not prejudice the interests of the government. Taxpayers requesting relief should follow the procedures for requesting a private letter ruling under § 301.9100 contained in section 5.02 of Rev. Proc. 2001–1 (or its successor), 2001–1 I.R.B. 1, 13.

EFFECTIVE DATE

This notice is effective with respect to requests for relief pending on, or filed after, December 31, 2000.

DRAFTING INFORMATION

The principal author of this notice is William L. Blodgett of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Blodgett at (202) 622-3090 (not a toll-free call).

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## Listed Transactions Update

## Notice 2001–51

On February 28, 2000, the Internal Revenue Service issued Notice 2000–15, 2000–12 I.R.B. 826, identifying certain transactions as "listed transactions" for purposes of § 1.6011–4T(b)(2) of the temporary Income Tax Regulations and § 301.6111–2T(b)(2) of the temporary Procedure and Administration Regulations. This notice restates the list of transactions identified in Notice 2000–15 as "listed transactions" effective February 28, 2000, and updates the list by adding transactions identified in notices released subsequent to February 28, 2000.

Transactions that are the same as or substantially similar to transactions described in the list below have been determined by the Service to be tax avoidance transactions and are identified as "listed transactions" for purposes of § 1.6011–4T(b)(2) and § 301.6111–2T(b)(2). As a result, corporate taxpayers may need to disclose their participation in these listed transactions as prescribed in § 1.6011–4T, and promoters (or other persons responsible for registering tax shelter transactions) may need to register these transactions under § 301.6111–2T. In addition, promoters must maintain lists of investors and other information with respect to these listed transactions pursuant to § 301.6112–1T.

(1) Rev. Rul. 90–105, 1990–2 C.B. 69 (transactions in which taxpayers claim deductions for contributions to a qualified cash or deferred arrangement or matching contributions to a defined contribution plan where the contributions are attributable to compensation earned by plan participants after the end of the taxable year (identified as "listed transactions" on February 28, 2000));

(2) Notice 95–34, 1995–1 C.B. 309 (certain trust arrangements purported to qualify as multiple employer welfare benefit funds exempt from the limits of §§ 419 and 419A of the Internal Revenue Code (identified as "listed transactions" on February 28, 2000));

(3) Notice 95–53, 1995–2 C.B. 334 (certain multiple-party transactions intended to allow one party to realize rental or other income from property or service contracts and to allow another party to report deductions related to that income

(often referred to as "lease strips") (identified as "listed transactions" on February 28, 2000));

(4) Transactions described in Part II of Notice 98–5, 1998–1 C.B. 334 (transactions in which the reasonably expected economic profit is insubstantial in comparison to the value of the expected foreign tax credits (identified as "listed transactions" on February 28, 2000));

(5) Transactions substantially similar to those at issue in *ASA Investerings Partnership v. Commissioner*, 201 F.3d 505 (D.C. Cir. 2000), and *ACM Partnership v. Commissioner*, 157 F.3d 231 (3d Cir. 1998) (transactions involving contingent installment sales of securities by partnerships in order to accelerate and allocate income to a tax-indifferent partner, such as a tax-exempt entity or foreign person, and to allocate later losses to another partner (identified as "listed transactions" on February 28, 2000));

(6) Treas. Reg. § 1.643(a)–8 (transactions involving distributions described in § 1.643(a)–8 from charitable remainder trusts (identified as "listed transactions" on February 28, 2000));

(7) Rev. Rul. 99–14, 1999–1 C.B. 835 (transactions in which a taxpayer purports to lease property and then purports to immediately sublease it back to the lessor (that is, lease-in/lease-out or LILO transactions) (identified as "listed transactions" on February 28, 2000));

(8) Notice 99–59, 1999–2 C.B. 761 (transactions involving the distribution of encumbered property in which taxpayers claim tax losses for capital outlays that they have in fact recovered (identified as "listed transactions" on February 28, 2000));

(9) Treas. Reg. § 1.7701(l)–3, (transactions involving fast-pay arrangements as defined in § 1.7701(l)–3(b) (identified as "listed transactions" on February 28, 2000));

(10) Rev. Rul. 2000–12, 2000–11 I.R.B. 744 (certain transactions involving the acquisition of two debt instruments the values of which are expected to change significantly at about the same time in opposite directions (identified as "listed transactions" on February 28, 2000));

(11) Notice 2000–44, 2000–36 I.R.B. 255 (transactions generating losses resulting from artificially inflating the basis of partnership interests (identified as "listed transactions" on August 11, 2000));

(12) Notice 2000–60, 2000–49 I.R.B. 568 (transactions involving the purchase of a parent corporation's stock by a subsidiary, a subsequent transfer of the purchased parent stock from the subsidiary to the parent's employees, and the eventual liquidation or sale of the subsidiary (identified as "listed transactions" on November 16, 2000));

(13) Notice 2000–61, 2000–49 I.R.B. 569 (transactions purporting to apply § 935 to Guamanian trusts (identified as "listed transactions" on November 21, 2000));

(14) Notice 2001–16, 2001–9 I.R.B. 730 (transactions involving the use of an intermediary to sell the assets of a corporation (identified as "listed transactions" on January 18, 2001));

(15) Notice 2001–17, 2001–9 I.R.B. 730 (transactions involving a loss on the sale of stock acquired in a purported § 351 transfer of a high basis asset to a corporation and the corporation's assumption of a liability that the transferor has not yet taken into account for federal income tax purposes (identified as "listed transactions" on January 18, 2001)); and

(16) Notice 2001–45, 2001–33 I.R.B. 129 (certain redemptions of stock in transactions not subject to U.S. tax in which the basis of the redeemed stock is purported to shift to a U.S. taxpayer (identified as "listed transactions" on July 26, 2001)).

Notice 2000–15 is supplemented and superseded.

The principal author of this notice is David A. Shulman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Shulman at (202) 622-3080 (not a toll-free call).

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*26 CFR 601.201: Rulings and determination letters.*
*(Also Part I, §§ 61, 83, 721; 1.721–1.)*

## Rev. Proc 2001–43

SECTION 1. PURPOSE

This revenue procedure clarifies Rev. Proc. 93–27 (1993–2 C.B. 343) by providing guidance on the treatment of the grant of a partnership profits interest that is substantially nonvested for the provision of services to or for the benefit of the partnership.

SECTION 2. BACKGROUND

Rev. Proc. 93–27 provides that (except as otherwise provided in section 4.02 of the revenue procedure), if a person receives a profits interest for the provision of services to or for the benefit of a partnership in a partner capacity or in anticipation of being a partner, the Internal Revenue Service will not treat the receipt of the interest as a taxable event for the partner or the partnership. For this purpose, section 2.02 of Rev. Proc. 93–27 defines a profits interest as a partnership interest other than a capital interest. Section 2.01 of Rev. Proc. 93–27 defines a capital interest as an interest that would give the holder a share of the proceeds if the partnership's assets were sold at fair market value and then the proceeds were distributed in a complete liquidation of the partnership. Section 2.01 of Rev. Proc. 93–27 provides that the determination as to whether an interest is a capital interest generally is made at the time of receipt of the partnership interest.

SECTION 3. SCOPE

This revenue procedure clarifies Rev. Proc. 93–27 by providing that the determination under Rev. Proc. 93–27 of whether an interest granted to a service provider is a profits interest is, under the circumstances described below, tested at the time the interest is granted, even if, at that time, the interest is substantially nonvested (within the meaning of § 1.83–3(b) of the Income Tax Regulations). Accordingly, where a partnership grants a profits interest to a service provider in a transaction meeting the requirements of this revenue procedure and Rev. Proc. 93–27, the Internal Revenue Service will not treat the grant of the interest or the event that causes the interest to become substantially vested (within the meaning of § 1.83–3(b) of the Income Tax Regulations) as a taxable event for the partner or the partnership. Taxpayers to which this revenue procedure applies need not file an election under section 83(b) of the Code.

## SECTION 4. APPLICATION

This revenue procedure clarifies that, for purposes of Rev. Proc. 93–27, where a partnership grants an interest in the partnership that is substantially nonvested to a service provider, the service provider will be treated as receiving the interest on the date of its grant, provided that:

.01 The partnership and the service provider treat the service provider as the owner of the partnership interest from the date of its grant and the service provider takes into account the distributive share of partnership income, gain, loss, deduction, and credit associated with that interest in computing the service provider's income tax liability for the entire period during which the service provider has the interest;

.02 Upon the grant of the interest or at the time that the interest becomes substantially vested, neither the partnership nor any of the partners deducts any amount (as wages, compensation, or otherwise) for the fair market value of the interest; and

.03 All other conditions of Rev. Proc. 93–27 are satisfied.

## SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 93–27 is clarified.

## SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Craig Gerson of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Craig Gerson at (202) 622-3050 (not a toll-free call).

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

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

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

**LIFO; price indexes; department stores.** The June 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, June 30, 2001.

## Rev. Rul. 2001–41

The following Department Store Inventory Price Indexes for June 2001 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46 (1986–2 C.B. 739) for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, June 30, 2001.

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

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

| Groups | June 2000 | June 2001 | Percent Change from June 2000 to June 2001[1] |
|---|---|---|---|
| 1. Piece Goods | 496.1 | 478.7 | -3.5 |
| 2. Domestics and Draperies | 615.8 | 603.2 | -2.0 |
| 3. Women's and Children's Shoes | 626.5 | 644.8 | 2.9 |
| 4. Men's Shoes | 926.1 | 888.8 | -4.0 |
| 5. Infants' Wear | 642.2 | 605.2 | -5.8 |
| 6. Women's Underwear | 568.3 | 562.2 | -1.1 |
| 7. Women's Hosiery | 334.2 | 354.0 | 5.9 |
| 8. Women's and Girls' Accessories | 538.3 | 547.3 | 1.7 |
| 9. Women's Outerwear and Girls' Wear | 385.0 | 378.1 | -1.8 |
| 10. Men's Clothing | 613.5 | 582.1 | -5.1 |
| 11. Men's Furnishings | 621.5 | 599.6 | -3.5 |
| 12. Boys' Clothing and Furnishings | 491.7 | 488.5 | -0.7 |
| 13. Jewelry | 924.3 | 936.8 | 1.4 |
| 14. Notions | 768.3 | 780.7 | 1.6 |
| 15. Toilet Articles and Drugs | 971.1 | 963.4 | -0.8 |
| 16. Furniture and Bedding | 670.6 | 639.9 | -4.6 |
| 17. Floor Coverings | 607.9 | 615.4 | 1.2 |
| 18. Housewares | 780.7 | 767.7 | -1.7 |
| 19. Major Appliances | 233.6 | 225.9 | -3.3 |
| 20. Radio and Television | 59.8 | 53.9 | -9.9 |
| 21. Recreation and Education[2] | 93.0 | 90.1 | -3.1 |
| 22. Home Improvements[2] | 128.2 | 124.7 | -2.7 |
| 23. Auto Accessories[2] | 106.3 | 109.1 | 2.6 |
| Groups 1 - 15: Soft Goods | 592.9 | 584.1 | -1.5 |
| Groups 16 - 20: Durable Goods | 438.1 | 422.5 | -3.6 |
| Groups 21 - 23: Misc. Goods[2] | 100.2 | 98.5 | -1.7 |
| Store Total[3] | 534.9 | 524.5 | -1.9 |

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

[2] Indexes on a January 1986=100 base.

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

DRAFTING INFORMATION

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

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## Section 6011.—General Requirement of Return, Statement, or List

*26 CFR 1.6011–4T: Requirement of statement disclosing participation in certain transactions by corporate taxpayers (Temporary)*

## T.D. 8961

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 301

## Modification of Tax Shelter Rules II

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: These temporary regulations modify the rules relating to the requirement that certain corporate taxpayers file a statement with their Federal corporate income tax returns under section 6011(a) and the registration of confidential corporate tax shelters under section 6111(d). These regulations provide the public with additional guidance needed to comply with the disclosure rules under section 6011(a), the registration requirement under section 6111(d), and the list maintenance requirement under section 6112 applicable to tax shelters. The temporary regulations affect corporations participating in certain reportable transactions, persons responsible for registering confidential corporate tax shelters, and organizers of potentially abusive tax shelters. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–103735–00, REG–110311–98, and REG–103736–00) on page 204 in this issue of the Bulletin.

DATES: *Effective Date*: These temporary regulations are effective August 2, 2001.

*Applicability Date*: For dates of applicability, see §1.6011–4T(g) and §301.6111–2T(h).

FOR FURTHER INFORMATION CONTACT: Danielle M. Grimm (202) 622-3080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document amends 26 CFR parts 1 and 301 to provide modified rules relating to the disclosure of certain reportable transactions by corporate investors on their Federal corporate income tax returns under section 6011 and the registration of confidential corporate tax shelters under section 6111.

On February 28, 2000, the IRS issued temporary and proposed regulations regarding section 6011 (T.D. 8877, 2000–11 I.R.B. 747; REG–103735–00, 2000–11 I.R.B. 770), section 6111 (T.D. 8876, 2000–11 I.R.B. 753; REG–110311–98, 2000–11 I.R.B. 767), and section 6112 (T.D. 8875, 2000–11 I.R.B. 761; REG–103736–00, 2000–11 I.R.B. 768) (collectively, the February regulations). The February regulations were published in the **Federal Register** (65 FR 11205, 65 FR 11215, 65 FR 11211) on March 2, 2000. On August 11, 2000, the IRS issued temporary and proposed regulations regarding sections 6011, 6111, and 6112 (T.D. 8896, 2000–36 I.R.B. 249; REG–103735–00, REG–110311–98, REG–103736–00, 2000–36 I.R.B. 258) (collectively, the August regulations). The August regulations were published in the **Federal Register** (65 FR 49909) on August 16, 2000, modifying the February regulations.

Based on comments that have been received, the IRS and Treasury have determined that certain additional interim changes to the temporary and proposed regulations are warranted. The changes in the proposed rules are published on page 204 in this issue of the Bulletin.

These interim changes are intended to assist taxpayers and ease tax administration by simplifying and clarifying certain provisions of the regulations, addressing certain practical problems relating to compliance with the regulations, and making certain other changes relating to the scope of the regulations. The IRS and Treasury continue to evaluate all the comments and recommendations received, and other changes may be made in the final regulations.

**Explanation of Provisions**

*1. Different Foreign Tax Treatment Characteristic in §1.6011–4T(b)(3)(i)(F)*

Under section 6011, reportable transactions include listed transactions and transactions that have at least two of six specified characteristics. One of the characteristics is present if the expected characterization of any significant aspect of the transaction for Federal income tax purposes differs from the expected characterization of such aspect of the transaction for purposes of taxation of any party to the transaction in another country. Commentators have suggested that the inclusion of this characteristic causes the regulations to be overinclusive. Based on these comments and further review, the IRS and Treasury have removed this characteristic from the temporary and proposed regulations.

*2. Clarification of Exceptions Under §1.6011–4T*

*a. "Long-standing and generally accepted exception" in §1.6011–4T(b)(3)(ii)(B)*

The temporary regulations under section 6011 provide that a transaction, other than a listed transaction, is not a reportable transaction if one of four exceptions is satisfied. One exception applies if the taxpayer has participated in the transaction in the ordinary course of its business in a form consistent with customary commercial practice, and the taxpayer reasonably determines that there is a long-standing and generally accepted understanding that the expected Federal income tax benefits (taking into account any combination of intended tax consequences) from the transaction are allowable under the Code for substantially similar transactions.

Commentators have requested additional guidance on the meaning of the phrase "long-standing and generally accepted" that is contained in this exception. This exception is intended to apply to transactions the structure of which is customary and the intended tax treatment of which is widely known and generally accepted as properly allowable under the Internal Revenue Code. Ordinarily, a determination as to whether the intended tax treatment of a transaction has achieved such a level of general acceptance cannot be made unless information relating to the structure and tax treatment of substantially similar transactions has been in the public domain and widely known for a period of years. However, the applicability of this exception does not depend on such general acceptance having existed for any minimum period of time. Accordingly, the IRS and Treasury have eliminated the phrase "long-standing" from the exception and have added language to clarify the scope of the exception. Corresponding changes have been made in §301.6111–2T.

b. *"No reasonable basis exception" in §1.6011–4T(b)(3)(ii)(C)*

This exception generally provides that a transaction, other than a listed transaction, is not reportable if the taxpayer reasonably determines that there is no reasonable basis under Federal tax law for denial of any significant portion of the expected Federal income tax benefits from the transaction. Commentators have requested additional guidance on the no reasonable basis determination. Accordingly, the regulations clarify that for purposes of this exception, whether the IRS would have a reasonable basis for its position is to be determined by applying the same standard as that applicable to taxpayers under §1.6662–3(b)(3). Thus, the reasonable basis standard is not satisfied by an IRS position that would be merely arguable or that would constitute merely a colorable claim. The determination of whether the IRS would have such a reasonable basis is qualitative in nature and does not depend on any percentage or other quantitative assessment of the likelihood that the taxpayer would ultimately prevail if a significant portion of the expected tax benefits were disallowed by the IRS. Corresponding changes have been made to newly redesignated §301.6111–2T(b)(4)(i).

3. *Economic Substance Test*

Commentators have suggested that the economic substance test, as articulated in §301.6111–2T(b)(3), may encompass transactions for which registration pursuant to section 6111(d) or list maintenance under section 6112 would not be appropriate. Further, the IRS and Treasury believe that substantially all transactions encompassed by the economic substance test for which registration and list maintenance are appropriate will constitute other tax structured transactions within the meaning of §301.6111–2T(b)(4). Accordingly, the economic substance test as described in §301.6111–2T(b)(3) is removed from the temporary and proposed regulations under section 6111.

4. *Presumption Against Confidentiality*

Section 301.6111–2T(c)(3) contains a presumption that, unless facts and circumstances clearly indicate otherwise, an offer is not considered made under conditions of confidentiality if the tax shelter promoter provides express written authorization to each offeree permitting the offeree (and each employee, representative, or other agent of such offeree) to disclose the structure and tax aspects of the transaction to any and all persons, without limitation of any kind on such disclosure. There has been a request to clarify the phrase "to disclose the structure and tax aspects of the transaction." Accordingly, the IRS and Treasury have added language to clarify that this phrase is to be construed broadly and includes all materials (including opinions or other tax analyses) that are provided to the offeree related to the structure and tax aspects of the transaction.

5. *Tax Shelter Registration in §301.6111–2T(e)(2)(ii)(E)*

The August regulations provided that the Form 8264, *"Application for Registration of a Tax Shelter,"* was to be filed with the Kansas City Service Center. Recently, the Service issued Announcement 2001–62 (2001–24 I.R.B. 1337) instructing taxpayers to file these forms with the Ogden Service Center. The instructions to Form 8264 will be revised to reflect the change in filing location. Accordingly, the regulations are amended to provide that the Form 8264 is to be filed as prescribed in the instructions to the form.

6. *Effective Date*

The regulations are applicable August 2, 2001. However, in general, taxpayers may rely on the regulations after February 28, 2000**.**

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations impose no new collection of information on small entities, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Drafting Information**

The principal author of these regulations is Danielle M. Grimm, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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**Adoption of Amendments to the Regulations**

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6011–4T is amended as follows:

1. Paragraph (b)(3)(i)(F) is removed.

2. Paragraphs (b)(3)(ii)(B) and (C) are revised.

3. Paragraph (b)(5) is amended by removing the language "long-standing and" from the fifth sentence in *Example 1* and the seventh sentence in *Example 3.*

4. Paragraph (g) is revised.

The revisions and addition read as follows:

*§1.6011–4T Requirement of statement disclosing participation in certain transactions by corporate taxpayers (Temporary).*

* * * * *

(b) * * *

(3) * * *

(ii) * * *

(B) The taxpayer has participated in the transaction in the ordinary course of its business in a form consistent with customary commercial practice, and the taxpayer reasonably determines that there is a generally accepted understanding that the taxpayer's intended tax treatment of the transaction (taking into account any combination of intended tax consequences) is properly allowable under the Internal Revenue Code for substantially similar transactions. There is no minimum period of time for which such a generally accepted understanding must exist. In general, however, a taxpayer cannot reasonably determine whether the intended tax treatment of a transaction has become generally accepted unless information relating to the structure and tax treatment of such transactions has been in the public domain (*e.g.*, rulings, published articles, etc.) and widely known for a sufficient period of time (ordinarily a period of years) to provide knowledgeable tax practitioners and the IRS reasonable opportunity to evaluate the intended tax treatment. The mere fact that the taxpayer may have received an opinion or advice from one or more knowledgeable tax practitioners to the effect that the taxpayer's intended tax treatment of the transaction should or will be sustained, if challenged by the IRS, is not sufficient to satisfy the requirements of this paragraph (b)(3)(ii)(B).

(C) The taxpayer reasonably determines that there is no reasonable basis under Federal tax law for denial of any significant portion of the expected Federal income tax benefits from the transaction. This paragraph (b)(3)(ii)(C) applies only if the taxpayer reasonably determines that there is no basis that would meet the standard applicable to taxpayers under §1.6662–3(b)(3) under which the IRS could disallow any significant portion of the expected Federal income tax benefits of the transaction. Thus, the reasonable basis standard is not satisfied by an IRS position that would be merely arguable or that would constitute merely a colorable claim. However, the taxpayer's determination of whether the IRS would or would not have a reasonable basis for such a position must take into account the entirety of the transaction and any combination of tax consequences that are expected to result from any component steps of the transaction, must not be based on any unreasonable or unrealistic factual assumptions, and must take into account all relevant aspects of Federal tax law, including the statute and legislative history, treaties, administrative guidance, and judicial decisions that establish principles of general application in the tax law (*e.g.*, *Gregory v. Helvering*, 293 U.S. 465 (1935)). The determination of whether the IRS would or would not have such a reasonable basis is qualitative in nature and does not depend on any percentage or other quantitative assessment of the likelihood that the taxpayer would ultimately prevail if a significant portion of the expected tax benefits were disallowed by the IRS.

* * * * *

(g) *Effective date*. This section applies to Federal corporate income tax returns filed after February 28, 2000. However, paragraphs (b)(3)(ii)(B), (b)(3)(ii)(C), and (b)(5) *Examples 1* and *3*, of this section apply to Federal corporate income tax returns filed after August 2, 2001. Taxpayers may rely on the rules in paragraphs (b)(3)(ii)(B), (b)(3)(ii)(C), and (b)(5) *Examples 1* and *3*, of this section for Federal corporate income tax returns filed after February 28, 2000. Otherwise, the rules that apply with respect to Federal corporate income tax returns filed after February 28, 2000, and on or before August 2, 2001, are contained in §1.6011–4T in effect prior to August 2, 2001 (see 26 CFR part 1 revised as of April 1, 2001).

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 4. Section 301.6111–2T is amended as follows:

1. Paragraph (b)(1) is revised.
2. Paragraph (b)(3) is removed.
3. Paragraphs (b)(4), (b)(5), (b)(6) and (b)(7) are redesignated paragraphs (b)(3), (b)(4), (b)(5) and (b)(6), respectively.
4. Newly redesignated paragraph (b)(3) introductory text is amended by revising the reference to "(b)(4)" with "(b)(3)."
5. Newly redesignated paragraph (b)(3)(ii) is revised.
6. Newly redesignated paragraph (b)(4) introductory text is amended by removing the reference "(b)(5)(i)" and adding "(b)(4)(i)" in its place.
7. Newly redesignated paragraph (b)(4)(i) is revised.
8. Newly redesignated paragraph (b)(4)(ii) is amended by removing the reference "(b)(6)" and adding "(b)(5)" in its place.
9. Newly redesignated paragraph (b)(6) is amended as follows:

a. Paragraph (b)(6), introductory text, is revised.

b. *Example 1* is removed.

c. "*Example 2*." is redesignated as "*Example*."

d. The language "long-standing and" is removed from paragraph (i) in the newly redesignated *Example*.

e. The fourth sentence of paragraph (i) in the newly redesignated *Example* is removed.

f. Paragraph (ii) in the newly redesignated "*Example*" is revised.

10. Paragraphs (c)(3) and (e)(2)(ii)(E) are revised.
11. Paragraph (h) is amended by adding 3 sentences at the end.

The revisions and additions read as follows:

*§301.6111–2T Confidential corporate tax shelters (temporary).*

* * * * *

(b) * * * (1) *In general*. The avoidance or evasion of Federal income tax will be considered a significant purpose of the structure of a transaction if the transaction is described in paragraph (b)(2) or (3) of this section. However, a transaction described in paragraph (b)(3) of this section need not be registered if the transaction is described in paragraph (b)(4) of this section. For purposes of this section, Federal income tax benefits include deductions, exclusions from gross income, nonrecognition of gain, tax credits, adjustments (or the absence of adjustments) to the basis of property, and any other tax consequences that may reduce a taxpayer's Federal income tax liability by affecting the timing, character, or source of any item of income, gain, deduction, loss, or credit.

* * * * *

(3) * * *

(ii) There is a generally accepted understanding that the expected Federal income tax benefits from the transaction (taking into account any combination of intended tax consequences) are properly allowable under the Internal Revenue Code for substantially similar transactions. There is no minimum period of time for which such a generally accepted understanding must exist. In general, however, a tax shelter promoter (or other person who would be responsible for registration under this section) cannot reasonably determine whether the intended tax treatment of a transaction has become generally accepted unless information relating to the structure and tax treatment of such transactions has been in the public domain (*e.g.*, rulings, published articles, etc.) and widely known for a sufficient period of time (ordinarily a period of years) to provide knowledgeable tax practitioners and the IRS reasonable opportunity to evaluate the intended tax treatment. The mere fact that one or more knowledgeable tax practitioners have provided an opinion or advice to the effect that the intended tax treatment of the transaction should or will be sustained, if challenged by the IRS, is not sufficient to satisfy the requirements of this paragraph (b)(3)(ii).

(4) * * *

(i) In the case of a transaction other than a transaction described in paragraph (b)(2) of this section, the tax shelter promoter (or other person who would be responsible for registration under this section) reasonably determines that there is no reasonable basis under Federal tax law for denial of any significant portion of the expected Federal income tax benefits from the transaction. This paragraph (b)(4)(i) applies only if the tax shelter promoter (or other person who would be responsible for registration under this section) reasonably determines that there is no basis that would meet the standard applicable to taxpayers under §1.6662–3(b)(3) of this chapter under which the IRS could disallow any significant portion of the expected Federal income tax benefits of the transaction. Thus, the reasonable basis standard is not satisfied by an IRS position that would be merely arguable or that would constitute merely a colorable claim. However, the determination of whether the IRS would or would not have a reasonable basis for such a position must take into account the entirety of the transaction and any combination of tax consequences that are expected to result from any component steps of the transaction, must not be based on any unreasonable or unrealistic factual assumptions, and must take into account all relevant aspects of Federal tax law, including the statute and legislative history, treaties, administrative guidance, and judicial decisions that establish principles of general application in the tax law (*e.g.*, *Gregory v. Helvering*, 293 U.S. 465 (1935)). The determination of whether the IRS would or would not have such a reasonable basis is qualitative in nature and does not depend on any percentage or other quantitative assessment of the likelihood that the taxpayer would ultimately prevail if a significant portion of the expected tax benefits were disallowed by the IRS.

* * * * *

(6) *Example*. The following example illustrates the application of paragraphs (b)(1) through (4) of this section. Assume, for purposes of the example, that the transaction is not the same as or substantially similar to any of the types of transactions that the IRS has identified as listed transactions under section 6111 and, thus, is not described in paragraph (b)(2) of this section. The example is as follows:

*Example.* * * *

(ii) *Analysis*. The transaction represented by this combination of financial instruments is a transaction described in paragraph (b)(3) of this section. However, if Y is uncertain whether this transaction is described in paragraph (b)(3) of this section, or is otherwise uncertain whether registration is required, Y may apply for a ruling under paragraph(b)(5) of this section, and the transaction will not be required to be registered while the ruling is pending or for sixty days thereafter.

(c) * * *

(3) *Presumption.* Unless facts and circumstances clearly indicate otherwise, an offer is not considered made under conditions of confidentiality if the tax shelter promoter provides express written authorization to each offeree permitting the offeree (and each employee, representative, or other agent of such offeree) to disclose to any and all persons, without limitation of any kind, the structure and tax aspects of the transaction, and all materials of any kind (including opinions or other tax analyses) that are provided to the offeree related to such structure and tax aspects.

* * * * *

(e) * * *

(2) * * *

(ii) * * *

(E) Sign the Form 8264 and file the form as prescribed in the instructions to the form.

* * * * *

(h) *Effective date*. * * * However, paragraphs (b)(1), (b)(3)(ii), (b)(4)(i), (b)(6) *Example* (i) and (ii), (c)(3), and (e)(2)(ii)(E) of this section apply to confidential corporate tax shelters in which any interests are offered for sale after August 2, 2001. The rules in paragraphs (b)(1), (b)(3)(ii), (b)(4)(i), (b)(6), (b)(6) *Example* (i) and (ii), (c)(3), and (e)(2)(ii)(E), of this section may be relied upon for confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000. Otherwise, the rules that apply to confidential corporate tax shelters in which any interests are offered for sale after February 28, 2000, and on or before August 2, 2001, are contained in this §301.6111–2T in effect prior to August 2, 2001 (see 26 CFR part 301 revised as of April 1, 2001).

Par. 5. Section 301.6112–1T is amended by removing the authority citation immediately following the section.

David A. Mader,
*Acting Deputy Commissioner of Internal Revenue.*

Approved July 31, 2001.

Mark Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on August 2, 2001, 2:50 p.m., and published in the issue of the Federal Register for August 7, 2001, 66 F.R. 41133)

## Section 6071.—Time for Filing Returns and Other Documents

*26 CFR 40.6071(a)–1: Time for filing returns.*

## T.D. 8963

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 40

## Deposits of Excise Taxes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains the final regulations relating to the requirements for excise tax returns, payments, and deposits. These regulations affect persons required to report liability for excise taxes on Form 720, *"Quarterly Federal Excise Tax Return."*

DATES: *Effective Date*: These regulations are effective August 9, 2001.

*Applicability Date*: These regulations are applicable with respect to returns and deposits that relate to calendar quarters beginning on or after October 1, 2001.

FOR FURTHER INFORMATION CONTACT: Susan Athy (202) 622-3130 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains final amendments to the Excise Tax Procedural Regulations (26 CFR part 40) relating to the requirements for excise tax returns, payments, and deposits. On January 7, 2000, an advance notice of proposed rulemaking (Ann. 2000–5, 2000–4 I.R.B. 427) that invited comments from the public on issues relating to the requirements for excise tax returns and deposits was published in the **Federal Register** (65 FR 1076). Several written comments were received and considered in drafting the proposed regulations. On February 16, 2001, a notice of proposed rulemaking (REG–106892–00, 2001–15 I.R.B. 1060) was published in the **Federal Register** (66 FR 10650). Written comments and requests for a public hearing were solicited.

Written comments responding to the notice were received from one commentator. The comments requested that the safe harbor rule based on look-back quarter liability be modified to be applicable: to each semimonthly period in a quarter if one-sixth of look-back quarter liability is deposited during that semimonthly period; when a taxpayer's liability includes new or reinstated taxes; and when a new legal entity includes a party that filed a Form 720 for the second preceding quarter. The final regulations do not adopt the requested modifications to the look-back safe harbor rule because doing so could significantly reduce the percentage of excise tax liability deposited without any corresponding reduction in the complexity of the deposit rules.

No public hearing was requested or held. After consideration of all of the comments, the proposed regulations are adopted without change by this Treasury decision.

**Special Analyses**

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

**Drafting Information**

The principal author of these regulations is Susan Athy, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 40 is amended as follows:

PART 40—EXCISE TAX PROCEDURAL REGULATIONS

Paragraph 1. The authority citation for part 40 is amended by removing the entries for Sections 40.6071(a)–1 and 40.6071(a)–2, and Sections 40.6302(c)–2, 40.6302(c)–3, and 40.6302(c)–4; and adding entries in numerical order to read in part as follows:

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

Section 40.6071(a)–1 also issued under 26 U.S.C. 6071(a). * * *

Section 40.6302(c)–2 also issued under 26 U.S.C. 6302(a).

Section 40.6302(c)–3 also issued under 26 U.S.C. 6302(a). * * *

**§40.0–1 [Amended]**

Par. 2. Section 40.0–1 is amended as follows:

1. Paragraphs (d) and (e) are removed.

2. Paragraph (f) is redesignated as new paragraph (d).

**§40.6011(a)–1 [Amended]**

Par. 3. Section 40.6011(a)–1 is amended by removing paragraph (c).

**§40.6011(a)–2 [Amended]**

Par. 4. Section 40.6011(a)–2 is amended as follows:

1. In paragraph (b)(2), the language "§40.6302(c)–1(f)(2)" is removed and "§40.6302(c)–1(e)(2)" is added in its place.

2. Paragraph (d) is removed.

Par. 5. Section 40.6071(a)–1 is amended by revising paragraphs (a), (b)(2), and (c) to read as follows:

*§40.6071(a)–1 Time for filing returns.*

(a) *Quarterly returns*. Each quarterly return required under §40.6011(a)–1(a)(2) must be filed by the last day of the first calendar month following the quarter for which it is made.

(b) * * *

(2) *Semimonthly returns*. Each semimonthly return required under §40.6011 (a)–1(b) must be filed by the last day of the semimonthly period (as defined in §40.0–1(c)) following the semimonthly period for which it is made.

(c) *Effective date*. This section is applicable with respect to returns that relate to calendar quarters beginning on or after October 1, 2001.

**§40.6071(a)–2 [Removed]**

Par. 6. Section 40.6071(a)–2 is removed.

**§40.6091–1 [Amended]**

Par. 7. Section 40.6091–1 is amended by removing paragraph (d).

Par. 8. Section 40.6101–1 is revised to read as follows:

*§40.6101–1 Period covered by returns.*

See §40.6011(a)–1(a)(2) for the rules relating to the period covered by the return.

Par. 9. Sections 40.6109(a)–1 and 40.6151(a)–1 are revised to read as follows:

*§40.6109(a)–1 Identifying numbers.*

Every person required under §40.6011(a)–1 to make a return must provide the identifying number required by the instructions applicable to the form on which the return is made.

*§40.6151(a)–1 Time and place for paying tax shown on return.*

Except as provided by statute, the tax must be paid at the time prescribed in §40.6071(a)–1 for filing the return, and at the place prescribed in §40.6091–1 for filing the return.

Par. 10. Section 40.6302(c)–1 is revised to read as follows:

*§40.6302(c)–1 Use of Government depositaries.*

(a) *In general*—(1) *Semimonthly deposits required*. Except as provided by statute or by paragraph (e) of this section, each person required under §40.6011(a)–1(a)(2) to file a quarterly return must make a deposit of tax for each semimonthly period (as defined in §40.0–1(c)) in which tax liability is incurred.

(2) *Treatment of taxes imposed by chapter 33*. For purposes of this part 40, tax imposed by chapter 33 (relating to communications and air transportation) is treated as a tax liability incurred during the semimonthly period—

(i) In which that tax is collected; or

(ii) In the case of the alternative method, in which that tax is considered as collected.

(3) *Definition of net tax liability*. Net tax liability means the tax liability for the specified period plus or minus any adjustments allowable in accordance with the instructions applicable to the form on which the return is made.

(4) *Computation of net tax liability for a semimonthly period*. The net tax liability for a semimonthly period may be computed by—

(i) Determining the net tax liability incurred during the semimonthly period; or

(ii) Dividing by two the net tax liability incurred during the calendar month that includes that semimonthly period, provided that this method of computation is used for all semimonthly periods in the calendar quarter.

(b) *Amount of deposit*—(1) *In general*. The deposit of tax for each semimonthly period must be not less than 95 percent of the amount of net tax liability incurred during the semimonthly period.

(2) *Safe harbor rules*—(i) *Applicability*. The safe harbor rules of this paragraph (b)(2) are applied separately to taxes deposited under the alternative method provided in §40.6302(c)–3 (alternative method taxes) and to the other taxes for which deposits are required under this section (regular method taxes).

(ii) *Regular method taxes*. Any person that made a return of tax reporting regular method taxes for the second preceding calendar quarter (the look-back quarter) is considered to have complied with the requirement of this part 40 for deposit of regular method taxes for the current calendar quarter if—

(A) The deposit of regular method taxes for each semimonthly period in the current calendar quarter is not less than 1/6 of the net tax liability for regular method taxes reported for the look-back quarter;

(B) Each deposit is made on time;

(C) The amount of any underpayment of regular method taxes is paid by the due date of the return; and

(D) The person's liability does not include any regular method tax that was not imposed at all times during the look-back quarter or a tax on a chemical not subject to tax at all times during the look-back quarter.

(iii) *Alternative method taxes*. Any person that made a return of tax reporting alternative method taxes for the look-back quarter is considered to have complied with the requirement of this part 40 for deposit of alternative method taxes for the current calendar quarter if—

(A) The deposit of alternative method taxes for each semimonthly period in the current calendar quarter is not less than 1/6 of the net tax liability for alternative method taxes reported for the look-back quarter;

(B) Each deposit is made on time;

(C) The amount of any underpayment of alternative method taxes is paid by the due date of the return; and

(D) The person's liability does not include any alternative method tax that was not imposed at all times during the look-back quarter and the month preceding the look-back quarter.

(iv) *Modification for tax rate increase*. The safe harbor rules of this paragraph (b)(2) do not apply to regular method taxes or alternative method taxes for the first and second calendar quarters beginning on or after the effective date of an increase in the rate of any tax to which this part 40 applies unless the deposit of those taxes for each semimonthly period in the calendar quarter is not less than 1/6 of the tax liability the person would have had with respect to those taxes for the look-back quarter if the increased rate of tax had been in effect for the look-back quarter.

(v) *Failure to comply with deposit requirements*. If a person fails to make deposits as required under this part 40, that failure may be reported to the appropriate IRS office and the IRS may withdraw the person's right to use the safe harbor rules of this paragraph (b)(2).

(c) *Time to deposit*—(1) *In general*. The deposit of tax for any semimonthly period must be made by the 14th day of the following semimonthly period unless such day is a Saturday, Sunday, or legal holiday in the District of Columbia in which case the immediately preceding day which is not a Saturday, Sunday, or legal holiday in the District of Columbia is treated as the 14th day. Thus, generally, the deposit of tax for the first semimonthly period in a month is due by the 29th day of that month and the deposit of tax for the second semimonthly period in a month is due by the 14th day of the following month.

(2) *Exceptions*. See §40.6302(c)–2 for the special rules for September. See §40.6302(c)–3 for the special rules for deposits under the alternative method.

(d) *Remittance of deposits*—(1) *Deposits by federal tax deposit coupon*. A completed Form 8109, *"Federal Tax Deposit Coupon,"* must accompany each deposit. The deposit must be remitted, in accordance with the instructions applicable to the form, to a financial institution authorized as a depositary for federal taxes (as provided in 31 CFR part 203).

(2) *Deposits by electronic funds transfer*. For the requirement to deposit excise taxes by electronic funds transfer, see §31.6302–1(h) of this chapter. A taxpayer not required to deposit by electronic funds transfer pursuant to §31.6302–1(h) of this chapter remains subject to the rules of this paragraph (d).

(e) *Exceptions*—(1) *Taxes excluded*. No deposit is required in the case of the taxes imposed by—

(i) Section 4042 (relating to fuel used on inland waterways);

(ii) Section 4161 (relating to sport fishing equipment and bows and arrow components);

(iii) Section 4682(h) (relating to floor stocks tax on ozone-depleting chemicals); and

(iv) Section 48.4081–3(b)(1)(iii) of this chapter (relating to certain removals of gasohol from refineries).

(2) *One-time filings*. No deposit is required in the case of any taxes reportable on a one-time filing (as defined in §40.6011(a)–2(b)).

(3) *De minimis exception*. For any calendar quarter, no deposit is required if the net tax liability for the quarter does not exceed $2,500.

(f) *Effective date*. This section is applicable with respect to deposits that relate to calendar quarters beginning on or after October 1, 2001.

Par. 11. Section 40.6302(c)–2 is revised to read as follows:

*§40.6302(c)–2 Special rules for September.*

(a) *In general*—(1) *Separate deposits required for the second semimonthly period*. In the case of deposits of taxes not deposited under the alternative method (regular method taxes) for the second semimonthly period in September, separate deposits are required for the period September 16th through 26th and for the period September 27th through 30th.

(2) *Amount of deposit*—(i) *In general*. The deposits of regular method taxes for the period September 16th through 26th and the period September 27th through 30th must be not less than 95 percent of the net tax liability for regular method taxes incurred during the respective periods. The net tax liability for regular method taxes incurred during these periods may be computed by—

(A) Determining the amount of net tax liability for regular method taxes reasonably expected to be incurred during the second semimonthly period in September;

(B) Treating 11/15 of the amount determined under paragraph (a)(2)(i)(A) of this section as the net tax liability for regular method taxes incurred during the period September 16th through 26th; and

(C) Treating the remainder of the amount determined under paragraph (a)(2)(i)(A) of this section (adjusted to reflect the amount of net tax liability for regular method taxes actually incurred through the end of September) as the net tax liability for regular method taxes incurred during the period September 27th through 30th.

(ii) *Safe harbor rules*. The safe harbor rules in §40.6302(c)–1(b)(2) do not apply for the third calendar quarter unless—

(A) The deposit of taxes for the period September 16th through 26th is not less than 11/90 of the net tax liability for regular method taxes reported for the look-back quarter; and

(B) The total deposit of taxes for the second semimonthly period in September is not less than 1/6 of the net tax liability for regular method taxes reported for the look-back quarter.

(3) *Time to deposit*. (i) The deposit required for the period beginning September 16th must be made by September 29th unless—

(A) September 29th is a Saturday, in which case the deposit must be made by September 28th; or

(B) September 29th is a Sunday, in which case the deposit must be made by September 30th.

(ii) The deposit required for the period ending September 30th must be made at the time prescribed in §40.6302(c)–1(c).

(b) *Persons not required to use electronic funds transfer*. The rules of this section are applied with the following modifications in the case of a person not required to deposit taxes by electronic funds transfer.

(1) *Periods*. The deposit periods for the separate deposits required under paragraph (a) of this section are September 16th through 25th and September 26th through 30th.

(2) *Amount of deposit*. In computing the amount of deposit required under paragraph (a)(2)(i)(B) of this section, the applicable fraction is 10/15. In computing the amount of deposit required under paragraph (a)(2)(ii)(A) of this section, the applicable fraction is 10/90.

(3) *Time to deposit*. In the case of the deposit required under paragraph (a) of this section for the period beginning September 16th, the deposit must be made by September 28th unless—

(i) September 28th is a Saturday, in which case the deposit must be made by September 27th; or

(ii) September 28th is a Sunday, in which case the deposit must be made by September 29th.

(c) *Effective date*. This section is applicable with respect to deposits that relate to calendar quarters beginning on or after October 1, 2001.

Par. 12. Section 40.6302(c)–3 is amended as follows:

1. In paragraph (b)(1)(ii), the language "9-day rule of §40.6302(c)–1(b)(6)" is removed and "rule of §40.6302(c)–1(c)(1)" is added in its place.

2. In paragraph (b)(3), last sentence, the language "6th" is removed and "16th" is added in its place.

3. In paragraph (d), first sentence, the language "not less than" is removed and "not less than 95 percent of" is added in its place.

4. In paragraph (f)(4) introductory text, the language "§40.6302(c)–1(c)(2)(i)" is removed and "§40.6302(c)–1(b)(2)" is added in its place.

5. Paragraphs (f)(5) and (f)(7) are removed.

6. Paragraph (f)(6) is redesignated as paragraph (f)(5).

7. Paragraph (g) is revised.

8. Paragraph (h) is removed.

The revision reads as follows:

*§40.6302(c)–3 Special rules for use of Government depositaries under chapter 33.*

* * * * *

(g) *Effective date*. This section is applicable with respect to deposits and returns that relate to taxes that are considered as collected in calendar quarters beginning on or after October 1, 2001.

**§40.6302(c)–4 [Removed]**

Par. 13. Section 40.6302(c)–4 is removed.

### §40.9999–1 [Removed]

Par. 14. Section 40.9999–1 is removed.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

Approved July 31, 2001.

Mark A. Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on August 8, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 9, 2001, 66 F.R. 41775)

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## Section 7701.—Definitions

*26 CFR 301.7701–7: Trusts–domestic and foreign.*

## T.D. 8962

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

## Classification of Certain Pension and Employee Benefit Trusts, and Other Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations amending the regulations defining a domestic or foreign trust for federal tax purposes. The regulations will affect certain specified employee benefit trusts and investment trusts. The regulations provide that these employee benefit trusts and investment trusts are deemed to satisfy the control test for domestic trust treatment if United States trustees control all of the substantial decisions of the trust made by the trustees of the trust.

DATES: *Effective Date*: These regulations are effective August 9, 2001.

*Applicability Dates*: For dates of applicability of §301.7701–7(d)(1)(iv) and (v) *Examples 1* and *5*, see § 301.7701–7(e)(3).

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

SUPPLEMENTARY INFORMATION:

**Background**

On October 12, 2000, the Treasury Department and the IRS published a notice of proposed rulemaking (REG–108553–00, 2000–44 I.R.B. 452) under section 7701 of the Internal Revenue Code (Code) in the **Federal Register** (65 FR 60822). The proposed regulations add group trusts consisting of qualified plan trusts and IRA trusts, as described in Rev. Rul. 81–100 (1981–1 C.B. 326), and certain investment trusts to the categories of trusts that may use the safe harbor in §301.7701–7(d)(1)(iv) of the Procedure and Administration Regulations relating to the application of the control test of section 7701(a)(30)(E). The proposed regulations also modify the safe harbor in §301.7701–7(d)(1)(iv) to clarify that employee benefit trusts and investment trusts identified in the regulations are deemed to satisfy the control test if United States trustees control all of the substantial decisions of the trust made by the trustees of the trust. No one requested to speak at the public hearing scheduled for January 31, 2001. Accordingly, the public hearing was canceled on January 26, 2001 (66 FR 7867). Comments in response to the notice of proposed rulemaking were received and are addressed in the following Explanation and Summary of Comments. This document finalizes the proposed regulations without change.

**Explanation and Summary of Comments**

*Reporting Requirements for Foreign Widely Held Fixed Investment Trusts*

Two commentators were concerned about United States investors in widely held fixed investment trusts that are outside the safe harbor provided by §301.7701–7(d)(1)(iv)(I) and therefore are treated as foreign trusts. These commentators suggested that United States investors in such trusts should not be subject to reporting under section 6048 and to the corresponding penalties in section 6677 for failure to comply with the section 6048 reporting requirements. A guidance project under section 671 concerning reporting requirements for all widely held fixed investment trusts is currently under consideration. Accordingly, these regulations do not specifically address this issue.

*Application to Certain Pension Trusts Created or Organized in Puerto Rico*

Section 1022(i)(1) of the Employee Retirement Income Security Act of 1974, Public Law 93–406 (88 Stat. 829) (September 2, 1974), provides for tax exemption for certain trusts created or organized in Puerto Rico that form part of a pension, profit-sharing, or stock bonus plan. Section 1022(i)(2) and §1.401(a)–50 of the Income Tax Regulations generally provide that the administrator of such a trust may elect to have the trust treated as a trust created or organized in the United States for purposes of section 401(a). In light of the changes made to section 7701(a)(30) in the Small Business Job Protection Act, Public Law 104–188 (110 Stat. 1755) (August 20, 1996), and the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788) (August 5, 1997), and the ensuing regulations, some taxpayers have expressed concerns regarding the continuing application of sections 1022(i)(1) and (2) and §1.401–50 to a pension trust created or organized in Puerto Rico that is not a domestic trust within the meaning of section 7701(a)(30). Because the application of these provisions is not restricted to trusts that are domestic trusts within the meaning of section 7701(a)(30), the 1996 and 1997 amendments to section 7701(a)(30) and the ensuing regulations do not affect the application of these provisions.

**Special Analyses**

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

### Drafting Information

The principal author of these regulations is James A. Quinn of the Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.7701–7 is amended as follows:

1. Paragraph (d)(1)(iv) introductory text is revised.
2. Paragraph (d)(1)(iv)(H) is redesignated as paragraph (d)(1)(iv)(J).
3. New paragraphs (d)(1)(iv)(H) and (d)(1)(iv)(I) are added.
4. In paragraph (d)(1)(v), *Example 1* is revised and *Example 5* is added.
5. The first sentence of paragraph (e)(1) is revised.
6. Paragraph (e)(3) is added.

The revisions and additions read as follows:

*§301.7701–7 Trusts—domestic and foreign.*

* * * * *

(d) * * * (1) * * *

(iv) *Safe harbor for certain employee benefit trusts and investment trusts*. Notwithstanding the provisions of this paragraph (d), the trusts listed in this paragraph (d)(1)(iv) are deemed to satisfy the control test set forth in paragraph (a)(1)(ii) of this section, provided that United States trustees control all of the substantial decisions made by the trustees of the trust—

* * * * *

(H) A group trust described in Rev. Rul. 81–100 (1981–1 C.B. 326) (see §601.601(d)(2) of this chapter);

(I) An investment trust classified as a trust under §301.7701–4(c), provided that the following conditions are satisfied–

(*1*) All trustees are United States persons and at least one of the trustees is a bank, as defined in section 581, or a United States Government-owned agency or United States Government-sponsored enterprise;

(*2*) All sponsors (persons who exchange investment assets for beneficial interests with a view to selling the beneficial interests) are United States persons; and

(*3*) The beneficial interests are widely offered for sale primarily in the United States to United States persons;

* * * * *

(v) * * *

*Example 1*. Trust is a testamentary trust with three fiduciaries, *A*, *B*, and *C*. *A* and *B* are United States citizens, and *C* is a nonresident alien. No persons except the fiduciaries have authority to make any decisions of the trust. The trust instrument provides that no substantial decisions of the trust can be made unless there is unanimity among the fiduciaries. The control test is not satisfied because United States persons do not control all the substantial decisions of the trust. No substantial decisions can be made without *C*'s agreement.

* * * * *

*Example 5*. *X*, a foreign corporation, conducts business in the United States through various branch operations. *X* has United States employees and has established a trust as part of a qualified employee benefit plan under section 401(a) for these employees. The trust is established under the laws of State *A*, and the trustee of the trust is *B*, a United States bank governed by the laws of State *A*. *B* holds legal title to the trust assets for the benefit of the trust beneficiaries. A plan committee makes decisions with respect to the plan and the trust. The plan committee can direct *B*'s actions with regard to those decisions and under the governing documents *B* is not liable for those decisions. Members of the plan committee consist of United States persons and nonresident aliens, but nonresident aliens make up a majority of the plan committee. Decisions of the plan committee are made by majority vote. In addition, *X* retains the power to terminate the trust and to replace the United States trustee or to appoint additional trustees. This trust is deemed to satisfy the control test under paragraph (d)(1)(iv) of this section because *B*, a United States person, is the trust's only trustee. Any powers held by the plan committee or *X* are not considered under the safe harbor of paragraph (d)(1)(iv) of this section. In the event that *X* appoints additional trustees including foreign trustees, any powers held by such trustees must be considered in determining whether United States trustees control all substantial decisions made by the trustees of the trust.

* * * * *

(e) *Effective date*—(1) *General rule*. Except for the election to remain a domestic trust provided in paragraph (f) of this section and except as provided in paragraph (e)(3) of this section, this section is applicable to taxable years ending after February 2, 1999. * * *

* * * * *

(3) *Effective date of safe harbor for certain employee benefit trusts and investment trusts*. Paragraphs (d)(1)(iv) and (v) *Examples 1* and *5* of this section apply to trusts for taxable years ending on or after August 9, 2001. Paragraphs (d)(1)(iv) and (v) *Examples 1* and *5* of this section may be relied on by trusts for taxable years beginning after December 31, 1996, and also may be relied on by trusts whose trustees have elected to apply sections 7701(a)(30) and (31) to the trusts for taxable years ending after August 20, 1996, under section 1907(a)(3)(B) of the SBJP Act.

* * * * *

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

Approved July 31, 2001.

Mark Weinberger,
*Assistant Secretary*
*of the Treasury.*

(Filed by the Office of the Federal Register on August 8, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 9, 2001, 66 F.R. 41778)

# Part III. Administrative, Procedural, and Miscellaneous

## Weighted Average Interest Rate Update

## Notice 2001–52

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for July 2001 is 5.61 percent.

The following rates were determined for the plan years beginning in the month shown below.

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---|---|---|---|---|
| August | 2001 | 5.79 | 5.21 to 6.08 | 5.21 to 6.37 |

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283-9702 (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, § 42; 1.42–14.)*

## Rev. Proc. 2001–44

SECTION 1. PURPOSE

This revenue procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under § 42(h)(3)(D) of the Internal Revenue Code for calendar year 2001.

SECTION 2. BACKGROUND

Rev. Proc. 92–31 (1992–1 C.B. 775) provides guidance to state housing credit agencies of qualified states on the procedure for requesting an allocation of unused housing credit carryovers under § 42(h)(3)(D). Section 4.06 of Rev. Proc. 92–31 provides that the Internal Revenue Service will publish in the Internal Revenue Bulletin the amount of unused housing credit carryovers allocated to qualified states for a calendar year from a national pool of unused credit authority (the National Pool). This revenue procedure publishes these amounts for calendar year 2001.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 2001 is as follows:

| *Qualified State* | *Amount Allocated* |
|---|---|
| Delaware | $ 5,771 |
| Florida | 117,712 |
| Illinois | 91,469 |
| Maine | 9,390 |
| Maryland | 39,009 |
| Massachusetts | 46,762 |
| Minnesota | 36,232 |
| Missouri | 41,209 |
| Nebraska | 12,604 |
| New Hampshire | 9,102 |
| New Jersey | 61,972 |
| Ohio | 83,617 |
| Oregon | 25,199 |
| Tennessee | 41,902 |
| Texas | 153,575 |
| Utah | 16,447 |
| Virginia | 52,134 |
| West Virginia | 13,319 |
| Wisconsin | 39,504 |

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for allocations of housing credit dollar amounts attributable to the National Pool component of a qualified state's housing credit ceiling for calendar year 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christopher J. Wilson of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Wilson at (202) 622-3040 (not a toll-free call).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking

## Modification of Tax Shelter Rules II

## REG–103735–00; REG–110311–98; REG–103736–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Cross-reference notice of proposed rulemaking.

SUMMARY: These proposed rules provide the public with additional guidance needed to comply with the disclosure rules under section 6011(a), the registration requirement under section 6111(d), and the list maintenance requirement under section 6112 applicable to tax shelters. The proposed rules affect corporations participating in certain reportable transactions, persons responsible for registering confidential corporate tax shelters, and organizers of potentially abusive tax shelters. In T.D. 8961, on page 194 in this issue of the Bulletin, the IRS is issuing temporary regulations modifying the rules relating to the requirement that certain corporate taxpayers file a statement with their Federal corporate income tax returns under section 6011(a) and the registration of confidential corporate tax shelters under section 6111(d). The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by October 31, 2001.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–103735–00; REG–110311–98; REG–103736–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–103735–00; REG–110311–98; REG–103736–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Danielle M. Grimm at (202) 622-3080; concerning submissions, Guy Traynor at (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

T.D. 8961 amends the Income Tax Regulations (26 CFR part 1) regarding rules relating to the filing and records requirements for certain corporate taxpayers under section 6011. The temporary regulations also amend the temporary procedure and administration regulations (26 CFR part 301) regarding the registration of confidential corporate tax shelters under section 6111.

The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the regulations.

**Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because these regulations impose no new collection of information on small entities, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Comments and Requests for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) or electronically generated comments that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

**Drafting Information**

The principal author of these regulations is Danielle M. Grimm, Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 301, which were proposed to be amended at 65 FR 49909 (August 16, 2000), are proposed to be further amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6011–4 as proposed to be added at 65 FR 49909 (August 16, 2000) is amended as follows:

*§1.6011–4 Requirement of statement disclosing participation in certain transactions by corporate taxpayers.*

[The text of the amendments to this proposed section is the same as the text of the amendments to §1.6011–4T published in T.D. 8961.]

PART 301— PROCEDURE AND ADMINISTRATION

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

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

Par. 4. Section 301.6111–2 as proposed to be added at 65 FR 49909 (August 16, 2000) is amended as follows:

*§301.6111–2 Confidential corporate tax shelters.*

[The text of the amendments to this proposed section is the same as the text of the amendments to §301.6111–2T published in T.D. 8961.]

David A. Mader,
*Acting Deputy Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on August 2, 2001, 2:50 p.m., and published in the issue of the Federal Register for August 7, 2001, 66 F.R. 41169)

## Invitation to Participate in Dialogue on Long-Term Future of Employee Plans Determination Letter Program

## Announcement 2001–83

The IRS invites the public to participate in a dialogue on the long-term future of the Employee Plans determination letter program.

Qualified plans offer significant tax advantages to employers and participants. Determination letters provide assurance to plan sponsors, participants, and other interested parties that the terms of employer-sponsored retirement plans satisfy the qualification requirements of the Code. The IRS has maintained an Employee Plans determination letter program for many years, essentially in its present form. Under this program, the Employee Plans (EP) segment of Tax Exempt and Government Entities (TE/GE) issues letters of determination regarding the qualified status of retirement plans under section 401(a) of the Internal Revenue Code and the status of related trusts under section 501(a).

A determination letter, however, only provides reliance that the plan is qualified under the rules in place at the time the letter was issued. The law and rules regarding qualified plans have changed frequently over the last twenty-seven years. This requires plan amendments that result in repeated applications for determination letters for the same plan. Currently, EP is reviewing applications for plans that have been amended to reflect changes in the law from 1994 through 2000. These are referred to as the GUST[1] amendments.

Following the recent reorganization of the IRS, EP has undertaken a project to consider the long-term future of the EP determination letter program after GUST. The question EP asks the public to consider with it is whether there might be better alternatives to the present determination letter program.

EP recently put into effect several improvements to the determination letter program (Announcement 2001–77, 2001–30 I.R.B. 83). The focus of the project that EP is now undertaking is long-term—perhaps five or more years into the future. While these long-term changes will not impact the GUST amendment process, they may have a significant impact on applications for determinations letters for changes in the law subsequent to GUST, such as those contained in the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16.

The scope of this project may be of interest to all parties who are involved in or affected by the determination letter program. The Service hopes to pursue this project in partnership with all stakeholders in the determination letter process who wish to participate, including plan sponsors and participants and employee benefits professionals. As a preliminary step, EP has prepared a white paper describing the project and outlining several options identified as possible alternatives to the present determination letter program. Legislative changes may be required to implement some of these options. The white paper is entitled *The Future of the Employee Plans Determination Letter Program: Some Possible Options* and it may be downloaded from the Internet at the following site: *http://www.irs.gov/ep.* EP asks the readers of the white paper to consider it as an invitation to a dialogue on the subject. The dialogue is not intended to be limited to ideas in the paper.

EP personnel plan to discuss the ideas raised in the paper and listen to others' ideas and views in professional conferences and meetings in which government representatives participate and all other available forums. In addition, EP solicits comments on whether EP should also hold a series of nationwide town meetings to permit furtherance of this dialogue. Finally, EP invites interested parties to submit written comments, preferably two copies referencing Announcement 2001–83, to the following address:

CC:M&SP:RU (Announcement 2001–83), room 5626
Internal Revenue Service
POB 7604, Ben Franklin Station
Washington, DC 20044

Alternatively, comments may be hand delivered between the hours of 8:30 a.m. and 5 p.m. to:

CC:M&SP:RU (Announcement 2001–83)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC

While not the subject of the white paper, commentators need not limit their comments to the long-term future of the determination letter program and are encouraged to submit any recommendations they have for short-term improvements. Written comments should be submitted by March 31, 2002. All written comments will be open to public inspection.

DRAFTING INFORMATION

The principal author of this announcement is James Flannery of Tax Exempt and Government Entities. For further information regarding this announcement, please contact the Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517 between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday. Mr. Flannery may be reached at (202) 283-9613. These telephone numbers are not toll-free.

[1] The term "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103-465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353;
- the Small Business Job Protection Act of 1996, Pub. L. 104-188;
- the Taxpayer Relief Act of 1997, Pub. L. 105-34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106-554.

## Foundations Status of Certain Organizations

## Announcement 2001–84

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

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

4 R Environment, San Anselmo, CA
Alabama A & M Military Alumni Association, Huntsville, AL
Alabama Association for Gifted Children, Birmingham, AL
Alabama Community Service Corporation, Birmingham, AL
Al-Nur Mosque/Islamic Center, Inc., Louisville, KY
Alexander Graham Bell Association for the Deaf of Tennessee, Inc., Nashville, TN
American Foundation for Courtesy, Montgomery, AL
Amy Baker Team Ministries, Inc., Owensboro, KY
Andrea Glenn Concert Ministry, Inc., Mobile, AL
Arts in Action, Inc., Lexington, KY
Ashberry Terrace, Inc., Elizabethtown, KY
Association of Christian Transport Services, Inc., Nashville, TN
Atlantic Bridges Foundation, Nashville, TN
Awake, Inc., Mobile, AL
Ballard Fastpitch Softball, Inc., Prospect, KY
Baroque Brass, Inc., Belleville, TX
Bible Alive Ministries, Fergus Falls, MN
Birmingham 2000, Inc., Birmingham, AL
Birmingham Society of Piping, Inc., Birmingham, AL
Blessed Are They Which Are Called, Los Angeles, CA
Brothers About Change BAC, Memphis, TN
Buddies of Wilson County, Inc., Lebanon, TN
Cancer Support Network, Inc., Lexington, KY
Carpe Diem of the South, Memphis, TN
Carthage Quarterback Club, Carthage, TN
Catholic Oversight Reserve Foundation, (COR), Mobile, AL
Cedarbrook Family Enrichment, Inc., Lebanon, TN
Children Count Foundation, Seattle, WA
Christian Word Ministries, Inc., Lexington, KY
Christians in Action, Inc., Barbourville, KY
Clarence B. and Lillian D. Robinson Education Fund, Inc., Chattanooga, TN
Clarksville Area Young Mens Christian Association, Clarksville, TN
Clifford D. Mallory Cup Foundation, Inc., Atlanta, GA
Common Cup, Memphis, TN
Community Bridges, Inc., Tempe, AZ
Community Builders of America, Knoxville, TN
Comprehensive Child Care Council, Inc., Scottsville, KY
Country Christmas Celebration Association, Savannah, TN
Development Corporation of Orchard Knob, Inc., Chattanooga, TN
Don’t Lose a Stroke of Breath, Inc., Birmingham, AL
Ebenezer Ministries, Inc., Knoxville, TN
Empowerment Network, Inc., Winston-Salem, NC
Fairhope Philanthropic Association, Inc., Fairhope, AL
For Little People Only, Inc., Atlanta, GA
For the Kids, Inc., Decatur, AL
Franklin County Christian Mens Fellowship, Inc., Frankfort, KY
Friends of Dare, Inc., Irondale, AL
Friends of Grassmere, Inc., Nashville, TN
Friends of Standing Stone State Park, Inc., Hilham, TN
Gain, Inc., Huntsville, AL
Gathering, Montgomery, AL
Gatlinburg Presbyterian Child Care Center, Gatlinburg, TN
Gilliam & Lynch, Inc., Birmingham, AL
Glendale Retirement Housing Association of Murray, Inc., Murray, KY
Gods Outreach, Inc., Owensboro, KY
Greensboro Baseball Association, Inc., Greensboro, AL
Habitat for Humanity International, Inc., Lawrenceburg, TN
Harvest Green Ministries, Inc., Birmingham, AL
Harvest Warriors Ministries, Inc., Lanett, AL
Hchs Patriot Quarterback Club, Inc., Paris, TN
Heart-to-Heart International, Inc., Birmingham, AL
Help Is Here, Inc., Miami, FL
Herman Maisel Gymnasium Renovation Fund, Inc., Mobile, AL
His Ministries, Franklinton, NC
In Touch in East Tennessee Crusade, Inc., Greeneville, TN
Innovative Solutions, Inc., Louisville, KY
Insa New York, Inc., New York, NY
International Child Care Alliance, Tucson, AZ
Island Creek Volunteer Fire Department, Inc., Pikeville, KY
Jericho Road, Inc., Memphis, TN
Johnsons Christian Care Home, Inc., Memphis, TN
Jonathans Servant Ministries, Nashville, TN
Just Us Kids Day Care and Learning Center, Memphis, TN
Justice Center, Birmingham, AL
Kare-N-Home, Inc., Birmingham, AL
Kentuckians for Intermodal Transportation, Inc., Louisville, KY
Kentucky Association of Senior Service Corps. Program, Inc., Louisville, KY
Kingdom Agenda Ministries, Inc., Lexington, KY
Kingdom News Outreach Program, Athens, AL
Knoxville Inner City Kids Outreach, Knoxville, TN
Lend-A-Hand Foundation, Inc., Paintsville, KY
Magnificat-Lexington, Inc., Lexington, KY
McCoy Center for Community Service, Inc., Birmingham, AL
Memphis Inner City Development Corporation, Memphis, TN
Michelle Shaffer Ministries, Inc., Murfreesboro, TN
Mid-South Africa Link, Inc., Memphis, TN

Mid-State Soccer League, Inc., Birmingham, AL
Middleton Art League, Middleton, TN
Millenium III Ministries, Huntsville, AL
Mission America Corporation, Memphis, TN
Montauk Non-Profit Housing Corp., Elizabethtown, KY
National Access to Cryptosporidium Testing, Murfreesboro, TN
National Community Development Corporation (Reaching Our Cities Kids), Land O Lakes, FL
National Donor Foundation, Inc., Louisville, KY
New Horizon Cooperative, Inc., Memphis, TN
Newports Ohio River Museum, Inc., Newport, KY
Nimbly Development Center, Memphis, TN
NKM 2, Denver, CO
North Birmingham Junior Golfers Charitable Trust, Birmingham, AL
North Henry Athletic Association, Inc., Stockbridge, GA
Our Daily Bread of Tennessee, Inc., Knoxville, TN
Owensboro Family YMCA Endowment Fund, Inc., Owensboro, KY
Parrot, Dothan, AL
Pathways Teen Services, Inc., Clarksville, TN
Phenix City Art Council, Phenix City, AL
Preakness I, Inc., Lexington, KY
Preakness II, Inc., Lexington, KY
Preschool Daycare Institute of America, Inc., Huntsville, AL
Resurrection Ministries, Inc., Lawrenceburg, TN
Rhema Development Foundation, Inc., Louisville, KY
Rhema-Grace Ministries, Inc., Madisonville, KY
Rutherford County Youth Ballet, Murfreesboro, TN
Salt & Light Ministries, Inc., Louisville, KY
Sarah House, Maryville, TN
Saving Animals From Euthansia, Inc., Florala, AL
Simpson County Heritage Fund, Inc., Franklin, KY
South Baldwin Museum Foundation, Inc., Foley, AL
South Central Alabama Coalition for Citizens With Disabilities, Andalusia, AL
Southwest Alabama Court Referral Program, Inc., Jackson, AL
Stonebridge, Inc., Lexington, KY
Storm Soccer Club, Inc., Paducah, KY
Streetfire Youth Ministries, Johnson City, TN
Students for a Drug-Free America, Inc., Nashville, TN
Turn Around Treasures, Inc., Tarrant, AL
United Eastern Lenape & Intertribal Band, Somerset, KY
Upton Foundation, Inc., Louisville, KY
Village Point Foundation, Daphne, AL
Vision Innercity Paducah, Inc., Paducah, KY
Widows Mite Home for Unwed Mothers and Their Babies, Utica, MI
Wildlife Rescue, Knoxville, TN
Wings Ministries, Gray, TN
Work Unlimited, Inc., Morganfield, KY
World Outreach, Inc., Eclectic, AL
World War II Preservation Society, Inc., Ashland, KY
Wyngate, Inc., Lexington, KY
Young Adult Leadership Association, Newport News, VA
Youth United With Senior Citizens, Memphis, TN

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

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## Changes in Accounting Periods; Correction

## Announcement 2001–86

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains corrections to a notice of proposed rulemaking and notice of public hearing (REG–106917–99, 2001–27 I.R.B. 4) that was published in the **Federal Register** on Wednesday, June 13, 2001 (66 FR 31850) relating to certain adoptions, changes, and retentions of annual accounting periods.

FOR FURTHER INFORMATION CONTACT: Roy A. Hirschhorn and Martin Scully, Jr. at (202) 622-4960 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

The notice of proposed rulemaking and notice of public hearing that are the subject of this correction are under sections 441, 442, 706, 898, and 1378 of the Internal Revenue Code.

**Need for Correction**

As published, the notice of proposed rulemaking and notice of public hearing contains errors that may prove to be misleading and are in need of clarification.

**Correction of Publication**

Accordingly, the publication of the notice of proposed rulemaking and notice of public hearing (REG–106917–99), which was the subject of FR Doc. 01–13536, is corrected as follows:

1. On page 31850, column 3, in the preamble under the caption "SUMMARY:", line 3, the language "441, 442, 706, and 1378 of the Internal" is corrected to read "441, 442, 706, 898, and 1378 of the Internal".

2. On page 31851, column 2, in the preamble under the paragraph heading *"A. Overview"*, line 4, the language "taxable income), and sections 442, 706," is corrected to read "taxable income), and sections 442, 706, 898."

3. On page 31851, column 3, in the preamble under the paragraph heading *"B. Section 441: Period for Computing Taxable Income,"* the last line of the first paragraph, the language "514, 99th Cong., 2d Sess. 318 (1986)." is corrected to read "841, 99th Cong., 2d Sess., II–318 1986–3 (Vol. 4) C.B. 318."

4. On page 31852, column 2, in the preamble under the paragraph heading *"3. 52-53-week Taxable Years."*, line 8 from the top of the column, the language "and Notice 2001–35 (IRB 2001–23). In"

is corrected to read "and Notice 2001–35 (2001–23 I.R.B. 1314). In".

5. On page 31852, column 2, in the preamble under the paragraph heading *"5. Personal Service Corporations."*, paragraph 1, lines 3 and 4 from the bottom of the column, the language "now contained in Notice 2001–35 (I.R.B. 2001–23). Similarly, the rules regarding" is corrected to read "now contained in Notice 2001–35 (2000–23 I.R.B. 1314). Similarly, the rules regarding".

6. On page 31852, column 3, in the preamble under the paragraph heading *"5. Personal Service Corporations."*, paragraph 1, the last line of the paragraph, the language "and Notice 2001–34 (I.R.B. 2001–23)." is corrected to read "and Notice 2001–34 (2001–23 I.R.B. 1302).".

**§1.441–3 [Corrected]**

7. On page 31859, column 3, §1.441–3, in paragraph (a)(2), line 3, the language "taxable year (i.e., a fiscal year) if elects" is corrected to read "taxable year (i.e., a fiscal year) if it elects".

LaNita Van Dyke,
*Acting Chief, Regulations Unit,*
*Associate Chief Counsel*
*(Income Tax and Accounting).*

(Filed by the Office of the Federal Register on August 6, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 7, 2001, 66 F.R. 41170)

## IRS Information Reporting Program (IRP) Seminars

## Announcement 2001–87

*IRS Announces Year-End Training for Withholding Agents/ Employers/Payers*

To help withholding agents, employers, and payers who file Forms 1042–S, *Foreign Person's U.S. Source Income Subject to Withholding*, the Internal Revenue Service, Martinsburg Computing Center (MCC) has arranged the following training sessions.

Three IRP seminars will be offered in one-day sessions, free of charge. The sessions will include the following topics:

- Changes to Internal Revenue Code Section 1441 and Regulations
- Effect of These Changes on Forms, Publications, and Instructions
- Service Center Processing Changes
- Magnetic/Electronic Format and Processing Changes

For more information, contact the IRS/MCC IRP Call Site at 304-263-8700 between 8:30 a.m. and 4:30 p.m., EST, Monday through Friday or e-mail: *mccirp@irs.gov*. The dates and locations are as follows:

| *Location* | *Date* |
|---|---|
| Washington, DC | October 9 |
| Oakland, CA | October 17 |
| Chicago, IL | October 23 |

## Minimum Cost Requirement Permitting the Transfer of Excess Assets of a Defined Benefit Pension Plan to a Retiree Health Account; Correction

## Announcement 2001–90

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 8948, 2001–28 I.R.B. 27) that were published in the **Federal Register** on Tuesday, June 19, 2001 (66 F.R. 32897) relating to the minimum cost requirement under section 420, which permits the transfer of excess assets of a defined benefit pension plan to a retiree health account.

DATES: This correction is effective June 19, 2001.

FOR FURTHER INFORMATION CONTACT: Janet A. Laufer or Vernon S. Carter at (202) 622-6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

The final regulations that are the subject of these corrections are under section 420 of the Internal Revenue Code.

**Need for Correction**

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

**Correction of Publication**

Accordingly, the publication of the final regulations (T.D. 8948), which were the subject of FR Doc. 01–15255, is corrected as follows:

1. On page 32900, column 1, amendatory instruction Paragraph 1., lines 2 and 3, the language "for part 1 continues to read in part as follows:" is corrected to read "for part 1 is amended by adding a new entry in numerical order to read in part as follows:".

2. On page 32900, column 1, the authority citation is corrected to read as follows:

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

§1.420–1 also issued under 26 U.S.C. 420(c)(3)(E).

LaNita Van Dyke,
*Acting Chief, Regulations Unit,*
*Associate Chief Counsel*
*(Income Tax and Accounting).*

(Filed by the Office of the Federal Register on August 6, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 7, 2001, 66 F.R. 41133)

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

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

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

The adjusted applicable federal long-term rate is set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

## Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

## Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, on this page.

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

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

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for September 2001.

## Rev. Rul. 2001–43

This revenue ruling provides various prescribed rates for federal income tax purposes for September 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2001–43 TABLE 1

Applicable Federal Rates (AFR) for September 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| *Short-Term* | | | | |
| AFR | 3.82% | 3.78% | 3.76% | 3.75% |
| 110% AFR | 4.20% | 4.16% | 4.14% | 4.12% |
| 120% AFR | 4.59% | 4.54% | 4.51% | 4.50% |
| 130% AFR | 4.97% | 4.91% | 4.88% | 4.86% |
| *Mid-Term* | | | | |
| AFR | 4.82% | 4.76% | 4.73% | 4.71% |
| 110% AFR | 5.31% | 5.24% | 5.21% | 5.18% |
| 120% AFR | 5.79% | 5.71% | 5.67% | 5.64% |
| 130% AFR | 6.29% | 6.19% | 6.14% | 6.11% |
| 150% AFR | 7.27% | 7.14% | 7.08% | 7.04% |
| 175% AFR | 8.50% | 8.33% | 8.25% | 8.19% |
| *Long-Term* | | | | |
| AFR | 5.57% | 5.49% | 5.45% | 5.43% |
| 110% AFR | 6.13% | 6.04% | 6.00% | 5.97% |
| 120% AFR | 6.70% | 6.59% | 6.54% | 6.50% |
| 130% AFR | 7.27% | 7.14% | 7.08% | 7.04% |

REV. RUL. 2001–43 TABLE 2
Adjusted AFR for September 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| Short-term adjusted AFR | 2.90% | 2.88% | 2.87% | 2.86% |
| Mid-term adjusted AFR | 3.73% | 3.70% | 3.68% | 3.67% |
| Long-term adjusted AFR | 4.85% | 4.79% | 4.76% | 4.74% |

REV. RUL. 2001–43 TABLE 3

Rates Under Section 382 for September 2001

| | |
|---|---|
| Adjusted federal long-term rate for the current month | 4.85% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 5.00% |

REV. RUL. 2001–43 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for September 2001

| | |
|---|---|
| Appropriate percentage for the 70% present value low-income housing credit | 8.21% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.52% |

| REV. RUL. 2001–43 TABLE 5 | |
|---|---|
| Rate Under Section 7520 for September 2001 | |
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | 5.8% |

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, page 209.

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, page 209.

## Section 7702A.—Modified Endowment Contract Defined

Procedures are provided by which an issuer may remedy an inadvertent non-egregious failure to comply with the modified endowment contract rules under § 7702A. Rev. Proc. 99–27 is superseded. See Rev. Proc. 2001–42, page 212.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2001. See Rev. Rul. 2001–43, page 209.

# Part III. Administrative, Procedural, and Miscellaneous

## Limitations on Passive Activity Losses and Credits—Treatment of Self-Charged Items of Income and Expense

## Notice 2001–47

On April 5, 1991, the Treasury Department and the Internal Revenue Service published in the Federal Register a notice of proposed rulemaking (PS–39–89, 1991–1 C.B. 983 [56 Fed. Reg. 14034]) relating to the treatment of self-charged items of income and expense for purposes of applying the limitations on passive activity losses and passive activity credits under § 469 of the Internal Revenue Code. The comment period for those regulations ended in 1991 and several comments were received.

Treasury and the Service intend to finalize regulations under § 1.469–7. Given the length of time since the regulations were proposed and the number of amendments that have been made to the statutory provisions since that time, Treasury and the Service believe that an additional comment period is appropriate. Consideration will be given to all comments previously submitted in response to the notice of proposed rulemaking published in 1991 as well as to any additional written comments on proposed regulations § 1.469–7 that are submitted timely to the Service in response to this notice.

Written (a signed original and eight (8) copies) or electronic comments must be received by November 5, 2001. Send written comments to: Internal Revenue Service, NT 2001–47, CC:PSI:3, P.O. Box 7604, Ben Franklin Station, Washington, DC. Comments may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to the courier's desk at 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to *Notice.Comments@m1.irscounsel.treas.gov*. All submissions will be open to public inspection.

The principal author of this notice is Paul B. Myers of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Paul B. Myers or Danielle Grimm at (202) 622-3080 (not a toll-free call).

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*26 CFR § 301.7121–1: Closing agreements.*
*(Also Part 1, section 7702A)*

## Rev. Proc. 2001–42

SECTION 1. PURPOSE

This revenue procedure provides the procedures by which an issuer may remedy an inadvertent non-egregious failure to comply with the modified endowment contract rules under § 7702A of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 *Definition of a modified endowment contract ("MEC").*

(1) Section 7702A(a) provides that a life insurance contract is a MEC if the contract—

(a) is entered into on or after June 21, 1988, and fails to meet the "7-pay test" of § 7702A(b), or

(b) is received in exchange for a contract described in paragraph (a) of this section 2.01(1).

(2) A contract fails to meet the 7-pay test if the accumulated amount paid under the contract at any time during the first 7 contract years exceeds the sum of the net level premiums which would have to be paid on or before such time if the contract were to provide for paid-up "future benefits" (as defined in §§ 7702A(e)(3) and 7702(f)(4)) after the payment of 7 level annual premiums.

(3) Section 72(e)(11) provides that, for purposes of determining amounts includible in gross income, all MECs issued by the same company to the same contract holder during any calendar year are treated as one MEC.

.02 *Tax treatment of amounts received under a MEC.* Section 72(e)(10) provides that a MEC is subject to the rules of § 72(e)(2)(B), which tax non-annuity distributions on an income-out-first basis, and the rules of § 72(e)(4)(A) (as modified by §§ 72(e)(10)(A)(ii) and 72(e)(10)(B)), which generally deem loans and assignments or pledges of any portion of the value of a MEC to be non-annuity distributions. Moreover, under § 72(v), the portion of any annuity or non-annuity distribution received under a MEC that is includible in gross income is subject to a 10% additional tax unless the distribution is made on or after the date on which the taxpayer attains age 59 1/2, is attributable to the taxpayer's becoming disabled (within the meaning of § 72(m)(7)), or is part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and the taxpayer's beneficiary.

.03 *Need for a correction mechanism.*

(1) The Internal Revenue Service ("Service") became aware of situations in which, as a result of inadvertent non-egregious failures to comply with the MEC rules, life insurance premiums had been collected which exceed the 7-pay limit provided by § 7702A(b). This could produce significant unforeseen tax consequences for the contract holders. To allow issuers to remedy such situations, Rev. Proc. 99–27, 1999–1 C.B. 1186, set forth the circumstances under which the Service would enter into closing agreements which would provide that contracts identified in the closing agreements would not be treated as MECs. Rev. Proc. 99–27 applied only to requests for relief that were received by the Service on or before May 31, 2001, generally permitted an issuer to make only one request for correction, and excluded certain contracts from the procedure's correction mechanism.

(2) Some issuers were unable to comply with the May 31, 2001, deadline in Rev. Proc. 99–27 or filed a timely submission for some contracts but desire to file supplemental submissions for additional contracts. Also, issuers desire to correct contracts that were not correctable under Rev. Proc. 99–27. To allow issuers to remedy such situations, the Service under the circumstances described below will enter into closing agreements which will provide that contracts identified in the closing agreements will not be treated as MECs.

SECTION 3. DEFINITIONS

The following definitions and rules apply solely for purposes of this revenue procedure.

.01 *Testing period.* The 7-year period described in § 7702A(b) or such additional period as may be required under § 7702A(c)(3) if a contract undergoes a material change.

.02 *Amount paid*. The amount paid under a contract in any "contract year" (as defined in § 7702A(e)(2)) equals the premiums paid for the contract during the year, reduced by amounts to which § 72(e) applies (determined without regard to § 72(e)(4)(A)) but not including amounts includible in gross income. For this purpose, premiums paid do not include—

(1) any portion of any premium paid during the contract year that is returned (with interest) to the contract holder within 60 days after the end of the contract year in order to comply with the 7-pay test, or

(2) the "cash surrender value" (as defined in § 7702(f)(2)(A)) of another life insurance contract (other than a contract that fails the 7-pay test) exchanged for the contract.

.03 *7-pay premium.* (1) *In general*. Except as otherwise provided in section 3.03(2) of this revenue procedure, the 7-pay premium for a contract is the net level premium (computed in accordance with the rules in § 7702A(c)) that would have to be paid for the contract if the contract were to provide for paid up future benefits after the payment of 7 level annual premiums.

(2) *7-pay premium for a contract that undergoes a material change*. If a contract (other than a contract that fails the 7-pay test) is materially changed, the contract is treated as newly issued on the date of the material change and the 7-pay premium for the changed contract is an amount equal to the excess, if any, of—

(a) the net level premium (computed in accordance with the rules in § 7702A(c)) that would have to be paid for the changed contract if the contract were to provide for paid up future benefits after the payment of 7 level annual premiums, over

(b) a "proportionate share of the cash surrender value" (as defined in section 3.04 of this revenue procedure) under the contract.

.04 *Proportionate share of cash surrender value.* The proportionate share of the cash surrender value of a contract is the amount obtained by multiplying—

(1) the "cash surrender value" (as defined in § 7702(f)(2)(A)) of the contract, by

(2) a fraction, the numerator of which is the net level premium (computed in accordance with the rules in § 7702A(c)) that would have to be paid for the changed or new contract if such contract were to provide for paid up future benefits after the payment of 7 level annual premiums, and the denominator of which is the net single premium (determined using the rules in § 7702) for such contract at that time.

.05 *Overage*. A contract's overage is the amount of the excess, if any, of—

(1) the sum of amounts paid under the contract during the testing period for the contract year and all prior contract years, over

(2) the sum of the 7-pay premiums for the contract year and all prior contract years of the testing period.

.06 *Overage earnings.* The overage earnings for a contract year is the amount obtained by multiplying—

(1) the sum of a contract's overage for the contract year and its cumulative overage earnings for all prior contract years, by—

(2) the earnings rate set forth in section 3.07 of this revenue procedure.

.07 *Earnings rates*. (1) *Contracts other than variable contracts.* Except as otherwise provided in sections 3.07(3) and 3.07(8) of this revenue procedure, the earnings rate applicable to a contract year is the "general account total return" (as defined in section 3.07(2) of this revenue procedure) for the calendar year in which the contract year begins.

(2) *General account total return*. The general account total return is the calendar year arithmetic average of the monthly interest rates described as Moody's Corporate Bond Yield Average - Monthly Average Corporates as published by Moody's Investors Service Inc., or any successor thereto.

(3)*Variable contracts described in § 817(d). (a) Pre-2001 contract years*. The earnings rate applicable to a contract year that begins before January 1, 2001, is the rate set forth in the following table for the calendar year in which the contract year begins.

| Calendar Year | Earnings Rate |
|---|---|
| 1988 | 13.5% |
| 1989 | 17.4% |
| 1990 | 1.4% |
| 1991 | 25.4% |
| 1992 | 5.9% |
| 1993 | 13.9% |
| 1994 | -1.0% |
| 1995 | 23.0% |
| 1996 | 14.3% |
| 1997 | 17.8% |
| 1998 | 19.7% |
| 1999 | 12.8% |
| 2000 | -5.5% |

*(b) Post-2000 contract years.* Except as otherwise provided in section 3.07(8), the earnings rate applicable to a contract year that begins after December 31, 2000, is equal to the sum of—

(i) 10 percent of the general account total return (as defined in section 3.07(2) of this revenue procedure), and

(ii) 90 percent of the "separate account total return" (as defined in section 3.07(4) of this revenue procedure) for the calendar year in which the contract year begins.

(4) *Separate account total return.* Except as otherwise provided in section 3.07(8), the separate account total return equals—

(a) 75 percent of the "equity fund total return" (as defined in section 3.07(5) of this revenue procedure), plus

(b) 25 percent of the "bond fund total return" (as defined in section 3.07(6) of this revenue procedure), less

(c) 1.1 percentage point.

(5) *Equity fund total return.* The equity fund total return equals—

(a) the "calendar year percentage return" (as defined in section 3.07(7) of this revenue procedure) represented by the end-of-year values of the Standard and Poor's (S&P) 500 Total Return Index, with daily dividend reinvestment, as published by The McGraw-Hill Companies, Inc., or any successor thereto, less

(b) 1.5 percentage point.

(6) *Bond Fund Total Return.* The bond fund total return equals—

(a) the "calendar year percentage return" (as defined in section 3.07(7) of this revenue procedure) represented by the end-of-year values of the Merrill Lynch Corporate Bond Master Bond Index, Total Return, as published by Merrill Lynch & Company, Inc., or any successor thereto, less

(b) 1.0 percentage point.

(7) *Calendar year percentage return.* The calendar year percentage return for an index described in section 3.07(5) or section 3.07(6) of this revenue procedure is calculated by—

(a) dividing the end-of-year value of the index for the calendar year by the end-of-year value of the index for the immediately preceding calendar year, and

(b) subtracting 1 from the result obtained under paragraph (a) of this section 3.07(7).

(8) If the general account total return or the separate account total return for a calendar year cannot be determined because the calendar year in which the contract year begins has not ended, then the earnings rate for the contract year (or portion thereof) is determined using the general account total return and, if applicable, the average separate account total return, for the 3 calendar years immediately preceding the calendar year in which the contract year begins.

.08 *Proportionate share of overage earnings allocable to taxable distributions.* The proportionate share of overage earnings allocable to taxable distributions under a contract is the amount obtained by multiplying—

(1) the total amount of the taxable distributions under the contract, by

(2) a fraction, the numerator of which is the contract's cumulative overage earnings and the denominator of which is the total income on the contract.

.09 *Total income on a contract.* The total income on a contract as of any date is an amount equal to the excess, if any, of—

(1) the contract's cash surrender value (as defined in § 7702(f)(2)(A)) on such date, over

(2) the premiums paid under the contract before such date, reduced by amounts to which § 72(e) applies (determined without regard to § 72(e)(4)(A)) but not including amounts includible in the contract holder's gross income.

.10 *Distribution frequency factor*. The distribution frequency factor for a contract is—

(1) .8, if—

(a) the interest rate with respect to any portion of a policy loan that could be made under the contract at any time (including policy loans that could be made after a contractually specified date in the future) is guaranteed not to exceed the sum of:

(i) 1 percentage point, plus

(ii) the rate at which earnings are credited to the portion of the contract's cash surrender value (as defined in § 7702(f)(2)(A)) that is allocable to such portion of the policy loan; or

(b) the contract holder has an option to make a partial withdrawal of the contract's cash surrender value that reduces the "death benefit" (as defined in § 7702(f)(3)) under the contract by less than an amount determined by multiplying—

(i) the death benefit under the contract immediately before the withdrawal, by

(ii) the percentage obtained by dividing the withdrawn amount by the contract's cash surrender value (as defined in § 7702(f)(2)(A)) immediately before the withdrawal; and

(2) .5 for all other contracts.

.11 *Applicable percentage.* (1) *In general.* The applicable percentage for a contract is—

(a) 15%, if the death benefit under the contract is less than $50,000,

(b) 28%, if the death benefit under the contract is equal to or exceeds $50,000 but is less than $180,000, and

(c) 36%, if the death benefit under the contract is equal to or exceeds $180,000.

(2) *Determination of amount of death benefit.* For purposes of determining the applicable percentage, the death benefit under the contract will be the death benefit (as defined in section 7702(f)(3)) as of any date within 120 days of the date of the request for closing agreement, or the last day the contract is in force.

.12 *Reported amount.* The reported amount for a contract is the amount that—

(1) the issuer reports on a timely filed information return as includible in the contract holder's gross income, or

(2) the contract holder includes in gross income on a timely filed income tax return.

.13 *Aggregation of contracts.* All MECs issued by the same issuer to the same contract holder during any calendar year are treated as one MEC.

SECTION 4. SCOPE

.01 *Applicability.* Except as provided in section 4.02 of this revenue procedure, the issuer of a contract can use this revenue procedure to remedy the failure of the contract to comply with the requirements of § 7702A.

.02 *Inapplicability.* The Service may exclude a contract from the correction mechanism provided under this revenue procedure if the contract's status as a MEC resulted from a failure to comply with the requirements of § 7702A that—

(1) are attributable to one or more defective interpretations or positions that the Service determines to be a significant feature of a program to sell investment oriented contracts, or

(2) arises where the controlling statutory provision, as supplemented by any legislative history or guidance published by the Service, is clear on its face and the Service determines that failure to follow the provision results in a significant increase in the investment orientation of a contract.

.03 *Example.* Pursuant to section 4.02, the Service generally will not apply the correction mechanism under this revenue procedure to a MEC if the contract provides for paid-up future benefits after the payment of less than 7 level annual premiums.

SECTION 5. PROCEDURE

.01 *Request for a ruling.* An issuer that seeks relief under this revenue procedure must submit a request for a ruling that meets the requirements of Rev. Proc. 2001–1, 2001–1 I.R.B. 1 (or any successor). Additionally, the submission must contain the following information:

(1) a specimen copy of each contract form;

(2) the policy number and original issue date for each contract;

(3) the taxpayer identification number of each contract holder;

(4) the "death benefit" (as defined in section 7702(f)(3)) under each contract for purposes of determining the 7-pay premium for the contract;

(5) the 7-pay premium assumed by the issuer when the contract was issued;

(6) the cash surrender value (within the meaning of § 7702(f)(2)(A)) of each contract at the end of each contract year;

(7) a description of the defect[s] that caused the contract[s] to fail to comply with the 7-pay test, including an explanation of how and why the defect[s] arose;

(8) a description of the administrative procedures the issuer has implemented to ensure that none of its contracts will inadvertently fail the 7-pay test in the future;

(9) a description of any material change[s] in the benefits under (or in the other terms of) any contract together with the date[s] on which the material change[s] occurred;

(10) for any contract with regard to which a contract holder directly or indirectly received (or was deemed to have received) any distribution to which § 72 applies—

(a) the date and amount of each distribution,

(b) the amount of the distribution includible in the contract holder's gross income,

(c) the amount of gross income reported to the contract holder and to the Service on a timely filed information return as a result of the distribution,

(d) the date on which the contract holder attained [or will attain] age 59 1/2,

(e) whether the distribution is attributable to the contract holder becoming disabled (within the meaning of § 72(m)(7)), and,

(f) whether the distribution is part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the contract holder or the joint lives (or joint life expectancies) of the contract holder and his or her beneficiary;

(11) a template (see, for example, section 5.03(3) of this revenue procedure) setting forth the following information for each contract:

(a) the cumulative amounts paid under the contract within each contract year of the testing period,

(b) the contract's cumulative 7-pay premium,

(c) the overage, if any, for each contract year,

(d) the earnings rate applicable for each contract year;

(e) the overage earnings for each contract year; and,

.02 *Closing agreement.* The issuer also must submit a proposed closing agreement, executed by the issuer, in substantially the same form as the model closing agreement in section 6 of this revenue procedure. The amount shown in section 1(A) of the closing agreement is the sum of the amounts required to be paid (determined under section 5.03 of this revenue procedure) for all of the contracts covered by the agreement.

.03 *Determination of amount required to be paid with regard to a contract.*

(1) *General rule.* Except as provided in section 5.03(2) of this revenue procedure, the amount required to be paid with regard to a contract is the sum of—

(a) the income tax (determined using the applicable percentage for the contract under section 3.11 of this revenue procedure) and the additional tax under section 72(v) with regard to amounts (other than reported amounts (as defined in section 3.12 of this revenue procedure)) received (or deemed received) under the contract during the period commencing with the date 2 years before the date on which the contract first failed to satisfy the MEC rules and ending on the effective date of the closing agreement;

(b) any interest computed under § 6621(a)(2) as if the amounts determined under section 5.03(1)(a) of this revenue procedure are underpayments by the contract holder[s] for the tax year[s] in which the amounts are received (or deemed received); and

(c) an amount, not less than \$0, obtained by multiplying—

(i) the excess, if any, of the contract's cumulative overage earnings over the proportionate share of overage earnings allocable to taxable distributions under the contract, by

(ii) the applicable percentage for the contract, and by

(iii) the distribution frequency factor for the contract under section 3.10 of this revenue procedure.

(2) *Special rule for contracts with de minimis overage earnings.* If the overage earnings of a contract at all times during the testing period do not exceed \$75, then the amount required to be paid with regard to the contract is determined without regard to paragraphs (a) and (b) of section 5.03(1) of this revenue procedure.

(3) *Examples of the determination of the amount required to be paid with regard to a contract.*

(a) *Example 1.* A, an individual, purchases a life insurance contract other than a contract described in section 3.07(3) or 4.02 of this revenue procedure. The death benefit of the contract exceeds \$180,000 on every day within 120 days of the date of the request for closing agreement. The net level premium (assuming paid-up future benefits after seven annual premium payments) for the contract is \$10,490. The contract provides that, within 60 days after the end of a contract year, the issuer will return (with interest) the amount of any excess premium that would cause the contract to be a MEC under § 7702A.

The interest rate on all portions of any policy loans will always exceed the rate at which interest is credited to the contract's associated cash value by more than 1 percentage point. A partial withdrawal of the cash surrender value (within the meaning of § 7702(f)(2)(A)) always reduces the death benefit by an amount not less than the amount determined by multiplying the death benefit immediately before the withdrawal by the percentage obtained by dividing the withdrawn amount by the cash surrender value immediately before the withdrawal.

A pays a premium of $10,000 when the contract is issued on January 1, 1991. At the beginning of each of the next 6 contract years, A pays additional premiums of $10,750, $10,800, $10,700, $11,500, $11,000, and $10,000, respectively. Due to an inadvertent error, the issuer fails to return any of the excess premiums.

The issuer desires to enter into a closing agreement to remedy the failure to comply with § 7702A. Pursuant to section 5.01(10) of this revenue procedure, the issuer prepares the following template with regard to the contract.

| Contract Year | Cumulative Amounts Paid | Cumulative 7-Pay Premiums | Overage | Earnings Rate | Overage Earnings |
|---|---|---|---|---|---|
| 1 (1991) | 10,000 | 10,490 | 0 | 9.2% | 0 |
| 2 (1992) | 20,750 | 20,980 | 0 | 8.6% | 0 |
| 3 (1993) | 31,550 | 31,470 | 80 | 7.5% | 6.00 |
| 4 (1994) | 42,250 | 41,960 | 290 | 8.3% | 24.57 |
| 5 (1995) | 53,750 | 52,450 | 1,300 | 7.8% | 103.78 |
| 6 (1996) | 64,750 | 62,940 | 1,810 | 7.7% | 149.71 |
| 7 (1997) | 74,750 | 73,430 | 1,320 | 7.6% | 121.91 |

Prior to A's payment of the $10,800 premium at the beginning of contract year 3, the cumulative premiums paid for the contract do not exceed the contract's cumulative 7-pay premiums. Therefore, there are no overage earnings in contract years 1 and 2.

Upon payment of the $10,800 premium at the beginning of contract year 3, however, the cumulative amount paid for the contract ($31,550) exceeds the contract's cumulative 7-pay premiums ($31,470) by $80. As the earnings rate for the calendar year in which contract year 3 begins is 7.5%, the contract's overage earnings for contract year 3 equal $6 ($80 x 7.5%).

For contract year 4, the overage is $290 ($42,250 - $41,960). The cumulative overage earnings for all prior contract years equal $6.00. The earnings rate is 8.3%. The overage earnings for contract year 4 equal $24.57 (($290 + $6) x 8.3%).

For contract year 5, the overage is $1,300 ($53,750 - $52,450). The cumulative overage earnings for all prior contract years equal $30.57 ($6 + $24.57). The earnings rate is 7.8%. The overage earnings for contract year 5 equal $103.78 (($1,300 + $30.57) x 7.8%).

For contract year 6, the overage is $1,810 ($64,750 - $62,940). The cumulative overage earnings for all prior contract years equal $134.35 ($6 + $24.57 + $103.78). The earnings rate is 7.7%. The overage earnings for contract year 6 equal $149.71 ($1,810 + $134.35) x 7.7%).

For contract year 7, the overage is $1,320 ($74,750 - $73,430). The cumulative overage earnings for all prior contract years equal $284.06 ($6 + $24.57 + $103.78 + $149.71). The earnings rate is 7.6%. The overage earnings for contract year 7 equal $121.91 (($1,320 + $284.06) x 7.6%).

The cumulative overage earnings for the contract equal $405.97 ($6 + $24.57 + $103.78 + $149.71 + $121.91). Under sections 3.10 and 3.11 of this revenue procedure, the distribution frequency factor is .5 and the applicable percentage is 36%. Accordingly, the amount required to be paid with regard to the contract under section 5.03 of this revenue procedure is $73.07 ($405.97 x .5 x 36%).

(b) Example 2. The facts are the same as in example 1 except that, at the beginning of contract year 5, A receives $3,000 as a policy loan. The contract's cash value (within the meaning of § 72(e)(3)(A)(i)) immediately prior to the loan is $58,500, which exceeds A's investment in the contract ($53,750) by $4,750. Each year A pays the interest on the policy loan. The issuer does not file a timely information return with regard to the deemed distribution resulting from the policy loan and A does not include the distribution in gross income reported on the income tax return for the taxable years in which the deemed distribution is received. The total income on the contract (as defined in section 3.09 of this revenue procedure) is $14,500.

The amount required to be paid with regard to the contract under section 5.03 of this revenue procedure is the sum of-

(1) an amount equal to the income tax (determined using a 36% tax rate) and the additional tax under section 72(v) with regard to the $3,000 deemed distribution in contract year 5;

(2) interest computed under section 6621(a)(2) as if the amounts determined under (1) were underpayments for the taxable year in which the distributions are deemed to have occurred; and

(3) 36% of $160.99, which is the excess of the contract's cumulative overage earnings over the proportionate share of the overage earnings allocable to taxable distributions ($405.97 - $83.99), multiplied by the distribution frequency factor (.5).

The proportionate share of overage earnings allocable to taxable distributions is obtained by multiplying the total amount of the taxable distribution under the contract ($3,000), by a fraction, the numerator of which is the contract's cumulative overage earnings ($405.97) and the denominator of which is the total income on the contract ($14,500).

.04 *Payment of amount.* The issuer is required to pay the amount determined under section 5.03 of this revenue procedure within thirty (30) days of the date of execution of the closing agreement by the Service. Payment shall be made by check payable to the "United States Treasury" delivered, together with a fully executed copy of the closing agreement, to Internal Revenue Service, Philadelphia Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19154, Attention: Chief, Receipt and Control Branch, DP3190.

.05 *Correction of contracts*. (1) *General rules.* If, on the date of the execution of the closing agreement by the Service, the testing period (as defined in section 3.01 of this revenue procedure) for a contract has more than ninety (90) days remaining, then the issuer must bring the contract into compliance with § 7702A. The issuer may bring a contract into compliance with § 7702A either by either increasing the contract's death benefit or returning the contract's excess premiums and earnings thereon to the contract holder. The issuer shall take the corrective action required under this section 5.05(1) within ninety (90) days of the date of execution of the closing agreement by the Service.

(2) *No corrective action required if Service executes closing agreement on a date within 90 days of the expiration of testing period.* If the testing period for a contract expires on or before the date within 90 days of the execution of the closing agreement by the Service, then the issuer is not required to take any corrective action under section 5.05(1) of this revenue procedure.

## SECTION 6. MODEL CLOSING AGREEMENT

Effective as of the date executed by Internal Revenue Service _________

CLOSING AGREEMENT AS TO FINAL DETERMINATION COVERING SPECIFIC MATTERS

THIS CLOSING AGREEMENT ("Agreement"), made pursuant to section 7121 of the Internal Revenue Code (the "Code") by and between [taxpayer's name, address, and identifying number] ("Taxpayer"), and the Commissioner of Internal Revenue (the "Service").

WHEREAS,

A. Taxpayer is the issuer of one or more modified endowment contracts, as defined in section 7702A of the Code;

B. On __________, Taxpayer pursuant to Rev. Proc. 2001–1, 2001–1 I.R.B. 1, submitted to the Service a request for a ruling that ______ modified endowment contracts (the "Contract[s]"), which are identified on Exhibit A to this Agreement, be treated as contracts that are not modified endowment contracts.

C. Taxpayer represents that the Contract[s] is [are] not described in section 4.02 of Rev. Proc. 2001–42.

D. Taxpayer represents that the cumulative "overage earnings," within the meaning of section 3.06 of Rev. Proc. 2001–42, for the Contract[s] equal $_____.

E. Taxpayer represents that the total of the amounts determined under section 5.03(1)(a), (b), and (c) of Rev. Proc. 2001–42, after taking the special rule in section 5.03(2) of the revenue procedure into account, with regard to the Contract[s] are $________, $________, and $______, respectively.

F. To ensure that the Contracts are not treated as modified endowment contracts, Taxpayer and the Service have entered into this Agreement.

NOW THEREFORE, IT IS HEREBY FURTHER DETERMINED AND AGREED BETWEEN TAXPAYER AND THE SERVICE AS FOLLOWS:

1. In consideration for the agreement of the Service as set forth in Section 2 below, Taxpayer agrees as follows:

(A) To pay to the Service the sum of ______ dollars and ______ cents ($_____) at the time and in the manner described in Section 3 below;

(B) The amount paid pursuant to Section 1(A) above is not deductible by Taxpayer, nor is such amount refundable, subject to credit or offset, or otherwise recoverable by Taxpayer from the Service;

(C) For purposes of its information reporting and withholding obligations under the Code, no holder's investment in any Contract may be increased by any portion of—

(i) the sum set forth in Section 1(A) above, or

(ii) the excess of the cumulative overage earnings over the proportionate share of overage earnings included in gross income reported to the Service on a timely filed information return or income tax return with regard to amounts received under any Contract; and

(D) To bring Contract[s] for which the testing period (as defined in section 3.01 of Revenue Procedure 2001–42) will not have expired on or before the date 90 days after the execution of this Agreement into compliance with § 7702A, either by an increase in death benefit[s] or the return of the excess premiums and earnings thereon to the contract holder[s].

2. In consideration of the agreement of Taxpayer set forth in Section 1 above, the Service and Taxpayer agree as follows:

(A) To treat each Contract as having satisfied the requirements of section 7702A during the period from the date of issuance of the Contract through and including the later of—

(i) date of the execution of this Agreement, and

(ii) the date of the corrective actions described in Section 1(D) above;

(B) To treat the corrective action described in 1(D) above as having no effect on the date the Contract was issued or entered into;

(C) To waive civil penalties for failure of Taxpayer to satisfy the reporting, withholding, and/or deposit requirements for income subject to tax under § 72(e)(10) that was received or deemed received by a contract holder under a Contract in a calendar year ending prior to the date of execution of this Agreement; and

(D) To treat no portion of the sum described in Section 1(A) above as income to the holders of the Contracts.

3. The actions required of Taxpayer in Section 1(D) above shall be taken by Taxpayer within ninety (90) days of the date of execution of this Agreement by the Service. Payment of the amount described in Section 1(A) above shall be made within thirty (30) days of the date of

execution of this Agreement by the Service by check payable to the "United States Treasury," delivered together with a fully executed copy of this Agreement, to Internal Revenue Service, Philadelphia Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19154, Attention: Chief, Receipt and Control Branch, DP3190.

4. This Agreement is, and shall be construed as being, for the benefit of Taxpayer. The holder[s] of Contract[s] covered by this Agreement are intended beneficiaries of this Agreement. This Agreement shall not be construed as creating any liability of an issuer to the holders of the Contract[s].

5. Neither the Service nor Taxpayer shall endeavor by litigation or other means to attack the validity of this Agreement.

6. This Agreement may not be cited or relied upon as precedent in the disposition of any other matter.

NOW THIS CLOSING AGREEMENT FURTHER WITNESSETH, that Taxpayer and the Service mutually agree that the matters so determined shall be final and conclusive, except as follows:

1. The matter to which this Agreement relates may be reopened in the event of fraud, malfeasance, or misrepresentation of material facts set forth herein.

2. This Agreement is subject to sections of the Code that expressly provide that effect be given to their provisions notwithstanding any other law or rule of law except § 7122 of the Code.

3. This Agreement is subject to any legislation enacted subsequent to the date of execution hereof if the legislation provides that it is effective with respect to closing agreements.

IN WITNESS WHEREOF, the parties have subscribed their names in triplicate.

Taxpayer

Date Signed: ________________ By: ______________________________

______________________________

Title/Office

Commissioner of Internal Revenue

Date Signed: ________________ By: ______________________________

______________________________

Title/Office

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective August 6, 2001, the date this revenue procedure was made available to the public.

SECTION 8. EFFECT ON OTHER DOCUMENTS.

This revenue procedure supersedes Rev. Proc. 99–27.

SECTION 9. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545 –1752.

The collection of information and reporting burden are in section 5 of this revenue procedure. This information will be used to determine whether an issuer may remedy failures to comply with the requirements of § 7702A. The likely respondents are insurance companies.

The estimated total annual reporting burden is 1000 hours.

The estimated annual burden per respondent varies from 50 hours to 150 hours with an average of 100 hours. The estimated number of respondents is 10.

The estimated annual frequency of the responses is one time.

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

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

DRAFTING INFORMATION

For further information regarding this revenue procedure, contact Donald Drees of Financial Institutions and Products at (202) 622-3970 (not a toll-free call).

# Part IV. Items of General Interest

## Foundations Status of Certain Organizations

## Announcement 2001–85

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

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

100 Black Men of Valdosta, Inc., Valdosta, GA
Affordable Housing Concepts, Inc., Clayton, GA
Alliance for a Responsible Swine Industry, Inc., Burgaw, NC
Alternatives to Violence Project USA, Inc., Albany, GA
American Saddlebreed Special Commissioned, Inc., Madison, GA
Arc of Union Co., Maynardville, TN
At-Risk Childrens-Teens Shelter, Inc., Atlanta, GA
Atlanta Doo-Wopp Association, Inc., Fayetteville, GA
Atlanta World Basketball Championships Organizing Comm., Inc., Atlanta, GA
Barbara A. Hayes Breast Cancer Foundation, Inc., Melbourne, FL
Bartow Blaze Fastpitch Softball, Inc., Bartow, FL
Bay County Council for Children, Inc., Panama City, FL
Birth Health, Inc., Atlanta, GA
Blacks United for Youth-Cobb, Inc., Marietta, GA
Building Hope, Inc., Atlanta, GA
Camp Kaleidoscope, Inc., Alpharetta, GA
Center Court, Inc., Baton Rouge, LA
Chosen Ministries, Inc., Augusta, GA
Christian Mental Health Services, Inc., Duluth, GA
Circle of Love, Inc., College Park, GA
Citizens Coalition for Responsible Power, Inc., Tampa, FL
Community Reinvestment Concepts, Inc., Clayton, GA
Consumer Law Center of the South, Inc., Atlanta, GA
Cup, Inc., Decatur, GA
Dale Davis Foundation, Inc., Boca Raton, FL
Economical Hope Development, Inc., Morrow, GA
Emmanuel Southside Community Enrichment Center, Inc., Atlanta, GA
Fishing Hall of Fame, Inc., Daytona Beach, FL
Freemind Generation, Inc., Atlanta, GA
Friends of Bowden, Inc., East Point, GA
Friends of Georgia Cycling, Inc., Sharpsburg, GA
Friends of Ghana, Inc., Macon, GA
Friends of Goethe, Inc., Atlanta, GA
Froghop, Inc., Atlanta, GA
Fulton Parks Foundation, Inc., Atlanta, GA
Fundacor Heart Foundation, Inc., Woodstock, GA
Global Health Service, Charlotte, NC
Golf Hall of Fame, Inc., Atlanta, GA
Greater Atlanta Inner City Games, Inc., Atlanta, GA
Greyt Friends, Inc., Marietta, GA
Hall of Success, Inc., Atlanta, GA
Help our Youth USA International, Inc., Ellenwood, GA
Hot Club of Atlanta, Inc., Decatur, GA
Jesse Solomon Scholarship Foundation, Inc., Madison, FL
John Chambers, Inc., Atlanta, GA
Kennesaw Youth Football Association, Kennesaw, GA
Korean-American Helping Hands Organization, Inc., Mableton, GA
Lee’s Mill Action Team, Inc., Plymouth, NC
Lifeline Academy, Inc., College Park, GA
Little Rock Housing Authority Technical Assistance Organization, Little Rock, AR
Maarji Institute, Inc., Fayetteville, GA
Macon County Community Housing Development Corporation, Montezuma, GA
Mary Lin Capital Campaign, Inc., Atlanta, GA
Marys Covenant Child Care and Learning Center, Inc., Atlanta, GA
Med. Help International, Inc., Melbourne Beach, FL
Mike Elk Foundation, Carrollton, GA
Ministry Resource Group, Inc., Atlanta, GA
Montgomery Improvement 40th Anniversary Foundation, Montgomery, AL
Morven Landmarks, Inc., Columbus, GA
National Community Development, Inc., Plantation, FL
Nehemiah Community Development Corporation, Inc., Riverdale, GA
Oakwood Non Profit Housing Corporation, Mt. Dora, FL
Outreach Center, Inc., La Grange, GA
Owens Community Caring & Sharing, Inc., Decatur, GA
Park Terrace Living Center, Lebanon, TN
Partnership of Atlanta Congregations, Inc., Atlanta, GA
Peachtree Christian Foundation, Inc., Atlanta, GA
Pediatric Life Support International, Inc., Macon, GA
Philippine Medical Society of Florida, Inc., East Coast Chapter, Neptune Beach, FL
Portsbridge Foundation, Inc., Dunwoody, GA
Prime Life Foundation, Inc., Plano, TX
Rest Haven Nursing Home Auxiliary, Ripley, MS
Rosslyn Counseling Ministry, Inc., Jonesboro, GA
Safe Start USA, Inc., Winter Park, FL
Sanford Festivals, Inc., Sanford, NC
Skua Productions, Inc., Atlanta, GA
Smith College Club of Atlanta, Atlanta, GA
Solid Rock Ranch, Inc., Valdosta, GA
South Central Community Development Corp., Memphis, TN
South Georgia Soccer Club, Inc., Douglas, GA
Southeast Community Development Corporation, Memphis, TN
Southside Mega Flood Task Force, Inc., Albany, GA
Suwanee Community Development Corp., Live Oak, FL
Sword of the Word, Inc., Augusta, GA
Twenty-First Century Senior Services, Inc., Memphis, TN

Tybee Island Land Trust, Inc., Tybee Island, GA
Uhuru, Inc., Atlanta, GA
United Christian Childrens Fund, Winter Springs, FL
United States Deaf Table Tennis Association, St. Augustine, FL
Vaughan Perry Foundation, Inc., Marion, AL
Vaughan Thomasville Foundation, Inc., Thomasville, AL
Victory Network, Inc., Albany, GA
We Share, Inc., College Park, GA
Wilbur Foundation, Inc., Atlanta, GA
Wild Care, Inc., Denver, NC
Youth United for Prosperity, Norcross, GA

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

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## The IRS Invites Your Comments on Proposed Changes to Substitute Forms Requirements for the Partner Copy of Schedule K-1 (Form 1065) and Schedule K-1 (Form 1065–B)

### Announcement 2001–88

**Background**

Based on recommendations of the Information Reporting Program Advisory Committee (IRPAC), the Internal Revenue Service (IRS) plans to revise Publication 1167, *Substitute Printed, Computer-Prepared, and Computer-Generated Tax Forms and Schedules*. It will provide revised substitute forms requirements for the copies of Schedule K-1 (Form 1065) and Schedule K-1 (Form 1065–B) furnished to partners, effective for the 2002 Schedule K-1.

The purpose of these revisions is to:

• Make the substitute forms requirements more specific.

• Set uniform visual standards that all taxpayers can recognize as representing a Schedule K-1.

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**Purpose**

The purpose of this announcement is to request comments on proposed changes to the substitute forms requirements for Schedule K-1 (Form 1065) and Schedule K-1 (Form 1065–B).

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**Revisions to Publication 1167**

The instructions in Publication 1167 would be supplemented by the following proposed requirements:

- Copies of substitute Schedules K-1 furnished to partners must be clear and legible.
- The substitute schedule must show the tax year, schedule number (K-1), related form number (1065 or 1065–B), and title exactly as shown on the official IRS schedule. This information must be prominently displayed together in one area of the schedule.
- The line items on the substitute schedule must be in the same order as those on the official IRS schedule. The wording for each line and instruction must be substantially the same as the official schedule.
- The schedule must contain all items required for use by the partner, but is not required to show lines that do not have entries required for the particular partner. If line items are omitted, do not renumber the remaining lines. The remaining lines must have the same letters or numbers as the corresponding lines on the official schedule. Instructions should be provided to make it clear that the number and order of the items relate to the official schedule.
- Either the official IRS version of the Partner's Instructions for Schedule K-1 or substantially similar instructions must be furnished with the partner's copy of Schedule K-1. If line items on a substitute schedule have been omitted on a partner's substitute Schedule K-1 because they do not apply to that partner, the corresponding line instructions may be omitted from that partner's substitute instructions.
- Logos are permitted on the substitute schedules, along with other information which is helpful to the partners' understanding of their tax responsibilities. Such information should be segregated in a manner that avoids confusion with the required Schedule K-1 tax items.

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|---|---|
| **Benefit to Partnerships** | By providing clear and consistent reporting of tax information to its partners, partnerships will make it easier for its partners to comply with their tax responsibilities. Partnerships will spend less time explaining to partners the tax information they have received and how it relates to their income tax returns. |
| **Benefit to Partners** | Income tax information the partners receive will be understandable and will be properly reflected on their income tax returns. Partners will receive fewer notices from the IRS. |
| **Benefit to the IRS** | The IRS will receive more accurate returns, which in turn will reduce the need to contact taxpayers. |
| **Comments Requested** | The IRS would like to receive comments on the proposed revisions to Publication 1167 regarding Schedule K-1 (Form 1065) and Schedule K-1 (Form 1065–B) from partnerships, partners, and other interested parties by October 1, 2001.<br><br>Please e-mail comments to the Substitute Forms Program Unit at tfp@publish.no.irs.gov. Please enter "Substitute Forms" on the Subject Line. You can also mail comments to Internal Revenue Service, Substitute Forms Program, W:CAR:MP:FP:S:CS, 1111 Constitution Avenue, NW, Room 5244, Washington, DC 20224. After the end of the comment period, the IRS will evaluate the comments and release a revised version of Publication 1167. Although we will not be able to respond to each comment, we will carefully consider all of them. |

## The Internal Revenue Service Will Permit Electronic Submission of Forms W-9 by Certain Intermediaries

## Announcement 2001–91

*Background*

In Announcement 98–27 (1998–1 C.B. 865) the Internal Revenue Service (the "Service") announced that it will allow payers to establish a system to electronically receive Form W-9, *"Request for Taxpayer Identification Number and Certification"* from payees. The *"Instructions for the Requester of Form W-9"* were revised to describe a proper electronic system.

The Service will also allow a payer with an electronic system to electronically receive a Form W-9 from an investment advisor or introducing broker authorized to transmit that form as the payee's agent. To receive a Form W-9 from an investment advisor or introducing broker, a payer's electronic system must meet the requirements described below. The Service will revise the instructions to Form W-9 to reflect the provisions of this announcement.

*Definitions*

For purposes of this announcement, the term "payer" means a person required to file an information return for payments described in §§ 3406(b)(2) and (3) of the Internal Revenue Code. The term "payee" means the person required to submit Form W-9 to the payer. The term "investment advisor" means a corporation, partnership or individual registered with the Securities and Exchange Commission ("SEC") under the Investment Advisers Act of 1940. The term "introducing broker" means a broker-dealer that is regulated by the SEC and the National Association of Securities Dealers, Inc., and that is not a payer.

*Reliance*

A payer receiving a Form W-9 from an investment advisor or introducing broker authorized to transmit the Form W-9 to the payer may rely on it as if the form had been received directly from the payee, for purposes of filing information returns and determining the payer's backup withholding obligations under § 3406. The advisor or broker must represent in writing (which may include electronic means) to the payer that the payee authorized the advisor or broker to transmit the Form W-9 to the payer.

The Form W-9 received from the investment advisor or introducing broker may be either the original paper Form W-9 or an electronic version (including a facsimile). An electronic version must be received by the payer through a system that meets the requirements described below. This announcement does not apply to situations in which a broker acts as a payee's agent with respect to "readily tradable instruments" pursuant to the special rule in § 31.3406(h)–3(d) of the Employment Tax Regulations. Therefore, in the case of readily tradable instruments, the payer may rely on a taxpayer identification number provided by the broker (including by electronic means) unless certification is required and the broker notifies the payer that the number was not certified.

*Electronic System Requirements*

(1) *In general*. The electronic system must ensure that the information received by the payer is the information sent by the investment advisor or introducing broker. The system must document all occasions of user access that result in the submission. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and submitting the Form W-9 is the investment advisor or introducing broker.

(2) *Same information as paper Form W-9*. The electronic submission must provide the payer with exactly the same information as the paper Form W-9.

(3) *Signature requirements and perjury statement*. The electronic submission

must be signed with the payee's electronic signature, but only in situations where Form W-9 and its instructions require a signature by the payee.

(A) *Electronic signature*. In addition to identifying the payee to whom the Form W-9 relates, the electronic signature must authenticate and verify the submission. For this purpose, the terms "authenticate" and "verify" have the same meanings as they do when applied to a written signature on a paper Form W-9. An electronic signature can be in any form that satisfies the foregoing requirements. The electronic signature must be the final entry in the submission.

(B) *Perjury statement*. The electronic signature on Form W-9 must be under penalties of perjury. The perjury statement must contain the language that appears on the paper Form W-9. The electronic system must inform the payee that, by signing, the payee makes the declaration contained in the perjury statement. The perjury statement must immediately precede the electronic signature.

(4) *Copies of electronic Forms W-9*. Upon request by the Service, the payer must supply a hard copy of the electronic Form W-9 and a statement that, to the best of the payer's knowledge, the electronic Form W-9 was submitted by the investment advisor or introducing broker acting as the payee's agent. The hard copy of the electronic Form W-9 must provide exactly the same information as, but need not be a facsimile of, the paper Form W-9.

(5) *Effective date.* This announcement applies to Forms W-9 submitted to payers by payees through investment advisors or introducing brokers on or after September 4, 2001.

For further information regarding this announcement, contact Nathan Rosen of the Office of the Associate Chief Counsel (Procedure & Administration), Administrative Provisions and Judicial Practice Division, at (202) 622-4910 (not a toll-free call).

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

## Section 61.—Gross Income Defined

*26 CFR 1.61–21: Taxation of fringe benefits.*

**Fringe benefits aircraft valuation formula.** For purposes of section 1.61–21(g) of the Income Tax Regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the second half of 2001 are set forth.

## Rev. Rul. 2001–42

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charges and SIFL mileage rates:

| *Period During Which the Flight Is Taken* | *Terminal Charge* | *SIFL Mileage Rates* |
|---|---|---|
| 7/1/01 - 12/31/01 | $36.88 | Up to 500 miles = $.2017 per mile |
| | | 501-1500 miles = $.1538 per mile |
| | | Over 1500 miles = $.1479 per mile |

DRAFTING INFORMATION

The principle author of this revenue ruling is Kathleen Edmondson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 622-6040 (not a toll-free call).

## Section 446.—General Rule for Methods of Accounting

*26 CFR 1.446–1: General rule for methods of accounting.*

A safe harbor method of accounting is provided for track structure expenditures paid or incurred by certain railroads, as well as procedures for automatic consent to change to this method. See Rev. Proc. 2001–46, page 263.

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

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

**LIFO; price indexes; department stores.** The July 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, July 31, 2001.

## Rev. Rul. 2001–44

The following Department Store Inventory Price Indexes for July 2001 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46 (1986–2 C.B. 739) for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, July 31, 2001.

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

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

| Groups | July 2000 | July 2001 | Percent Change from July 2000 to July 2001[1] |
|---|---|---|---|
| 1. Piece Goods | 519.6 | 495.0 | -4.7 |
| 2. Domestics and Draperies | 630.3 | 604.1 | -4.2 |
| 3. Women's and Children's Shoes | 613.6 | 652.3 | 6.3 |
| 4. Men's Shoes | 896.4 | 865.9 | -3.4 |
| 5. Infants' Wear | 629.5 | 593.7 | -5.7 |
| 6. Women's Underwear | 561.4 | 567.1 | 1.0 |
| 7. Women's Hosiery | 335.1 | 352.6 | 5.2 |
| 8. Women's and Girls' Accessories | 528.2 | 542.1 | 2.6 |
| 9. Women's Outerwear and Girls' Wear | 364.0 | 355.7 | -2.3 |
| 10. Men's Clothing | 602.8 | 577.6 | -4.2 |
| 11. Men's Furnishings | 608.8 | 588.4 | -3.4 |
| 12. Boys' Clothing and Furnishings | 478.6 | 476.0 | -0.5 |
| 13. Jewelry | 945.5 | 946.5 | 0.1 |
| 14. Notions | 780.8 | 805.8 | 3.2 |
| 15. Toilet Articles and Drugs | 965.7 | 972.5 | 0.7 |
| 16. Furniture and Bedding | 689.2 | 637.7 | -7.5 |
| 17. Floor Coverings | 609.8 | 628.7 | 3.1 |
| 18. Housewares | 783.5 | 771.5 | -1.5 |
| 19. Major Appliances | 232.9 | 225.6 | -3.1 |
| 20. Radio and Television | 59.1 | 53.9 | -8.8 |
| 21. Recreation and Education[2] | 92.6 | 89.8 | -3.0 |
| 22. Home Improvements[2] | 127.9 | 125.8 | -1.6 |
| 23. Auto Accessories[2] | 106.5 | 109.4 | 2.7 |
| Groups 1 - 15: Soft Goods | 583.3 | 575.7 | -1.3 |
| Groups 16 - 20: Durable Goods | 439.9 | 423.3 | -3.8 |
| Groups 21 - 23: Misc. Goods[2] | 100.0 | 98.5 | -1.5 |
| Store Total[3] | 529.2 | 519.5 | -1.8 |

[1] Absence of a minus sign before the percentage change in this column signifies a price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

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

## Section 481.—Adjustments Required by Changes in Method of Accounting

*26 CFR 1.481–1: Adjustments in general.*

A safe harbor method of accounting is provided for track structure expenditures paid or incurred by certain railroads, as well as procedures for automatic consent to change to this method. See Rev. Proc. 2001–46, page 263.

# Part III. Administrative, Procedural, and Miscellaneous

## 2001 Marginal Production Rates

## Notice 2001–53

Section 613A(c)(6)(C) of the Internal Revenue Code defines the term "applicable percentage" for purposes of determining percentage depletion for oil and gas produced from marginal properties. The applicable percentage is the percentage (not greater than 25 percent) equal to the sum of 15 percent, plus one percentage point for each whole dollar by which $20 exceeds the reference price (determined under § 29(d)(2)(C)) for crude oil for the calendar year preceding the calendar year in which the taxable year begins. The reference price determined under § 29(d)(2)(C) for the 2000 calendar year is $26.73.

Table 1 contains the applicable percentages for marginal production for taxable years beginning in calendar years 1991 through 2001.

Notice 2001–53 Table 1

APPLICABLE PERCENTAGE FOR MARGINAL PRODUCTION

| *Calendar Year* | *Applicable Percentage* |
|---|---|
| 1991 | 15 percent |
| 1992 | 18 percent |
| 1993 | 19 percent |
| 1994 | 20 percent |
| 1995 | 21 percent |
| 1996 | 20 percent |
| 1997 | 16 percent |
| 1998 | 17 percent |
| 1999 | 24 percent |
| 2000 | 19 percent |
| 2001 | 15 percent |

The principal author of this notice is Brenda M. Stewart of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Stewart at (202) 622-3120 (not a toll-free call).

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## 2001 Section 43 Inflation Adjustment

## Notice 2001–54

Section 43(b)(3)(B) of the Internal Revenue Code requires the Secretary to publish an inflation adjustment factor. The enhanced oil recovery credit under § 43 for any taxable year is reduced if the "reference price," determined under § 29(d)(2)(C), for the calendar year preceding the calendar year in which the taxable year begins is greater than $28 multiplied by the inflation adjustment factor for that year.

The term "inflation adjustment factor" means, with respect to any calendar year, a fraction the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990.

Because the reference price for the 2000 calendar year ($26.73) does not exceed $28 multiplied by the inflation adjustment factor for the 2001 calendar year, the enhanced oil recovery credit for qualified costs paid or incurred in 2001 is determined without regard to the phase-out for crude oil price increases.

Table 1 contains the GNP implicit price deflator used for the 2001 calendar year, as well as the previously published GNP implicit price deflators used for the 1991 through 2000 calendar years.

Notice 2001–54 TABLE 1

GNP IMPLICIT PRICE DEFLATORS

| *Calendar Year* | *GNP Implicit Price Deflator* |
|---|---|
| 1990 | 112.9 (used for 1991) |
| 1991 | 117.0 (used for 1992) |
| 1992 | 120.9 (used for 1993) |
| 1993 | 124.1 (used for 1994) |
| 1994 | 126.0 (used for 1995) |
| 1995 | 107.5 (used for 1996)* |
| 1996 | 109.7 (used for 1997) |
| 1997 | 112.35 (used for 1998)** |
| 1998 | 112.64 (used for 1999) |
| 1999 | 104.59 (used for 2000)*** |
| 2000 | 106.89 (used for 2001) |

* Beginning in 1995, the GNP implicit price deflator was rebased relative to 1992. The 1990 GNP implicit price deflator used to compute the 1996 § 43 inflation adjustment factor is 93.6.

** Beginning in 1997, two digits follow the decimal point in the GNP implicit price deflator. The 1990 GNP price deflator used to compute the 1998 § 43 inflation adjustment factor is 93.63.

*** Beginning in 1999, the GNP implicit price deflator was rebased relative to 1996. The 1990 GNP implicit price deflator used to compute the 2000 § 43 inflation adjustment factor is 86.53.

Table 2 contains the inflation adjustment factor and the phase-out amount for taxable years beginning in the 2001 calendar year as well as the previously published inflation adjustment factors and phase-out amounts for taxable years beginning in the 1991 through 2000 calendar years.

Notice 2001–54 TABLE 2

INFLATION ADJUSTMENT FACTORS AND
PHASE-OUT AMOUNTS

| *Calendar Year* | *Inflation Adjustment Factor* | *Phase-out Amount* |
|---|---|---|
| 1991 | 1.0000 | 0 |
| 1992 | 1.0363 | 0 |
| 1993 | 1.0708 | 0 |
| 1994 | 1.0992 | 0 |
| 1995 | 1.1160 | 0 |
| 1996 | 1.1485 | 0 |
| 1997 | 1.1720 | 0 |
| 1998 | 1.1999 | 0 |
| 1999 | 1.2030 | 0 |
| 2000 | 1.2087 | 0 |
| 2001 | 1.2353 | 0 |

DRAFTING INFORMATION

The principal author of this notice is Brenda M. Stewart of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Stewart at (202) 622-3120 (not a toll-free call).

**NOTE: This revenue procedure will be reprinted as the next revision of IRS Publication 1167, *Substitute Printed, Computer-Prepared, and Computer-Generated Tax Forms and Schedules.***

## Rev. Proc. 2001–45

**TABLE OF CONTENTS**

**EXHIBITS**



# Chapter 1
# Introduction to Substitute Forms

## Section 1.1—Overview of Revenue Procedure 2001–45

**1.1.1 Purpose**

The purpose of this revenue procedure is to provide procedural guidelines and general requirements for the development, printing, and approval of all substitute tax forms. Approval will be based on these guidelines. After review and approval, submitted forms will be accepted as substitutes for official IRS forms.

**1.1.2 Unique Forms**

Certain unique specialized forms require the use of other additional revenue procedures to supplement this publication. See Chapter 4.

**1.1.3 Scope**

The Internal Revenue Service accepts quality substitute tax forms that are consistent with the official forms and do not have an adverse impact on our processing. The IRS Substitute Forms Program administers the formal acceptance and processing of these forms nationwide. While this program deals primarily with paper documents, it also interfaces with other processing and filing media such as:

- Magnetic tape,
- Optical character recognition, and
- Electronic filing.

Only those substitute forms that comply fully with the requirements set forth are acceptable. Exhibit D lists the form numbers mentioned in this document, their titles, and where their references are made. This revenue procedure is updated as required to reflect pertinent tax year form changes and to meet processing and/or legislative requirements.

**1.1.4 Forms Covered by This Revenue Procedure**

The following types of forms are covered by this revenue procedure:

- IRS tax returns and their related forms and schedules.
- Worksheets as they appear in instruction packages.
- Applications for permission to file returns electronically and forms used as required documentation for electronically filed returns.
- Powers of Attorney.
- Over-the-counter estimated tax payment vouchers.
- Forms and schedules relating to partnerships, exempt organizations, and employee plans.

**1.1.5 Forms NOT Covered by This Revenue Procedure**

The following types of forms are not covered by this revenue procedure:

- W-2, W-3 (see Publication 1141 for information on these forms).
- 1096, 1098 series, 1099 series, 5498 series, and W-2G (see Publication 1179 for information on these forms).
- Federal Tax Deposit (FTD) coupons, which may not be reproduced.
- Forms 1040-ES(OCR) and 1041-ES(OCR), which may not be reproduced.
- Requests for information or documentation initiated by the Service.
- Forms used internally by the Service.
- State tax forms.
- Forms developed outside IRS (except for Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts*).

## Section 1.2—IRS Contacts

**1.2.1 Where To Send Substitute Forms**

Send your substitute forms for approval to the following offices (DO NOT send forms with taxpayer data):

| Form | Office and Address |
|---|---|
| 4789, 8300, 8362, 8852,<br>TD F 90–22.1, TD F 90–22.47 | IRS Computing Center<br>BSA Compliance Branch<br>P.O. Box 32063<br>Detroit, MI 48232-0063 |
| All others (except W-2, W-3, 1096, 1098, 1099, 5498, and W-2G) | Internal Revenue Service<br>Attn: Substitute Forms Program<br>W:CAR:MP:FP:S:CS<br>1111 Constitution Avenue, NW<br>Room 5244 IR<br>Washington, DC 20224 |

In addition, the Substitute Forms Program Unit can be contacted via e-mail at *tfp@publish.no.irs.gov.* Please enter "Substitute Forms" on the Subject Line. Use this e-mail address only to inquire about forms covered by this revenue procedure. DO NOT attach graphic files for approval with e-mail.

For questions about Forms W-2 and W-3, refer to IRS Publication 1141, *General Rules and Specifications for Private Printing of Substitute Forms W-2 and W-3*. For Forms 1096, 1098, 1099, 5498, and W-2G, refer to IRS Publication 1179, *Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 5498, and W-2G.*

## Section 1.3—Nature of Changes

**1.3.1 Changes to the Revenue Procedure**

The following changes have been made to the Revenue Procedure for 2001:

- The pages have been renumbered for easier use.
- IRS Internet Web Site addresses have been updated.
- The OCR Forms address in Section 1.2.1 has been omitted. These form submissions may now be sent to the Substitute Forms Program Unit.
- The Substitute Forms Program office symbols have been changed to W:CAR:MP:FP:S:CS.
- The definition under Section 1.4.7 has been deleted.
- The list of related publications in Chapter 4 has been updated. Pub. 1192 has been deleted from the list because it is obsolete.
- Pricing information for the Federal Tax Forms CD-ROM has been revised.
- Section 7.1 has been deleted. Form 1040EZ is no longer being scanned.
- Information about Form 1040PC in Section 7.2 and elsewhere has been deleted. Effective tax year 2000, the Service is no longer accepting Form 1040PC.
- Section 7.3 has been deleted. The information concerning these OCR scannable forms is no longer valid.
- Because the information in Chapter 7 of the previous revision has been deleted, Chapters 8 and 9 are now Chapters 7 and 8.
- Form 1042–S specifications have been revised.
- Forms 5500 and 5500–EZ are now handled by the Pension and Welfare Benefits Administration (PWBA). Forms 5500 and 5500–EZ will no longer be accepted for IRS approval. Information can be found in Section 7.4. Other references to these forms have been deleted throughout this revenue procedure.
- Exhibit L–1 is renamed Exhibit D. The list has been reformatted and updated.
- Various editorial changes have been made.

## Section 1.4—Definitions

| | |
|---|---|
| **1.4.1 Substitute Form** | A tax form (or related schedule) that differs in any way from the official version and is intended to replace the entire form that is printed and distributed by the Service. This term also covers those approved substitute forms exhibited in this revenue procedure. |
| **1.4.2 Printed/ Preprinted Form** | A form produced using conventional printing processes. Also, a printed form which has been reproduced by photocopying or a similar process. |
| **1.4.3 Preprinted Pin-Fed Form** | A printed form that has marginal perforations for use with automated and high-speed printing equipment. |
| **1.4.4 Computer-Prepared Substitute Form** | A preprinted form in which the taxpayer's tax entry information has been inserted by a computer, computer-printer, or other computer type equipment such as word-processing equipment. |
| **1.4.5 Computer-Generated Substitute Tax Return or Form** | A tax return or form that is entirely designed and printed using a computer printer such as a laser printer, etc., on plain white paper. This return or form must conform to the physical layout of the corresponding IRS form, although the typeface may differ. The text should match the text on the officially printed form as closely as possible. Condensed text and abbreviations will be considered on a case-by-case basis.<br><br>**Exception:** All jurats (perjury statements) must be reproduced verbatim. |
| **1.4.6 Manually-Prepared Form** | A preprinted reproduced form in which the taxpayer's tax entry information is entered by an individual using a pen, pencil, typewriter, or other non-automated equipment. |
| **1.4.7 Graphics** | Parts of a printed tax form that are not tax amount entries or required information. Examples of graphics are line numbers, captions, shadings, special indicators, borders, rules, and strokes created by typesetting, photo-graphics, photo-composition, etc. |
| **1.4.8 Acceptable Reproduced Form** | A legible photocopy of an original form. |
| **1.4.9 Supporting Statement (Supplemental Schedule)** | A document providing detailed information to support a line entry on an official or approved substitute form and filed with (attached to) a tax return.<br><br>**Note:** *A supporting statement is not a tax form and does not take the place of an official form unless specifically permitted elsewhere in this procedure.* |
| **1.4.10 Specific Form Terms** | The following specific terms are used throughout this revenue procedure in reference to all substitute forms: format, sequence, line reference, item caption, and data entry field. |
| **1.4.11 Format** | The overall physical arrangement and general layout of a substitute form. |
| **1.4.12 Sequence** | Sequence is an integral part of the total format requirement. The substitute form should show the same numeric and logical placement order of data, as shown on the official form. |
| **1.4.13 Line Reference** | The line numbers, letters, or alphanumerics used to identify each captioned line on an official form. These line references are printed to the immediate left of each caption or data entry field. |
| **1.4.14 Item Caption** | The text on each line of a form, which identifies the data required. |

**1.4.15 Data Entry Field**

Designated areas for the entry of data such as dollar amounts, quantities, responses, checkboxes, etc.

**1.4.16 Advanced Draft**

A draft version of a new or revised form may be posted to the IRS Internet site for information purposes. Substitute forms may be submitted based on these advanced drafts, but any company that receives forms approval based on these early drafts is responsible for monitoring and revising forms to mirror any revisions in the final forms provided by the Service.

## Section 1.5—Agreement

**1.5.1 Important Stipulation of This Revenue Procedure**

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure agrees to the following stipulations:

- The Internal Revenue Service presumes the changes are made in accordance with these procedures and, as such, will be non-interruptive to the processing of the tax return.
- Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Internal Revenue Service during processing of the tax return, the person or company agrees to accept the determination of the IRS as to whether or not the form may continue to be used during the filing season.
- The person or company agrees to work with the IRS in correcting noted deficiencies. Notification of deficiencies may be made by any combination of fax, letter, e-mail, or phone contact and may include the return of unacceptable forms for re-submission of acceptable forms.

# Chapter 2
# General Guidelines for Submissions and Approvals

## Section 2.1—General Specifications for Approval

**2.1.1 Overview**

If you produce any tax returns and forms using IRS guidelines on permitted changes, you can generate your own substitutes without further approval. If your changes are more extensive, you must get official approval before using substitute forms. These changes include the use of typefaces and sizes other than those found on the official form and the condensing of line item descriptions to save space.

**2.1.2 Schedules**

Schedules are considered to be an integral part of a complete tax return. A schedule may be included as part of a form or printed separately.

**2.1.3 Example of Schedules That Must Be Submitted With the Return**

Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return,* is an example of this situation. Its Schedules A through U have pages numbered as part of the basic return. For Form 706 to be approved, the entire form including Schedules A through U must be submitted.

**2.1.4 Examples of Schedules That Can Be Submitted Separately**

However, Schedules 1, 2, and 3 of Form 1040A are examples of schedules that can be separately computer-generated. Although printed by the IRS as a supplement to Form 1040A, none of these schedules are required to be filed with Form 1040A. These schedules may be separated from Form 1040A and submitted as computer-generated substitute forms.

**2.1.5 Use and Distribution of Unapproved Forms**

The Internal Revenue Service is continuing a program to identify and contact tax return preparers, forms developers, and software publishers who use or distribute unapproved forms that do not conform to this revenue procedure. The use of unapproved forms impedes processing of the returns.

## Section 2.2—Highlights of Permitted Changes and Requirements

**2.2.1 Methods of Reproducing Internal Revenue Service Forms**

Official versions are supplied by the Internal Revenue Service, such as those in the taxpayer's tax package, those printed in revenue procedures, and over-the-counter forms available at IRS and other governmental public offices or buildings. Forms are also available on CD-ROM, and on-line via the Internet.

There are methods of reproducing Internal Revenue Service printed tax forms suitable for use as substitute tax forms without prior approval.

- You can photocopy most tax forms and use them instead of the official ones. The entire substitute form, including entries, must be legible.
- You can reproduce any current tax form as cut sheets, snap sets, and marginally punched, pin-fed forms so long as you use an official IRS version as the master copy.
- You can reproduce a "signature form" as a valid substitute form. Many tax forms (including returns) have a taxpayer signature requirement as part of the form layout. **The jurat/perjury statement/signature line areas must be retained and worded exactly as on the official form**. The requirement for a signature by itself does not prohibit a tax form from being properly computer-generated.

## Section 2.3—Vouchers

**2.3.1 Overview**

All payment vouchers (Forms 940–V, 940–EZ(V), 941–V, 943–V, 945–V, 1040–V, and 2290–V) must be reproduced. Substitute vouchers must be the same size as the officially printed vouchers. Vouchers that are prepared for printing on a laser printer may include a scan line.

**2.3.2 Scan Line Specifications**

| | NNNNNNNNN | AA | AAAA | NN | N | NNNNNN | NNN |
|---|---|---|---|---|---|---|---|
| *Item:* | *A* | *B* | *C* | *D* | *E* | *F* | *G* |

*A.* Social Security Number/Employer Identification Number (SSN/EIN) has 9 numeric spaces.
*B.* Check Digit has 2 alpha spaces.
*C.* Name Control has 4 alphanumeric spaces.
*D.* Master File Tax (MFT) Code has 2 numeric spaces (see below).
*E.* Taxpayer Identification Number (TIN) Type has 1 numeric space (see below).
*F.* Tax period has six numeric spaces in year/month format (YYYYMM).
*G*. Transaction Code has 3 numeric spaces.

**2.3.3 MFT Code**

Code Number for Form:
- 1040 family – 30;
- 940/940–EZ – 10;
- 941 – 01;
- 943 – 11;
- 945 – 16; and
- 2290 – 60.

**2.3.4 TIN Type**

Type Number for:
- Form 1040 family – 0; and
- Forms 940, 940–EZ, 941, 943, 945, and 2290 – 2.

**2.3.5 Voucher Size**

The voucher size must be exactly 8.0″ x 3.25″ (Forms 1040–ES and 1041–ES must be 7.625″ x 3.0″). The document scan line must be vertically positioned 0.25 inches from the bottom of the scan line to the bottom of the voucher. The last character on the right of the scan line must be placed 3.5 inches from the right leading edge of the document. The minimum required horizontal clear space between characters is .014 inches. The line to be scanned must have a clear band 0.25 inches in height from top to bottom of the scan line, and from border to border of the document. "Clear band" means no printing except for dropout ink.

**2.3.6 Print and Paper Weight**

Vouchers must be imaged in black ink using OCR A, OCR B, or Courier 10. These fonts may not be mixed in the scan line. The horizontal character pitch is 10 CPI. The paper must be 20 to 24 pound OCR bond paper weight.

## Section 2.4—Restrictions on Changes

**2.4.1 Things You CANNOT Do to IRS Forms Suitable for Substitute Tax Forms**

You cannot, without prior IRS approval, change any IRS tax form or use your own (non-approved) versions including graphics, unless specifically permitted by this revenue procedure.

You cannot adjust any of the graphics on Forms 1040, 1040A, and 1040EZ (except in those areas specified in Chapter 5 of this revenue procedure) without prior approval from the IRS Substitute Forms Program Unit.

You cannot use your own preprinted label on tax returns filed with the IRS unless you fully comply with the criteria specified in the section in this revenue procedure on use of pre-addressed IRS labels.

## Section 2.5—Guidelines for Obtaining IRS Approval

**2.5.1 Basic Requirements**

Preparers who submit substitute privately-designed, privately-printed, computer-generated, or computer-prepared tax forms must develop these substitutes using the guidelines established in this chapter. These forms, unless excepted by the revenue procedure, must be approved by the IRS before being filed.

**2.5.2 Conditional Approval Based on Advance Drafts**

The IRS cannot grant final approval of your substitute form until the official form has been published. However, the IRS has established a location on the Internet for the posting of advance drafts of forms. This site can be reached through the Tax Professional's Corner at:

*http://www.irs.gov/prod/bus_info/tax_pro.*

We encourage submission of proposed substitutes of these advance draft forms, and will grant conditional approval based solely on these early drafts. These advance drafts are subject to significant change before forms are finalized. If these advance drafts are used as the basis for your substitute forms, you will be responsible for subsequently updating your final forms to agree with the final official version. These revisions need not be submitted for further approval.

**Note:** *Approval of forms based on advance drafts will not be granted after the final version of an official form is published.*

**2.5.3 Submission Procedures**

Please follow these general guidelines when submitting substitute forms for approval.

- Any alteration of forms must be within the limits acceptable to the Service. It is possible that, from one filing period to another, a change in law or a change in internal need (processing, audit, compliance, etc.) may change the allowable limits for the alteration of the official form.
- When specific approval of any substitute form (other than those specified in Chapter 2, IRS Contacts) is desired, a sample of the proposed substitute should be forwarded for consideration by letter to the Substitute Forms Program Unit at the address shown in Section 1.2.
- To expedite multiple forms approval, we prefer that your proposed forms be submitted in separate sets by return. For example, Forms 1040 and their normally related schedules or attachments should be submitted separately from Forms 1120 and 1065 if possible. Schedules and forms (*e.g.*, Forms 3468, 4136, etc.) that can be used with more than one type of return (*e.g.*, 1040, 1041, 1120, etc.) should be submitted only once for approval, regardless of the number of different tax returns with which they may be associated. Also, all pages of multi-page forms or returns should be submitted in the same package.

**2.5.4 Approving Offices**

As no IRS office except the ones specified in this procedure (per the chart in Section 1.2) are authorized to approve substitute forms, unnecessary delay may result if forms are sent elsewhere for approval. All forms submitted to any other office must be forwarded to the appropriate office for formal control and review. The Substitute Forms Program Unit may then coordinate the response with the program analyst responsible for the processing of that form. Such coordination may include allowing the analyst to officially approve the form. No IRS office is authorized to allow deviations from this revenue procedure.

**2.5.5 Service's Review of Software Programs, etc.**

The IRS does not review or approve the logic of specific software programs, nor does the IRS confirm the calculations on the forms produced by these programs. The accuracy of the program remains the responsibility of the software package developer, distributor, or user.

The Substitute Forms Program is primarily concerned with the pre-filing quality review of the final forms, produced by whatever means, that are expected to be processed by IRS field offices. For the above reasons, you should submit forms without including any "taxpayer" information such as names, addresses, monetary amounts, etc.

**2.5.6 When To Send Proposed Substitutes**

Proposed substitutes, which are required to be submitted per this revenue procedure, should be sent as much in advance of the filing period as possible. This is to allow adequate time for analysis and response.

**2.5.7 Accompanying Statement**

When submitting sample substitutes, you should include an accompanying statement that lists each form number and its changes from the official form (position, arrangement, appearance, line numbers, additions, deletions, etc.). With each of the items you should include a detailed reason for the change and an estimate of the number of forms expected to be filed.

When requesting approval for multiple forms, the statement should be presented as a checklist. Checklists are not mandatory, but do expedite the approval process. The checklist may look like the example (Exhibit C) displayed in the back of this procedure or may be one of your own design. Please include your fax number on the checklist.

**2.5.8 Approval/Non-Approval Notice**

The Substitute Forms Unit will fax the checklist or an approval letter to the originator if a fax number has been provided, unless:

- The requester has asked for a formal letter; or
- Significant corrections to the submitted forms are required.

Notice of approval may contain qualifications for use of the substitutes. Notices of nonapproval letters may specify the changes required for approval, and may also require re-submission of the form(s) in question. Telephone contact is used when possible.

**2.5.9 Duration of Approval**

Most signature tax returns and many of their schedules and related forms have the tax (liability) year printed in the upper right corner. Approvals for these forms are usually good for one calendar year (January through December of the year of filing). Quarterly tax forms in the 94X series and Form 720 require approval for any quarter in which the form has been revised.

Because changes are made to a form every year, each new filing season generally requires a new submission of a form. Very rarely is updating the preprinted year the only change made to a form.

**2.5.10 Limited Continued Use of an Approved Change**

Limited continued use of a change approved for one tax year may be allowed for the same form in the following tax year. Examples of such limitations and requirements are the use of abbreviated words, revised form spacing, compressed text lines, shortened captions, etc., which do not change the consistency of lines or text on the official forms.

If substantial changes are made to the form, new substitutes must be submitted for approval. If only minor editorial changes are made to the form, it is not subject to review. It is the responsibility of each vendor who has been granted permission to use substitute forms to monitor and revise forms to mirror any revisions to official forms made by the Service. If there are any questions, please contact the Substitute Forms Unit.

If you received written approval of a previous tax year substitute form governed by this revenue procedure and continue to use the approved change on your current tax year substitute form, you may revise your form to include this change. Without additional written approval, you may use it as a current tax year substitute form, provided you comply with the requirements in this revenue procedure.

**2.5.11 When Approval Is Not Required**

If you received written approval for a specific change on a form last year, such as deleting the vertical lines used to separate dollars and cents, you may make the same change this year if the item is still present on the official form.

- The new substitute does not have to be sent to the IRS and written approval is not required.

- However, the new substitute must conform to the official current year IRS form in other respects: date, Office of Management and Budget (OMB) approval number, attachment sequence number, Paperwork Reduction Act Notice Statement, arrangement, item caption, line number, line reference, data sequence, etc.
- It must also comply with this revenue procedure. The procedure may have eliminated, added to, or otherwise changed the guideline(s) that affected the change approved last year.
- An approved change is authorized only for the period from a prior tax year substitute form to a current tax year substitute form.

**Exception:** Forms with temporary, limited, or interim approvals (or with approvals that state an approved change is not allowed in any other tax year) are subject to review in subsequent years.

**2.5.12 Continuous Use Forms**

Forms without preprinted tax years are called "continuous use" forms. Continuous use forms are revised when a legislative change affects the form or a change will facilitate processing. These forms may have revision dates that are valid for longer than one year.

**2.5.13 Internet Program Chart**

A chart of print dates (for annual and quarterly forms) and most current revision dates (for continuous use forms) will be maintained on the Internet. For further details, see Section 4.3.1 on access to the Internet.

**2.5.14 Required Copies**

Generally, you must send us one copy of each form being submitted for approval. However, if you are producing forms for different computer systems (*e.g.*, IBM (or compatible) vs. Macintosh) or different types of printers (laser vs. dot matrix), and these forms differ significantly in appearance, submit one copy for each type of system or printer.

**2.5.15 Requestor's Responsibility**

Following the receipt of initial approval for a substitute forms package or of a software output program to print substitute forms, it is the responsibility of the originator (designer or distributor) to provide client firms or individuals with the Service forms requirements that must be met for continuing acceptability. Examples of this responsibility include:

- Using the prescribed print paper, font size, legibility, state tax data deletion, etc.
- Informing all users of substitute forms of the legal requirements of the Paperwork Reduction Act Notice, which is generally found in the instructions for the official IRS forms.

**2.5.16 Source Code**

The Substitute Forms Program Unit, W:CAR:MP:FP:S:CS, will assign a unique source code to each firm that submits substitute paper forms for approval. This will be a permanent control number that should be used on every form created by a particular firm.

The source code:
- For paper returns consists of three alpha characters.
- Should be printed at the bottom left margin area on the first page of every approved substitute paper form.
- Should not be used on optically scanned (OCR) forms.

## Section 2.6—Office of Management and Budget (OMB) Requirements for All Substitute Forms

**2.6.1 OMB Requirements for All Substitute Forms**

There are legal requirements of the Paperwork Reduction Act of 1995 (The Act). Public Law 104–13 requires that:

- OMB approve all IRS tax forms that are subject to the Act,
- Each IRS form contains (in the upper right corner) the OMB number, if any, and
- Each IRS form (or its instructions) states why IRS needs the information, how it will be used, and whether or not the information is required to be furnished.

This information must be provided to every user of official or substitute tax forms.

**2.6.2 Application of the Paperwork Reduction Act**

On forms that have been assigned OMB numbers:

- All substitute forms must contain in the upper right corner the OMB number that is on the official form.
- The required format is: **OMB No. XXXX-XXXX** (Preferred) **or OMB # XXXX-XXXX** (Acceptable).

**2.6.3 Required Explanation to Users**

You must inform the users of your substitute forms of the IRS use and collection requirements stated in the instructions for official IRS forms.

- If you provide your users or customers with the official IRS instructions, page 1 of each form must retain either the Paperwork Reduction Act Notice (or Disclosure, Privacy Act, and Paperwork Reduction Act Notice), or a reference to it as the IRS does on the official forms (usually in the lower left corner of the forms).
- This notice reads, in part, "We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax...."

**Note:** *If the IRS instructions are not provided to users of your forms, the exact text of the Paperwork Reduction Act Notice (or Disclosure, Privacy Act, and Paperwork Reduction Act Notice) must be furnished separately or on the form.*

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**2.6.4 Finding the OMB Number and Paperwork Reduction Act Notice**

The OMB number and the Paperwork Reduction Act Notice, or references to it, may be found printed on an official form (or its instructions). The number and the notice are included on the official paper format and in other formats produced by the IRS (*e.g.*, compact disc (CD) or Internet download)

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# Chapter 3
# Physical Aspects and Requirements

## Section 3.1—General Guidelines for Substitute Forms

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**3.1.1 General Information**

The official form is the standard. Because a substitute form is a variation from the official form, you should know the requirements of the official form for the year of use before you modify it to meet your needs. The IRS provides several means of obtaining the most frequently used tax forms. These include the Internet, fax-on-demand, and CD-ROM (see Chapter 4).

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**3.1.2 Design**

Each form must follow the design of the official form as to format arrangement, item caption, line numbers, line references, and sequence.

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**3.1.3 State Tax Information Prohibited**

State tax information must not appear on the Federal tax return, associated form, or schedule that is filed with the IRS. Exceptions occur when amounts are claimed on, or required by, the Federal return (*e.g.*, state and local income taxes, on Schedule A of Form 1040).

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**3.1.4 Vertical Alignment of Amount Fields**

| IF a form is to be... | THEN... |
|---|---|
| Manually prepared | • The column must have a vertical line or some type of indicator in the amount field to separate dollars from cents, if the official form has a vertical line.<br>• The cents column must be at least 3/10″ wide. |
| Computer-generated | • Vertically align the amount entry fields where possible.<br>• Use one of the following amount formats:<br>  • 0,000,000.<br>  • 0,000,000.00. |
| Computer-prepared | • You may remove the vertical line in the amount field that separates dollars from cents.<br>• Use one of the following amount formats:<br>  • 0,000,000.<br>  • 0,000,000.00. |

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**3.1.5 Attachment Sequence Number**

Many individual income tax forms have a required "attachment sequence number" located just below the year designation in the upper right corner of the form. The IRS uses this number to indicate the order in which forms are to be attached to the tax return for processing. Some of the attachment sequence numbers may change each year.

On computer-prepared forms:
- The sequence number may be printed in no less than 12-point boldface type and centered below the form's year designation.
- The sequence number may also be placed following the year designation for the tax form and separated with an asterisk.
- The actual number may be printed without labeling it the "Attachment Sequence Number."

**3.1.6 Paid Preparer's Information and Signature Area**

On Forms 1040EZ, 1040A, 1040, and 1120, etc., the "Paid Preparer's Use Only" area may not be rearranged or relocated. You may, however, add three extra lines to the paid preparer's address area without prior approval. This applies to other tax forms as well.

**3.1.7 Assembly of Forms**

If developing software or forms for use by others, please inform your customers/clients that the order in which the forms are arranged may affect the processing of the package. A return must be arranged in the order indicated below.

| IF the form is... | THEN the sequence is... |
|---|---|
| 1040 | • Form 1040.<br>• Schedules and forms in sequence number order. |
| Any other tax return (Form 1120, 1120S, 1065, 1041, etc.) | • The tax return.<br>• Directly associated schedules (Schedule D, etc.).<br>• Directly associated forms.<br>• Additional schedules in alphabetical order.<br>• Additional forms in numerical order. |

Supporting statements should then follow in the same sequence as the forms they support. Additional information required should be attached last.

In this way, the forms are received in the order in which they must be processed. If you do not send returns to us in order, processing may be delayed.

## Section 3.2—Paper

**3.2.1 Paper Content**

The paper must be:

- Chemical wood writing paper that is equal to or better than the quality used for the official form,
- At least 18 pound (17″ x 22″, 500 sheets), or
- At least 50 pound offset book (25″ x 38″, 500 sheets).

**3.2.2 Paper With Chemical Transfer Properties**

There are several kinds of paper prohibited for substitute forms. These are:

- Carbon-bonded paper.
- Chemical transfer paper except when the following specifications are met:
  - Each ply within the chemical transfer set of forms must be labeled, and
  - Only the top ply (ply one and white in color), the one that contains chemical on the back only (coated back), may be filed with the Service.

**3.2.3 Example**

A set containing three plies would be constructed as follows: ply one (coated back), "Federal Return, File with IRS"; ply two (coated front and back), "Taxpayer's copy"; and ply three (coated front), "Preparer's copy."

The file designation, "Federal Return, File with IRS," for ply one must be printed in the bottom right margin (just below the last line of the form) in 12-point, bold-face type.

It is not mandatory, but recommended, that the file designation "Federal Return, File with IRS," be printed in a contrasting ink for visual emphasis.

**3.2.4 Carbon Paper**

Do not attach any carbon paper to any return you file with the IRS.

**3.2.5 Paper and Ink Color**

We prefer that the color and opacity of paper substantially duplicates that of the original form. This means that your substitute must be printed in black ink and may be on white or on the colored paper the IRS form is printed on. Forms 1040A and 1040 substitute reproductions may be in black ink without the colored shading. The only exception to this rule is Form 1041–ES, which should always be printed with a very light gray shading in the color screened area. This is necessary to assist us in expeditiously separating this form from the very similar Form 1040–ES.

**3.2.6 Page Size**

Substitute or reproduced forms and computer prepared/generated substitutes may be the same size as the official form (8″ x 11″ in most cases) or they may be the standard commercial size (8 1/2″ x 11″) exclusive of pin-feed holes. The thickness of the stock cannot be less than .003 inch.

## Section 3.3—Printing

**3.3.1 Printing Medium**

The private printing of all substitute tax forms must be by conventional printing processes, photocopying, computer-graphics, or similar reproduction processes.

**3.3.2 Legibility**

All forms must have a high standard of legibility as to printing, reproduction, and fill-in matter. Entries of taxpayer data may be no smaller than eight points. The IRS reserves the right to reject those with poor legibility. The ink and printing method used must ensure that no part of a form (including text, graphics, data entries, etc.) develops "smears" or similar quality deterioration. This includes any subsequent copies or reproductions made from an approved master substitute form, either during preparation or during IRS processing.

**3.3.3 Type Font**

Many Federal tax forms are printed using "Helvetica" as the basic type font. We request that you use this type font when composing substitute forms.

**3.3.4 Print Spacing**

Substitute forms should be printed using a 6 lines/inch vertical print option. They should also be printed horizontally in 10 pitch pica (*i.e.*, 10 print characters per inch) or 12 pitch elite (*i.e.*, 12 print positions per inch).

**3.3.5 Image Size**

The image size of a printed substitute form should be as close as possible to that of the official form. You may omit any text on both computer-prepared and computer-generated forms that is solely instructional.

**3.3.6 Title Area Changes**

To allow a large top margin for marginal printing and more lines per page, the title line(s) for all substitute forms (not including the form's year designation and sequence number, when present) may be photographically reduced by 40 percent or reset as one line of type. When reset as one line, the type size may be no smaller than 14-point. You may omit "Department of the Treasury, Internal Revenue Service" and all reference to instructions in the form's title area.

**3.3.7 Remove Government Printing Office Symbol and IRS Catalog Number**

When privately printing substitute tax forms, the Government Printing Office (GPO) symbol and/or jacket number must be removed. In the same place, using the same type size, print the Employer Identification Number (EIN), the Social Security Number (SSN) of the printer or designer, or the IRS-assigned source code. (We prefer this last number be printed in the lower left area of the first page of each form.) Also, remove the IRS Catalog Number (Cat. No.) if one is present in the bottom center margin, and the recycle symbol if the substitute is not produced on recycled paper.

**3.3.8 Printing on One Side of Paper**

While it is preferred that both sides of the paper be used for substitute and reproduced forms, resulting in the same page arrangement as that of the official form or schedule, the IRS will not reject your forms if only one side of the paper is used.

**3.3.9 Photocopy Equipment**

The IRS does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms. Photocopies of forms must be entirely legible and satisfy the conditions stated in this and other revenue procedures.

**3.3.10 Reproductions**

Reproductions of official forms and substitute forms that do not meet the requirements of this revenue procedure may not be filed instead of the official forms. Illegible photocopies are subject to being returned to the filer for re-submission of legible copies.

**3.3.11 Removal of Instructions**

You may remove references to instructions. No prior approval is needed.

**Exception:** *The words "For Paperwork Reduction Act Notice, see instructions" must be retained or a similar statement provided on each form. Some forms refer the taxpayer to a page number in the instructions for information on the Paperwork Reduction Act Notice.*

## Section 3.4—Margins

**3.4.1 Margin Size**

The format of a reproduced tax return when printed on the page must have margins on all sides at least as large as the margins on the official form. This allows room for IRS employees to make the necessary entries on the form during processing.

- A 1/2 inch to 1/4 inch margin must be maintained across the top, bottom, and both sides (exclusive of any pin-fed holes) of all computer-generated substitutes.
- The marginal, perforated strips containing the pin-fed holes must be removed from all forms prior to filing with the Internal Revenue Service.

**3.4.2 Marginal Printing**

Prior approval is not required for the marginal printing allowed when printed on an official form or on a photocopy of an official form.

- With the exception of the actual tax return forms (*i.e.*, Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.), you may print in the left vertical margin and in the left half of the bottom margin.
- Printing is never allowed in the top right margin of the tax return form (*i.e.*, Forms 1040, 1040A, 1040EZ, 1120, 940, 941, etc.). The Service uses this area to imprint a Document Locator Number for each return. There are no exceptions to this requirement.

## Section 3.5—Examples of Approved Formats

**3.5.1 Examples of Approved Formats From the Exhibits**

Two sets of exhibits (Exhibits A-1, A-2, B-1, and B-2) are at the end of this revenue procedure. These are examples of how the guidelines in this revenue procedure may be used in some specific cases. Vertical spacing is six (6) lines to the inch.

**3.5.2 Examples of Acceptable Computer-Generated Formats**

Examples of acceptable computer-generated formats are also shown in the exhibits section of this revenue procedure. Exhibits CG-A and CG-B show computer-generated 1995 Schedules A and B. Vertical spacing is six (6) lines to the inch. You may also refer to them as examples of how the guidelines in this revenue procedure may be used in specific cases. A combination of upper and lower-case print fonts is acceptable in producing the computer-generated forms included in this procedure. The same logic for computer-generated forms can be applied to any IRS form that is normally reproducible as a substitute form, with the exception of tax return forms as discussed elsewhere. These examples are from a prior year and are not to be used as substitute forms.

## Section 3.6—Miscellaneous Information for Substitute Forms

**3.6.1 Filing Substitute Forms**

To be acceptable for filing, a substitute return or form must print out in a format that will allow the party submitting the return to follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package or in the related form instructions. The form must be on the appropriate size paper, be legible, and include a jurat where one appears on the published form.

**3.6.2 Caution to Software Publishers**

The IRS has received returns produced by software packages with approved output where either the form heading was altered or the lines were spaced irregularly. This produces an illegible or unrecognizable return or a return with the wrong number of pages. We realize that many of these problems are caused by individual printer differences but they may delay input of return data and, in some cases, generate correspondence to the taxpayer. Therefore, in the instructions to the purchasers of your product, both individual and professional, please stress that their returns will be processed more efficiently if they are properly formatted. This includes:

- Having the correct form numbers and titles at the top of the return, and
- Submitting the same number of pages as if the form were an official IRS form with the line items on the proper pages.

**3.6.3 Use Pre-Addressed IRS Label**

If you are a practitioner filling out a return for a client or a software publisher who prints instruction manuals, stress the use of the pre-addressed label provided in the tax package the IRS sent to the taxpayer, when available. The use of this label (or its precisely duplicated label information) is extremely important for the efficient, accurate, and economical processing of a taxpayer's return. Labeled returns indicate that a taxpayer is an established filer and permits the IRS to automatically accelerate processing of those returns. This results in quicker refunds, more accurate names/addresses and postal deliveries, and less manual review by IRS functions.

**3.6.4 Caution to Producers of Software Packages**

If you are producing a software package that generates name and address data onto the tax return, do not under any circumstances, program either the Service preprinted check digits or a practitioner-derived name control to appear on any return prepared and filed with the IRS.

**3.6.5 Programming To Print Forms**

Whenever applicable:

- Use only the following label information format for single filers:
  JOHN Q. PUBLIC
  310 OAK DRIVE
  HOMETOWN, STATE 94000
- Use only the following information for joint filers:
  JOHN Q. PUBLIC
  MARY I. PUBLIC
  310 OAK DRIVE
  HOMETOWN, STATE 94000

# Chapter 4
# Additional Resources

## Section 4.1—Guidance From Other Revenue Procedures

**4.1.1 General**

Guidance for the substitute tax forms not covered in this revenue procedure and the revenue procedures that govern their use are as follows:

- Revenue Procedure 94–79, IRS Publication 1355, *Requirements and Conditions for the Reproduction, Private Design, and Printing of Substitute Forms 1040–ES*.
- Revenue Procedure 2001–26, IRS Publication 1141, *General Rules and Specifications for Private Printing of Substitute Forms W-2 and W-3*.

- Revenue Procedure 2000–28, IRS Publication 1179, *Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 5498, and W-2G.*
- Revenue Procedure 2001–40, IRS Publication 1187, *Specifications for Filing Form 1042–S, Foreign Person's U.S. Source Income Subject to Withholding Magnetically or Electronically.*
- Revenue Procedure 2001–32, IRS Publication 1220, *Specifications for Filing Forms 1098, 1099, 5498, and W-2G Magnetically or Electronically.*
- Revenue Procedure 95–18, IRS Publication 1223, *Specifications for Private Printing of Substitute Forms W-2c and W-3c.*

## Section 4.2—Ordering Publications

**4.2.1 Sources of Publications**

The publications listed below are available either on the IRS Internet web site or may be ordered by calling 1-800-TAX-FORM (1-800-829-3676). Identify the requested document by IRS publication number:

- Pub. 1141, the revenue procedure on specifications for private printing for Forms W-2 and W-3.
- Pub. 1167, the revenue procedure on substitute printed, computer-prepared, and computer-generated tax forms and schedules.
- Pub. 1179, the revenue procedure on paper substitute information returns (Forms 1096, 1098, 1099, 5498, and W-2G).
- Pub. 1220, the revenue procedure on electronic or magnetic reporting for information returns (Forms 1098, 1099 series, 5498, and W-2G).
- Pub. 1223, the revenue procedure on substitute Forms W-2c and W-3c.
- Pub. 1239, *Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, on Magnetic Tape.*
- Pub. 1245, *Magnetic Tape Reporting for Forms W-4*.
- Pub. 1345, *Handbook for Electronic Filers of Individual Income Tax Returns (Tax Year 2000)*. (This is an annual publication; tax year is subject to change).
- Pub. 1345-A, *Handbook for Electronic Filers of Individual Income Tax Returns (Tax Year 2000)* (Supplement). This publication, printed in the late fall, supplements Publication 1345.
- Pub. 1355, the revenue procedure on the requirements for substitute Form 1040–ES.

**4.2.2 Where To Order**

If you are mailing your order, the address to use is determined by your location.

| IF you live in the ... | THEN mail your order to ... |
|---|---|
| Western United States | Western Area Distribution Center<br>Rancho Cordova, CA 95743-0001 |
| Central United States | Central Area Distribution Center<br>P.O. Box 8903<br>Bloomington, IL 61702-8903 |
| Eastern United States or a foreign country | Eastern Area Distribution Center<br>P.O. Box 85074<br>Richmond, VA 23261-5074 |

## Section 4.3—Electronic Tax Products

**4.3.1 The Internet**

Copies of tax forms with instructions, publications, and other tax-related materials may be obtained via the Internet at *www.irs.gov.* Forms can be downloaded in several file formats (PDF - Portable Document Format, PS - PostScript, and PCL - Printer Control Language). Those choosing to use PDF files for viewing on a personal computer can also download a free copy of the Adobe Acrobat Reader.

**4.3.2 Tax Fax**

The most frequently requested tax forms, instructions, and other information are available through IRS Tax Fax at (703) 368-9694. Call from your fax machine and follow the voice prompts. Your request will be transmitted directly back to you. Each call is limited to requesting three items; users pay the telephone line charges.

**4.3.3 Report of Print Dates**

The Service makes available a site on the Internet that shows print dates for forms used by taxpayers in the preparation of returns and subsequent transactions. It has three schedules:

- Anticipated print dates of annual returns,
- Anticipated print dates of quarterly returns, and
- Last revision dates for continuous use only forms.

The site address is *http://www.irs.gov/prod/bus_info/tax_pro/formsch.html*. The site will be updated weekly during peak printing periods and as necessary at other times.

## Section 4.4—Federal Tax Forms on CD-ROM

**4.4.1 Information About Federal Tax Forms CD-ROM**

The CD-ROM contains over 3,000 tax forms and publications for small businesses, return preparers, and others who frequently need current or prior year tax products. Most current tax forms on the CD-ROM may be filled in electronically, then printed out for submission and saved for record keeping. Other products on the CD-ROM include the Internal Revenue Bulletins, Tax Supplements, and Internet resources for the tax professional with links to the World Wide Web.

All necessary software to view the files must be installed from the CD-ROM. Software for Adobe Acrobat Reader is included on the disk. The software will run under Windows 95/98/NT and Macintosh System 7.5 and later. All products are presented in Adobe's Portable Document Format (PDF). In addition, the TIPs are provided in the Hyper Text Markup Language (HTML).

**4.4.2 System Requirements and How To Order the Federal Tax Forms CD-ROM**

For system requirements, contact the National Technical Information Service (NTIS) help desk at 703-487-4608.

The cost of the CD, if purchased via the Internet at *http://www.irs.gov/cdorders* from NTIS, is $21 (with no handling fee).

If purchased using the following methods, the cost for each CD is $21 (plus a $5 handling fee). The price for 100 or more copies is $15.75 per CD (plus a $5 handling fee). These methods are:

- By phone - 1-877-CDFORMS (1-877-233-6767)
- By fax - (703) 605-6900
- By mail using the order form contained in IRS Publication 1045 (Tax Professionals Program)
- By mail to:
  National Technical Information Service
  5285 Port Royal Road
  Springfield, VA 22161

# Chapter 5
# Requirements for Specific Tax Returns

## Section 5.1—Tax Returns (Form 1040, 1040A, 1120, Etc.)

**5.1.1 Acceptable Forms**

Tax return forms (such as Forms 1040, 1040A, and 1120) require signature and establish tax liability upon completion. Computer-generated versions are acceptable under the following conditions:

- These substitute returns must be printed on plain white paper.
- Substitute returns and forms must conform to the physical layout of the corresponding IRS form although the typeface may differ. The text should match the text on the officially published form as

closely as possible. Condensed text and abbreviations will be considered on a case-by-case basis. Caution: All jurats (perjury statements) must be reproduced verbatim. No text can be added, deleted, or changed in meaning.

- Various computer-graphic print media such as laser printing, dot matrix printing, etc., may be used to produce the substitute forms.
- The substitute return must be the same number of pages and contain the same line text as the official return.
- All computer-generated tax returns must be submitted for approval prior to their original use. You do not need approval for a substitute tax return form if its only change is the preprinted year and you had received a prior year approval letter.

**Exception:** *If the approval letter specifies a one-time exception for your return, the next year's return must be approved.*

**5.1.2 Prohibited Forms**

The following are prohibited:

- Tax returns *(e.g.,* Forms 1040, etc.) computer-generated on lined or color-barred paper.
- Tax returns that differ from the official IRS forms in a manner that makes them not standard or processable.

**5.1.3 Changes Permitted to Forms 1040 and 1040A**

Certain changes (listed in Sections 5.2 through 5.4) are permitted to the graphics of the form without prior approval, but these changes apply only to acceptable preprinted forms. Changes not requiring prior approval are good only for the annual filing period, which is the current tax year. Such changes are valid in subsequent years only if the official form does not change.

**5.1.4 Other Changes Not Listed**

All changes not listed in Sections 5.2 through 5.4 require approval from the Service **before** the form may be filed.

## Section 5.2—Changes Permitted to Graphics (Forms 1040A and 1040)

**5.2.1 Adjustments**

You may make minor vertical and horizontal spacing adjustments to allow for computer or word-processing printing. This includes widening the amount columns or tax entry areas if the adjustments comply with other provisions stated in revenue procedures. No prior approval is needed for these changes.

**5.2.2 Name and Address Area**

The horizontal rules and instructions within the name and address area may be removed and the entire area left blank. No line or instruction can remain in the area. However, the statement regarding use of the IRS label should be retained. The heavy ruled border (when present) that outlines the name, address area, and social security number must not be removed, relocated, expanded, or contracted.

**5.2.3 Required Format**

When the name and address area is left blank, the following format must be used when printing the taxpayer's name and address. Otherwise, unless the taxpayer's preprinted label is affixed over the information entered in this area, the lines must be filled in as shown:

- 1st name line (35 characters maximum).
- 2nd name line (35 characters maximum).
- In-care-of name line (35 characters maximum).
- City, state (25 characters maximum), one blank character, & ZIP code.

**5.2.4 Conventional Name and Address Data**

When there is no in-care-of name line, the name and address will consist of only three lines (single filer) or four lines (joint filer). Name and address (joint filer) with no in-care-of name line:

JOHN Z. JONES
MARY I. JONES
1234 ANYWHERE ST., APT 111
ANYTOWN, STATE 12321

**5.2.5 Example of In-Care-Of Name Line**

Name and address (single filer) with in-care-of name line:

JOHN Z. JONES
C/O THOMAS A. JONES
4311 SOMEWHERE AVE.
SAMETOWN, STATE 54345

**5.2.6 SSN and Employer Identification Number (EIN) Area**

The vertical lines separating the format arrangement of the SSN/EIN may be removed. When the vertical lines are removed, the SSN and EIN formats must be 000-00-0000 or 00-0000000, respectively.

**5.2.7 Cents Column**

- You may remove the vertical rule that separates the dollars from the cents.
- All entries in the amount column should have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present.
- You may omit printing the cents, but all amounts entered on the form must follow a consistent format. You are strongly urged to round off the figures to whole dollar amounts, following the official return instructions.
- When several amounts are summed together, the total should be rounded off after addition (*i.e*, individual amounts should not be rounded off for computation purposes).
- When printing money amounts, you must use one of the following ten-character formats: (a) 0,000,000. (b) 000,000.00.
- When there is no entry for a line, leave the line blank.

**5.2.8 "Paid Preparer's Use Only" Area**

On all forms, the paid preparer's information area may not be rearranged or relocated. You may add three lines and remove the horizontal rules in the preparer's address area.

## Section 5.3—Changes Permitted to Form 1040A Graphics

**5.3.1 General**

No prior approval is needed for the following changes (for use with computer-prepared forms only).

**5.3.2 Line 4 of Form 1040A**

This line may be compressed horizontally (to allow for same line entry for the name of the qualifying child) by using the following caption: "Head of household; child's name" (name field).

**5.3.3 Other Lines**

Any line with text that takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

**5.3.4 Page 2 of Form 1040A**

All lines must be present and numbered in the order shown on the official form. These lines may also be compressed.

**5.3.5 Color Screening**

It is not necessary to duplicate the color screening used on the official form. A substitute Form 1040A may be printed in black and white only with no color screening.

**5.3.6 Other Changes Prohibited**

No other changes to the Form 1040A graphics are allowed without prior approval except for the removal of instructions and references to instructions.

## Section 5.4—Changes Permitted to Form 1040 Graphics

**5.4.1 General**

No prior approval is needed for the following changes (for use with computer-prepared forms only).

**5.4.2 Line 4 of Form 1040**

This line may be compressed horizontally (to allow for a larger entry area for the name of the qualifying child) by using the following caption: "Head of household; child's name" (name field).

**5.4.3 Line 6c of Form 1040**

The vertical lines separating columns (1) through (4) may be removed. The captions may be shortened to allow a one-line caption for each column.

**5.4.4 Other Lines**

Any other line with text that takes up two or more vertical lines may be compressed to one line by using contractions, etc., and by removing instructional references.

**5.4.5 Line 21 - Other Income**

The fill-in portion of this line may be expanded vertically to three lines. The amount entry box must remain a single entry.

**5.4.6 Line 40 of Form 1040 - Tax**

You may change the line caption to read "Tax" and computer print the words "Total includes tax from" and either "Form(s) 8814" or "Form 4972". If both forms are used, print both form numbers.

**5.4.7 Line 49 of Form 1040**

You may change the caption to read: "Other credits from Form" and computer-print only the form(s) that apply.

**5.4.8 Color Screening**

It is not necessary to duplicate the color screening used on the official form. A substitute Form 1040 may be printed in black and white only with no color screening.

**5.4.9 Other Changes Prohibited**

No other changes to the Form 1040 graphics are permitted without prior approval except for the removal of instructions and references to instructions.

# Chapter 6
# Format and Content of Substitute Returns

## Section 6.1—Acceptable Formats for Computer-Generated Forms and Schedules

**6.1.1 Exhibits and Use of Acceptable Computer-Generated Formats**

Exhibits of acceptable computer-generated formats for the schedules usually attached to the Form 1040 are shown in the exhibits section of this revenue procedure.

- If your computer-generated forms appear exactly like the exhibits, no prior authorization is needed.
- You may computer-generate forms not shown here, but you must design them by following the manner and style of those in the exhibits section. Take care to observe other requirements and conditions in this revenue procedure. The Service encourages the submission of all proposed forms covered by this revenue procedure.

**6.1.2 Instructions**

The format of each substitute schedule or form must follow the format of the official schedule or form as to item captions, line references, line numbers, sequence, form arrangement and format, etc. Basically, try to make the form look like the official one, with readability and consistency being primary factors. You may use periods and/or other similar special characters to separate the various parts and sections of the form. DO NOT use alpha or numeric characters for these purposes. With the exceptions described in paragraph 6.1.3, all line numbers and items must be printed even though an amount is not entered on the line.

**6.1.3 Line Numbers**

When a line on an official form is designated by a number or a letter, that designation (reference code) must be used on a substitute form. The reference code must be printed to the left of the text of each line and immediately preceding the data entry field, even if no reference code precedes the data entry field on the official form. If an entry field contains multiple lines and shows the line references once on the left and right side of the form, use the same number of line references on the substitute return.

In addition, the reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parenthesis and the first digit of the data field. (See example below.)

**6.1.4 Decimal Points**

A decimal point (*i.e.*, a period) should be used for each money amount regardless of whether the amount is reported in dollars and cents or in whole dollars, or whether or not the vertical line that separates the dollars from the cents is present. The decimal points must be vertically aligned when possible.

**Example:**

```
5  STATE & LOCAL INC.
   TAXES................5  495.00
6  REAL ESTATE
   TAXES................6
7  PERSONAL PROPERTY
   TAXES................7  198.00
         or
5  STATE & LOCAL INC.
   TAXES................(5) 495.00
6  REAL ESTATE
   TAXES................(6)
7  PERSONAL PROPERTY
   TAXES................(7) 198.00
```

**6.1.5 Multi-Page Forms**

When submitting a multi-page form, send all its pages in the same package. If you are not producing certain pages, please note that in your cover letter.

## Section 6.2—Additional Instructions for All Forms

**6.2.1 Use of Your Own Internal Control Numbers and Identifying Symbols**

You may show computer-preparer internal control numbers and identifying symbols on the substitute, if using such numbers or symbols is acceptable to the taxpayer and the taxpayer's representative. Such information must not be printed in the top 1/2 inch clear area of any form or schedule requiring a signature. Except for the actual tax return form (Forms 1040, 1120, 940, 941, etc.), you may print in the left vertical and bottom left margins. The bottom left margin you may use extends 3 1/2 inches from the left edge of the form.

**6.2.2 Descriptions for Captions, Lines, etc.**

Descriptions for captions, lines, etc., appearing on the substitute forms may be limited to one print line by using abbreviations and contractions, and by omitting articles, prepositions, etc. However, sufficient key words must be retained to permit ready identification of the caption, line, or item.

**6.2.3 Determining Final Totals**

Explanatory detail and/or intermediate calculations for determining final line totals may be included on the substitute. We prefer that such calculations be submitted in the form of a supporting statement. If intermediate calculations are included on the substitute, the line on which they appear may not be numbered or lettered. Intermediate calculations may not be printed in the right column. This column is reserved only for official numbered and lettered lines that correspond to the ones on the official form. Generally, you may choose the format for intermediate calculations or subtotals on supporting statements to be submitted.

**6.2.4 Instructional Text on the Official Form**

Text on the official form, which is solely instructional (*e.g.*, "Attach this schedule to Form 1040," "See instructions," etc.) may be omitted from the substitute form.

**6.2.5 Mixing Forms on the Same Page Prohibited**

You may not show more than one schedule or form on the same printout page. Both sides of the paper may be printed for multi-page official forms, but it is unacceptable to intermix single-page schedules of forms except for Schedules A and B (Form 1040), which are printed back to back by the Service.

For instance, Schedule E can be printed on both sides of the paper because the official form is multi-page, with page 2 continued on the back. However, do not print Schedule E on the front page and Schedule SE on the back, or Schedule A on the front and Form 8615 on the back, etc. Both pages of a substitute form must match the official form. The back page may be left blank if the official form contains only the instructions.

**6.2.6 Identifying Computer-Prepared Substitutes**

Identify all computer-prepared substitutes clearly. Print the form designation 1/2 inch from the top margin and 1 1/2 inches from the left margin. Print the title centered on the first line of print. Print the taxable year and, where applicable, the sequence number on the same line 1/2 inch to 1 inch from the right margin. Include the taxpayer's name and SSN on all forms and attachments. Also, print the OMB number as reflected on the official form.

**6.2.7 Negative Amounts**

Negative (or loss) amount entries should be enclosed in brackets or parentheses or include a minus sign. This assists in accurate computation and input of form data. The Service preprints brackets in negative data fields on many official forms. These brackets should be retained or inserted on affected substitute forms.

# Chapter 7
# Miscellaneous Forms and Programs

## Section 7.1—Paper Substitutes for Form 1042–S

**7.1.1 Paper Substitutes**

Paper substitutes for Form 1042–S, *Foreign Person's U.S. Source Income Subject to Withholding*, that totally conform to the specifications contained in this procedure may be privately printed without prior approval from the Internal Revenue Service. Proposed substitutes not conforming to these specifications must be submitted for consideration.

**7.1.2 Time Frame For Submission of Form 1042–S**

The request should be submitted by November 15 of the year prior to the year the form is to be used. This is to allow the Service adequate time to respond and the submitter adequate time to make any corrections. These requests should contain a copy of the proposed form, the need for the specific deviation(s), and the number of information returns to be printed.

**7.1.3 Revisions**

Form 1042–S is subject to annual review and possible change. Withholding agents and form suppliers are cautioned against overstocking supplies of the privately printed substitutes.

**7.1.4 Obtaining Copies**

Copies of the official form for the reporting year may be obtained from most Service offices. The Service provides only cut sheets (no carbon interleaves) of these forms. Continuous fan-fold/pinned forms are not provided.

**7.1.5 Instructions For Withholding Agents**

Intructions for withholding agents:

- Only original copies may be filed with the Service. Carbon copies and reproductions are not acceptable.
- The term "Recipient's U.S. TIN" for an individual means the social security number (SSN) or IRS individual taxpayer identification number (ITIN), consisting of nine digits separated by hyphens as follows: 000-00-0000. For all other recipients, the term means employer identification number (EIN) or qualified intermediary employer identification number (QI-EIN). The EIN and QI-EIN consist of nine digits separated by a hyphen as follows: 00-0000000. The taxpayer identification number (TIN) must be in one of these formats.
- Withholding agents are requested to type or machine print whenever possible, provide quality data entries on the forms (that is, use black ribbon and insert data in the middle of blocks well separated from other printing and guidelines), and take other measures to guarantee a clear, sharp image. Withholding agents are not required, however, to acquire special equipment solely for the purpose of preparing these forms.
- The "VOID," "CORRECTED," and "PRO-RATA BASIS REPORTING" boxes must be printed at the top center of the form under the title and checked, if applicable.

• Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single form before they are filed with the Service. The dimensions are found below. Computer cards are acceptable provided they meet all requirements regarding layout, content, and size.

**7.1.6 Substitute Forms Format Requirements**

| Property | Substitute Forms Format Requirements |
|---|---|
| Printing | Privately printed substitute Forms 1042–S must be exact replicas of the official forms with respect to layout and content. Only the dimensions of the substitute form may differ. The Government Printing Office (GPO) symbol must be deleted. The exact dimensions are found below. |
| Box Entries | Only one item of income may be represented on the copy submitted to the Service (Copy A). Multiple income items may be used on copies provided to recipients only. All boxes appearing on the official form must be present on the substitute form, with appropriate captions. |
| Color and Quality of Ink | All printing must be in high quality non-gloss black ink. Bar codes should be free from picks and voids. |
| Typography | Type must be substantially identical in size and shape to corresponding type on the official form. All rules on the document are either 1 point (0.015″) or 3 point (0.045″). Vertical rules must be parallel to the left edge of the document; horizontal rules must be parallel to the top edge. |
| Carbons | Carbonized forms or “spot carbons” are not permissible. Interleaved carbons, if used, must be of good quality to preclude smudging and should be black. |
| Assembly | If all five parts are present, the parts of the assembly shall be arranged from top to bottom as follows: Copy A (Original) “For Internal Revenue Service,” Copies B, C, and D “For Recipient,” and Copy E “For Withholding Agent.” |
| Color Quality of Paper | • Paper For Copy A must be white chemical wood bond, or equivalent, 20 pound (basis 17 x 22-500), plus or minus 5 percent; or offset book paper, 50 pound (basis 25 x 38-500). No optical brighteners may be added to the pulp or paper during manufacture. The paper must consist of principally bleach chemical wood pulp or recycled printed paper. It also must be suitably sized to accept ink without feathering.<br>• Copies B, C, D (for Recipient), and E (For Withholding Agent) are provided in the official assembly solely for the convenience of the withholding agent. Withholding agents may choose the format, design, color, and quality of the paper used for these copies. |
| Dimensions | • The official form is 8 inches wide x 5 1/2 inches deep, exclusive of a 1/2 inch snap stub on the left side of the form. The snap feature is not required on substitutes.<br>• The width of a substitute Copy A must be a minimum of 7 inches and a maximum of 8 inches, although adherence to the size of the official form is preferred. If the width of substitute Copy A is reduced from that of the official form, the width of each field on the substitute form must be reduced proportionately. The left margin must be 1/2 inch |

| Property | Substitute Forms Format Requirements |
|---|---|
| Dimensions—continued | and free of all printing other than that shown on the official form.<br>• The depth of a substitute Copy A must be a minimum of 5 1/6 inches and a maximum of 5 1/2 inches. |
| Other Copies | Copies B, C, and D must be furnished for the convenience of payees who must send a copy of the form with other Federal and State returns they file. Copy E may be used as a withholding agent's record/copy. |

## Section 7.2—Specifications for Substitute Schedules K-1

**7.2.1 Schedule K-1 Requirements**

Prior approval is not required for a substitute Schedule K-1 that accompanies Form 1065 (for partnership), Form 1120S (for small business corporation), or Form 1041 (for fiduciary) when the substitute Schedule K-1 meets all of the following requirements.

- The Schedule K-1 must contain the payer and recipient's name, address, and SSN/EIN.
- The Schedule K-1 must contain all the items required for use by the taxpayer.
- The line items must be in the same order and arrangement as those on the official form.
- The Schedule K-1 must include the OMB number.
- Each taxpayer's information must be on a separate sheet of paper. Therefore, all continuously printed substitutes must be separated, by taxpayer, before filing with the Service.
- Schedule K-1 for recipients must have instructions for required line items attached.
- You may be subject to penalties if you file Schedules K-1 with the Service and furnish Schedules K-1 to partners, shareholders, or beneficiaries that do not conform to the specifications of this revenue procedure.
- The amount of each partner's, shareholder's, or beneficiary's share of each line item must be shown. The furnishing of a total amount of each line item and a percentage (or decimal equivalent) to be applied to such total amount by the partner, shareholder, or beneficiary does not satisfy the law and the specifications of this revenue procedure.
- If you file Schedules K-1 not conforming to the above specifications, IRS may consider these as not processable and return them to you to be filed correctly. You may also be subjected to a penalty.

## Section 7.3—Procedures for Printing IRS Envelopes

**7.3.1 Procedures for Printing IRS Envelopes**

Organizations are permitted to produce substitute tax return envelopes. Use of substitute return envelopes that comply with the requirements set forth in this section will assist in delivery of mail by the U.S. Postal Service and facilitate internal sorting at the Internal Revenue Service Centers.

Use the following five-digit ZIP codes when mailing returns to the IRS Service Centers:

| Service Center | ZIP Code |
|---|---|
| Atlanta, GA | 39901 |
| Kansas City, MO | 64999 |
| Austin, TX | 73301 |
| Philadelphia, PA | 19255 |
| Memphis, TN | 37501 |
| Andover, MA | 05501 |
| Cincinnati, OH | 45999 |
| Holtsville, NY | 00501 |
| Ogden, UT | 84201 |
| Fresno, CA | 93888 |

**7.3.2 Sorting Returns by Form Type**

Sorting returns by form type is accomplished by the preprinted bar codes on return envelopes included in each specific type of form or package mailed to the taxpayers. The 32 bit bar code on the left of the address on each envelope identifies the type of form the taxpayer is filing, and it assists in consolidating like returns for processing. Failure to use the envelopes furnished by the Service results in additional processing time and effort, and possibly delays the timely deposit of funds, processing of returns, and issuance of refund checks.

**7.3.3 ZIP+4 or 9-Digit ZIP Codes**

The IRS will not furnish or sell bulk quantities of preprinted tax return envelopes to taxpayers or tax practitioners. A suitable alternative has been developed that will accommodate the sorting needs of both the IRS and the United States Postal Service (USPS). The alternative is based on the use of ZIP + 4, or 9-digit ZIP codes for mailing various types of tax returns to the IRS Service Centers. The IRS uses the last four digits to identify and sort the various form types into separate groups for processing. The list of 4-digit extensions with the related form designations is provided below.

| ZIP + FOUR | Package |
|---|---|
| XXXXX-0002 | 1040 |
| XXXXX-0005 | 941 |
| XXXXX-0006 | 940 |
| XXXXX-0008 | 943 |
| XXXXX-0011 | 1065 |
| XXXXX-0012 | 1120 |
| XXXXX-0013 | 1120S |
| XXXXX-0014 | 1040EZ |
| XXXXX-0015 | 1040A |
| XXXXX-0027 | 990 |
| XXXXX-0031 | 2290 |
| XXXXX-0042 | 945 |

**7.3.4 Guidelines for Having Envelopes Preprinted**

You may use the preparer company names, addresses, and logos as long as you do not interfere with the clear areas. The government recommends that the envelope stock have an average opacity of not less than 89 percent and contain a minimum of 50 percent waste paper. Use of carbon-based ink is essential for effective address and bar code reading. Envelope construction can be of side seam or diagonal seam design. The government recommends that the size of the envelope should be 5 3/4 inches by 9 inches. Continuous pin-fed construction is not desirable but is permissible if the glued edge is at the top. This requirement is firm because mail opening equipment is designed to open the bottom edge of each envelope.

**7.3.5 Envelopes/ ZIP Codes**

The above procedures or guidelines are written for the user having envelopes preprinted. Many practitioners may not wish to have large quantities of envelopes with differing ZIP codes/form designations preprinted due to low volume, warehousing, waste, etc. In this case, the practitioner can type or machine print the addresses with the appropriate ZIP codes to accommodate sorting. If the requirements/guidelines outlined in this section cannot be met, then use only the appropriate five-digit service center ZIP code.

## Section 7.4—Changes Involving EPMF Forms

**7.4.1 Changes Involving Forms 5500 and 5500–EZ**

All Forms 5500 and 5500-EZ are now processed by the Pension and Welfare Benefits Administration (PWBA), an agency of the Department of Labor.

Under the computerized ERISA Filing Acceptance System (EFAST) filers can choose between two computer scannable formats: “machine print” and “hand-print”. Machine print forms can be filed electronically or by mail using computer software from EFAST approved vendors. Hand-print forms cannot be filed electronically.

Forms 5500 and 5500–EZ for plan year 2000 are printed in black ink with gray shading in response to requests from Form 5500 software vendors who wanted to develop computer software for a hand-print version. The hand-print version for 2000 permits completion by hand, typewriter, or computer software from EFAST approved vendors.

Additional information is available on the PWBA web site, *http://www.efast.dol.gov*.

**7.4.2 EFAST Processing Tips**

To reduce the possibility of correspondence and penalties,

- Paper forms must be obtained from the IRS or printed using software from an EFAST approved software developer.
- Original forms are preferable. Photocopies may be rejected or cause correspondence requiring additional information.
- All information should be in the specific fields or boxes provided on the forms and schedules or the information may not be processed.
- Do not use felt tip pens or other writing instruments that can cause signatures or data to bleed through to the other side of the paper. One-sided documents should have no markings on the blank side.
- Paper should be clean without glue or other sticky substances.
- Do not staple the forms. Use binder clips or other fasteners that do not perforate the paper.
- Do not submit extraneous material or information such as arrows used to indicate where to sign, notes between preparers of the report, notations on the form, *e.g.*, "DOL copy," etc.
- Do not submit unnecessary or blank schedules. Except for certain Schedule SSA filings specifically permitted by the instructions, schedules should be submitted only with a Form 5500 or in response to correspondence from the PWBA regarding processing your return/report.
- Manual entries on the machine print forms are not permitted.

## Section 7.5—Procedures for Substitute Forms 5471 and 5472

**7.5.1 Forms 5471 and 5472**

This section covers instructions for producing substitutes for:

- Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations*, and accompanying Schedules J, M, N, and O.
- Form 5472, *Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business*.

**7.5.2 Paper and Computer-Generated Substitutes**

Paper and computer-generated substitutes for Form 5471 and the accompanying Schedules J, M, N, and O, and Form 5472 that totally conform to the specifications contained in this procedure may be privately printed, but must have prior approval and are subject to annual review from the Internal Revenue Service.

**7.5.3 Where To Get the Official Forms**

Copies of the official Forms 5471 and 5472 for the reporting year may be obtained from most IRS offices. The IRS provides only cut sheets of these forms. Continuous fan-folded/pin-fed forms are not provided.

**7.5.4 Quality Substitute Forms**

The Service will accept quality substitute tax forms that are consistent with the official forms they represent AND that do not have an adverse impact on our processing. Therefore, only those substitute forms that conform to, and do not deviate from, the corresponding official forms are acceptable.

**7.5.5 Computer-Prepared Tax Forms**

If the substitute returns and schedules meet the guidelines in this revenue procedure, the Service will (for filing purposes) accept computer-prepared Forms 5471 and 5472 filled in by a computer, word processing, or similar automated equipment. The IRS will also accept a combination of computer-prepared/generated and filled-in information. They may be filed separately or attached to individual or business income tax returns.

**7.5.6 Format Arrangement**

The specifications for Forms 5471 and 5472 are as follows:

- The substitute must follow the design of the official form as to format, arrangement, item caption, line numbers, line references, and sequence. It must be an exact textual and graphic mirror image of the official form.

- The filer must use one of the official ten character amount formats. All entries in the amount column should have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present. It must follow a consistent format.
- The reference code must be printed to the left of the corresponding captioned line and also immediately preceding the data entry field even if there is no reference code preceding the data entry field on the official form. The reference code that is immediately before the data field must either be followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parenthesis and the first digit of the data field.
- The size of the page must be the same as the official form (8 1/2″ x 11″).
- The acceptable type is Helvetica.
- The spacing of the type must be 6 lines per inch vertically, 10 or 12 print characters per inch horizontally.
- A 1/4 inch to 1/2 inch margin must be maintained across the top, bottom, and both sides (exclusive of any pin-fed holes).
- The substitute form must be the same number of pages as the official one.
- The preprinted brackets in the money fields should be retained.
- The filer must completely fill in all the specified numbers or referenced lines as they appear on the official form (not just totals) before attaching any supporting statement.
- Supporting statements are never to be used until the required official form they support are completely filled-in. A blank or incomplete form that refers to a supporting statement, in lieu of completing a tax return, is unacceptable.
- Descriptions for captions, lines, etc., appearing in the substitute forms may be limited to one print line by using abbreviations and contractions, and by omitting articles, prepositions, etc. However, sufficient key words must be retained to permit ready identification of the caption, line, or item.
- Text prescribed for the official form, which is solely instructional (*e.g.*, “Attach this schedule to Form 1120”, “See instructions”, etc.) may be omitted from the form.

**7.5.7 Filing Instructions**

Instructions for filing substitute forms are the same as for filing official forms.

# Chapter 8
# Alternative Methods of Filing

## Section 8.1—Forms for Electronically Filed Returns

**8.1.1 Electronic Filing Program**

Electronic filing is a method by which qualified filers transmit tax return information directly to an IRS Service Center over telephone lines in the format of the official Internal Revenue Service forms. The Service accepts both refund and balance due individual tax returns that are filed electronically.

**8.1.2 Applying for the Electronic Filing Program**

Anyone wishing to participate in the IRS *e-file* program for individual income tax returns must submit a Form 8633, Application To Participate in the IRS *e-file* Program.

**Note:** *For business returns, prospective participants must submit a Form 9041, Application For Electronic/Magnetic Media Filing of Business and Employee Benefit Plan Returns.*

**8.1.3 Mailing Instructions**

| IF an application filed is... | THEN mail it to... |
|---|---|
| Form 8633 for individual income taxes (regular mail) | Internal Revenue Service<br>Andover Submission Processing Center<br>Attn: EFU Acceptance - Testing Stop 983<br>P.O. Box 4099<br>Woburn, MA 01888-4099 |

| IF an application filed is... | THEN mail it to... |
|---|---|
| Form 8633 for individual income taxes (overnight mail) | Internal Revenue Service<br>Andover Submission Processing Center<br>Attn: EFU Acceptance - Testing Stop 983<br>310 Lowell Street<br>Andover, MA 05501-0001 |
| Form 9041 for Forms 940, 941, and 1065 | Internal Revenue Service<br>Austin Submission Processing Center<br>Attn: EFU, Stop 6380<br>P.O. Box 1231<br>Austin, TX 78767 |
| Form 9041 for Forms 1041 | Internal Revenue Service<br>Philadelphia Submission Processing Center<br>Attn: DP 2720<br>11601 Roosevelt Blvd.<br>Philadelphia, PA 19154 |

**8.1.4 Obtaining the Taxpayer Signature**

The taxpayer signature does not appear on the electronically transmitted tax return and is obtained by the qualified electronic filer on Form 8453, U. S. Individual Income Tax Declaration for an IRS *e-file* Return, for Forms 1040, 1040A, and 1040EZ. Form 8453, which serves as a transmittal for the associated non-electronic (paper) documents, such as Forms W–2, W–2G, and 1099–R, is a one-page form and can only be approved through the Substitute Forms Program in that format. Forms 8453–OL and 8453–NR serve the same purpose for taxpayers filing through online services and Form 1040–NR filers, respectively. For specific information about electronic filing, refer to Publication 1345, Handbook for Electronic Filers of Individual Income Tax Returns.

**Note:** *For business returns, the electronic/magnetic media participants must use the official Form 8453–E, F, or P, or an approved substitute that duplicates the official form in language, format, content, color, and size.*

**8.1.5 Guidelines for Preparing Substitute Forms in the Electronic Filing Program**

A participant in the electronic filing program, who wants to develop a substitute form should follow the guidelines throughout this publication and send a sample form for approval to the Substitute Forms Unit at the address in Chapter 2. If you do not prepare Substitute Form 8453 using a font in which all IRS wording fits on a single page, the form will not be accepted. This applies primarily to dot-matrix printers, although forms prepared similarly on laser and ink-jet printers will also be rejected.

**Note:** *Use of unapproved forms could result in suspension of the participant from the electronic filing program.*

## Section 8.2—FTD Magnetic Tape Payments

**8.2.1 Instructions for Reporting Agents**

Publication 1315 provides the requirements and instructions for reporting agents who submit Federal Tax Deposit (FTD) payment information on magnetic tape. Magnetic tape submissions for FTD can be made for Forms 940, 941, 942, 943, 720, CT–1, 990–PF, 990–T, 990–C, 1042, and 1120.

**8.2.2 Instructions for Banks and Fiduciaries**

Revenue Procedure 89–49 (Pub. 1374) provides the requirements and instructions for certain banks and fiduciaries to submit quarterly Form 1041–ES payments on magnetic tape through the system.

## Section 8.3—Effect on Other Documents

**8.3.1 Effect on Other Documents**

This revenue procedure supersedes Revenue Procedure 2000–19, I.R.B. 2000–12, 785.

Exhibit A-1 (Preferred Format)

**SCHEDULES A&B (Form 1040)**

Department of the Treasury Internal Revenue Service (99)

# Schedule A—Itemized Deductions

(Schedule B is on back)

▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).

OMB No. 1545-0074

**1999**

Attachment Sequence No. 07

Name(s) shown on Form 1040 | Your social security number

| | | | | |
|---|---|---|---|---|
| **Medical and Dental Expenses** | | Caution. Do not include expenses reimbursed or paid by others. | | |
| | 1 | Medical and dental expenses (see page A-1) . . . . | 1 | |
| | 2 | Enter amount from Form 1040, line 34. [2] | | |
| | 3 | Multiply line 2 above by 7.5% (.075) . . . . . . | 3 | |
| | 4 | Subtract line 3 from line 1. If line 3 is more than line 1, enter -0- . . . . . | | 4 |
| **Taxes You Paid** (See page A-2.) | 5 | State and local income taxes . . . . . . . . . | 5 | |
| | 6 | Real estate taxes (see page A-2) . . . . . . . | 6 | |
| | 7 | Personal property taxes . . . . . . . . . . . | 7 | |
| | 8 | Other taxes. List type and amount ▶ .................. | 8 | |
| | 9 | Add lines 5 through 8 . . . . . . . . . . . . . . . . . . | | 9 |
| **Interest You Paid** (See page A-3.) | 10 | Home mortgage interest and points reported to you on Form 1098 | 10 | |
| | 11 | Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶ .................. | 11 | |
| **Note.** Personal interest is not deductible. | 12 | Points not reported to you on Form 1098. See page A-3 for special rules. . . . . . . . . . . | 12 | |
| | 13 | Investment interest. Attach Form 4952 if required. (See page A-3.) . . . . . . . . . . . . | 13 | |
| | 14 | Add lines 10 through 13 . . . . . . . . . . . . . . . . . . | | 14 |
| **Gifts to Charity** If you made a gift and got a benefit for it, see page A-4. | 15 | Gifts by cash or check. If you made any gift of $250 or more, see page A-4 . . . . . . . . . . . | 15 | |
| | 16 | Other than by cash or check. If any gift of $250 or more, see page A-4. You **MUST** attach Form 8283 if over $500 | 16 | |
| | 17 | Carryover from prior year . . . . . . . . . | 17 | |
| | 18 | Add lines 15 through 17 . . . . . . . . . . . . . . . . . . | | 18 |
| **Casualty and Theft Losses** | 19 | Casualty or theft loss(es). Attach Form 4684. (See page A-5.) . . . . . . | | 19 |
| **Job Expenses and Most Other Miscellaneous Deductions** | 20 | Unreimbursed employee expenses—job travel, union dues, job education, etc. You **MUST** attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶ .................. | 20 | |
| | 21 | Tax preparation fees . . . . . . . . . . . | 21 | |
| (See page A-5 for expenses to deduct here.) | 22 | Other expenses—investment, safe deposit box, etc. List type and amount ▶ .................. | 22 | |
| | 23 | Add lines 20 through 22 . . . . . . . . . . | 23 | |
| | 24 | Enter amount from Form 1040, line 34. [24] | | |
| | 25 | Multiply line 24 above by 2% (.02) . . . . . . . | 25 | |
| | 26 | Subtract line 25 from line 23. If line 25 is more than line 23, enter -0- . . . . | | 26 |
| **Other Miscellaneous Deductions** | 27 | Other—from list on page A-6. List type and amount ▶ .................. | | 27 |
| **Total Itemized Deductions** | 28 | Is Form 1040, line 34, over $126,600 (over $63,300 if married filing separately)?<br>☐ **No.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 36. ▶<br>☐ **Yes.** Your deduction may be limited. See page A-6 for the amount to enter. | | 28 |

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For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11330X **Schedule A (Form 1040) 1999**

Exhibit A-2 (Acceptable Format)

**SCHEDULES A&B (Form 1040)**

Department of the Treasury Internal Revenue Service (99)

# Schedule A—Itemized Deductions

(Schedule B is on back)

▶ Attach to Form 1040. ▶ See Instructions for Schedules A and B (Form 1040).

OMB No. 1545-0074

**1999**

Attachment Sequence No. 07

Name(s) shown on Form 1040 | Your social security number

| | | | | |
|---|---|---|---|---|
| **Medical and Dental Expenses** | | Caution. Do not include expenses reimbursed or paid by others. | | |
| | 1 | Medical and dental expenses (see page A-1) | 1 | |
| | 2 | Enter amount from Form 1040, line 34. 2 | | |
| | 3 | Multiply line 2 above by 7.5% (.075) | 3 | |
| | 4 | Subtract line 3 from line 1. If line 3 is more than line 1, enter -0- | | 4 |
| **Taxes You Paid** (See page A-2.) | 5 | State and local income taxes | 5 | |
| | 6 | Real estate taxes (see page A-2) | 6 | |
| | 7 | Personal property taxes | 7 | |
| | 8 | Other taxes. List type and amount ▶ | 8 | |
| | 9 | Add lines 5 through 8 | | 9 |
| **Interest You Paid** (See page A-3.) | 10 | Home mortgage interest and points reported to you on Form 1098 | 10 | |
| | 11 | Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶ | 11 | |
| **Note.** Personal interest is not deductible. | 12 | Points not reported to you on Form 1098. See page A-3 for special rules | 12 | |
| | 13 | Investment interest. Attach Form 4952 if required. (See page A-3.) | 13 | |
| | 14 | Add lines 10 through 13 | | 14 |
| **Gifts to Charity** If you made a gift and got a benefit for it, see page A-4. | 15 | Gifts by cash or check. If you made any gift of $250 or more, see page A-4 | 15 | |
| | 16 | Other than by cash or check. If any gift of $250 or more, see page A-4. You **MUST** attach Form 8283 if over $500 | 16 | |
| | 17 | Carryover from prior year | 17 | |
| | 18 | Add lines 15 through 17 | | 18 |
| **Casualty and Theft Losses** | 19 | Casualty or theft loss(es). Attach Form 4684. (See page A-5.) | | 19 |
| **Job Expenses and Most Other Miscellaneous Deductions** | 20 | Unreimbursed employee expenses—job travel, union dues, job education, etc. You **MUST** attach Form 2106 or 2106-EZ if required. (See page A-5.) ▶ | 20 | |
| | 21 | Tax preparation fees | 21 | |
| (See page A-5 for expenses to deduct here.) | 22 | Other expenses—investment, safe deposit box, etc. List type and amount ▶ | 22 | |
| | 23 | Add lines 20 through 22 | 23 | |
| | 24 | Enter amount from Form 1040, line 34. 24 | | |
| | 25 | Multiply line 24 above by 2% (.02) | 25 | |
| | 26 | Subtract line 25 from line 23. If line 25 is more than line 23, enter -0- | | 26 |
| **Other Miscellaneous Deductions** | 27 | Other—from list on page A-6. List type and amount ▶ | | 27 |
| **Total Itemized Deductions** | 28 | Is Form 1040, line 34, over $126,600 (over $63,300 if married filing separately)? ☐ **No.** Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 36. ☐ **Yes.** Your deduction may be limited. See page A-6 for the amount to enter. | ▶ | 28 |

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**For Paperwork Reduction Act Notice, see Form 1040 instructions.** Cat. No. 11330X **Schedule A (Form 1040) 1999**

## Exhibit B-1 (Preferred Format)



| Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side. | Your social security number |
|---|---|
| | |

# Schedule B—Interest and Ordinary Dividends

Attachment Sequence No. 08

**Note.** If you had over $400 in taxable interest, you must also complete Part III.

## Part I Interest

(See page B-1 and the instructions for Form 1040, line 8a.)

**Note.** If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

| | | | Amount |
|---|---|---|---|
| 1 | List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶ | 1 | |
| 2 | Add the amounts on line 1 | 2 | |
| 3 | Excludable interest on series EE and I U.S. savings bonds issued after 1989 from Form 8815, line 14. You MUST attach Form 8815 | 3 | |
| 4 | Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶ | 4 | |

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**Note.** If you had over $400 in ordinary dividends, you must also complete Part III.

## Part II Ordinary Dividends

(See page B-1 and the instructions for Form 1040, line 9.)

**Note.** If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

| | | | Amount |
|---|---|---|---|
| 5 | List name of payer. Include only ordinary dividends. If you received any capital gain distributions, see the instructions for Form 1040, line 13 ▶ | 5 | |
| 6 | Add the amounts on line 5. Enter the total here and on Form 1040, line 9 ▶ | 6 | |

## Part III Foreign Accounts and Trusts

(See page B-2.)

| | You must complete this part if you (a) had over $400 of interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust. | Yes | No |
|---|---|---|---|
| 7a | At any time during 1999, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1 | | |
| b | If "Yes," enter the name of the foreign country ▶ | | |
| 8 | During 1999, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See page B-2 | | |

For Paperwork Reduction Act Notice, see Form 1040 instructions. Schedule B (Form 1040) 1999

## Exhibit B-2 (Acceptable Format)



Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side. | Your social security number

# Schedule B—Interest and Ordinary Dividends

Attachment Sequence No. 08

**Part I Interest**

(See page B-1 and the instructions for Form 1040, line 8a.)

**Note.** If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

**Note.** If you had over $400 in taxable interest, you must also complete Part III.

| | | | Amount |
|---|---|---|---|
| 1 | List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also, show that buyer's social security number and address ▶ | 1 | |
| 2 | Add the amounts on line 1 | 2 | |
| 3 | Excludable interest on series EE and I U.S. savings bonds issued after 1989 from Form 8815, line 14. You MUST attach Form 8815 | 3 | |
| 4 | Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶ | 4 | |

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**Part II Ordinary Dividends**

(See page B-1 and the instructions for Form 1040, line 9.)

**Note.** If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the ordinary dividends shown on that form.

**Note.** If you had over $400 in ordinary dividends, you must also complete Part III.

| | | | Amount |
|---|---|---|---|
| 5 | List name of payer. Include only ordinary dividends. If you received any capital gain distributions, see the instructions for Form 1040, line 13 ▶ | 5 | |
| 6 | Add the amounts on line 5. Enter the total here and on Form 1040, line 9 ▶ | 6 | |

**Part III Foreign Accounts and Trusts**

(See page B-2.)

| | You must complete this part if you (a) had over $400 of interest or ordinary dividends; (b) had a foreign account; or (c) received a distribution from, or were a grantor of, or a transferor to, a foreign trust. | Yes | No |
|---|---|---|---|
| 7a | At any time during 1999, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1 | | |
| b | If "Yes," enter the name of the foreign country ▶ | | |
| 8 | During 1999, did you receive a distribution from, or were you the grantor of, or transferor to, a foreign trust? If "Yes," you may have to file Form 3520. See page B-2 | | |

For Paperwork Reduction Act Notice, see Form 1040 instructions. Schedule B (Form 1040) 1999

Exhibit CG-A (Schedule A)

Schedule A (Form 1040) ITEMIZED DEDUCTIONS 1995 * 07 OMB No. 1545-0074

______________________________ SSN______________

***MEDICAL AND DENTAL EXPENSES*****************************************************

1 Medical and dental expenses........................................................(1) ___________
2 Amount from Form 1040, line 32...............................(2) ___________
3 Multiply line 2 by 7.5% (.075)..........................................................(3) ___________
4 Subtract line 3 from line 1, not less than zero...............................................(4) ___________

***TAXES YOU PAID**********************************************************************

5 State and local income taxes.........................................................(5) ___________
6 Real estate taxes................................................................................(6) ___________
7 Personal property taxes......................................................................(7) ___________
8 Other taxes. List type and amount.
______________________ ..........................................................(8) ___________
9 Add lines 5 thru 8.............................................................................(9) ___________

***INTEREST YOU PAID**************************************************************

10 Home mortgage interest and points reported to you on Form 1098...............................................(10) ___________
11 Home mtg. int. not reported on Form 1098. If to seller, person's name, I.D. No., and address:

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______________________

______________________

______________________ ..............................................(11) ___________
12 Points not reported to you on Form 1098.....................................(12) ___________
13 Investment interest. Att. Form 4952 if req....................................(13) ___________
14 Add lines 10 thru 13...........................................................................(14) ___________

***GIFTS TO CHARITY*****************************************************************

15 Gifts by cash or check.........................................................(15) ___________
16 Other than cash or check. If over $500, you MUST attach Form 8283..........................................(16) ___________
17 Carryover from prior year.....................................................(17) ___________
18 Add lines 15 thru 17...........................................................................(18) ___________

***CASUALTY AND THEFT LOSSES*******************************************************

19 Casualty or theft loss(es) from Form 4684.............................................(19) ___________

***JOB EXPENSES & MOST OTHER MISCELLANEOUS DEDUCTIONS*************************

20 Unreim employee exp. (Form 2106) _________

______________________ _________

______________________ _________ ..........................(20) ___________
21 Tax preparation fees...........................................................(21) ___________
22 Other expenses:

______________________ _________

______________________ _________ ..........................(22) ___________
23 Add lines 20 thru 22...........................................................(23) ___________
24 Amount from Form 1040, line 32..............................(24) ___________
25 Multiply line 24 by 2% (.02)..................................................(25) ___________
26 Subtract line 25 from line 23, not less than zero.........................................(26) ___________

***OTHER MISCELLANEOUS DEDUCTIONS*************************************************

______________________ .................................___________ (27) ___________

***TOTAL INTEMIZED DEDUCTIONS******************************************************

28 If Form 1040, line 32 is more than $114,700 ($57,350 MFS), see page A-5. Else add right column of lines 4-27......................................(28) ___________

************************************************************************************

D260 For Paperwork Reduction Act Notice, see Form 1040 Instruction.

Exhibit CG-B ( Schedule B )

Schedule B (Form 1040) — INTEREST AND DIVIDEND INCOME — 1995 * 08

OMB No. 1545-0074

______________________________ SSN ______________

******************************************************************************************

## Part I - Interest Income

| | | Amount |
|---|---|---|
| 1 ______________________ | ........................(1) | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| Less tax-exempt interest........................ | To Form 1040, line 8b........ | ________ |
| 2 Add the amounts on line 1........................ | ........................(2) | ________ |
| 3 Excludable savings bond interest from Form 8815 | ........................(3) | ________ |
| 4 Subtract line 3 from line 2........................ | To From 1040, line 8a....(4) | ________ |

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## Part II - Dividend Income

| | | Amount |
|---|---|---|
| 5 Dividend income (include capital gain dist., nontaxable dist., etc.) | | |
| ______________________ | ........................(5) | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| ______________________ | ........................ | ________ |
| 6 Add the amounts on line 5........................ | ........................(6) | ________ |
| 7 Capital gain distributions........................(7) ________ | | |
| 8 Nontaxable distributions........................(8) ________ | | |
| 9 Add lines 7 and 8........................ | ........................(9) | ________ |
| 10 Subtract line 9 from line 6........................ | To From 1040, line 9.....(10) | ________ |

******************************************************************************************

## Part III - Foreign Accounts and Foreign Trusts

If you had over $400 of interest or dividends OR had a foreign account or were a grantor of, or a transferor to, a foreign trust, must complete:

11a At any time during 1995, did you have an interest in or a signature authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)?........................ ________

b If Yes, name of foreign country. ______________________

12 Were you the grantor of, or transferor to, a foreign trust that existed during 1995, whether or not you have any beneficial interest in it? If yes, you may have to file Form 3520, 3520-A, or 926........................ ________

******************************************************************************************

D260 For Paperwork Reduction Act Notice, see Form 1040 Instructions.

# EXHIBIT C

Checklist of IRS Subsititute Forms Submitted on ..............20 :

Company: ............................................
Contact: ............................................
Phone: ............................................
Fax: ............................................
Source Code: ......................................

| Approved | Approved With Corrections | Must Be Resubmitted | Form Number | Comments |
|---|---|---|---|---|
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| | | | | |

Authorized Name: ____________________

Title: ____________________

Reviewer's Name:____________________

Telephone:____________________

Date: ____________________

**Exhibit D - List of Forms Referred to in the Revenue Procedure**

| Form | Title | Section |
|---|---|---|
| 706 | United States Estate (and Generation-Skipping Transfer) Tax Return | 2.1 |
| 720 | Quarterly Federal Excise Tax Return | 2.5; 8.2 |
| 940 | Employer’s Annual Federal Unemployment (FUTA) Tax Return | 2.3; 3.4; 6.2; 7.3; 8.2 |
| 940-EZ | Employer’s Annual Federal Unemployment (FUTA) Tax Return | 2.3 |
| 941 | Employer’s Quarterly Federal Tax Return | 2.3; 3.4; 6.2; 7.3; 8.2 |
| 941-V | Form 941 Payment Voucher | 2.3 |
| 943 | Employer’s Annual Tax Return for Agricultural Employees | 2.3; 7.3; 8.2 |
| 943-V | Form 943 Payment Voucher | 2.3 |
| 945 | Annual Return of Withheld Federal Income Tax | 2.3 |
| 945-V | Form 945 Payment Voucher | 2.3 |
| 990-C | Farmers’ Cooperative Association Income Tax Return | 8.2 |
| 990-PF | Return of Private Foundation or Section 4947(a)(1) Non-exempt Charitable Trust Treated as a Private Foundation | 8.2 |
| 990-T | Exempt Organization Business Income Tax Return (and proxy tax under section 6033 (e)) | 8.2 |
| 1040 | U.S. Individual Income Tax Return | 2.3; 2.4; 2.5; 3.1; 3.2; 3.4; 5.1; 5.2; 5.4; 6.1; 6.2; 7.3; 7.5; 8.1 |
| 1040-ES | Estimated Tax for Individuals | 1.1; 2.3; 3.2; 4.1; 4.2 |
| 1040A | U.S. Individual Income Tax Return | 2.1; 2.4; 3.1; 3.2; 3.4; 5.1; 5.2; 5.3; 7.3; 8.1 |
| 1040EZ | Income Tax Return for Single and Joint Filers with No Dependents | 2.4; 3.1; 3.4; 7.3; 8.1 |
| 1040-NR | U.S. Nonresident Alien Income Tax Return | 8.1 |
| 1040-V | Form 1040 Payment Voucher | 2.3 |
| 1041 | U.S. Income Tax Return for Estates and Trusts | 2.5; 3.1; 7.2; 8.1 |
| 1041-ES | Estimated Income Tax for Estates and Trusts | 1.1; 2.3; 3.2; 8.2 |
| 1042 | Annual Withholding Tax Return for U.S. Source Income of Foreign Persons | 8.2 |
| 1042-S | Foreign Person’s U.S. Source Income Subject to Withholding | 4.1; 7.1 |
| 1065 | U.S. Partnership Return of Income | 2.5; 3.1; 7.2; 7.3; 8.1 |
| 1096 | Annual Summary and Transmittal of U.S. Information Returns | 1.1; 1.2; 4.1; 4.2 |
| 1098 | Mortgage Interest Statement | 1.1; 1.2; 4.1; 4.2 |
| 1099 | Series | 1.1; 1.2; 4.1; 4.2 |
| 1120 | U.S. Corporation Income Tax Return | 2.5; 3.1; 3.4; 5.1; 6.2; 7.3; 8.2 |
| 2290 | Heavy Vehicle Use Tax Return | 2.3; 7.3 |
| 3468 | Investment Credit | 2.5 |
| 4136 | Credit for Federal Tax Paid on Fuels | 2.5 |

| Form | Title | Section |
|---|---|---|
| 4972 | Tax on Lump Sum Distributions | 5.4 |
| 5471 | Information Return of U.S. Persons With Respect to Certain Foreign Corporations | 7.5 |
| 5472 | Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business | 7.5 |
| 5498 | Individual Retirement Arrangement Information | 1.1; 1.2; 4.1; 4.2 |
| 5500 | Annual Return/Report of Employee Benefit Plan | 1.3; 7.4 |
| 5500-EZ | Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan | 1.3; 7.4 |
| 8453 | U.S. Individual Income Tax Declaration for an IRS e-file Return | 8.1 |
| 8453-E | Employee Benefit Plan Declaration and Signature for Electronic/ Magnetic Media Filing | 8.1 |
| 8453-F | U.S. Estate or Trust Income Tax Declaration and Signature for Electronic and Magnetic Media Filing | 8.1 |
| 8453-NR | U.S. Nonresident Alien Income Tax Declaration for Magnetic Media Filing | 8.1 |
| 8453-OL | U.S. Individual Income Tax Declaration for an e-file Online Return | 8.1 |
| 8453-P | U.S. Partnership Declaration and Signature for Electronic and Magnetic Media Filing | 8.1 |
| 8633 | Application to Participate in the IRS e-file Program | 8.1 |
| 8814 | Parents' Election To Report Child's Interest and Dividends | 5.4 |
| 9041 | Application for Electronic/Magnetic Media Filing of Business and Employee Benefit Plan Returns | 8.1 |
| CT-1 | Employer's Annual Railroad Retirement Tax Return | 8.2 |
| W-2 | Wage and Tax Statement | 1.1; 1.2; 4.1; 4.2; 8.1 |
| W-2c | Corrected Wage and Tax Statement | 4.1; 4.2 |
| W-2G | Certain Gambling Winnings | 1.1; 1.2; 4.1; 4.2; 8.1 |
| W-3 | Transmittal of Income and Tax Statements | 1.1; 1.2; 4.1; 4.2 |
| W-3c | Transmittal of Corrected Wage and Tax Statements | 4.1; 4.2 |
| W-4 | Employee's Withholding Allowance Certificate | 4.2 |

*26 CFR 601.204: Changes in accounting periods and in methods of accounting.*
*(Also Part I, §§ 446, 481; 1.446-1, 1.481-1.)*

# Rev. Proc. 2001–46

CONTENTS



## SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method of accounting for track structure expenditures paid or incurred by certain railroads ("track maintenance allowance method"). This revenue procedure also provides procedures for a qualifying taxpayer to obtain automatic consent from the Commissioner of Internal Revenue to change to the track maintenance allowance method, including rules relating to the limitations, terms, and conditions the Commissioner deems necessary to make the change. In addition, this revenue procedure provides an optional procedure for a qualifying taxpayer whose treatment of track structure expenditures is an issue under consideration in examination, before an area appeals office, or before the United States Tax Court ("Tax Court") to settle open taxable years using the track maintenance allowance method.

## SECTION 2. BACKGROUND

.01 Under § 446(b) of the Internal Revenue Code, the Commissioner has broad authority to determine whether a method of accounting clearly reflects income. If a taxpayer's method of accounting does not clearly reflect income, the computation of taxable income must be made under a method that, in the opinion of the Secretary, does clearly reflect income. *See Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979); *Commissioner v. Hansen*, 360 U.S. 446 (1959); § 1.446–1(c)(2)(ii) of the Income Tax Regulations.

.02 Section 446(e) and § 1.446–1(e) provide that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting.

.03 A railroad incurs track structure expenditures as a result of performing various activities to acquire, construct, maintain, repair, and improve track structure. To minimize disputes regarding the accounting for these track structure expenditures, the Internal Revenue Service will permit a railroad that complies with the requirements of this revenue procedure to account for track structure expenditures using the track maintenance allowance method described in section 5 of this revenue procedure.

## SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that files (or is a member of a combined reporting group that files) a Railroad Annual Report R-1 ("Form R-1") with the Surface Transportation Board ("STB") based on the same reporting period as the taxpayer's taxable year and that chooses to account for track structure expenditures under the track maintenance allowance method described in section 5 of this revenue procedure.

## SECTION 4. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 *Track Structure.* "Track structure" means the combination of a taxpayer's rail and other track material (OTM), ties, and ballast, which provides a track for rail cars and equipment powered by locomotives.

.02 *Track Structure Expenditures*. "Track structure expenditures" for a particular taxable year are the sum of the taxpayer's expenditures for that year for current additions (including new track structure), operating items, and removal costs.

.03 *Current Additions.* "Current additions" are the amounts included in the Form R-1, on Schedule 330 (Road Property and Equipment and Improvements to Leased Property and Equipment), in Column (e) (Balance sheet additions), for Accounts 8 (Ties), 9 (Rail and OTM), and 11 (Ballast), that represent additions to the taxpayer's track structure, that are taken into account for federal income tax purposes (*see*, *e.g.*, §§ 404 and 461). Thus, for example, current additions do not include the assigned value of relay materials - Schedule 330.

.04 *New Track Structure.* "New track structure" means the amount included in current additions that reflect the taxpayer's expenditures for (1) track structure laid where none previously existed; (2) existing track structure acquired by the taxpayer; or (3) track structure previously abandoned by the taxpayer that must be rehabilitated or improved to make it suitable for the use intended by the taxpayer, that are taken into account for federal income tax purposes. New track structure includes the cost of acquiring and installing new track structure as well as the cost of any rehabilitation or improvement necessary to put newly acquired or previously abandoned track structure into operation. New track structure does not include new track amounts not reflected in current additions (*i.e.*, amounts reflected in Column (c) (Expenditures during the year for original road and equipment, and road extensions) or Column (d) (Expenditures during the year for purchase of existing lines, reorganizations, etc.)).

.05 *Assigned Value of Relay Materials – Schedule 330.* The "assigned value of relay materials - Schedule 330" means the amounts included on Schedule 330, in Column (e), on Lines 8, 9, and 11, that reflect the taxpayer's fair market value adjustments (excluding rewelding and other processing costs) for track materials relaid that were previously retired for financial reporting purposes. The assigned value of relay materials does not include relay track materials purchased by the taxpayer.

.06 *Operating Items*. "Operating items" are the amounts included in the Form R-1, on Schedule 410 (Railway Operating Expenses), in Column (h) (Total), on Lines 1 (Track - Administration), 12 (Ties - Running), 13 (Ties - Switching), 14 (Rail and OTM - Running), 15 (Rail and OTM - Switching), 16 (Ballast - Running), and 17 (Ballast - Switching), that represent the taxpayer's repairs and maintenance to its track structure, that are taken into account for federal income tax purposes. Thus, for example, operating items do not include salvage material credits - Schedule 410 or the assigned value of relay materials - Schedule 410.

.07 *Salvage Material Credits – Schedule 410*. "Salvage material credits - Schedule 410" means the amounts included on Schedule 410, in Column (h), on Lines 1, 12, 13, 14, 15, 16, and 17, that reflect credits to operating expenses for the value of salvaged materials.

.08 *Assigned Value of Relay Materials – Schedule 410.* The "assigned value of relay materials - Schedule 410" means the amounts included on Schedule 410, in Column (h), on Lines 1, 12, 13, 14, 15, 16, and 17, that reflect the taxpayer's fair market value adjustments (excluding rewelding and other processing costs) for track materials relaid that were previously retired for financial reporting purposes. The assigned value of relay materials does not include relay track materials purchased by the taxpayer.

.09 *Removal Costs.* "Removal costs" means the amount included in Account 735 (Accumulated Depreciation, Road and Equipment Property) that represents the taxpayer's expenditures for track removal that are taken into account for federal income tax purposes.

SECTION 5. TRACK MAINTENANCE ALLOWANCE METHOD

.01 *In General.* Under the track maintenance allowance method, the taxpayer must determine the amount of its track structure expenditures that may be currently deducted under section 5.02 (the track maintenance allowance) and the amount required to be capitalized under section 5.03 (the capitalized amount). A taxpayer that uses the track maintenance allowance method described in this section 5 must use that method for all of its track structure expenditures.

.02 *Track Maintenance Allowance*. The track maintenance allowance for a particular taxable year under the track maintenance allowance method is determined as follows:

(1) Determine the track structure expenditures for the taxable year;

(2) Subtract from the track structure expenditures in (1) the following amounts for the taxable year:

(a) New track structure; and

(b) Operating items;

(3) Multiply the resulting amount in (2) by 40 percent; and

(4) Add to the product of (3) the operating items for the taxable year.

.03 *Capitalized Amount.* The capitalized amount for the taxable year under the track maintenance allowance method is determined as follows:

(1) Determine the track structure expenditures for the taxable year (see section 5.02(1));

(2) Subtract from the track structure expenditures in (1) the track maintenance allowance determined under section 5.02 for the taxable year to determine the capital track structure expenditures;

(3) Allocate the capital track structure expenditures determined in (2) to each track account (Rail and OTM, Ties, and Ballast), first to new track to the extent of the new track structure for each track account. The remaining capitalized amount represents replacement track and should be allocated to each track account in proportion to adjusted current additions (*i.e.*, current additions for each track account after excluding the amount allocated to new track from each account). For purposes of determining basis, the amounts allocated to each track account must be allocated further to the assets within each account using any reasonable method;

(4) For each track account, apply the taxpayer's method of accounting for uniform capitalization, as governed by § 263A and the regulations thereunder, to the amounts capitalized to new track and to replacement track (*i.e.*, the amounts de-

termined in (3)) to determine the additional § 263A costs (as defined in § 1.263A–1(d)(3)), whether positive or negative, and, if applicable, interest costs that must be capitalized;

(5) For each track account, add the amounts capitalized to new track and to replacement track in (3) to the additional § 263A costs and interest costs determined in (4) to determine the total capitalized amount;

(6) For each track account, treat the total capitalized amount determined in (5) as a capital expenditure and depreciate that amount in accordance with § 167 and the regulations thereunder.

.04 *Changes to Form R-1.* If the STB modifies the Form R-1 by changing the names of any account, column, or line on the Schedule 330 or 410, any references to that account, column, or line in this revenue procedure (including the definitions in section 4 of this revenue procedure) are automatically modified accordingly. Thus, for example, if the STB changes Schedule 330 to require the reporting of current additions in Column (f), rather than Column (e), any reference to Column (e) in this revenue procedure is to be treated by the taxpayer as a reference to Column (f). If the STB no longer requires Form R-1, or any schedule referenced in this revenue procedure, a change in material facts upon which the original consent was based will have occurred. See section 6.05 of this revenue procedure (Effect of Consent).

.05 *Example.*

(1) *Facts.* X is a railroad that owns and maintains several thousand miles of track structure throughout the United States. X is a member of a combined reporting group that files a calendar year Form R-1 and uses a calendar year for tax purposes. For the year ending December 31, 2001, X includes the following amounts in the Form R-1, Schedule 330, Column (e) for Accounts 8, 9, and 11:

| | |
|---|---|
| Account 8 (Ties) | $1,500,000 |
| Account 9 (Rail & OTM) | 2,500,000 |
| Account 11 (Ballast) | 500,000 |
| Total | $4,500,000 |

Included in this amount are:

| | | |
|---|---|---|
| New track structure | Account 8 | $ 150,000 |
| | Account 9 | $ 250,000 |
| | Account 11 | $ 100,000 |
| | Total | $ 500,000 |
| Assigned value of relay materials - Schedule 330 | Account 8 | $ 30,000 |
| | Account 9 | $ 120,000 |
| | Account 11 | $ 0 |
| | Total | $ 150,000 |

All of X's current additions are taken into account for federal income tax purposes in the taxable year ended December 31, 2001, except for the assigned value of relay materials - Schedule 330. Thus, X's current additions for the taxable year ending December 31, 2001, are $4,350,000 ($4,500,000 - $150,000).

For the same taxable year, the following amounts included in the Form R-1, Schedule 410, Column (h) for Lines 1, 12, 13, 14, 15, 16, and 17, constitute X's operating items:

| | |
|---|---|
| Line 1 (Track - Administration) | $ 315,000 |
| Line 12 (Ties - Running) | 100,000 |
| Line 13 (Ties - Switching) | 10,000 |
| Line 14 (Rail & OTM - Running) | 600,000 |
| Line 15 (Rail & OTM - Switching) | 60,000 |
| Line 16 (Ballast - Running) | 150,000 |
| Line 17 (Ballast - Switching) | 15,000 |
| Total | $1,250,000 |

Included in this amount are:

| | |
|---|---|
| Salvage material credits - Schedule 410 | ($50,000) |
| Assigned value of relay materials - Schedule 410 | $100,000 |

All of X's operating items are taken into account for federal income tax purposes in the taxable year ended December 31, 2001, except for the salvage material credits - Schedule 410 and the assigned value of relay materials - Schedule 410. Thus, X's operating items for the taxable year ended December 31, 2001, are $1,200,000 ($1,250,000 + $50,000 - $100,000). For the taxable year ended December 31, 2001, X included in Account 735 the following amount which is taken into account for federal income tax purposes in the taxable year ended December 31, 2001:

| | |
|---|---|
| Removal costs | $300,000 |

(2) *Track maintenance allowance.* To determine the track maintenance allowance for the taxable year ended December 31, 2001, X first determines its track structure expenditures, as follows:

$4,350,000 current additions
1,200,000 operating items
+ 300,000 removal costs
$5,850,000 track structure expenditures

X then adjusts its track structure expenditures as follows:

$5,850,000 track structure expenditures
(500,000) new track structure
(1,200,000) operating items
$4,150,000 adjusted track structure expenditures

X then determines the track maintenance allowance as follows:

$4,150,000 adjusted track structure expenditures
x .40 allowance
$1,660,000
+1,200,000 operating items
$2,860,000 track maintenance allowance

(3) *Capitalized amount.* To determine the capitalized amount, X first determines the capital track structure expenditures by subtracting the track maintenance allowance determined in (2) as follows:

$5,850,000 track structure expenditures
(2,860,000) track maintenance allowance
$2,990,000 capital track structure expenditures

X then allocates its capital track structure expenditures to each track account (Rail and OTM, Ties, and Ballast), first to new track to the extent of the $500,000 of new track structure for each track account. The remaining $2,490,000 of capital track structure expenditures is then allocated to replacement track for each track account in proportion to the adjusted current additions. Thus, X allocates these amounts as follows:

| | Current Additions | Amount Capitalized – New Track | Adjusted Current Additions | Amount Capitalized – Replacement Track |
|---|---|---|---|---|
| Account 8 (Ties) | $1,470,000 | $ 150,000 | $1,320,000 | $ 853,714 |
| Account 9 (Rail & OTM) | 2,380,000 | 250,000 | 2,130,000 | 1,377,585 |
| Account 11 (Ballast) | 500,000 | 100,000 | 400,000 | 258,701 |
| Total | $4,350,000 | $ 500,000 | $3,850,000 | $2,490,000 |

For each track account, X applies its method of accounting for uniform capitalization under § 263A to the amounts capitalized to new track and to replacement track to determine the additional § 263A costs (whether positive or negative) that must be capitalized. The total capitalized amount for each track account is determined by combining the amounts capitalized to new track and to replacement track with the additional § 263A costs for each track account. X must depreciate the total capitalized amount for each track account in accordance with § 167 and the regulations thereunder.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

.01 *In General.* A change in a taxpayer's treatment of track structure expenditures to the track maintenance allowance method is a change in method of accounting to which §§ 446 and 481 apply.

.02 *Issue Not Under Consideration.* If a taxpayer within the scope of this revenue procedure wants to change to the track maintenance allowance method for either its first or second taxable year ending on or after December 31, 2000, ("year of change") and the treatment of its track structure expenditures is not an issue under consideration in examination, before an area appeals office, or before a federal court (within the meaning of section 3.08 of Rev. Proc. 97–27 (1997–1 C.B. 680)) on August 21, 2001, the taxpayer must follow the automatic change in method of accounting provisions in Rev. Proc. 99–49 (1999–52 I.R.B. 725) (or its successor) with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply. If the taxpayer is under examination, before an area appeals office, or before a federal court regarding any income tax issue other than its treatment of track structure expenditures, the taxpayer must provide a copy of the Form 3115, *Application for Change in Accounting Method*, to the examining officer, appeals officer, or government counsel (whichever is applicable) at the time that it files the copy of the Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining officer, appeals officer or government counsel (whichever is applicable).

(2) A taxpayer that wants to change to the track maintenance allowance method for its first taxable year ending on or after December 31, 2000, and that, on or before October 22, 2001, files its original federal income tax return for its first taxable year ending on or after December 31, 2000, is not subject to the filing requirements in section 6.02(2)(a) of Rev. Proc. 99–49, provided that it complies with the following filing requirements. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for its first taxable year ending on or after December 31, 2000. This amended return must be filed no later than January 28, 2002. A copy of the Form 3115 must be filed with the national office (see section 6.02(5)(a) of Rev. Proc. 99–49 for the address) no later than when the taxpayer's amended return is filed.

(3) To assist the Service in processing changes in method of accounting under this section of the revenue procedure, and to ensure proper handling, section 6.02(3) of Rev. Proc. 99–49 is modified to require that a Form 3115 filed under this revenue procedure include the statement: "Automatic Change Filed Under Rev. Proc. 2001–46." This statement should be legibly printed or typed at the top of any Form 3115 filed under this revenue procedure.

(4) If a taxpayer did not file Form R-1 for one or more of the taxable years to which the § 481(a) adjustment relates, the taxpayer must compute the § 481(a) adjustment based on information equivalent to that required by Form R-1.

.03 *Issue Under Consideration.* If a taxpayer within the scope of this revenue procedure wants to change to the track maintenance allowance method for either its first or second taxable year ending on or after December 31, 2000, ("year of change") and the treatment of its track structure expenditures is an issue under consideration in examination, before an area appeals office, or before a federal court (within the meaning of section 3.08 of Rev. Proc. 97–27) on August 21, 2001, the taxpayer must follow the automatic change in method of accounting provisions in Rev. Proc. 99–49 with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply. The taxpayer must provide a copy of the Form 3115 to the examining officer, appeals officer, or government counsel (whichever is applicable) at the time that it files the copy of the Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining officer, appeals officer, or government counsel (whichever is applicable).

(2) A taxpayer that wants to change to the track maintenance allowance method for its first taxable year ending on or after December 31, 2000, and that, on or before October 22, 2001, files its original federal income tax return for its first taxable year ending on or after December 31, 2000, is not subject to the filing requirements in section 6.02(2)(a) of Rev. Proc. 99–49, provided that it complies with the following filing requirements. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for its first taxable year ending on or after December 31, 2000. This amended return must be filed no later than January 28, 2002. A copy of the Form 3115 must be filed with the national office (see section 6.02(5)(a) of Rev. Proc. 99–49 for the address) no later than when the taxpayer's amended return is filed.

(3) To assist the Service in processing changes in method of accounting under this section of the revenue procedure, and to ensure proper handling, section 6.02(3) of Rev. Proc. 99–49 is modified to require that a Form 3115 filed under this revenue procedure include the statement: "Automatic Change Filed Under Rev. Proc. 2001–46." This statement should be legibly printed or typed at the top of any Form 3115 filed under this revenue procedure.

(4) The change to the track maintenance allowance method will be made using a "cut-off method." Under a cut-off method, only the items arising on or after the beginning of the year of change are accounted for under the track maintenance allowance method. Any items arising before the year of change continue to be accounted for under the taxpayer's former method of accounting. Because no items are duplicated or omitted from income when a cut-off method is used to effect a change in accounting method, no § 481(a) adjustment is necessary.

(5) Section 7 of Rev. Proc. 99–49 does not apply. The taxpayer does not receive audit protection in connection with a change to the track maintenance allowance method.

.04 *Special Rule for Certain Taxpayers with Issue Under Consideration.* If a taxpayer is within the scope of this revenue procedure, and the treatment of its track structure expenditures is an issue under consideration (within the meaning of section 3.08 of Rev. Proc. 97–27) in examination, before an area appeals office, or before the Tax Court on August 21, 2001, the taxpayer may change to the track maintenance allowance method for its first or second taxable year ending on or after December 31, 2000, under section 6.03 of this revenue procedure or, alternatively, for an earlier taxable year under section 8 of this revenue procedure.

.05 *Effect of Consent.* For purposes of section 8.01 of Rev. Proc. 99–49 (Effect of Consent), a change in the material facts on which the consent was based includes a material change in how a taxpayer reports amounts on the Form R-1 or a change in the taxpayer's obligation to file a Form R-1.

.06 *Changes Not Made Under this Revenue Procedure.* A taxpayer that wants to change to the track maintenance allowance method described in section 5 of this revenue procedure that does not change its method of accounting under section 6 or 8 of this revenue procedure must follow the change in method of accounting provisions in Rev. Proc. 97–27 (1997–1 C.B. 680) (or any successor).

## SECTION 7. RECORD KEEPING

Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. The books or records required by § 6001 must be kept at all times available for inspection by authorized internal revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law. Section 1.6001–1(e). In order to satisfy the record keeping requirements of § 6001 and the regulations thereunder, a taxpayer that changes to the track maintenance allowance method should maintain records substantiating all aspects of entitlement to the deduction, including, but not limited to, the following:

.01 The Form R-1 and adequate documentation to verify the taxpayer's information included in the Form R-1. This documentation includes reports and workpapers of independent auditors with respect to agreed upon procedures, as submitted to the STB pursuant to Ex Parte 460, Certification of Railroad Annual Report R-1 by Independent Accountant;

.02 Work papers or reports that identify and extract the taxpayer's costs for new track structure, including costs to rehabilitate or improve newly acquired or previously abandoned track structure;

.03 Work papers or reports that identify and extract the taxpayer's assigned value of relay materials - Schedule 330 from the Schedule 330;

.04 Work papers or reports that identify and extract the taxpayer's assigned value of relay materials - Schedule 410 and salvage material credits - Schedule 410 from the Schedule 410; and

.05 Work papers or reports that identify the amounts included in Account 735 for the taxpayer's removal costs.

## SECTION 8. OPTIONAL SETTLEMENT FOR TAXPAYERS UNDER EXAMINATION, BEFORE AN AREA APPEALS OFFICE, OR BEFORE THE TAX COURT

.01 *In General.* If a taxpayer is within the scope of this revenue procedure, the treatment of its track structure expenditures is an issue under consideration (within the meaning of section 3.08 of Rev. Proc. 97–27) in examination, before an area appeals office, or before the Tax Court on August 21, 2001, and the taxpayer does not change to the track maintenance allowance method under section 6.03 of this revenue procedure, the Service offers to settle the track structure expenditure issue by changing the taxpayer's method of accounting for track structure expenditures to the track maintenance allowance method in the earliest open taxable year after which there is no closed taxable year.

.02 *Terms of Settlement.*

(1) The Service will change the taxpayer's method of accounting for track structure expenditures to the track maintenance allowance method described in section 5 of this revenue procedure.

(2) The change to the track maintenance allowance method will be made in the earliest open taxable year after which there is no closed taxable year using a cut-off method.

(3) The taxpayer must reflect the settlement on its federal income tax returns for any affected succeeding taxable years. For example, an amount required to be capitalized during a taxable year covered by the settlement should be depreciated in that taxable year and in affected succeeding taxable years (whether or not covered by the settlement) in accordance with the taxpayer's method of accounting for depreciation.

(4) The Service will not require the taxpayer to change its method of accounting for track structure expenditures to a method other than the track maintenance allowance method for any taxable year for which a federal income tax return has been filed as of the date of the closing agreement or other appropriate settlement agreement, provided that:

(a) the taxpayer has complied with all the applicable provisions of the closing agreement or other appropriate settlement agreement;

(b) there has been no taxpayer fraud, malfeasance, or misrepresentation of a material fact;

(c) there has been no change in the material facts on which the closing agreement or other appropriate settlement agreement was based; and

(d) there has been no change in the applicable law on which the closing agreement or other appropriate settlement agreement was based.

(5) The taxpayer must execute a closing agreement under § 7121 or other appropriate settlement agreement as described in section 8.05 of this revenue procedure.

.03 *Procedures for Requesting the Settlement.*

(1) *Initiating the request.*

(a) *Taxable years under examination or in Appeals.* A taxpayer that wants to request a settlement under this section for taxable years under examination or in Appeals must submit its request in writing to the first line examination manager or appeals officer (whichever is applicable) on or before January 28, 2002.

(b) *Taxable years before the Tax Court.* A taxpayer that wants to request a settlement under this section for taxable years before the Tax Court must submit its request in writing to the Chief Counsel attorney assigned to the case on or before the earlier of January 28, 2002, or the date that is 30 days before the date the case is first set for trial, which is the date scheduled for the calendar call.

(2) *Statement of facts, law, and arguments.* The request for settlement must include the following information:

(a) the taxpayer's name, address, telephone number, and taxpayer identification number;

(b) the taxable years covered by the proposed settlement;

(c) the taxpayer's earliest open taxable year after which there is no closed taxable year;

(d) the taxpayer's current method of accounting for track structure expenditures;

(e) a statement of the material facts, including the track maintenance allowance and the capitalized amount under the track maintenance allowance method for each taxable year under examination, before an area appeals office, or before the Tax Court, and an explanation of the computations used to determine those amounts; and

(f) a statement of whether the track maintenance allowance for each taxable year under examination, before an area appeals office, or before the Tax Court is taken into account for federal income tax purposes, for example, whether the amount was incurred under § 461 in that taxable year, and, if § 404 applies to any portion of the amount in a particular taxable year, whether that portion meets the deductibility requirements of § 404.

(3) *Perjury statement.* The request for settlement must be accompanied by the following declaration: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the request contains all the relevant facts relating to the request, and such facts are true, correct, and complete." This declaration must be signed by, or on behalf of, the taxpayer by an individual with the authority to bind the taxpayer in these matters. The declaration may not be signed by the taxpayer's representative.

.04 *Procedures for Processing the Request.*

(1) *Receipt of request acknowledged.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will acknowledge receipt of the taxpayer's request for settlement in writing within 15 business days of receipt.

(2) *Factual development.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will contact the taxpayer to discuss any questions the Service may have, or ask for additional information believed to be necessary to execute the settlement (for example, to verify the correctness of the taxpayer's information).

(3) *Acceptance.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will accept the taxpayer's request for settlement if the request complies with the applicable terms of this revenue procedure. For taxable years before the Tax Court, the settlement is subject to the approval of the Court.

(4) *Notification of acceptance.* The first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) will notify the taxpayer in writing when the Service agrees to the settlement requested by the taxpayer.

.05 *Procedures for Implementing the Settlement.*

(1) *Closing agreement or other appropriate settlement agreement required.* A taxpayer implementing a settlement is required to execute a closing agreement under § 7121 or other appropriate settlement agreement.

(2) *Contents of closing agreement or other appropriate settlement agreement.* A closing agreement must comply with the requirements of Rev. Proc. 68–16 (1968–1 C.B. 770) and must be substantially in the form set forth in the APPENDIX of this revenue procedure. Settlement agreements in cases pending before the Tax Court must conform substantially to the provisions set forth in the APPENDIX of this revenue procedure and must conform to the rules and procedures of the Tax Court.

(3) *Review and execution of closing agreement or other appropriate settlement agreement.*

(a) *Taxpayers under examination.* The first line examination manager will prepare a closing agreement. The first line examination manager should submit the closing agreement to the Ground Transportation Technical Advisor and his assigned counsel for review prior to submitting the closing agreement to the taxpayer for execution. Failure to submit the closing agreement to the Technical Advisor or his assigned counsel for review will not invalidate the closing agreement. After the closing agreement has been executed by the taxpayer, it will be executed on behalf of the Service by the Director, Field Operations (LMSB) MCT, New Jersey.

(b) *Taxpayers before an area appeals office.* The appeals officer or appeals team case leader will prepare a closing agreement. After the closing agreement has been executed by the taxpayer, it will be executed on behalf of the Service by an authorized official from Appeals.

(c) *Taxpayers before the Tax Court.* For docketed tax years before the Tax Court, the taxpayer and the Chief Counsel attorney must prepare an appropriate settlement document, settlement stipulation, or stipulated decision document, pursuant to the rules and procedures of the court. Such settlement document, settlement stipulation, or stipulated decision document is subject to the approval of the court.

(4) *Amended returns.*

(a) *In general.* In cases pending before examination or appeals, the Service will make the adjustments necessary to reflect the settlement to the taxpayer's returns for the taxable years under examination or before an area appeals office. In cases pending before the Tax Court, the settlement agreement will include adjustments necessary to reflect the settlement with respect to the year(s) before the court. The taxpayer is required to file amended returns to reflect the settlement for any other affected taxable years for which a federal income tax return has been filed as of the date of the closing agreement or other appropriate settlement agreement. The amended returns must include the adjustments to taxable income necessary to reflect the new method and any collateral adjustments to taxable income or tax liability resulting from the change. A taxpayer eligible to file a "qualified amended return" under Rev. Proc. 94–69 (1994–2 C.B. 804) may satisfy the requirements of this section by filing a qualified amended return in accordance with that revenue procedure.

(b) *Time and manner.* The taxpayer must file any required amended returns on or before the date it executes the closing agreement or other appropriate settlement agreement. The taxpayer must provide a copy of the amended returns to the first line examination manager, appeals officer, or Chief Counsel attorney (whichever is applicable) at the time it files the amended returns.

.07 *Effect on Other Offices of the Service.* If a taxpayer is before an area appeals office or the Tax Court regarding the treatment of its track structure expenditures and does not settle this issue under the provisions of this section 8, an appropriate representative from an area appeals office or Chief Counsel office may settle a particular taxpayer's case involving this issue on a more favorable or less favorable basis than provided in this revenue procedure. For example, an appeals officer may settle a case based on the hazards of litigation.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2000.

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–49 is modified and amplified to include this accounting method change in the APPENDIX.

DRAFTING INFORMATION

The principal author of this revenue procedure is Kimberly L. Koch of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Koch at (202) 622-5020 (not a toll-free call).

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APPENDIX

Department of the Treasury Internal Revenue Service

Closing Agreement on Final Determination Covering Specific Matters

Under § 7121 of the Internal Revenue Code of 1986, [Taxpayer's name, address, telephone number, and identifying number] ("the taxpayer") and the Commissioner of Internal Revenue make the following closing agreement:

WHEREAS:

1. The taxpayer files (or is a member of a combined reporting group that files) a Form R-1 based on the same reporting period as the taxpayer's taxable year.

2. The taxpayer is an accrual basis taxpayer.

3. The issue covered in this closing agreement is the taxpayer's treatment of track structure expenditures incurred as a result of performing various activities to acquire, construct, maintain, repair, and improve track structure. The definition of "track structure expenditures" and other terms defined in section 4 of Rev. Proc. 2001–46, apply for purposes of this closing agreement.

4. The taxable years covered by this closing agreement are [insert applicable taxable years].

5. The taxpayer currently accounts for track structure expenditures as follows: [insert taxpayer's current method of accounting for track structure expenditures].

6. The taxpayer and the Internal Revenue Service ("Service") rely on the following facts and representations in making this closing agreement: [insert relevant facts, including the track maintenance allowance and the capitalized amount under the track maintenance allowance method for each taxable year under examination, before an area appeals office, or before the Tax Court, (whichever is applicable) an explanation of the computations used to determine those amounts, and a statement of whether the track maintenance allowance for each of those taxable years is taken into account for federal income tax purposes].

NOW IT IS HEREBY DETERMINED AND AGREED for federal income tax purposes:

1. That the Service is changing the taxpayer's method of accounting for track structure expenditures to the track maintenance allowance method of accounting described in section 5 of Rev. Proc. 2001–46, for the taxable year ending [insert earliest open taxable year after which there is no closed taxable year].

2. That the method change will be implemented using a cut-off method.

3. That the adjustments to taxable income necessary to reflect the new method, and any collateral adjustments to taxable income or tax liability resulting from the change for each of the taxable years covered by this agreement, are as follows: [insert appropriate adjustments].

4. (If appropriate), That the taxpayer has filed any amended returns required by section 8.05(4) of Rev. Proc. 2001–46, to reflect the settlement.

5. That the Service will not require the taxpayer to change its method of accounting for track structure expenditures to a method other than the track maintenance allowance method for any taxable year for which a federal income tax return has been filed as of the date of this closing agreement, provided that: (a) the taxpayer has complied with all the applicable provisions of the closing agreement; (b) there has been no taxpayer fraud, malfeasance, or misrepresentation of a material fact; (c) there has been no change in the material facts on which the closing agreement was based; and (d) there has been no change in the applicable law on which the closing agreement was based.

6. That the Service is not precluded from challenging the computation of the track maintenance allowance for any taxable year covered by this closing agreement on a basis unrelated to the track maintenance allowance method (for example, that all or a portion of the amount is not incurred under § 461 or that the taxpayer has not properly applied the uniform capitalization rules of § 263A and the regulations thereunder).

7. That the taxpayer accepts this settlement and agrees to the applicable terms of Rev. Proc. 2001–46.

This agreement is final and conclusive except:

(1) The matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of a material fact;

(2) It is subject to the Internal Revenue Code sections that expressly provide that effect be given to their provisions (including any stated exception for § 7122) notwithstanding any law or rule of law; and

(3) If it relates to a tax period ending after the date of this agreement, it is subject to any law enacted after the agreement date, that applies to the tax period.

By signing, the parties certify that they have read and agreed to the terms of this document.

Taxpayer (other than individual):

By: ______________________________ Date: __________________

Title: ______________________________

Commissioner of Internal Revenue:

By: ______________________________ Date: __________________

Title: ______________________________

Instructions

[This agreement must be signed and filed in triplicate. (All copies must have original signatures.) The original and copies of the agreement must be identical. The name of the taxpayer must be stated accurately. The agreement may relate to one or more years.

If an attorney or agent signs the agreement for the taxpayer, the power of attorney (or a copy) authorizing that person to sign must be attached to the agreement.

If the taxpayer is a corporation, the agreement must be dated and signed with the name of the corporation, the signature and title of an authorized officer or officers, or the signature of an authorized attorney or agent. It is not necessary that a copy of an enabling corporate resolution be attached.

Use additional pages if necessary and identify them as part of this agreement.

Please see Rev. Proc. 68–16 (1968–1 C.B. 770) for a detailed description of practices and procedures applicable to most closing agreements.]

I have examined the specific matters involved and recommend the acceptance of the proposed agreement

(Receiving Officer) ___________________ (Date) _________________

(Title) ______________________________

I have examined the specific matters involved and recommend the acceptance of the proposed agreement

(Receiving Officer) __________________ (Date) _________________

(Title) ______________________________

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking

## Qualified Subchapter S Trust Election for Testamentary Trusts

## REG–106431–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to a qualified subchapter S trust election for testamentary trusts under section 1361 of the Internal Revenue Code. The Small Business Job Protection Act of 1996 and the Taxpayer Relief Act of 1997 made changes to the applicable law. These proposed regulations affect S corporations and their shareholders.

DATES: Written or electronic comments and requests for a public hearing must be received by November 23, 2001.

ADDRESSES: Send submissions to: CC:IT&A:RU (REG–106431–01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:IT&A:RU (REG–106431–01), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Deane M. Burke (202) 622-3070; concerning submissions of comments, Sonya Cruse (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

This document proposes to amend section 1361 of the Income Tax Regulations (26 CFR part 1) regarding a qualified subchapter S trust (QSST) election for testamentary trusts.

Section 1361(a) defines an S corporation as a small business corporation for which an election under section 1362(a) is in effect for the year. Section 1361(b) provides, in part, that a small business corporation is a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than a trust described in section 1361(c)(2)) who is not an individual. Under section 1361(c)(2), subpart E trusts and testamentary trusts are permitted S corporation shareholders. A qualified subpart E trust is a trust, all of which is treated (under subpart E of part I of subchapter J, chapter 1) as owned by an individual who is a citizen or resident of the United States. A qualified subpart E trust that continues in existence after the death of the deemed owner (former qualified subpart E trust) is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner's death. A testamentary trust is a trust to which S corporation stock is transferred pursuant to the terms of a will, but only for the 2-year period beginning on the day the stock is transferred to it.

Section 1303 of the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1779) (August 20, 1996) (1996 Act) amended section 1361 for taxable years beginning after December 31, 1996. Prior to the 1996 Act, a former qualified subpart E trust was a permitted shareholder for a 60-day period beginning on the day of the deemed owner's death. However, if the entire corpus of the trust was includible in the gross estate of the deemed owner, the trust was a permitted shareholder for a 2-year period beginning on the day of the deemed owner's death. Under the regulations, special rules applied if the trust consisted of community property. A testamentary trust was a permitted shareholder of an S corporation for a 60-day period beginning on the day that the S corporation stock was transferred to the trust.

After the 1996 Act, both a testamentary trust and a former qualified subpart E trust, whether or not the entire corpus is included in the deemed owner's gross estate, are permitted shareholders for a 2-year period. Because the entire corpus of a former qualified subpart E trust is not required to be included in the deemed owner's estate, it is no longer relevant whether the trust consists of community property for purposes of the trust's qualifying as a permitted shareholder for a 2-year period. However, whether a former qualified subpart E trust consists of community property is still relevant for purposes of determining the shareholders of S corporation stock held by the trust.

**Explanation of Provisions**

A. *Incorporation of Changes from the 1996 Act*

The proposed regulations incorporate changes from the 1996 Act regarding section 1361 to provide that a testamentary trust may be a permitted shareholder for a 2-year period. The proposed regulations also provide that a former qualified subpart E trust is a permitted shareholder for a 2-year period whether or not the entire corpus is included in the deemed owner's gross estate. The proposed regulations thus eliminate the special rules for determining whether trusts consisting of community property qualify for the 2-year period.

The proposed regulations also incorporate additional changes made to section 1361 by the 1996 Act. Section 1302 of the 1996 Act added a new type of trust, the electing small business trusts (ESBTs), to the types of trusts permitted to be S corporation shareholders under section 1361(c)(2). Section 1601(c) of the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 1086) (August 5, 1997) made technical amendments to section 1361 affecting ESBTs and S corporation shareholders. A notice of proposed rulemaking (REG–251701–96, 2001–4 I.R.B. 396) regarding ESBTs was published in the **Federal Register** (65 FR 82963) on December 29, 2000. The proposed regulations refer to ESBTs and provide that certain former qualified subpart E trusts and testamentary trusts can continue as permitted shareholders after the end of the 2-year period by becoming ESBTs.

Section 1316 of the 1996 Act allowed certain exempt organizations to be S corporation shareholders for taxable years beginning after December 31, 1997, and section 1301 increased the number of permissible S corporation shareholders from 35 to 75. The proposed amendments incorporate these additional changes.

B. *QSST Election for Testamentary Trusts*

Section 1.1361–1(j)(6)(iii)(C) of the Income Tax Regulations provides guidance regarding when a QSST election is made for a former qualified subpart E trust that also satisfies the requirements of a QSST. Under the provision, a QSST election may be made for a former qualified subpart E trust at any time, but no later than the end of the 16-day-and-2-month period beginning on the date on which the estate of the deemed owner ceases to be treated as a shareholder (as late as the end of the 2-year period). Thus, a former qualified subpart E trust can continue as a permitted shareholder after the end of the 2-year period by electing to be a QSST.

Section 1.1361–1(h)(3)(ii)(B) provides that if a testamentary trust continues to own S corporation stock after the expiration of the 60-day period (now 2-year period), the corporation's S election will terminate unless the trust otherwise qualifies as a permitted shareholder. The trust otherwise qualifies as a permitted shareholder if it satisfies the requirements of a QSST under section 1361(d)(3) and the trust income beneficiary makes a timely QSST election under section 1361(d)(2). The regulations, promulgated before 1996, do not address when a QSST election may be made for a testamentary trust during its 2-year period as a permitted shareholder. The IRS and the Treasury Department believe that the regulations should provide guidance similar to that for former qualified subpart E trusts clarifying when an income beneficiary of a testamentary trust may make a QSST election.

Accordingly, the proposed regulations clarify that a current income beneficiary of a testamentary trust that satisfies the QSST requirements may make a QSST election at any time during the 2-year period that the trust is a permitted shareholder or the 16-day-and-2-month period beginning on the date after the 2-year period ends. Under this provision, a testamentary trust continues as a permitted shareholder after the end of the 2-year period by becoming an electing QSST. Once the trust becomes an electing QSST, the beneficiary is treated as the shareholder of the S corporation as of the effective date of the QSST election.

**Proposed Effective Date**

The regulations are proposed to apply on and after the date that final regulations are published in the **Federal Register**.

**Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Comments and Request for a Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

**Drafting Information**

The principal author of these proposed regulations is Deane M. Burke, Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1361–1 is amended as follows:

1. Revising paragraphs (b)(1)(ii), (f), (h)(1)(ii), (h)(1)(iv), (h)(3)(i)(B), and (h)(3)(i)(D). The undesignated paragraph following (h)(3)(i)(B) is removed.
2. Revising the second sentence of paragraph (h)(3)(ii)(A).
3. Revising paragraphs (h)(3)(ii)(B) and (j)(6)(iii)(C).
4. Redesignating paragraph (j)(6)(iii)(D) as paragraph (j)(6)(iii)(E).
5. Adding new paragraph (j)(6)(iii)(D).
6. Revising paragraph (j)(7)(ii).
7. Revising the fourth sentence of paragraph (k)(1) *Example 2*(ii).
8. Revising paragraph (k)(1) *Examples 3* and *4*(iii).
9. Adding a sentence to the end of paragraph (k)(2)(i).

The revisions and additions read as follows:

*§1.1361–1 S corporation defined.*

* * * * *

(b)* * *(1)* * *

(ii) As a shareholder, a person (other than an estate, a trust described in section 1361(c)(2), or, for taxable years beginning after December 31, 1997, an organization described in section 1361(c)(6)) who is not an individual;

* * * * *

(f) *Shareholder must be an individual or estate*. Except as otherwise provided in paragraph (e)(1) of this section (relating to nominees), paragraph (h) of this section (relating to certain trusts), and, for taxable years beginning after December 31, 1997, section 1361(c)(6) (relating to certain exempt organizations), a corporation in which any shareholder is a corporation, partnership, or trust does not qualify as a small business corporation.

* * * * *

(h)* * *(1)* * *

(ii) *Subpart E trust ceasing to be a qualified subpart E trust after the death of deemed owner*. A trust which was a qualified subpart E trust immediately before the death of the deemed owner and which continues in existence after the death of the deemed owner, but only for the 2-year period beginning on the day of the deemed owner's death. A trust is considered to continue in existence if the trust continues to hold the stock of the S corporation during the period of administration of the decedent's estate or if, after the period of administration, the trust continues to hold the stock pursuant to the terms of the will or the trust agreement. See §1.641(b)–3 for rules concerning the termination of estates and trusts for federal income tax purposes.

* * * * *

(iv) *Testamentary trusts*. A trust (other than a qualified subpart E trust, an electing QSST, or an electing small business trust (ESBT)) to which S corporation stock is transferred pursuant to the terms of a will, but only for the 2-year period beginning on the day the stock is transferred to the trust.

* * * * *

(3)* * *

(i)* * *

(B) If stock is held by a trust defined in paragraph (h)(1)(ii) of this section, the estate of the deemed owner is generally treated as the shareholder as of the day of the deemed owner's death. However, if stock is held by such a trust in a community property state, the decedent's estate is the shareholder only of the portion of the trust included in the decedent's gross estate (and the surviving spouse continues to be the shareholder of the portion of the trust owned by that spouse under the applicable state's community property law). The estate ordinarily will cease to be treated as the shareholder upon the earlier of the transfer of that stock by the trust or the expiration of the 2-year period beginning on the day of the deemed owner's death. If the trust qualifies and becomes an electing QSST, the beneficiary and not the estate is treated as the shareholder as of the effective date of the QSST election, and the rules provided in paragraph (j)(7) of this section apply. If the trust qualifies and becomes an ESBT, the shareholders are determined under provisions of REG–251701–96 in 2001–4 I.R.B. 396 (see §601.601(d)(2) of this chapter) as of the effective date of the ESBT election.

* * * * *

(D) If stock is transferred to a testamentary trust described in paragraph (h)(1)(iv) of this section (other than a qualified subpart E trust, an electing QSST, or an ESBT), the estate of the testator is treated as the shareholder until the earlier of the transfer of that stock by the trust or the expiration of the 2-year period beginning on the day that the stock is transferred to the trust. If the trust qualifies and becomes an electing QSST, the beneficiary and not the estate is treated as the shareholder as of the effective date of the QSST election, and the rules provided in paragraph (j)(7) of this section apply. If the trust qualifies and becomes an ESBT, the shareholders are determined under provisions of REG–251701–96 in 2001–4 I.R.B. 396 (see §601.601(d)(2) of this chapter) as of the effective date of the ESBT election.

* * * * *

(ii)* * *

(A)* * * If the trust continues to own the stock after the expiration of the 2-year period, the corporation's S election will terminate unless the trust is otherwise a permitted shareholder.* * *

(B) If stock is transferred to a testamentary trust described in paragraph (h)(1)(iv) of this section (other than a qualified subpart E trust, an electing QSST, or an ESBT), the trust is treated as the shareholder. If the trust continues to own the stock after the expiration of the 2-year period, the corporation's S election will terminate unless the trust otherwise qualifies as a permitted shareholder. If the trust qualifies as a QSST described in section 1361(d) and the income beneficiary of the trust makes a timely QSST election, the beneficiary and not the trust is treated as the shareholder from the effective date of the QSST election.

* * * * *

(j)* * *

(6)* * *

(iii)* * *

(C) If a trust ceases to be a qualified subpart E trust but also satisfies the requirements of a QSST, the QSST election must be filed within the 16-day-and-2-month period beginning on the date on which the trust ceases to be a qualified subpart E trust. If the estate of the deemed owner of the trust is treated as the shareholder under paragraph (h)(3)(i) of this section, the QSST election may be filed at any time, but no later than the end of the 16-day-and-2-month period beginning on the date on which the estate of the deemed owner ceases to be treated as a shareholder.

(D) If a testamentary trust is a permitted shareholder under paragraph (h)(1)(iv) of this section and also satisfies the requirements of a QSST, the QSST election may be filed at any time, but no later than the end of the 16-day-and-2-month period beginning on the date after the end of the 2-year period.

* * * * *

(7)* * *

(ii) If, upon the death of an income beneficiary, the trust continues in existence, continues to hold S corporation stock but no longer satisfies the QSST requirements, and is not a qualified subpart E trust, then, solely for purposes of section 1361(b)(1), as of the date of the income beneficiary's death, the estate of that income beneficiary is treated as the shareholder of the S corporation with respect to which the income beneficiary made the QSST election. The estate ordinarily will cease to be treated as the shareholder for purposes of section 1361(b)(1) upon the earlier of the transfer of that stock by the trust or the expiration of the 2-year period beginning on the day of the income beneficiary's death. During the period that the estate is treated as the shareholder for purposes of section 1361(b)(1), the trust is treated as the shareholder for purposes of sections 1366, 1367, and 1368. If, after the 2-year period, the trust continues to hold S corporation stock, the corporation's S election terminates. If the termination is inadvertent, the corporation may request relief under section 1362(f).

* * * * *

(k)(1)* * *

*Example 2*.* * *

(ii)* * * A's estate will cease to be treated as the shareholder for purposes of section 1361(b)(1) upon the earlier of the transfer of the Corporation M stock by the trust (other than to A's estate), the expiration of the 2-year period beginning on the day of A's death, or the effective date of a QSST election if the trust qualifies as a QSST.* * *

* * * * *

*Example 3. 2-year rule under section 1361(c)(2)(A)(ii) and (iii)*. F owns stock of Corporation P, an S corporation. In addition, F is the deemed owner of a qualified subpart E trust that holds stock in Corporation O, an S corporation. F dies on July 1, 2001. The trust continues in existence after F's death but is no longer a qualified subpart E trust. On August 1, 2001, F's shares of stock in Corporation P are transferred to the trust pursuant to the terms of F's will. Because the stock of Corporation P was not held by the trust when F died, section 1361(c)(2)(A)(ii) does not apply with respect to that stock. Under section 1361(c)(2)(A)(iii), the last day on which F's estate could be treated as a permitted shareholder of Corporation P is July 31, 2003, (that is, the last day of the 2-year period that begins on the date of the transfer from the estate to the trust). With respect to the shares of stock in Corporation O held by the trust at the time of F's death, section 1361(c)(2)(A)(ii) applies and the last day on which F's estate could be treated as a permitted shareholder of Corporation O is June 30, 2003, (that is, the last day of the 2-year period that begins on the date of F's death).

*Example 4.** * *

*(iii) QSST when a person other than the current income beneficiary may receive trust corpus*. Assume the same facts as in paragraph (i) of this *Example 4,* except that H dies on November 1, 2001. Under the terms of the trust, after H's death, L is the income beneficiary of the trust and the trustee is authorized to distribute trust corpus to L as well as to J. The trust ceases to be a QSST as of November 1, 2001, because corpus distributions may be made to someone other than L, the current (successive) income beneficiary. Under section 1361(c)(2)(B)(ii), H's estate (and not the trust) is considered to be the shareholder for purposes of section 1361(b)(1) for the 2-year period beginning on November 1, 2001. However, because the trust continues in existence after H's death and will receive any distributions from the corporation, the trust (and not H's estate) is treated as the shareholder for purposes of sections 1366, 1367, and 1368, during that 2-year period. After the 2-year period, the S election terminates and the trust continues as a shareholder of a C corporation. If the termination is inadvertent, Corporation Q may request relief under section 1362(f). However, the S election would not terminate if the trustee distributed all Corporation Q shares to L, J, or both before October 31, 2003 (the last day of the 2-year period), assuming that neither L nor J becomes the 76th shareholder of Corporation Q as a result of the distribution.

* * * * *

(2)* * *(i)* * * In addition, paragraphs (h)(1)(ii), (h)(1)(iv), (h)(3)(i)(B), (h)(3)(i)(D), (h)(3)(ii)(A) second sentence, (h)(3)(ii)(B), (j)(6)(iii)(C), (j)(6)(iii)(D), (j)(7)(ii), and (k)(1) *Example 2*(ii) fourth sentence, *Example 3,* and *Example 4*(iii) of this section apply on and after the date that final regulations are published in the **Federal Register**.

* * * * *

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on August 23, 2001, 8:45 a.m. and published in the issue of the Federal Register for August 24, 2001, 66 F.R. 44565)

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

## Section 6407.—Date of Allowance of Refund or Credit

*26 CFR 301.6407–1: Date of allowance of refund or credit*

This revenue ruling modifies Revenue Ruling 78–127 by clarifying when the Internal Revenue Service allows a refund or credit of an overassessed tax.

## Rev. Rul. 2001–40

PURPOSE

This revenue ruling modifies the discussion of section 6407 of the Internal Revenue Code (the Code) in Rev. Rul. 78–127 (1978–1 C.B. 436). Specifically, this revenue ruling clarifies when the Internal Revenue Service (the Service) allows a refund or credit of an overassessed tax.

LAW AND ANALYSIS

Section 6407 of the Code states: "The date on which the Secretary first authorizes the scheduling of an overassessment of any internal revenue tax shall be considered as the date of allowance of refund or credit in respect of such tax."

Congress adopted the rule defining the scheduling date as the allowance date in the Revenue Act of 1926. See section 1116 of the Act, the predecessor of current section 6407 of the Code. The rule was designed to reflect Service processing practice. The legislative history explains:

> In the case of refunds, interest is allowed "to the date of the allowance of the refund." In practice, the Commissioner first signs a schedule of overassessments, which is sent to the collector, in order to determine whether the overpayment should be credited or refunded. The committee amendment proposes to fix as the date on which the refund is allowed the date on which the Commissioner signs the schedule of overassessments. (S. Rep. No. 52, 69th Cong., 1st Sess. 38 (1926).)

Section 301.6407–1 of the Regulations on Procedure and Administration reflects the legislative intent that the Secretary would delegate authority to allow refunds and credits to Internal Revenue Service officials. Over the years, different certifying officers have been authorized to schedule overassessments and allow refunds and credits.

In addition, the Service has revised the method of scheduling overassessments and allowing refunds and credits. For example, the Service does not currently use Form 1166 to schedule overassessments. It may use different paper forms or electronic entries to schedule and allow refunds and credits. Regardless of processing method, the taxpayer's account will reflect the date that the certifying officer schedules the overassessment.

HOLDING

Consequently, references to the Form 1166 and other processing forms are removed from Rev. Rul. 78–127. The two paragraphs beginning "Section 6407 of the Code..." are modified to read as follows:

> Section 6407 of the Code provides that the date on which the Secretary first authorizes the scheduling of an overassessment of any internal revenue tax shall be considered the date of allowance of any refund or credit of the tax. Section 301.6407–1 of the regulations delegates scheduling authority to a certifying officer. The certifying officer authorizes a credit or refund by signing a schedule of overassessments identifying the taxpayer and the amount of the overassessment.
>
> The date the summary record of assessment is signed, and the date on which the schedule of overassessments is signed are dates of authorization for the purpose of section 301.6521–1(c) of the regulations.

EFFECT ON OTHER REVENUE RULING(S)

Rev. Rul. 78–127 is modified.

DRAFTING INFORMATION

The principal author of this revenue ruling is Tiffany P. Smith of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact Tiffany Smith at (202) 622-4910 (not a toll-free call).

# Part III. Administrative, Procedural, and Miscellaneous

## Effective Dates for Certain Amendments Made by the Economic Growth and Tax Relief Reconciliation Act of 2001

## Notice 2001–56

### I. Purpose

This notice provides guidance relating to the effective dates for §§ 611(c), 613, and 636(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107–16. Section 611(c) of EGTRRA increases the compensation limit of § 401(a)(17) of the Internal Revenue Code (Code) and related sections. Section 613 of EGTRRA modifies the rules in § 416 of the Code regarding determination of top-heavy status. Section 636(a) of EGTRRA directs the Secretary to revise the regulations relating to hardship distributions under § 401(k)(2)(B)(i)(IV) of the Code.

Notice 2001–42 (2001–30 I.R.B. 70), provides a remedial amendment period for EGTRRA, in which any needed retroactive remedial EGTRRA plan amendments may be adopted. The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of required good faith EGTRRA plan amendments. See Notice 2001–57, page 279, this bulletin, for sample good faith amendments. Although a good faith plan amendment need not reflect all guidance issued under EGTRRA, the plan's operation must be consistent with that guidance, beginning with the effective date of that guidance.

### II. Compensation Limit under § 401(a)(17)

#### A. Background

Section 401(a)(17) of the Code limits the annual compensation that may be taken into account for purposes of determining a participant's benefit accruals under a defined benefit plan or a participant's allocations under a defined contribution plan. Section 401(a)(17) also limits the annual compensation that may be taken into account for purposes of certain nondiscrimination requirements, including those in §§ 401(a)(4), 401(a)(5), 401(l), 401(k), 401(m), 403(b)(12), 404(a)(2), and 410(b)(2), and for purposes of determining whether a definition of compensation is nondiscriminatory under § 414(s)(3). Under § 401(a)(17) as in effect prior to the effective date of the EGTRRA amendment, the compensation limit is $150,000, indexed in $10,000 increments for cost-of-living adjustments. For 2001, the compensation limit is $170,000. A higher compensation limit applies to eligible participants in certain governmental plans. See Treas. Reg. § 1.401(a)(17)–1(d)(4)(ii).

Section 611(c) of EGTRRA amended § 401(a)(17) of the Code by increasing the $150,000 limit (as adjusted) to $200,000, and changing the method used for cost-of-living adjustments. Section 611(c) of EGTRRA made similar amendments to §§ 404(l), 408(k), and 505(b)(7) of the Code.

#### B. Effective Date

Section 611(i)(1) of EGTRRA provides that the increase in the compensation limit of § 401(a)(17) of the Code applies to years beginning after December 31, 2001. Thus, for purposes of determining benefit accruals or the amount of allocations for plan years beginning on or after January 1, 2002, compensation taken into account may not exceed the compensation limit under § 401(a)(17), as amended by § 611(c) of EGTRRA. In the case of a plan that uses annual compensation for periods prior to the first plan year beginning on or after January 1, 2002, to determine accruals or allocations for a plan year beginning on or after January 1, 2002, the plan is permitted to provide that the $200,000 compensation limit applies to annual compensation for such prior periods in determining such accruals or allocations.

The compensation limit under § 401(a)(17) of the Code is adjusted for cost-of-living increases in accordance with § 401(a)(17)(B), as amended by EGTRRA, as of the beginning of a calendar year. As under pre-EGTRRA law, any such increases shall apply only with respect to annual compensation during the plan year or other 12-month period over which compensation is determined that begins with or within such calendar year (and any subsequent calendar year).

*Example. B is a participant in a nongovernmental defined benefit plan, Plan A. Plan A has a calendar plan year, and a benefit formula that provides for an annual benefit at normal retirement age equal to the product of: (years of service) x (1 percent) x (high 3-year average compensation). For this purpose, high 3-year average compensation is the average of the compensation over the 3 consecutive plan years for which the average is the highest, and compensation for each year is limited to $150,000, as adjusted for cost-of-living increases. As of December 31, 2001, B has 10 years of service and compensation of $250,000 for each of the 3 years 1999, 2000, and 2001. B's high 3-year average compensation of $166,667 is determined as the average of annual compensation (as limited by § 401(a)(17) of the Code) of $160,000 for 1999, $170,000 for 2000, and $170,000 for 2001. B's annual benefit under the plan formula as of December 31, 2001, is $16,667, calculated as (10) x (.01) x ($166,667).*

*In 2002, Plan A is amended (1) to use the $200,000 compensation limit for compensation paid in years beginning after December 31, 2001, and (2) to use the $200,000 compensation limit for compensation paid in years beginning prior to January 1, 2002, in determining benefit accruals in years beginning after December 31, 2001. B has annual compensation of $250,000 for 2002. A high 3-year average compensation of $200,000 is determined for B as of December 31, 2002, as the average of annual compensation (as limited by § 401(a)(17) of the Code, as amended by EGTRRA) of $200,000 for 2000, $200,000 for 2001, and $200,000 for 2002. As of December 31, 2002, B's annual benefit under the plan formula is $22,000, calculated as (11) x (.01) x ($200,000).*

*Plan A is not required to implement the EGTRRA increase in the compensation limit under § 401(a)(17) of the Code in its benefit formula. Plan A could retain the compensation limit in effect prior to EGTRRA, or provide for any other compensation limit that is less than the compensation limit as amended by EGTRRA. Accordingly, Plan A could be amended to provide that the increased compensation limit applies only to annual compensation paid in plan years beginning on or after January 1, 2002. In that case, a high 3-year average compensation of $180,000 would be determined for B as of December 31, 2002, as the average of annual compensation of $170,000 for 2000 and $170,000 for 2001 (both as limited by § 401(a)(17) of the Code, as in effect prior to amendment by EGTRRA), and $200,000 for 2002 (as limited by § 401(a)(17) of the Code, as amended by EGTRRA). B's annual benefit as of December 31, 2002, would be $19,800, calculated as (11) x (.01) x ($180,000).*

## III. Determination of Top-Heavy Status under § 416

### A. Background

Section 416(a) of the Code provides that a plan that is a top-heavy plan for a plan year must satisfy the vesting and minimum benefit requirements of § 416(b) and (c) for the plan year. A defined benefit plan is a top-heavy plan for a plan year if, as of the determination date, the present value of the cumulative accrued benefits under the plan for key employees exceeds 60 percent of the present value of the cumulative accrued benefits under the plan for all employees. A defined contribution plan is a top-heavy plan for a plan year if, as of the determination date, the aggregate of the accounts of key employees under the plan exceeds 60 percent of the aggregate of the accounts of all employees under the plan. The determination date with respect to any plan year is the last day of the preceding plan year or, in the case of the first plan year of a plan, the last day of such plan year. The determination of whether a plan is top-heavy is made in accordance with the requirements of § 416(g) (including the aggregation requirements of § 416(g)(2)).

Section 613 of EGTRRA amended several provisions of § 416 of the Code, including provisions related to the requirements for determining whether a plan is a top-heavy plan for a plan year. Section 613(a) of EGTRRA modified the definition of "key employee" in § 416(i)(1) of the Code by increasing the compensation threshold for determining when officers are key employees to $130,000 and by eliminating the ten employees owning the largest interests in the employer as a separate category of key employees. Section 613(c) of EGTRRA also provides that the determination of key employee status is made based on the plan year ending on the determination date, thereby eliminating the additional 4-year lookback period for determining key employee status. In general, § 613(c) of EGTRRA modified §§ 416(g)(3) and 416(g)(4)(E) of the Code to exclude from the determination of top-heavy status (1) distributions made prior to the 1-year period ending on the determination date (except that a 5-year period is retained for in-service distributions) and (2) the accrued benefits and account balances of employees who performed no service for the employer during the 1-year period ending on the determination date.

### B. Effective Date

Section 613(f) of EGTRRA provides that the amendments made by § 613 apply to years beginning after December 31, 2001. Thus, the EGTRRA amendments to § 416 of the Code apply for purposes of determining whether a plan is top-heavy for the first plan year beginning after December 31, 2001, even though the determination date for that plan year is before the effective date of the EGTRRA amendment.

Thus, for example, for a plan with a calendar plan year (other than a plan in its first plan year), the determination of whether the plan is top-heavy for the plan year beginning January 1, 2002, is made as of December 31, 2001. This determination is made in accordance with the provisions of § 416 of the Code, as amended by EGTRRA. For example, for purposes of identifying key employees in accordance with § 416(i)(1)(A) of the Code as amended by EGTRRA, officers with annual compensation greater than $130,000 for 2001 are key employees, and the additional 4-year lookback period does not apply for purposes of that determination.

## IV. Hardship Distributions

### A. Background

Elective deferrals under a qualified cash or deferred arrangement subject to § 401(k) of the Code may not be distributable to participants prior to the occurrence of one of the events specified in § 401(k)(2). One of these events is a hardship of the employee. Treas. Reg. § 1.401(k)–1(d)(2)(i) provides that a distribution is treated as made on account of an employee's hardship if it is made on account of an immediate and heavy financial need and is necessary to satisfy the financial need. Treas. Reg. § 1.401(k)–1(d)(2)(iv)(B) provides a safe harbor pursuant to which a distribution is deemed necessary to satisfy an immediate and heavy financial need. One of the requirements of the safe harbor is that the employee is prohibited from making elective contributions and employee contributions under the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution. See Treas. Reg. § 1.401(k)–1(d)(2)(iv)(B)(*4*).

Sections 401(k)(12) and 401(m)(11) of the Code provide design-based safe harbor methods for satisfying the actual deferral percentage (ADP) test contained in § 401(k)(3)(A)(ii) and the actual contribution percentage (ACP) test contained in § 401(m)(2) based on matching contributions that meet certain conditions and that satisfy certain notice requirements. Notice 98–52 (1998–2 C.B. 632), provides that a plan will not fail to satisfy the ADP matching contribution safe harbor merely because an eligible employee's ability to make elective deferrals is suspended for 12 months following a hardship distribution. Notice 98–52 also provides that a plan will not fail to satisfy the ACP matching contribution safe harbor merely because an eligible employee's ability to make elective deferrals and employee contributions is suspended for 12 months following a hardship distribution. See Treas. Reg. § 1.401(k)–1(d)(2)(iv)(B)(*4*) and sections V.B.1.c.iv and VI.B of Notice 98–52.

Section 636(a) of EGTRRA directs the Secretary of the Treasury to modify the regulations regarding hardship distributions to provide that the period during which an employee is prohibited from making elective deferrals in order for the distribution to be deemed necessary to satisfy a financial need shall be 6 months (instead of 12 months).

### B. Effective Date

Section 636(a) of EGTRRA provides that the regulations as revised in accordance with § 636(a) shall apply to years beginning after December 31, 2001. Thus, the revised regulations will be effective for calendar years beginning after December 31, 2001, rather than effective only with respect to hardship distributions received after December 31, 2001. For example, a plan that provides for hardship distributions in accordance with the safe harbor in Treas. Reg. § 1.401(k)–1(d)(2)(iv)(B) may be amended to provide that an employee who receives a hardship distribution in 2001 is prohibited from making elective deferrals and employee contributions for 6 months after receipt of the distribution (or until January 1, 2002, if later). However, a plan sponsor generally could retain its existing suspension period for all hardship distributions (or for all hardship distributions prior to January 1, 2002).

However, in order to continue to rely on the matching contribution safe harbor in § 401(k)(12) or § 401(m)(11) of the Code to satisfy the ADP or ACP test, a plan must reduce the period during which elective deferrals and employee contributions are suspended following a hardship distribution from 12 months to 6 months for calendar years beginning after December 31, 2001. A plan will not fail to satisfy this requirement merely because it provides that the reduction from 12 months to 6 months applies only to hardship distributions made after December 31, 2001.

**V. Effect on Other Documents**

Notice 98–52 is modified.

**DRAFTING INFORMATION**

The principal author of this notice is Ann Trichilo of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Ms. Trichilo may be reached at (202) 283-9695. These telephone numbers are not toll-free.

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## Sample Plan Amendments for the Economic Growth and Tax Relief Reconciliation Act of 2001

## Notice 2001–57

I. Purpose

This notice provides sample plan amendments for the changes to the plan qualification requirements under § 401(a) of the Internal Revenue Code that were made by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107–16 ("EGTRRA"). These sample amendments will help plan sponsors and sponsors and adopters of pre-approved plans comply with the requirement to adopt good faith EGTRRA plan amendments on a timely basis.

In some cases, plan sponsors may be able to adopt the sample amendments verbatim. In other cases, plan sponsors may have to modify the sample amendments to make the amendments appropriate for adoption in their plans.

The sample amendments are examples of plan amendments that satisfy the good faith requirement and should not be viewed as interpretive guidance on the EGTRRA changes to the qualification requirements. Other guidance will address the EGTRRA changes. See, for example, Notice 2001–56, p. 277, this bulletin.

II. Background

*EGTRRA.* EGTRRA, which was enacted on June 7, 2001, includes numerous changes to the qualified plan rules. Most of these changes are effective in years beginning after December 31, 2001. While many of the changes are not mandatory, a plan sponsor that chooses to implement an optional provision of EGTRRA will have to amend its plan to conform plan provisions to plan operation.

*EGTRRA Remedial Amendment Period Requirements.* Notice 2001–42 (2001–30 I.R.B. 70) designated as disqualifying provisions under Treas. Reg. § 1.401(b)–1(b) plan provisions that (1) must be amended to satisfy the qualification requirements of the Code because of changes in those requirements made by EGTRRA or (2) are integral to qualification requirements changed by EGTRRA. The effect of this designation is to provide a remedial amendment period under § 401(b), ending no earlier than the end of the 2005 plan year, in which any needed retroactive remedial EGTRRA plan amendments may be adopted (the EGTRRA remedial amendment period).

The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of required good faith EGTRRA plan amendments. There are two circumstances in which a good faith EGTRRA plan amendment is required. First, a plan is required to have a good faith EGTRRA plan amendment in effect for a year if the plan is required to implement a provision of EGTRRA for the year and the plan language, prior to the amendment, is not consistent with the provision of EGTRRA. Second, a plan is required to have a good faith EGTRRA plan amendment in effect for a year if the plan sponsor elects to implement a provision of EGTRRA for the year and the plan language, prior to the amendment, is not consistent with the operation of the plan in a manner consistent with EGTRRA. A good faith EGTRRA plan amendment is timely if it is adopted no later than the later of (i) the end of the plan year in which the EGTRRA change in the qualification requirements is required to be, or is optionally, put into effect under the plan or (ii) the end of the GUST remedial amendment period for the plan.[1]

*Good Faith.* A plan amendment is a good faith EGTRRA plan amendment only if the amendment represents a reasonable effort to take into account all of the requirements of the applicable EGTRRA provision and does not reflect an unreasonable or inconsistent interpretation of the provision.

III. Sample EGTRRA Plan Amendments

*In General.* As provided in Notice 2001–42, the Service is publishing sample EGTRRA plan amendments that can be adopted or used in drafting individualized good faith plan amendments for individually designed and pre-approved plans. In some cases, plan sponsors may be able to adopt the sample amendments in this notice verbatim. In other cases, plan sponsors may have to modify the sample amendments to make them appropriate for adoption in their plans.

The availability of the EGTRRA remedial amendment period is conditioned on the timely adoption of good faith

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[1] The term "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103-465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103-353;
- the Small Business Job Protection Act of 1996, Pub. L. 104-188;
- the Taxpayer Relief Act of 1997, Pub. L. 105-34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106-554

Unless section 19 of Rev. Proc. 2000-20, 2000-6 I.R.B. 553, as modified by Notice 2001-42, applies, the GUST remedial amendment period generally ends on the last day of the 2001 plan year.

EGTRRA plan amendments, as noted above. Many of the issues and questions concerning the EGTRRA changes to the qualification requirements are not addressed in the sample amendments. Therefore, the sample amendments may not contain all those provisions that will be necessary to comply with the EGTRRA changes once guidance on the changes is issued. Nevertheless, proper adoption of the sample amendments, or plan amendments that are materially similar to the sample amendments, will, with respect to the EGTRRA provisions addressed in the amendments that a sponsor adopts, satisfy the good faith plan amendment requirement and allow the amended plan provisions to be retroactively amended within the EGTRRA remedial amendment period.

Of course, regardless of whether a plan sponsor adopts the sample amendments in this notice or its own good faith amendments, the operation of the plan must also reflect a good faith, reasonable interpretation of EGTRRA. Plan operation will not reflect a good faith, reasonable interpretation of EGTRRA unless the operation is consistent with published guidance beginning no later than the effective date of the guidance.

Some of the sample amendments reflect other guidance issued with respect to the applicable section of EGTRRA. Notice 2001–56 provides guidance with respect to the effective dates of the increase in the § 401(a)(17) compensation limit under EGTRRA § 611(c), the changes to the top-heavy requirements of § 416 under EGTRRA § 613, and the change to the suspension period for hardship distributions in a § 401(k) plan under EGTRRA § 636(a). The Service and Treasury will issue additional guidance on other EGTRRA changes in the near future, including the increase in the § 415(b) dollar limit under EGTRRA § 611(a) and the catch-up contribution provisions under EGTRRA § 631. The sample amendments in this notice, materially similar amendments, and other good faith amendments will continue to be good faith EGTRRA plan amendments, even after the publication of additional guidance. However, as provided above, a plan will have to be operated in accordance with such additional guidance as of the effective date of the guidance, notwithstanding the provisions of the plan's good faith amendments.

*Good Faith.* The sample amendments, and plan amendments that are materially similar to the sample amendments, are sufficient to satisfy the good faith plan amendment requirement. A plan amendment that represents a reasonable effort to take into account all of the requirements of the applicable EGTRRA provision and does not reflect an unreasonable or inconsistent interpretation of the provision will not fail to be a good faith plan amendment merely because it is not materially similar to a sample EGTRRA plan amendment.

*Scope of the Sample Amendments.* The sample amendments address most of the EGTRRA changes for which plan amendments are either required or optional. The sample amendments do not address changes not generally applicable to plans; changes not effective prior to the issuance of regulations; and changes under EGTRRA §§ 602 and 617, regarding deemed individual retirement accounts and annuities and Roth contribution programs in qualified plans, respectively. The good faith plan amendment requirement described above applies with respect to all the EGTRRA changes to the plan qualification requirements, including those that are not addressed in the sample amendments. The sample amendments also do not address EGTRRA changes regarding deduction limits and excise taxes.

Some amendments that would generally be optional may, in certain circumstances, be required. Plan sponsors should make the determination of which amendments are appropriate after reviewing the EGTRRA changes in the context of their plans and particular circumstances. The sample amendments include notes to assist plan sponsors in this determination.

*Format of the Sample Amendments.* The format of the sample amendments generally follows the design of pre-approved plans, including all M&P plans, that employ a "basic plan document" and an "adoption agreement." Thus, each sample amendment includes language designed for inclusion in a basic plan document. In addition, some of the sample amendments include language designed for inclusion in an adoption agreement to allow the employer to indicate whether, or when, the corresponding basic plan document provision will be effective in the employer's plan and to select among options related to the application of the basic plan document provision. Sponsors may modify the amendments to specify the "default" option that will apply if an employer does not select an alternative option in the adoption agreement.

Sponsors of plans that do not use an adoption agreement should modify the format of the amendments to incorporate the appropriate adoption agreement option(s) in the terms of the amendments. The adoption agreement format is not used in the sample amendment for multiemployer plans for EGTRRA §§ 611(a) and 654, regarding changes in the limitations of § 415(b) of the Code.

Pre-approved plans that are amended for EGTRRA in any manner other than by the adoption of a separate, clearly identified addendum to the plan (or basic plan document) and/or adoption agreement, limited to the provisions of EGTRRA, will be treated as individually designed plans. The sample EGTRRA plan amendments in this notice are designed to be easily incorporated in such a separate addendum, so that a pre-approved plan will not be treated as an individually designed plan.

The sample amendments have been designed to facilitate their adoption in cases where the plan's language, including definitions, is similar to the sample plan provisions in the Service's *Listing of Required Modifications* (which is available at *http://www.irs.gov/ep*). Thus, the sample amendments generally do not provide definitions of terms used in the amendments if equivalent terms should already be defined in a plan. Among these terms are the following: annual addition, annual benefit, defined benefit compensation limitation, determination date for top-heavy status, elective deferrals, eligible retirement plan, eligible rollover distribution, limitation year, and matching contributions. Of course, a sponsor needs to ensure that the terminology of its good faith EGTRRA plan amendments is consistent with the plan's existing terminology and definitions. The sample amendments generally do not address issues of plan design. Sponsors may want to add to or modify the sample amendments to address these issues.

The sample amendments are arranged in these categories: all plans, defined contribution plans, section 401(k) plans, and defined benefit plans.

*Effective Dates.* Sponsors that adopt the sample amendments may have to modify the amendments' effective dates to ensure that no optional plan amendment is effective earlier than the date on which the corresponding EGTRRA change is put into effect under the plan. For plans maintained pursuant to a collective bargaining agreement, the effective date of the sample amendment for EGTRRA § 633, regarding faster vesting of matching contributions, may be modified to reflect the effective date in § 633(c)(2).

*Time and Manner of Adoption.* Although good faith EGTRRA plan amendments are generally not required to be adopted earlier than the end of the plan year in which the amendments are required to be, or are optionally, put into effect, earlier adoption may be necessary in order to avoid a decrease or elimination of benefits protected by § 411(d)(6). See the discussion of § 411(d)(6) in section III of Notice 2001–42.

A pre-approved plan may be amended by the document's sponsor to the extent authorized. For example, a sponsor of an M&P plan may amend the plan on behalf of adopting employers. If the amendment of a pre-approved plan includes an addendum to the adoption agreement, the addendum is effective only if signed and dated by the employer.

*Determination Letters and Reliance.* Until further notice, the Service will not consider EGTRRA in issuing determination, opinion, and advisory letters, and such letters may not be relied on with respect to the EGTRRA changes, regardless of whether the plan has been amended by the adoption of the sample EGTRRA plan amendments. However, an employer's ability to otherwise rely on a favorable letter will not be adversely affected by the timely adoption of good faith EGTRRA plan amendments.

*Possible Subsequent Required Amendments.* The Service and Treasury will provide additional guidance on EGTRRA. Plans amended by the timely adoption of good faith EGTRRA plan amendments, including the sample amendments, may have to be amended again by the end of the EGTRRA remedial amendment period to comply with additional guidance. In addition, as provided above, plans will have to be operated consistent with such additional guidance as of the effective date of the guidance.

*Application to Other Plans.* Although the sample amendments are designed for plans qualified under § 401(a), some of the sample amendments may be used in an appropriate context in other plans, including § 403(b) plans. Future guidance will address the EGTRRA changes applicable to § 457 plans.

IV. Effect on Other Documents.

Notice 2001–42 is modified.

DRAFTING INFORMATION

The principal drafter of this notice is James Flannery of Employee Plans. For further information regarding this notice, please contact Employee Plans' taxpayer assistance telephone service at (202) 283-9516 or (202) 283-9517, between the hours of 1:30 p.m. and 3:30 p.m. Eastern Time, Monday through Thursday. Mr. Flannery may be reached at (202) 283-9613. These telephone numbers are not toll-free.

## SAMPLE EGTRRA PLAN AMENDMENTS FOR ALL PLANS

### Sample Preamble Adopting Good Faith Amendments and Superseding Inconsistent Plan Provisions

(The following sample preamble is optional. However, plan sponsors that do not adopt this or a similar provision will have to modify some of the amendments that follow to specify effective dates and supersede inconsistent plan provisions.)

AMENDMENT OF THE PLAN FOR EGTRRA

PREAMBLE

1. Adoption and effective date of amendment. This amendment of the plan is adopted to reflect certain provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). This amendment is intended as good faith compliance with the requirements of EGTRRA and is to be construed in accordance with EGTRRA and guidance issued thereunder. Except as otherwise provided, this amendment shall be effective as of the first day of the first plan year beginning after December 31, 2001.

2. Supersession of inconsistent provisions. This amendment shall supersede the provisions of the plan to the extent those provisions are inconsistent with the provisions of this amendment.

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### Sample Plan Amendment for § 612 of EGTRRA

(The following amendment is required for plans that provide loans to participants but prohibit the making of loans to owner-employees or Subchapter S shareholder-employees.)

SECTION ______. PLAN LOANS FOR OWNER-EMPLOYEES AND SHAREHOLDER EMPLOYEES

Effective for plan loans made after December 31, 2001, plan provisions prohibiting loans to any owner-employee or shareholder-employee shall cease to apply.

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## SAMPLE EGTRRA PLAN AMENDMENTS FOR DEFINED CONTRIBUTION PLANS

### Sample Plan Amendment for §§ 611(b) and 632 of EGTRRA

(Although plans may impose lower limits on contributions and allocations than the limits under § 415(c) of the Code, the following amendment will generally be required in order to avoid a related violation of § 401(a). This could occur, for example, if the plan allocates excess annual additions to a suspense account. (See Notice 99–44, Q&A–8, 1999–2 C.B. 326.) A plan that correctly incorporates the § 415(c) limits by reference will automatically reflect the EGTRRA changes and need not be amended.)

SECTION ______. LIMITATIONS ON CONTRIBUTIONS

1. Effective date. This section shall be effective for limitation years beginning after December 31, 2001.

2. Maximum annual addition. Except to the extent permitted under section _____of this amendment [enter the section of the amendment that provides for catch-up

contributions under EGTRRA § 631] and section 414(v) of the Code, if applicable, the annual addition that may be contributed or allocated to a participant's account under the plan for any limitation year shall not exceed the lesser of:

(a) $40,000, as adjusted for increases in the cost-of-living under section 415(d) of the Code, or
(b) 100 percent of the participant's compensation, within the meaning of section 415(c)(3) of the Code, for the limitation year.

The compensation limit referred to in (b) shall not apply to any contribution for medical benefits after separation from service (within the meaning of section 401(h) or section 419A(f)(2) of the Code) which is otherwise treated as an annual addition.

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**Sample Plan Amendment for § 611(c) of EGTRRA**

(The following sample amendment is optional. It should be adopted if the plan sponsor wants to increase the limit on annual compensation taken into account under the plan in plan years beginning after December 31, 2001, to $200,000. If the plan bases allocations for plan years beginning after December 31, 2001, on compensation for periods beginning before January 1, 2002, the amendment should be modified to include provisions similar to the prior year limit and adoption agreement provisions of the sample amendment for EGTRRA § 611(c) for defined benefit plans. Also see Notice 2001–56 for guidance regarding the effective date of the change made by EGTRRA § 611(c).)

SECTION ______. INCREASE IN COMPENSATION LIMIT

The annual compensation of each participant taken into account in determining allocations for any plan year beginning after December 31, 2001, shall not exceed $200,000, as adjusted for cost-of-living increases in accordance with section 401(a)(17)(B) of the Code. Annual compensation means compensation during the plan year or such other consecutive 12-month period over which compensation is otherwise determined under the plan (the determination period). The cost-of-living adjustment in effect for a calendar year applies to annual compensation for the determination period that begins with or within such calendar year.

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**Sample Plan Amendment for § 613 of EGTRRA**

(The following sample amendment applies to all plans that are required to include provisions to determine whether the plan is top-heavy and that apply if the plan is top-heavy. The amendment is required. However, the amendment is not required for plans that consist solely of a cash or deferred arrangement which meets the safe harbor requirements of § 401(k)(12) of the Code and matching contributions with respect to which the safe harbor requirements of § 401(m)(11) of the Code are met. For these plans, see the sample plan amendments for EGTRRA § 613 under **Sample Plan Amendments for Section 401(k) Plans.**)

SECTION______. MODIFICATION OF TOP-HEAVY RULES

1. Effective date. This section shall apply for purposes of determining whether the plan is a top-heavy plan under section 416(g) of the Code for plan years beginning after December 31, 2001, and whether the plan satisfies the minimum benefits requirements of section 416(c) of the Code for such years. This section amends section ______ of the plan [enter the section of the plan that includes top-heavy provisions].

2. Determination of top-heavy status.

2.1 Key employee. Key employee means any employee or former employee (including any deceased employee) who at any time during the plan year that includes the determination date was an officer of the employer having annual compensation greater than $130,000 (as adjusted under section 416(i)(1) of the Code for plan years beginning after December 31, 2002), a 5-percent owner of the employer, or a 1-percent owner of the employer having annual compensation of more than $150,000. For this purpose, annual compensation means compensation within the meaning of section 415(c)(3) of the Code. The determination of who is a key employee will be made in accordance with section 416(i)(1) of the Code and the applicable regulations and other guidance of general applicability issued thereunder.

2.2 Determination of present values and amounts. This section 2.2 shall apply for purposes of determining the present values of accrued benefits and the amounts of account balances of employees as of the determination date.

2.2.1 Distributions during year ending on the determination date. The present values of accrued benefits and the amounts of account balances of an employee as of the determination date shall be increased by the distributions made with respect to the employee under the plan and any plan aggregated with the plan under section 416(g)(2) of the Code during the 1-year period ending on the determination date. The preceding sentence shall also apply to distributions under a terminated plan which, had it not been terminated, would have been aggregated with the plan under section 416(g)(2)(A)(i) of the Code. In the case of a distribution made for a reason other than separation from service, death, or disability, this provision shall be applied by substituting "5-year period" for "1-year period."

2.2.2 Employees not performing services during year ending on the determination date. The accrued benefits and accounts of any individual who has not performed services for the employer during the 1-year period ending on the determination date shall not be taken into account.

3. Minimum benefits.

3.1 Matching contributions. Employer matching contributions shall be taken into account for purposes of satisfying the minimum contribution requirements of section 416(c)(2) of the Code and the plan. The preceding sentence shall apply with respect to matching contributions under the plan or, if the plan provides that the minimum contribution requirement shall be met in another plan, such other plan. Employer matching contributions that are used to satisfy the minimum contribution requirements shall be treated as matching contributions for purposes of the actual contribution percentage test and other requirements of section 401(m) of the Code.

3.2 Contributions under other plans. The employer may provide in the adoption agreement that the minimum benefit requirement shall be met in another plan (including another plan that consists solely of a cash or deferred arrangement which meets the requirements of section 401(k)(12) of the Code and matching contributions with respect to which the requirements of section 401(m)(11) of the Code are met).

(Adoption agreement provision)

Minimum Benefits for Employees Also Covered Under Another Plan:

(The employer should describe below the extent, if any, to which the top-heavy minimum benefit requirement of section 416(c) of the Code and section_______ of the plan shall be met in another plan. This should include the name of the other plan, the minimum benefit that will be provided under such other plan, and the employees who will receive the minimum benefit under such other plan.)

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**Sample Plan Amendment for § 633 of EGTRRA**

(Plans that provide for matching contributions, as defined in § 401(m)(4)(A) of the Code, that do not vest at least as rapidly as under one of the two alternative schedules in EGTRRA § 633 must be amended to satisfy EGTRRA § 633 for contributions for plan years beginning after December 31, 2001. The following amendment is effective for plan years beginning after December 31, 2001, but applies to all matching contributions under the plan, including contributions for plan years beginning before January 1, 2002. The amendment may be modified to limit its application to contributions for plan years beginning after December 31, 2001. The amendment may also be modified to provide for any other vesting schedule that is at least as rapid as one of the alternative schedules in EGTRRA § 633.)

SECTION ______. VESTING OF EMPLOYER MATCHING CONTRIBUTIONS

1. Applicability. This section shall apply to participants with accrued benefits derived from employer matching contributions who complete an hour of service under the plan in a plan year beginning after December 31, 2001. If elected by the employer in the adoption agreement, this section shall also apply to all other participants with accrued benefits derived from employer matching contributions.

2. Vesting schedule. A participant's accrued benefit derived from employer matching contributions shall vest as provided by the employer in the adoption agreement. If the vesting schedule for employer matching contributions in Option 3 of the adoption agreement is elected, the election in section _______of the plan [enter the section of the plan that provides for the election of the former vesting schedule under § 411(a)(10) of the Code] shall apply.

(Adoption agreement provisions)

Application of Section ______, Vesting of Employer Matching Contributions:

(Check the following option to apply Section _____, Vesting of Employer Matching Contributions, to all participants with accrued benefits derived from employer matching contributions, rather than just those who complete an hour of service under the plan in a plan year beginning after December 31, 2001.)

______ Section _______, Vesting of Employer Matching Contributions, shall apply to all participants with accrued benefits derived from employer matching contributions.

Vesting Schedule for Employer Matching Contributions:

_____ Option 1. A participant's accrued benefit derived from employer matching contributions shall be fully and immediately vested.

______ Option 2. A participant's accrued benefit derived from employer matching contributions shall be nonforfeitable upon the participant's completion of three years of vesting service.

_____ Option 3. A participant's accrued benefit derived from employer matching contributions shall vest according to the following schedule:

| **Years of vesting service** | **Nonforfeitable percentage** |
|---|---|
| 2 | 20 |
| 3 | 40 |
| 4 | 60 |
| 5 | 80 |
| 6 | 100 |

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**Sample Plan Amendment for §§ 636(b), 641, 642, and 643 of EGTRRA**

(The following sample amendment is required. However, the third paragraph should be deleted in the case of plans that do not provide for hardship distributions. The fourth paragraph should be deleted in the case of plans that do not have after-tax employee contributions.)

SECTION ________. DIRECT ROLLOVERS OF PLAN DISTRIBUTIONS

1. Effective date. This section shall apply to distributions made after December 31, 2001.

2. Modification of definition of eligible retirement plan. For purposes of the direct rollover provisions in section ____ of the plan, an eligible retirement plan shall also mean an annuity contract described in section 403(b) of the Code and an eligible plan under section 457(b) of the Code which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state and which agrees to separately account for amounts transferred into such plan from this plan. The definition of eligible retirement plan shall also apply in the case of a distribution to a

surviving spouse, or to a spouse or former spouse who is the alternate payee under a qualified domestic relation order, as defined in section 414(p) of the Code.

3. Modification of definition of eligible rollover distribution to exclude hardship distributions. For purposes of the direct rollover provisions in section _______ of the plan, any amount that is distributed on account of hardship shall not be an eligible rollover distribution and the distributee may not elect to have any portion of such a distribution paid directly to an eligible retirement plan.

4. Modification of definition of eligible rollover distribution to include after-tax employee contributions. For purposes of the direct rollover provisions in section ________ of the plan, a portion of a distribution shall not fail to be an eligible rollover distribution merely because the portion consists of after-tax employee contributions which are not includible in gross income. However, such portion may be transferred only to an individual retirement account or annuity described in section 408(a) or (b) of the Code, or to a qualified defined contribution plan described in section 401(a) or 403(a) of the Code that agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible.

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**Sample Plan Amendment to Specify Additional Types of Rollovers Accepted by the Plan Pursuant to EGTRRA §§ 641, 642, and 643**

(A plan is not required to accept rollover contributions, including direct rollovers under § 401(a)(31) of the Code. The following optional sample amendment may be used to specify additional types of rollovers the plan will accept pursuant to EGTRRA §§ 641, 642, and 643. A plan that accepts rollovers may be required to separately account for such amounts.)

SECTION _____. ROLLOVERS FROM OTHER PLANS

If provided by the employer in the adoption agreement, the plan will accept participant rollover contributions and/or direct rollovers of distributions made after December 31, 2001, from the types of plans specified in the adoption agreement, beginning on the effective date specified in the adoption agreement.

(Adoption agreement provisions)

Direct Rollovers:

The plan will accept a direct rollover of an eligible rollover distribution from: (Check each that applies or none.)

____ a qualified plan described in section 401(a) or 403(a) of the Code, excluding after-tax employee contributions.

____ a qualified plan described in section 401(a) or 403(a) of the Code, including after-tax employee contributions.

____ an annuity contract described in section 403(b) of the Code, excluding after-tax employee contributions.

____ an eligible plan under section 457(b) of the Code which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state.

Participant Rollover Contributions from Other Plans:

The plan will accept a participant contribution of an eligible rollover distribution from: (Check each that applies or none.)

____ a qualified plan described in section 401(a) or 403(a) of the Code.

____ an annuity contract described in section 403(b) of the Code.

____ an eligible plan under section 457(b) of the Code which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state.

Participant Rollover Contributions from IRAs:

The plan: (Choose one.)

____ will

____ will not

accept a participant rollover contribution of the portion of a distribution from an individual retirement account or annuity described in section 408(a) or 408(b) of the Code that is eligible to be rolled over and would otherwise be includible in gross income.

Effective Date of Direct Rollover and Participant Rollover Contribution Provisions:

Section _______, Rollovers From Other Plans, shall be effective:

________________ (Enter a date no earlier than January 1, 2002.)

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**Sample Plan Amendment for § 648 of EGTRRA**

(The following optional sample amendment may be adopted by plans that provide for involuntary cash-outs, other than plans that are subject to the qualified joint and survivor annuity requirements of §§ 401(a)(11) and 417 of the Code. Note that this amendment will result in the involuntary distribution of a separated participant's account over $5,000 if the portion of the account that is not attributable to rollover contributions is $5,000 or less.)

SECTION _____. ROLLOVERS DISREGARDED IN INVOLUNTARY CASH-OUTS

1. Applicability and effective date. This section shall apply if elected by the employer in the adoption agreement and shall be effective as specified in the adoption agreement.

2. Rollovers disregarded in determining value of account balance for involuntary distributions. If elected by the employer in the adoption agreement, for purposes of section _______ of the plan [enter the section of the plan that provides for the involuntary distribution of vested accrued benefits of $5,000 or less], the value of a participant's nonforfeitable account balance shall be determined without regard to that portion of the account balance that is attributable to rollover contributions (and earnings allocable thereto) within the meaning of sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3)(A)(ii), and 457(e)(16) of the Code. If the value of the participant's nonforfeitable account balance as so determined is $5,000 or less, the plan shall immediately distribute the participant's entire nonforfeitable account balance.

(Adoption agreement provisions)

Treatment of Rollovers in Application of Involuntary Cash-out Provisions:

The employer: (choose one)

____ elects

____ does not elect

to exclude rollover contributions in determining the value of the participant's nonforfeitable account balance for purposes of the plan's involuntary cash-out rules.

If the employer has elected to exclude rollover contributions, the election shall apply with respect to distributions made after:

______________ (Enter a date no earlier than December 31, 2001.)

with respect to participants who separated from service after:

_______________ (Enter date. The date may be earlier than December 31, 2001.)

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**Sample Plan Amendment for § 666 of EGTRRA**

(The following sample amendment is required for plans subject to the multiple use test described in Treas. Reg. § 1.401 (m)–2.)

SECTION _______. REPEAL OF MULTIPLE USE TEST

The multiple use test described in Treasury Regulation section 1.401(m)–2 and section __________ of the plan shall not apply for plan years beginning after December 31, 2001.

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**SAMPLE PLAN AMENDMENTS FOR SECTION 401(k) PLANS**

**Sample Plan Amendment for § 611(d) of EGTRRA**

(Unless the plan correctly incorporates the limitation of § 402(g) of the Code by reference, the plan cannot permit the higher amount of elective deferrals under EGTRRA unless it adopts the following or similar amendment.)

SECTION ______. ELECTIVE DEFERRALS — CONTRIBUTION LIMITATION

No participant shall be permitted to have elective deferrals made under this plan, or any other qualified plan maintained by the employer during any taxable year, in excess of the dollar limitation contained in section 402(g) of the Code in effect for such taxable year, except to the extent permitted under section _________ of this amendment [enter the section of the amendment that provides for catch-up contributions under EGTRRA § 631] and section 414(v) of the Code, if applicable.

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**Sample Plan Amendment for § 611(f) of EGTRRA**

(The following sample amendment is only for SIMPLE 401(k) plans. This amendment is not necessary if the plan correctly incorporates the limitation in § 408(p)(2)(A)(ii) of the Code.)

SECTION _______. MAXIMUM SALARY REDUCTION CONTRIBUTIONS

Except to the extent permitted under section ______ of this amendment [enter the section of the amendment that provides for catch-up contributions under EGTRRA § 631] and section 414(v) of the Code, if applicable, the maximum salary reduction contribution that can be made to this plan is the amount determined under section 408(p)(2)(A)(ii) of the Code for the calendar year.

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**Sample Plan Amendment for § 613 of EGTRRA**

(The following sample amendment is only for plans that consist solely of a cash or deferred arrangement which meets the requirements of § 401(k)(12) of the Code and matching contributions with respect to which the requirements of § 401(m) (11) of the Code are met.)

SECTION ______. MODIFICATION OF TOP-HEAVY RULES

The top-heavy requirements of section 416 of the Code and section ______ of the plan shall not apply in any year beginning after December 31, 2001, in which the plan consists solely of a cash or deferred arrangement which meets the requirements of section 401(k)(12) of the Code and matching contributions with respect to which the requirements of section 401(m)(11) of the Code are met.

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**Sample Plan Amendment for § 631 of EGTRRA**

(The following amendment is optional.)

SECTION ______. CATCH-UP CONTRIBUTIONS

If elected by the employer in the adoption agreement, all employees who are eligible to make elective deferrals under this plan and who have attained age 50 before the close of the plan year shall be eligible to make catch-up contributions in accordance with, and subject to the limitations of, section 414(v) of the Code. Such catch-up contributions shall not be taken into account for purposes of the provisions of the plan implementing the required limitations of sections 402(g) and 415 of the Code. The plan shall not be treated as failing to satisfy the provisions of the plan implementing the requirements of section 401(k)(3), 401(k)(11), 401(k)(12), 410(b), or 416 of the Code, as applicable, by reason of the making of such catch-up contributions.

(Adoption agreement provision)

Section _______, Catch-up Contributions: (Choose one.)

_______ shall apply to contributions after _______ . (Enter December 31, 2001, or a later date).

_______ shall not apply.

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**Sample Plan Amendment for § 636(a) of EGTRRA**

(The following sample amendment is optional for section 401(k) plans (other than plans described in § 401(k)(12) or 401(m)(11) of the Code) that use the safe harbor (deemed) standards for hardship distributions of elective contributions set forth in Treas. Reg. § 1.401(k)–1(d) (2)(iv). The amendment is required for a plan described in § 401(k)(12) or 401(m)(11) of the Code. Also see Notice 2001–56 for guidance regarding the effective date of the change made by EGTRRA § 636(a).)

SECTION _____. SUSPENSION PERIOD FOLLOWING HARDSHIP DISTRIBUTION

A participant who receives a distribution of elective deferrals after December 31, 2001, on account of hardship shall be prohibited from making elective deferrals and employee contributions under this and all other plans of the employer for 6 months after receipt of the distribution. A participant who receives a distribution of elective deferrals in calendar year 2001 on account of hardship shall be prohibited from making elective deferrals and employee contributions under this and all other plans of the employer for the period specified by the employer in the adoption agreement.

(Adoption agreement provision)

Suspension Period for Hardship Distributions: (Choose one.)

_____ A participant who receives a distribution of elective deferrals in calendar year 2001 on account of hardship shall be prohibited from making elective deferrals and employee contributions under this and all other plans of the employer for 6 months after receipt of the distribution or until January 1, 2002, if later.

_____ A participant who receives a distribution of elective deferrals in calendar year 2001 on account of hardship shall be prohibited from making elective deferrals and employee contributions under this and all other plans of the employer for the period specified in the provisions of the plan relating to suspension of elective deferrals that were in effect prior to this amendment.

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**Sample Plan Amendment for § 646 of EGTRRA**

(The following amendment is optional.)

SECTION _____. DISTRIBUTION UPON SEVERANCE FROM EMPLOYMENT

1. Effective date. If elected by the employer in the adoption agreement, this section shall apply for distributions and severances from employment occurring after the dates specified in the adoption agreement.

2. New distributable event. A participant's elective deferrals, qualified nonelective contributions, qualified matching contributions, and earnings attributable to these contributions shall be distributed on account of the participant's severance from employment. However, such a distribution shall be subject to the other provisions of the plan regarding distributions, other than provisions that require a separation from service before such amounts may be distributed.

(Adoption agreement provision)

Section _______, Distribution Upon Severance from Employment, shall apply for distributions after:

_______ (Enter a date no earlier than December 31, 2001.),

(Choose one.)

_________ regardless of when the severance from employment occurred.

_________ for severances from employment occurring after__________. (Enter date.)

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**SAMPLE PLAN AMENDMENTS FOR DEFINED BENEFIT PLANS**

**Sample Plan Amendment for § 611(a) of EGTRRA for Non-Multiemployer Plans**

(The following sample amendment is optional for non-multiemployer plans that do not incorporate the § 415(b) limits by reference.

The last two sentences of section 3.2(b) of the amendment and the last sentence of section 3.2(c) may be modified to conform to Notice 87–21 (1987–1 C.B. 458) and Notice 83–10 (1983–1 C.B. 536). These notices provide alternatives with regard to the application of the mortality decrement in making the adjustments under section 3.2(b) and (c) of the amendment.

In addition to the following amendment, non-multiemployer plans should be amended as necessary to reflect EGTRRA § 654(b). Section 654(b) of EGTRRA changed the § 415 aggregation rules to provide that, for limitation years beginning after December 31, 2001, a multiemployer plan is not combined or aggregated with a non-multiemployer plan for purposes of applying the § 415(b)(1)(B) compensation limit to the non-multiemployer plan.

If a plan's normal retirement age (NRA) is below 65, the plan's provisions regarding post-NRA accruals and actuarial increases for deferred benefits must be coordinated with the following amendment to ensure that the plan does not violate § 401(a) of the Code. In order to avoid such a violation, a plan may have to pay benefits at NRA, notwithstanding a participant's continued employment, or provide for the suspension of benefits in accordance with § 411(a)(3)(B) of the Code.)

SECTION ______. LIMITATIONS ON BENEFITS

1. Effective date. This section shall be effective for limitation years ending after December 31, 2001.

2. Effect on participants. Benefit increases resulting from the increase in the limitations of section 415(b) of the Code will be provided to those participants specified by the employer in the adoption agreement.

3. Definitions.

3.1 Defined benefit dollar limitation. The "defined benefit dollar limitation" is $160,000, as adjusted, effective January 1 of each year, under section 415(d) of the Code in such manner as the Secretary shall prescribe, and payable in the form of a straight life annuity. A limitation as adjusted under section 415(d) will apply to limitation years ending with or within the calendar year for which the adjustment applies.

3.2 Maximum permissible benefit: The "maximum permissible benefit" is the lesser of the defined benefit dollar limitation or the defined benefit compensation limitation (both adjusted where required, as provided in (a) and, if applicable, in (b) or (c) below).

(a) If the participant has fewer than 10 years of participation in the plan, the defined benefit dollar limitation shall be multiplied by a fraction, (i) the numerator of which is the number of years (or part thereof) of participation in the plan and (ii) the denominator of which is 10. In the case of a participant who has fewer than 10 years of service with the employer, the defined benefit compensation limitation shall be multiplied by a fraction, (i) the numerator of which is the number of years (or part thereof) of service with the employer and (ii) the denominator of which is 10.

(b) If the benefit of a participant begins prior to age 62, the defined benefit dollar limitation applicable to the participant at such earlier age is an annual benefit payable in the form of a straight life annuity beginning at the earlier age that is the actuarial equivalent of the defined benefit dollar limitation applicable to the participant at age 62 (adjusted under (a) above, if required). The defined benefit dollar limitation applicable at an age prior to age 62 is determined as the lesser of (i) the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using the interest rate and mortality table (or other tabular factor) specified in section___________of the plan and (ii) the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using a 5-percent interest rate and the applicable mortality table as defined in section _______of the plan. Any decrease in the defined benefit dollar limitation determined in accordance with this paragraph (b) shall not reflect a mortality decrement if benefits are not forfeited upon the death of the participant. If any benefits are forfeited upon death, the full mortality decrement is taken into account.

(c) If the benefit of a participant begins after the participant attains age 65, the defined benefit dollar limitation applicable to the participant at the later age is the annual benefit payable in the form of a straight life annuity beginning at the later age that is actuarially equivalent to the defined benefit dollar limitation applicable to the participant at age 65 (adjusted under (a) above, if required). The actuarial equivalent of the defined benefit dollar limitation applicable at an age after age 65 is determined as (i) the lesser of the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using the interest rate and mortality table (or other tabular factor) specified in section ________ of the plan and (ii) the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using a 5-percent interest rate assumption and the applicable mortality table as defined in section _________ of the plan. For these purposes, mortality between age 65 and the age at which benefits commence shall be ignored.

(Adoption agreement provision)

Benefit Increases Resulting from the Increase in the Limitations of Section 415(b) of the Code

Benefit increases resulting from the increase in the limitations of section 415(b) of the Code shall be provided to: (Choose one.)

______ all current and former participants (with benefits limited by section 415(b)) who have an accrued benefit under the plan immediately prior to the effective date of this section (other than an accrued benefit resulting from a benefit increase solely as a result of the increases in limitations under section 415(b)).

______ all employees participating in the plan who have one hour of service on or after the first day of the first limitation year ending after December 31, 2001.

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**Sample Plan Amendment for §§ 611(a) and 654 of EGTRRA for Multiemployer Plans**

(The following sample amendment is optional for multiemployer plans that do not incorporate the § 415(b) limits by reference.

The last two sentences of section 3.2(b) of the amendment and the last sentence of section 3.2(c) may be modified to conform to Notice 87–21 (1987–1 C.B. 458) and Notice 83–10 (1983–1 C.B. 536). These notices provide alternatives with regard to the application of the mortality decrement in making the adjustments under section 3.2(b) and (c) of the amendment.

Section 3.2(d) of the amendment should be deleted if the plan's limitation year is the calendar year.

Section 654(b) of EGTRRA changed the § 415 aggregation rules to provide that, for limitation years beginning after December 31, 2001, a multiemployer plan is not combined or aggregated with a non-multiemployer plan for purposes of applying the § 415(b)(1)(B) compensation limit to the non-multiemployer plan. This change is not reflected in this amendment for multiemployer plans. Plan sponsors should review their plans to determine if a plan amendment for EGTRRA § 654(b) should be adopted.

If a plan's normal retirement age (NRA) is below 65, the plan's provisions regarding post-NRA accruals and actuarial increases for deferred benefits must be coordinated with the following amendment to ensure that the plan does not violate § 401(a) of the Code. In order to avoid such a violation, a plan may have to pay benefits at NRA, notwithstanding a participant's continued employment, or provide for the suspension of benefits in accordance with § 411(a)(3)(B) of the Code.)

SECTION ______. LIMITATIONS ON BENEFITS

1. Effective date. This section shall be effective for limitation years ending after December 31, 2001, except as provided in section 3.2(d).

2. Effect on participants. Benefit increases resulting from the increase in the limitations of section 415(b) of the Code will be provided to [enter one of the following 2 options: all current and former participants (with benefits limited by section 415(b)) who have an accrued benefit under the plan immediately prior to the effective date (other than an accrued benefit resulting from a benefit increase solely as a result of the increases in limitations under section 415(b)); all employees participating in the plan who have one hour of service on or after the first day of the first limitation year ending after December 31, 2001].

3. Definitions.

3.1 Defined benefit dollar limitation. The "defined benefit dollar limitation" is $160,000, as adjusted, effective January 1 of each year, under section 415(d) of the Code in such manner as the Secretary shall prescribe, and payable in the form of a straight life annuity. A limitation as adjusted under section 415(d) will apply to limitation years ending with or within the calendar year for which the adjustment applies.

3.2 Maximum permissible benefit: The "maximum permissible benefit" is the defined benefit dollar limitation (adjusted where required, as provided in (a) and, if applicable, in (b) or (c) below, and limited, if applicable, as provided in (d) below).

(a) If the participant has fewer than 10 years of participation in the plan, the defined benefit dollar limitation shall be multiplied by a fraction, (i) the numerator of which is the number of years (or part thereof) of participation in the plan and (ii) the denominator of which is 10.

(b) If the benefit of a participant begins prior to age 62, the defined benefit dollar limitation applicable to the participant at such earlier age is an annual benefit payable in the form of a straight life annuity beginning at the earlier age that is the actuarial equivalent of the defined benefit dollar limitation applicable to the participant at age 62 (adjusted under (a) above, if required). The defined benefit dollar limitation applicable at an age prior to age 62 is determined as the lesser of (i) the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using the interest rate and mortality table (or other tabular factor) specified in section _________of the plan and (ii) the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using a 5-percent interest rate and the applicable mortality table as defined in section _______of the plan. Any decrease in the defined benefit dollar limitation determined in accordance with this paragraph (b) shall not reflect a mortality decrement if benefits are not forfeited upon the death of the participant. If any benefits are forfeited upon death, the full mortality decrement is taken into account.

(c) If the benefit of a participant begins after the participant attains age 65, the defined benefit dollar limitation applicable to the participant at the later age is the annual benefit payable in the form of a straight life annuity beginning at the later age that is actuarially equivalent to the defined benefit dollar limitation applicable to the participant at age 65 (adjusted under (a) above, if required). The actuarial equivalent of the defined benefit dollar limitation applicable at an age after age 65 is determined as (i) the lesser of the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using the interest rate and mortality table (or other tabular factor) specified in section _______of the plan and (ii) the actuarial equivalent (at such age) of the defined benefit dollar limitation computed using a 5-percent interest rate assumption and the applicable mortality table as defined in section ________ of the plan. For these purposes, mortality between age 65 and the age at which benefits commence shall be ignored.

(d) Notwithstanding the above, for limitation years beginning before January 1, 2002, the maximum permissible benefit will not exceed the defined benefit compensation limitation. In the case of a participant who has fewer than 10 years of service with the employer, the defined benefit compensation limitation shall be multiplied by a fraction, (i) the numerator of which is the number of years (or part thereof) of service with the employer and (ii) the denominator of which is 10.

---

**Sample Plan Amendment for § 611(c) of EGTRRA**

(The following sample amendment is optional. It should be adopted if the plan sponsor wants to increase the limit on annual compensation taken into account under the plan in plan years beginning after December 31, 2001, to $200,000.

The last sentence of the first paragraph of the amendment and the related adoption agreement provision are applicable to plans that base benefit accruals in plan years beginning after December 31, 2001, on compensation for periods beginning before January 1, 2002. Also see Notice 2001–56 for guidance regarding the effective date of the change made by EGTRRA § 611(c).)

SECTION _____. INCREASE IN COMPENSATION LIMIT

1. Increase in limit. The annual compensation of each participant taken into account in determining benefit accruals in any plan year beginning after December 31, 2001, shall not exceed $200,000. Annual compensation means compensation during the plan year or such other consecutive 12-month period over which compensation is otherwise determined under the plan (the determination period). For purposes of determining benefit accruals in a plan year beginning after December 31, 2001, compensation for any prior determination period shall be limited as provided by the employer in the adoption agreement.

2. Cost-of-living adjustment. The $200,000 limit on annual compensation in paragraph 1 shall be adjusted for cost-of-living increases in accordance with section 401(a)(17)(B) of the Code. The cost-of-living adjustment in effect for a calendar year applies to annual compensation for the determination period that begins with or within such calendar year.

(Adoption agreement provision)

Compensation Limit for Prior Determination Periods:

In determining benefit accruals in plan years beginning after December 31, 2001, the annual compensation limit in paragraph 1 of Section _______, Increase in Compensation Limit, for determination periods beginning before January 1, 2002, shall be: (Choose one.)

_______ $200,000.

______ $150,000 for any determination period beginning in 1996 or earlier; $160,000 for any determination period beginning in 1997, 1998, or 1999; and $170,000 for any determination period beginning in 2000 or 2001.

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**Sample Plan Amendment for § 613 of EGTRRA**

(The following sample amendment applies to all plans that are required to include provisions to determine whether the plan is top-heavy and that apply if the plan is top-heavy. The amendment is required.

The amendment may be modified in accordance with § 416(f) of the Code and the regulations thereunder to provide that the minimum benefit requirement shall be satisfied by benefits or contributions, including employer matching contributions, under another plan, including another plan that consists solely of a cash or deferred arrangement which meets the requirements of § 401(k)(12) of the Code and matching contributions with respect to which the requirements of § 401(m)(11) of the Code are met. See section 3 and the adoption agreement provision for the sample plan amendment for EGTRRA § 613 for defined contribution plans.)

SECTION ______. MODIFICATION OF TOP-HEAVY RULES

1. Effective date. This section shall apply for purposes of determining whether the plan is a top-heavy plan under section 416(g) of the Code for plan years beginning after December 31, 2001, and whether the plan satisfies the minimum benefits requirements of section 416(c) of the Code for such years. This section amends section _________ of the plan [enter the section of the plan that includes top-heavy provisions].

2. Determination of top-heavy status.

2.1 Key employee. Key employee means any employee or former employee (including any deceased employee) who at any time during the plan year that includes the determination date was an officer of the employer having annual compensation greater than $130,000 (as adjusted under section 416(i)(1) of the Code for plan years beginning after December 31, 2002), a 5-percent owner of the employer, or a 1-percent owner of the employer having annual compensation of more than $150,000. For this purpose, annual compensation means compensation within the meaning of section 415(c)(3) of the Code. The determination of who is a key employee will be made in accordance with section 416(i)(1) of the Code and the applicable regulations and other guidance of general applicability issued thereunder.

2.2 Determination of present values and amounts. This section 2.2 shall apply for purposes of determining the present values of accrued benefits and the amounts of account balances of employees as of the determination date.

2.2.1 Distributions during year ending on the determination date. The present values of accrued benefits and the amounts of account balances of an employee as of the determination date shall be increased by the distributions made with respect to the employee under the plan and any plan aggregated with the plan under section 416(g)(2) of the Code during the 1-year period ending on the determination date. The preceding sentence shall also apply to distributions under a terminated plan which, had it not been terminated, would have been aggregated with the plan under section 416(g)(2)(A)(i) of the Code. In the case of a distribution made for a reason other than separation from service, death, or disability, this provision shall be applied by substituting "5-year period" for "1-year period."

2.2.2 Employees not performing services during year ending on the determination date. The accrued benefits and accounts of any individual who has not performed services for the employer during the 1-year period ending on the determination date shall not be taken into account.

3. Minimum benefits. For purposes of satisfying the minimum benefit requirements of section 416(c)(1) of the Code and the plan, in determining years of service with the employer, any service with the employer shall be disregarded to the extent that such service occurs during a plan year when the plan benefits (within the meaning of section 410(b) of the Code) no key employee or former key employee.

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**Sample Plan Amendment for §§ 641, 642, and 643 of EGTRRA**

(The following sample amendment is required. However, the third paragraph should be deleted in the case of plans that do not have after-tax employee contributions.)

SECTION ______. DIRECT ROLLOVERS OF PLAN DISTRIBUTIONS

1. Effective date. This section shall apply to distributions made after December 31, 2001.

2. Modification of definition of eligible retirement plan. For purposes of the direct rollover provisions in section _________of the plan, an eligible retirement plan shall also mean an annuity contract described in section 403(b) of the Code and an eligible plan under section 457(b) of the Code which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state and which agrees to separately account for amounts transferred into such plan from this plan. The definition of eligible retirement plan shall also apply in the case of a distribution to a surviving spouse, or to a spouse or former spouse who is the alternate payee under a qualified domestic relation order, as defined in section 414(p) of the Code.

3. Modification of definition of eligible rollover distribution to include after-tax employee contributions. For purposes of the direct rollover provisions in section _________ of the plan, a portion of a distribution shall not fail to be an eligible rollover distribution merely because the portion consists of after-tax employee contributions which are not includible in gross income. However, such portion may be paid only to an individual retirement account or annuity described in section 408(a) or (b) of the Code, or to a qualified defined contribution plan described in section 401(a) or 403(a) of the Code that agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible.

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**Sample Plan Amendment to Specify Additional Types of Rollovers Accepted by the Plan Pursuant to EGTRRA §§ 641, 642, and 643**

(A plan is not required to accept rollover contributions, including direct rollovers under § 401(a)(31) of the Code. The following optional sample amendment may be used to specify additional types of rollovers the plan will accept pursuant to EGTRRA §§ 641, 642, and 643. A defined benefit plan that accepts rollovers must separately account for such amounts.)

SECTION ______. ROLLOVERS FROM OTHER PLANS

If provided by the employer in the adoption agreement, the plan will accept participant rollover contributions and/or direct rollovers of distributions made after December 31, 2001, from the types of plans specified in the adoption agreement, beginning on the effective date specified in the adoption agreement.

(Adoption agreement provisions)

Direct Rollovers:

The plan will accept a direct rollover of an eligible rollover distribution from: (Check each that applies or none.)

_____ a qualified plan described in section 401(a) or 403(a) of the Code.

____ an annuity contract described in section 403(b) of the Code.

____ an eligible plan under section 457(b) of the Code which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state.

Participant Rollover Contributions from Other Plans:

The plan will accept a participant contribution of an eligible rollover distribution from: (Check each that applies or none.)

____ a qualified plan described in section 401(a) or 403(a) of the Code.

____ an annuity contract described in section 403(b) of the Code.

____ an eligible plan under section 457(b) of the Code which is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or political subdivision of a state.

Participant Rollover Contributions from IRAs:

The plan: (Choose one.)

____ will

____ will not

accept a participant rollover contribution of the portion of a distribution from an individual retirement account or annuity described in section 408(a) or 408(b) of the Code that is eligible to be rolled over and would otherwise be includible in gross income.

Effective Date of Direct Rollover and Participant Rollover Contribution Provisions:

Section ________, Rollovers From Other Plans, shall be effective:

_______________ (Enter a date no earlier than January 1, 2002.)

# Part IV. Items of General Interest

## Foundations Status of Certain Organizations

## Announcement 2001–89

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

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

Academie-Therapeutic Equestrian Park, Gladwin, MI
Affection Connection Rescue League, Macomb, MI
Affordable Housing Ventures, Inc., Dade City, FL
Affordable Neighborhood Economic Development, Inc., Jacksonville, FL
Aids Memorial Monument Foundation, Inc., Orlando, FL
Airseds Institute, Inc., Holland, MI
All Kentucky Ag Expo, Inc., Lexington, KY
American Cross Foundation, Amarillo, TX
American Foundation for Education in Health Care, Inc., Tampa, FL
Angels Group, Inc., Leesburg, FL
Angelvision, Inc., Parsippany, NJ
Association of Ethiopian Community in Colorado, Inc., Aurora, CO
Athletic Booster Club, Inc., New Smyrna Beach, FL
Atlantic Non-Profit Housing Corp., Los Angeles, CA
Autism Community of the Upper Midwest, Fargo, ND
B.V. Assisted Living, Inc., Melbourne, FL
Bay Area Cheerleader Association, Inc., Tampa, FL
Bird Lovers of the Bluegrass, Inc., Lexington, KY
Black-Footed Ferret Recovery Foundation, Wheatland, WY
Black Wolf Farm, Inc., Lipan, TX
Blessed Sacrament Athletic Boosters Association, Inc., Fort Mitchell, KY
BRE CD, Inc., Chicago, IL
Candyland Kinder Kollege Enterprise, Marrero, LA
Cave Services, Inc., St. Petersburg, FL
Cedar Springs Volunteer Fire Department, Inc., Scottsville, KY
Central Florida Center for Grieving Children, Inc., Maitland, FL
Chase Place Housing, Inc., Dunn, NC
Cherith House Ministries, Inc., Blackey, KY
Childrens Hope International, Inc., Plant City, FL
Christ Healing & Restoration Ministries, Inc., Walton, KY
Christ the Redeemer Foundation, Inc., Louisville, KY
Circle Non-Profit Housing Corporation, Elizabethtown, KY
Citizens Against Domestic Violence, Inc., New York, NY
CJS Angels, Inc., Maitland, FL
Cloverport Community Volunteer Fire Department, Incorporated, Cloverport, KY
Colins Park, Inc., Ormond Beach, FL
Community Fund for America, Colchester, VT
Comprehensive Healthcare Services, Inc., Auburn, AL
Concern Citizens of Tripoli, Inc., Loughman, FL
Cornelia Lluberes Family Fund, Inc., New York, NY
Cristoasis, Elgin, IL
Daughters of Jerusalem, Inc., Louisville, KY
Deaf Heritage Library and Cultural Center, Lehi, UT
Deb Richard Foundation, Inc., Ponte Vedra Beach, FL
Dogwood Invitational, Inc., Jacksonville, FL
Dorton Volunteer Fire Department, Dorton, KY
East Bay Rockies Fast Pitch Girls Softball, Inc., Wilmauma, FL
East Little Rock Community Development Corporation, East Little Rock, AR
Eastern KY Needy Childrens Foundation, Pikeville, KY
Emerald Coast Foundation, Fort Walton Beach, FL
Equal Start Child Development Center, Inc., Jacksonville, FL
Eye Research Foundation, Albany, NY
Faith in Action in Northwest Florida, Inc., Pensacola, FL
Family Services Home Makers, Inc., Philadelphia, PA
Far Corners Medical Missions, Inc., Cerritos, CA
Fishing for Success, Inc., Gainesville, FL
Fleming County Hospital Foundation, Inc., Flemingsburg, KY
Florida Association of Healthy Starts Coalition, Inc., Clearwater, FL
Florida Horse Trainers Association, Brooksville, FL
Florida Indian Alliance, Inc., Petersburg, FL
Florida Performing Arts, Inc., Ormond Beach, FL
Forsyth Foundation, Inc., Golden Valley, MN
Friends of the Lynn Haven Library, Inc., Lynn Haven, FL
Friends of Wakulla Springs State Park, Inc., Wakulla Springs, FL
Good Shepherd Christian Charities, Mitchell, IL
Grace Citadel of Social and Job Training Programs, Inc., Newark, NJ
Green Networking for Orange County, Gibsonia, PA
Half Moon Bay Coastside Sister City Committee, Half Moon Bay, CA
Havanna Non-Profit Housing Corporation, Tampa, FL
Health Alliance Foundation, Inc., Louisville, KY
Helping Hand Financial Services, Inc., Dade City, FL
Henry Clay Football Boosters, Inc., Lexington, KY
HPC Foundation For Hospice Care, Port Smith, AR
Independence Civic Association, Independence, KY
Institute For Health and Human Performance, Inc., Orlando, FL
International Leadership Foundation, Inc., Altamonte Springs, FL

International Peace Contest, Beachwood, OH
Isef Kentucky, Inc., Louisville, KY
Jacksonville Community Access Network, Inc., Jacksonville, FL
Kanapaha Park Development Committee, Incorporated, Gainsville, FL
Keenes Creek Youth Organization, Duluth, MN
Kids Safe Education Foundation, Encino, CA
Kinsman Transportation, Inc., Orlando, FL
Korean Association of North Florida, Inc., Jacksonville, FL
Lansing Housing Commission City-Wide Resident Council, Lansing, MI
Lee Middle School Foundation, Inc., Orlando, FL
LUCI Let us Conserve, Del Rio, TX
Managed Care Institute, Harleysville, PA
Management Technologies International, Inc., Poulsbo, WA
Mangrove Action Group, Naples, FL
Marion Non-Profit Housing Corporation, Tampa, FL
Maryland Space Research Institute, Ltd., Columbia, MD
Mason County Historical Society, Inc., Maysville, KY
Medical Mission-Ecuador, Inc., Nicholasville, KY
Mercy Ministries, Inc., San Jose, CA
Michaele Vollbracht Humanitarian Foundation, Inc., Safety Harbor, FL
National Alliance for Quality Health Care, Inc., Clearwater, FL
National Animal Health Alliance, Inc., Trilby, FL
National Forensic Science Technology Center, Inc., Largo, FL
Network of Humane Organization of Florida, Inc., Beverly Hills, FL
Neustart Social Services, Inc., Eagan, MN
New Beginnings of South West Florida, Inc., Sarasota, FL
New Heart, Ashland, KY
New Life Hope Foundation, Inc. Orlando, FL
North American Indian Center of Western Florida, Inc., Homosassa Springs, FL
Northside Improvements Corporation, Lexington, KY
Oasis Ministries International, Inc., of Tampa Florida, Ormond Beach, FL
Ohio Black Expo Boxing Association, Inc., Cleveland, OH
Ohio County Kinship, Inc., Hartford, KY
Old James County Chapter of East Tennessee Historical Society, Ooltewah, TN
Open Door Community Services, Inc., Titusville, FL
Operation Win, Inc., Houston, TX
Orlando Singers, Inc., Altamonte Springs, FL
Pals Society, Inc., Milton, FL
Parent Education Project, Sanford, FL
Pet-A-Pup Therapy Dogs, Inc., Cape Coral, FL
Philadelphia Support Resources Corp., Jamison, PA
Plantation Retreat and Conference Center, Inc., Tallahassee, FL
Pleasant Hills Dolphins Swim Team, Pleasant Hill, MO
Proud to be Good Charitable Foundation, St. Augustine, FL
Punjabi Sangh of Florida, Inc., Altamonte Springs, FL
Reach Out International, Inc., Clendenin, WV
Reaching Out Against Guns Endangering Our Youth, Inc., Jacksonville, FL
Reaching Out For Christian Kids, Scottsville, KY
Reality Check, Inc., Leesburg, FL
Renewed Hope, Inc., Bartlesville, OK
Rex Logan Dean Hoskins Memorial Fund, Inc., Manchester, KY
Rising Suns Home, Inc., Greensboro, NC
Rybnikov Foundation, Inc., Osprey, FL
Safehouse Ministries, Inc., St. Louis, MO
Santa Fe High School Band Booster Association, Inc., Santa Fe, NM
Search & Rescue Dogs of Broken Arrow Oklahoma, Inc., Broken Arrow, OK
Seven Hills Charitable Fund, Inc., Spring Hill, FL
Shaktikrupa Charitable Foundation, Inc., Tampa, FL
Shelter to Endemic Wildlife Appreciation Recovery Discovery, Orlando, FL
Shiloh Foundation, Rockville Center, NY
South Louisville Football Association, Louisville, KY
Space Coast Water Ski Club, Inc., Melbourne, FL
Sparta Volunteer Fire Department, Sparta, KY
Speaking Life Ministries, Inc., Wilmington, DE
St. John Lutheran School Foundation, Inc., Ocala, FL
Sunset Terrace Resident Organization, Little Rock, AR
Tampa Jazz Club, Inc., Tampa, FL
Theatre of the Mind, Inc., Glendale, CA
Thistleberry Ministries, Belfair, WA
Time Has Come Ministry, Inc., Miami, FL
Turning Point of Brevard, Inc., Merritt Island, FL
Twin City Performing Arts, Inc., Monroe, LA
Velvet Bird Cage, Chicago, IL
Victim Trauma Care, Inc., Tallahassee, FL
Volunteer Firefighter Charitable Trust, Panama City, FL
WCC II, Inc., Uncasville, CT
West Central Florida Urban League Sponsoring Committee, Inc., Ocala, FL
West Fresno School District Foundation No. 1819326, Fresno, CA
What’s Up Club, Houston, TX
Wheelchair Sports USA, Inc., of Florida, St. Petersburg, FL
Wildlife Sanctuary Fund, Inc., Ormond Beach, FL
Wiseburn Education Foundation, Hawthorne, CA
Youth in Action, Covington, KY

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

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

## Section 6621.— Determination of Interest Rate

*26 CFR 301.6621–1: Interest rate.*

**Interest rates; underpayments and overpayments**. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 2001, will be 7 percent for overpayments (6 percent in the case of a corporation), 7 percent for underpayments, and 9 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 4.5 percent.

## Rev. Rul. 2001–47

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under § 6621(a)(1), the overpayment rate beginning October 1, 2001, is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under § 6601 on any large corporate underpayment, the underpayment rate under § 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See § 6621(c) and § 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and § 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under § 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59 (1988–1 C.B. 546) announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under § 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with § 6621 which, pursuant to § 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of July 2001 is 4 percent. Accordingly, an overpayment rate of 7 percent (6 percent in the case of a corporation) and an underpayment rate of 7 percent are established for the calendar quarter beginning October 1, 2001. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning October 1, 2001, is 4.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning October 1, 2001, is 9 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 4.5 percent, 6 percent, 7 percent, and 9 percent are published in Tables 14, 17, 19, and 23 of Rev. Proc. 95–17 (1995–1 C.B. 556, 568, 571, 573, and 577).

Annual interest rates to be compounded daily pursuant to § 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Associate Chief Counsel (Procedure & Administration), Administrative Provisions & Judicial Practice Division. For further information regarding this revenue ruling, contact Mr. Bailey at (202) 622-6226 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

| PERIOD | RATE | In 1995–1 C.B. DAILY RATE TABLE |
|---|---|---|
| Before Jul. 1, 1975 | 6% | Table 2, pg. 557 |
| Jul. 1, 1975—Jan. 31, 1976 | 9% | Table 4, pg. 559 |
| Feb. 1, 1976—Jan. 31, 1978 | 7% | Table 3, pg. 558 |
| Feb. 1, 1978—Jan. 31, 1980 | 6% | Table 2, pg. 557 |
| Feb. 1, 1980—Jan. 31, 1982 | 12% | Table 5, pg. 560 |
| Feb. 1, 1982—Dec. 31, 1982 | 20% | Table 6, pg. 560 |
| Jan. 1, 1983—Jun. 30, 1983 | 16% | Table 37, pg. 591 |
| Jul. 1, 1983—Dec. 31, 1983 | 11% | Table 27, pg. 581 |
| Jan. 1, 1984—Jun. 30, 1984 | 11% | Table 75, pg. 629 |
| Jul. 1, 1984—Dec. 31, 1984 | 11% | Table 75, pg. 629 |
| Jan. 1, 1985—Jun. 30, 1985 | 13% | Table 31, pg. 585 |
| Jul. 1, 1985—Dec. 31, 1985 | 11% | Table 27, pg. 581 |
| Jan. 1, 1986—Jun. 30, 1986 | 10% | Table 25, pg. 579 |
| Jul. 1, 1986—Dec. 31, 1986 | 9% | Table 23, pg. 577 |

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 - DEC. 31, 1998

| | OVERPAYMENTS | | | UNDERPAYMENTS | | |
|---|---|---|---|---|---|---|
| | RATE | 1995–1 C.B. TABLE | PG | RATE | 1995–1 C.B. TABLE | PG |
| Jan. 1, 1987—Mar. 31, 1987 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1987—Jun. 30, 1987 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jul. 1, 1987—Sep. 30, 1987 | 8% | 21 | 575 | 9% | 23 | 577 |
| Oct. 1, 1987—Dec. 31, 1987 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jan. 1, 1988—Mar. 31, 1988 | 10% | 73 | 627 | 11% | 75 | 629 |
| Apr. 1, 1988—Jun. 30, 1988 | 9% | 71 | 625 | 10% | 73 | 627 |
| Jul. 1, 1988—Sep. 30, 1988 | 9% | 71 | 625 | 10% | 73 | 627 |
| Oct. 1, 1988—Dec. 31, 1988 | 10% | 73 | 627 | 11% | 75 | 629 |
| Jan. 1, 1989—Mar. 31, 1989 | 10% | 25 | 579 | 11% | 27 | 581 |
| Apr. 1, 1989—Jun. 30, 1989 | 11% | 27 | 581 | 12% | 29 | 583 |
| Jul. 1, 1989—Sep. 30, 1989 | 11% | 27 | 581 | 12% | 29 | 583 |
| Oct. 1, 1989—Dec. 31, 1989 | 10% | 25 | 579 | 11% | 27 | 581 |
| Jan. 1, 1990—Mar. 31, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Apr. 1, 1990—Jun. 30, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Jul. 1, 1990—Sep. 30, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Oct. 1, 1990—Dec. 31, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Jan. 1, 1991—Mar. 31, 1991 | 10% | 25 | 579 | 11% | 27 | 581 |
| Apr. 1, 1991—Jun. 30, 1991 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jul. 1, 1991—Sep. 30, 1991 | 9% | 23 | 577 | 10% | 25 | 579 |
| Oct. 1, 1991—Dec. 31, 1991 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jan. 1, 1992—Mar. 31, 1992 | 8% | 69 | 623 | 9% | 71 | 625 |
| Apr. 1, 1992—Jun. 30, 1992 | 7% | 67 | 621 | 8% | 69 | 623 |
| Jul. 1, 1992—Sep. 30, 1992 | 7% | 67 | 621 | 8% | 69 | 623 |
| Oct. 1, 1992—Dec. 31, 1992 | 6% | 65 | 619 | 7% | 67 | 621 |
| Jan. 1, 1993—Mar. 31, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |
| Apr. 1, 1993—Jun. 30, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |
| Jul. 1, 1993—Sep. 30, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |
| Oct. 1, 1993—Dec. 31, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 - DEC. 31, 1998—Continued

| | OVERPAYMENTS | | | UNDERPAYMENTS | | |
|---|---|---|---|---|---|---|
| | RATE | 1995–1 C.B. TABLE | PG | RATE | 1995–1 C.B. TABLE | PG |
| Jan. 1, 1994—Mar. 31, 1994 | 6% | 17 | 571 | 7% | 19 | 573 |
| Apr. 1, 1994—Jun. 30, 1994 | 6% | 17 | 571 | 7% | 19 | 573 |
| Jul. 1, 1994—Sep. 30, 1994 | 7% | 19 | 573 | 8% | 21 | 575 |
| Oct. 1, 1994—Dec. 31, 1994 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jan. 1, 1995—Mar. 31, 1995 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1995—Jun. 30, 1995 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jul. 1, 1995—Sep. 30, 1995 | 8% | 21 | 575 | 9% | 23 | 577 |
| Oct. 1, 1995—Dec. 31, 1995 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jan. 1, 1996—Mar. 31, 1996 | 8% | 69 | 623 | 9% | 71 | 625 |
| Apr. 1, 1996—Jun. 30, 1996 | 7% | 67 | 621 | 8% | 69 | 623 |
| Jul. 1, 1996—Sep. 30, 1996 | 8% | 69 | 623 | 9% | 71 | 625 |
| Oct. 1, 1996—Dec. 31, 1996 | 8% | 69 | 623 | 9% | 71 | 625 |
| Jan. 1, 1997—Mar. 31, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1997—Jun. 30, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jul. 1, 1997—Sep. 30, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Oct. 1, 1997—Dec. 31, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jan. 1, 1998—Mar. 31, 1998 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1998—Jun. 30, 1998 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jul. 1, 1998—Sep. 30, 1998 | 7% | 19 | 573 | 8% | 21 | 575 |
| Oct. 1, 1998—Dec. 31, 1998 | 7% | 19 | 573 | 8% | 21 | 575 |

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 - PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

| | RATE | 1995–1 C.B. TABLE | PAGE |
|---|---|---|---|
| Jan. 1, 1999—Mar. 31, 1999 | 7% | 19 | 573 |
| Apr. 1, 1999—Jun. 30, 1999 | 8% | 21 | 575 |
| Jul. 1, 1999—Sep. 30, 1999 | 8% | 21 | 575 |
| Oct. 1, 1999—Dec. 31, 1999 | 8% | 21 | 575 |
| Jan. 1, 2000—Mar. 31, 2000 | 8% | 69 | 623 |
| Apr. 1, 2000—Jun. 30, 2000 | 9% | 71 | 625 |
| Jul. 1, 2000—Sep. 30, 2000 | 9% | 71 | 625 |
| Oct. 1, 2000—Dec. 31, 2000 | 9% | 71 | 625 |
| Jan. 1, 2001—Mar. 31, 2001 | 9% | 23 | 577 |
| Apr. 1, 2001—Jun. 30, 2001 | 8% | 21 | 575 |
| Jul. 1, 2001—Sep. 30, 2001 | 7% | 19 | 573 |
| Oct. 1, 2001—Dec. 31, 2001 | 7% | 19 | 573 |

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 - PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

| | OVERPAYMENTS | | | UNDERPAYMENTS | | |
|---|---|---|---|---|---|---|
| | RATE | 1995–1 C.B. TABLE | PG | RATE | 1995–1 C.B. TABLE | PG |
| Jan. 1, 1999—Mar. 31, 1999 | 6% | 17 | 571 | 7% | 19 | 573 |
| Apr. 1, 1999—Jun. 30, 1999 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jul. 1, 1999—Sep. 30, 1999 | 7% | 19 | 573 | 8% | 21 | 575 |
| Oct. 1, 1999—Dec. 31, 1999 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jan. 1, 2000—Mar. 31, 2000 | 7% | 67 | 621 | 8% | 69 | 623 |
| Apr. 1, 2000—Jun. 30, 2000 | 8% | 69 | 623 | 9% | 71 | 625 |
| Jul. 1, 2000—Sep. 30, 2000 | 8% | 69 | 623 | 9% | 71 | 625 |
| Oct. 1, 2000—Dec. 31, 2000 | 8% | 69 | 623 | 9% | 71 | 625 |
| Jan. 1, 2001—Mar. 31, 2001 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 2001—Jun. 30, 2001 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jul. 1, 2001—Sep. 30, 2001 | 6% | 17 | 571 | 7% | 19 | 573 |
| Oct. 1, 2001—Dec. 31, 2001 | 6% | 17 | 571 | 7% | 19 | 573 |

TABLE OF INTEREST RATES FOR

LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 - PRESENT

| | RATE | 1995–1 C.B. TABLE | PG |
|---|---|---|---|
| Jan. 1, 1991—Mar. 31, 1991 | 13% | 31 | 585 |
| Apr. 1, 1991—Jun. 30, 1991 | 12% | 29 | 583 |
| Jul. 1, 1991—Sep. 30, 1991 | 12% | 29 | 583 |
| Oct. 1, 1991—Dec. 31, 1991 | 12% | 29 | 583 |
| Jan. 1, 1992—Mar. 31, 1992 | 11% | 75 | 629 |
| Apr. 1, 1992—Jun. 30, 1992 | 10% | 73 | 627 |
| Jul. 1, 1992—Sep. 30, 1992 | 10% | 73 | 627 |
| Oct. 1, 1992—Dec. 31, 1992 | 9% | 71 | 625 |
| Jan. 1, 1993—Mar. 31, 1993 | 9% | 23 | 577 |
| Apr. 1, 1993—Jun. 30, 1993 | 9% | 23 | 577 |
| Jul. 1, 1993—Sep. 30, 1993 | 9% | 23 | 577 |
| Oct. 1, 1993—Dec. 31, 1993 | 9% | 23 | 577 |
| Jan. 1, 1994—Mar. 31, 1994 | 9% | 23 | 577 |
| Apr. 1, 1994—Jun. 30, 1994 | 9% | 23 | 577 |
| Jul. 1, 1994—Sep. 30, 1994 | 10% | 25 | 579 |
| Oct. 1, 1994—Dec. 31, 1994 | 11% | 27 | 581 |
| Jan. 1, 1995—Mar. 31, 1995 | 11% | 27 | 581 |
| Apr. 1, 1995—Jun. 30, 1995 | 12% | 29 | 583 |
| Jul. 1, 1995—Sep. 30, 1995 | 11% | 27 | 581 |
| Oct. 1, 1995—Dec. 31, 1995 | 11% | 27 | 581 |
| Jan. 1, 1996—Mar. 31, 1996 | 11% | 75 | 629 |
| Apr. 1, 1996—Jun. 30, 1996 | 10% | 73 | 627 |
| Jul. 1, 1996—Sep. 30, 1996 | 11% | 75 | 629 |
| Oct. 1, 1996—Dec. 31, 1996 | 11% | 75 | 629 |
| Jan. 1, 1997—Mar. 31, 1997 | 11% | 27 | 581 |
| Apr. 1, 1997—Jun. 30, 1997 | 11% | 27 | 581 |
| Jul. 1, 1997—Sep. 30, 1997 | 11% | 27 | 581 |
| Oct. 1, 1997—Dec. 31, 1997 | 11% | 27 | 581 |

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 - PRESENT—Continued

| | RATE | 1995–1 C.B. TABLE | PG |
|---|---|---|---|
| Jan. 1, 1998—Mar. 31, 1998 | 11% | 27 | 581 |
| Apr. 1, 1998—Jun. 30, 1998 | 10% | 25 | 579 |
| Jul. 1, 1998—Sep. 30, 1998 | 10% | 25 | 579 |
| Oct. 1, 1998—Dec. 31, 1998 | 10% | 25 | 579 |
| Jan. 1, 1999—Mar. 31, 1999 | 9% | 23 | 577 |
| Apr. 1, 1999—Jun. 30, 1999 | 10% | 25 | 579 |
| Jul. 1, 1999—Sep. 30, 1999 | 10% | 25 | 579 |
| Oct. 1, 1999—Dec. 31, 1999 | 10% | 25 | 579 |
| Jan. 1, 2000—Mar. 31, 2000 | 10% | 73 | 627 |
| Apr. 1, 2000—Jun. 30, 2000 | 11% | 75 | 629 |
| Jul. 1, 2000—Sep. 30, 2000 | 11% | 75 | 629 |
| Oct. 1, 2000—Dec. 31, 2000 | 11% | 75 | 629 |
| Jan. 1, 2001—Mar. 31, 2001 | 11% | 27 | 581 |
| Apr. 1, 2001—Jun. 30, 2001 | 10% | 25 | 579 |
| Jul. 1, 2001—Sep. 30, 2001 | 9% | 23 | 577 |
| Oct. 1, 2001—Dec. 31, 2001 | 9% | 23 | 577 |

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000
FROM JANUARY 1, 1995 - PRESENT

| | RATE | 1995–1 C.B. TABLE | PG |
|---|---|---|---|
| Jan. 1, 1995—Mar. 31, 1995 | 6.5% | 18 | 572 |
| Apr. 1, 1995—Jun. 30, 1995 | 7.5% | 20 | 574 |
| Jul. 1, 1995—Sep. 30, 1995 | 6.5% | 18 | 572 |
| Oct. 1, 1995—Dec. 31, 1995 | 6.5% | 18 | 572 |
| Jan. 1, 1996—Mar. 31, 1996 | 6.5% | 66 | 620 |
| Apr. 1, 1996—Jun. 30, 1996 | 5.5% | 64 | 618 |
| Jul. 1, 1996—Sep. 30, 1996 | 6.5% | 66 | 620 |
| Oct. 1, 1996—Dec. 31, 1996 | 6.5% | 66 | 620 |
| Jan. 1, 1997—Mar. 31, 1997 | 6.5% | 18 | 572 |
| Apr. 1, 1997—Jun. 30, 1997 | 6.5% | 18 | 572 |
| Jul. 1, 1997—Sep. 30, 1997 | 6.5% | 18 | 572 |
| Oct. 1, 1997—Dec. 31, 1997 | 6.5% | 18 | 572 |
| Jan. 1, 1998—Mar. 31, 1998 | 6.5% | 18 | 572 |
| Apr. 1, 1998—Jun. 30, 1998 | 5.5% | 16 | 570 |
| Jul. 1. 1998—Sep. 30, 1998 | 5.5% | 16 | 570 |
| Oct. 1, 1998—Dec. 31, 1998 | 5.5% | 16 | 570 |
| Jan. 1, 1999—Mar. 31, 1999 | 4.5% | 14 | 568 |
| Apr. 1, 1999—Jun. 30, 1999 | 5.5% | 16 | 570 |
| Jul. 1, 1999—Sep. 30, 1999 | 5.5% | 16 | 570 |
| Oct. 1, 1999—Dec. 31, 1999 | 5.5% | 16 | 570 |
| Jan. 1, 2000—Mar. 31, 2000 | 5.5% | 64 | 618 |
| Apr. 1, 2000—Jun. 30, 2000 | 6.5% | 66 | 620 |
| Jul. 1, 2000—Sep. 30, 2000 | 6.5% | 66 | 620 |
| Oct. 1, 2000—Dec. 31, 2000 | 6.5% | 66 | 620 |
| Jan. 1, 2001—Mar. 31, 2001 | 6.5% | 18 | 572 |

TABLE OF INTEREST RATES FOR CORPORATE

OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 - PRESENT—Continued

| | RATE | 1995–1 C.B. TABLE | PG |
|---|---|---|---|
| Apr. 1, 2001—Jun. 30, 2001 | 5.5% | 16 | 570 |
| Jul. 1, 2001—Sep. 30, 2001 | 4.5% | 14 | 568 |
| Oct. 1, 2001—Dec. 31, 2001 | 4.5% | 14 | 568 |

# Part III. Administrative, Procedural, and Miscellaneous

## Section 529—Programs

## Notice 2001–55

This notice provides guidance to qualified tuition programs described in § 529 of the Internal Revenue Code and participants in § 529 programs regarding the restriction on investment direction described in § 529(b)(5). This notice sets forth a special rule under which a program may permit investments in a § 529 account to be changed annually, and upon a change in the designated beneficiary of the account.

Section 529(b)(5) states that a program shall not be treated as a § 529 program unless it provides that any contributor to, or designated beneficiary under, such program may not directly or indirectly direct the investment of any contributions to the program (or any earnings thereon). The proposed regulations under § 529, which were published in the Federal Register on August 24, 1998 (63 F.R. 45019), provide that a program does not violate this requirement if it permits a person who establishes a § 529 account to select among different investment strategies designed exclusively by the program, only at the time when the initial contribution is made establishing the account. Prop. Treas. Reg. § 1.529–2(g).

Several commenters on the proposed regulations suggested that permitting a participant in a § 529 program to select among various broad-based investment strategies offered by a program, both at the time that contributions are made, and at certain other times, would be consistent with § 529(b)(5). For example, these commenters suggested that it would be appropriate to allow a change in the investment strategy selected for an account where there has been a significant change in market circumstances since the account was initially established, where there is a change in the designated beneficiary of an account (as permitted under § 529(c)(3)(C)) and the new beneficiary has a different expected matriculation date, or where the program establishes new investment options.

The Internal Revenue Service and the Treasury Department recognize that there are a number of situations that might warrant a change in the investment strategy with respect to a § 529 account. Accordingly, the Internal Revenue Service and the Treasury Department expect that the final regulations under § 529 will provide that a program does not violate § 529(b)(5) if it permits a change in the investment strategy selected for a § 529 account once per calendar year, and upon a change in the designated beneficiary of the account. It is expected that the final regulations will also provide that, to qualify under this special rule, a program must (1) allow participants to select only from among broad-based investment strategies designed exclusively by the program; and (2) establish procedures and maintain appropriate records to prevent a change in investment options from occurring more frequently than once per calendar year or upon a change in the designated beneficiary of the account. The Internal Revenue Service and the Treasury Department believe that permitting a change in investment options once per calendar year, and upon a change in designated beneficiary should provide sufficient flexibility to address concerns raised by commenters.

Section 529 programs and their participants may rely on this notice pending the issuance of final regulations under § 529.

The Internal Revenue Service invites comments on the matter described in this notice and any other comments relating to § 529, including the amendments made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. No. 107–16, 115 Stat. 38). Please send written comments by December 24, 2001, to: CC:ITA:RU (Notice 2001–55), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. Submission may be hand-delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (Notice 2001–55), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/prod/tax_regs/regslist.html*. Comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this notice is Monice Rosenbaum of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice contact Ms. Rosenbaum at (202) 622-6070 (not a toll-free number).

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## Weighted Average Interest Rate Update

## Notice 2001–58

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for August 2001 is 5.48 percent.

The following rates were determined for the plan years beginning in the month shown below.

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---|---|---|---|---|
| September | 2001 | 5.77 | 5.20 to 6.06 | 5.20 to 6.35 |

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283-9702 (not a toll-free number).

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*26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.*
*(Also Part I, Sections 6700, 6701, 7408).*

## Rev. Proc. 2001–49

SECTION 1. PURPOSE

This revenue procedure revokes Rev. Proc. 83–78 (1983–2 C.B. 595) and Rev. Proc. 84–84 (1984–2 C.B. 782) which describe procedures which had been used by the Internal Revenue Service to identify and investigate abusive tax shelter promotions. The procedures being revoked are inconsistent with the Service's current practices and new organizational structure. In the future, the Service's procedures for the identification and investigation of abusive tax shelter promotions will be set forth in the Internal Revenue Manual or other forms of published guidance.

SECTION 2. BACKGROUND

.01 Section 7408 of the Internal Revenue Code authorizes the United States, at the request of the Secretary, to seek an injunction to enjoin any person from further engaging in conduct subject to a penalty under section 6700 or section 6701.

.02 Section 6700 of the Code imposes monetary penalties on promoters of abusive tax shelters and other tax avoidance schemes. These penalties are in addition to all other penalties provided by law. Persons subject to the penalties include any person who organizes, assists in the organization of, or participates in the sale of, any interest in an entity, plan or arrangement, and who makes or furnishes a statement with respect to any material tax matter either that the person knows or has reason to know is a false statement or that is a gross valuation overstatement.

.03 Section 6701 imposes a penalty on any person who aids, assists, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document, provided that such person knows (or has reason to believe) that such portion will be used in connection with any material matter arising under the internal revenue laws and also provided that such person knows that such portion (if so used) would result in an understatement of the liability for tax of another person. The penalty imposed by section 6701 is in addition to all other penalties provided by law.

.04 Rev. Proc. 83–78 (1983–2 C.B. 595) provided procedures for the identification and investigation of abusive tax shelter promotions which might be subject to penalties under section 6700 or injunction under section 7408. Rev. Proc. 84–84 (1984–2 C.B. 782) modified Rev. Proc. 83–78 and described additional measures the Service was taking to address abusive tax shelters. Those revenue procedures set forth duties for organizational units of the Service that no longer exist because of a reorganization of the Service under the requirements of the Internal Revenue Service Restructuring and Reform Act of 1998.

.05 The IRS is establishing new procedures for identifying and investigating abusive tax shelter promotions. These new procedures will be set forth in the Internal Revenue Manual or in other forms of published guidance that will be issued in the future.

SECTION 3. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 83–78 is revoked.
.02 Rev. Proc. 84–84 is revoked.

SECTION 4. DRAFTING INFORMATION

The principal author of this revenue procedure is Brinton T. Warren of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this revenue procedure, contact Brinton T. Warren at (202) 622-4940 (not a toll-free call).

# Part IV. Items of General Interest

## Separate Reporting of Nonstatutory Stock Option Income in Box 12 of the Form W-2, Using Code V, Optional for Year 2002

## Announcement 2001–92

I. PURPOSE

This announcement extends through year 2002, the relief from mandatory reporting of compensation resulting from employer-provided nonstatutory stock options in box 12 of the Form W-2, using Code V. In particular, this announcement provides that, with respect to Forms W-2 issued for the year 2002, the use of Code V is optional.

The announcement also invites public comment and suggestions regarding potential methods that would enable more efficient and cost effective means of collecting the information that would be reported using Code V. Specifically, this announcement requests proposals for better and less burdensome methods of collecting the information about employee income that arises from the exercise of nonstatutory stock options, including information about the presence and amount of nonstatutory stock option income on an employee (or former employee) basis.

II. BACKGROUND

When an employee (or former employee) exercises nonstatutory stock options, employers are required to report the excess of the fair market value of the stock received upon exercise of the option over the amount paid for that stock. That amount is reported on Form W-2 in boxes 1, 3 (up to the social security wage base), and 5.[1]

Announcement 2000–97 (2000–48 I.R.B. 557) advised employers that, beginning for 2001 Forms W-2, income from the exercise of nonstatutory stock options would also be required to be reported in box 12 and identified by a new code, Code V – Income from the exercise of nonstatutory stock options.

In response to employer concerns, Announcement 2001–7 (2001–3 I.R.B. 357) provided that the use of Code V would be optional for the 2001 Forms W-2.

III. EXTENSION OF RELIEF

The separate reporting of the amount of any compensation relating to the exercise of a nonstatutory stock option in box 12, using Code V, is optional for the 2002 Forms W-2.

Treasury and the Service will consider replacing the separate reporting of this compensation in Box 12, using Code V, now mandatory for 2003 Forms W-2, with other cost effective alternatives that would allow for collection of the information regarding the presence and amount of income from the exercise of nonstatutory stock options that employers would otherwise be required to report under Code V. However, if the comment process outlined in Section IV, below, does not result in the development of cost effective alternatives, the new Code V reporting requirement will be mandatory for the 2003 Forms W-2. Therefore, absent future guidance modifying or eliminating this reporting requirement, beginning with year 2003 Forms W-2, any amounts of compensation relating to the exercise of a nonstatutory stock option included in boxes 1, 3 (if applicable), and 5 of the Form W-2 must also be shown separately in box 12, using Code V.

IV. REQUEST FOR COMMENTS

This announcement requests comments and suggestions proposing cost effective alternatives that would allow the collection of information regarding the presence and amount of income from the exercise of nonstatutory stock options that employers will be required to report under Code V beginning with 2003 Forms W-2. The information to be collected refers not only to the aggregate amount of nonstatutory stock option income, but also information about the presence and amount of nonstatutory stock option income on an employee (or former employee) basis.

Comments must be submitted by December 14, 2001. Treasury and the Service will carefully consider all of the comments received, although Treasury and the Service will not be able to respond to each comment. Comments should reference Announcement 2001–92, and be addressed to:

Internal Revenue Service
Tax Forms and Publications Division
W:CAR:MP:FP:F:R—GPF
1111 Constitution Ave., NW
Washington, DC 20224

V. Drafting Information

The principal author of this announcement is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this announcement contact Stephen Tackney at (202) 622-6040 or Gerald Fournier at (202) 622-3186 (not toll-free calls).

[1] For purposes of the special rule under § 1.83–6(a)(2) that provides that an employee or former employee is deemed to have included the amount in gross income, an employer's inclusion of the nonstatutory stock option income in Box 1 of the Form W-2 will be sufficient.

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## Foundations Status of Certain Organizations

## Announcement 2001–94

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

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

A Better Way Community Development Corporation, Miami, FL
Abundant Harvest Ministries, Dania, FL
Academy of Business and Commerce, Inc., Ft. Lauderdale, FL
Adonis Family Farms, Inc., Fort Myers, FL

Agape Communications Institute, Inc., Fort Lauderdale, FL
Aqua Trek Marine Education Center, Inc., Ft. Myers, FL
Art for Humanity, Inc., Tamarac, FL
Awareness America, Inc., Boca Raton, FL
Berean Benevolent Fund, Inc., Albany, LA
Big Brothers Big Sisters Association of Florida, Inc., Ft. Lauderdale, FL
Birmingham Music Club Endowment, Birmingham, AL
Branches of Love, Inc., Miami, FL
Broward Center for Living, Inc., Fort Lauderdale, FL
Canton Community Development Corporation, Canton, MS
Caribbean Agricultural Research Institute, Inc., Miami, FL
Caribbean Aid, Inc., Johnstown, PA
Caribbean Development Research Institute, Inc., Miami, FL
Center for African Cultural Studies, Inc., Miami, FL
Childrens & Survivors Fun, Inc., Miami, FL
Coalition for Mississippi's Children, Jackson, MS
Community Alliance for Economic Development, Miami, FL
Community Development & Housing Alliance, Ridgeland, MS
Community of People, Inc., Jackson, MS
Cortez Community Center, Inc., Bradenton, FL
Creating Jobs for Life Worldwide, Inc., Coral Gables, FL
Cultura Italiana, Inc., Coral Gables, FL
Dennis Dreams Ministries, Inc., West Palm Beach, FL
Diabetic Foundation of America, Inc., West Palm Beach, FL
Dothan-Houston County Rotary Foundation, Inc., Dothan, AL
E-Comb, Inc., Miami Beach, FL
Ecudrama Ministries, Inc., Clinton, MS
Ekdikeo Rising, Inc., Coral Springs, FL
Emmanuel Haitian Christian Community Center, Inc., Miami, FL
Equal Housing Fund of Florida Corp., Miami, FL
Faith House International, Inc., Boca Raton, FL
Family Approach to Child Enrichment, Inc., Miami, FL
Family Life Matters Institute, Inc., Riverdale, GA
Family Resource Connection, Inc., Venice, FL
Feeding the Mind Foundation, Inc., Miami, FL
Female and Safe, Inc., New York, NY
Flames Youth Basketball, Riviera Beach, FL
Fort Lauderdale Community Development Corporation, Inc., Ft. Lauderdale, FL
Friends of Sandoway House Nature Center, Inc., Boca Raton, FL
Friends of the West Palm Beach Public Library, Inc., W. Palm Beach, FL
Future Champs, Inc., Hialeah, FL
Gamma Theta Educational Foundation, Inc., Starkvile, MS
Glades Jim Wilson Real Life Crusade, Inc., Belle Glade, FL
Gods Rest Ministries, Inc., Okeechobee, FL
Gold Coast DMDA, Inc., Coral Gable, FL
Golden Wattle Refuge, Inc., Vero Beach, FL
Good Ole Boys Club, Inc., Parrish, FL
Grand Prix Foundation, Inc., Homestead, FL
Greater Mt. Calvary - Calvary Care (Community Vision Development Agency, Inc.), Jackson, MS
Guatemalan-American Childrens Foundation, Inc., Coral Gables, FL
Heart Acts to Follow, Inc., Miami, FL
Heartland Safety Clowns, Inc., Sebring, FL
Hialeah Athletic Association, Inc., Hialeah, FL
Historical Foundation of Palm Beach County, Inc., West Palm Beach, FL
Historical Knights Building, Inc., Pt. Charlotte, FL
Holy Redeemer Independent Episcopal Church, Inc., Ft. Lauderdale, FL
Hope House of Jackson, Jackson, MS
Hope Springs, Inc., Boca Raton, FL
House of Refuge, Inc., Latana, FL
Iglesia Biblica Buenos Nuevas, Inc., Palm Beach Gardens, FL
Jazz Hall Friends, Birmingham, AL
Key West Aids Memorial, Inc., Keywest, FL
Kids Prep. Child & Train Ctr., Grenada, MS
La Hora Bautista, Miami, FL
Latin American Communications Network, Inc., Miami, FL
Lees Tae Kwan Do Charity, Inc., N. Palm Beach, FL
Light Up Miami, Inc., Miami, FL
Look Organization-Literacy of Our Kids, McComb, MS
Loving Family Foundation, Inc., West Palm Beach, FL
Marine Mammal Conservancy, Inc., Key Largo, FL
Medical Foundation of Southwest Florida, Inc., Ft. Myers, FL
Miami Affordable Housing, Inc., Miami, FL
Miami Wildcats, Inc., Miami, FL
Mission Possible Ministries, Inc., Naples, FL
Mississippi Confederated Child Care Nutrition, Inc., Tunica, MS
Mississippi Criminal Justice Assoc., Jackson, MS
Mount-Horeb Community Action Agency, Inc., Hollandale, MS
Mr. B's Learning Center, Inc., Pearl, MS
Narrow Gate Publications, Inc., Dania, FL
National Retinoblastoma Research & Support Foundation, Inc., Miami, FL
Opportunities and Enrichment Services, Inc., Miami, FL
Opportunities, Inc., Milford, CT
Palm Beach County Childrens Cultural Community Center, Inc., West Palm Beach, FL
Patton Lane Community Civic Center, Enid, MS
Peterbos Outreach, Belzoni, MS
Phlex Diversified Service, Inc., Jackson, MS
Pike County United Way, Inc., (Association of Pike County Charities, Inc.), Troy, AL
Project Debby, Inc., Hypoluxo, FL
Protecting Our Loved Ones-Polo-International, Miami, FL
PWA Nourishment Organization, Inc., Margate, FL
Quality Housing Foundation, Inc., Miami, FL
Recovery Haven, Inc., North Miami, FL
Redland Tropical Gardens Botanical Foundation, Inc., Homestead, FL
Rescue Autistic Society Corp., Miami Beach, FL
Sarasota Youth Baseball Club, Inc., Sarasota, FL
Seabreeze Elementary-PTO, Brandenton, FL
Second Home Daycare Center, Inc., Ellisville, MS
Set Free Ministries, Richland, MS
Sheridan Foundation, Inc., Miami, FL

South Florida Storm, Inc., Miami, FL
South Florida Super Bowl Host Committee Foundation, Inc., Miami, FL
South Florida Veterans Foundation, Inc., Miami, FL
South Florida Youth Scholarship Foundation, Inc., Boca Raton, FL
St. Columbia Interfaith Schools, Inc., Utica, MS
St. Francis Village, Inc., Coral Springs, FL
St. Thomas Community Services, Inc., Hollywood, FL
Strong Families, Inc., Hattiesburg, MS
Sunlight Ministries, Inc., Brookhaven, MS
Temple Finance, Inc., Louin, MS
Tender Loving Care Complex, Inc., Cape Coral, FL
Tomorrows Leaders, Inc., Avon Park, FL
Trinity Parents League, Natches, MS
Trumpeter Foundation, Inc., Miami, FL
Tuscaloosa Voices of Tomorrow, Inc., Tuscaloosa, AL
USA Police Athletic League, Inc., Palm Beach Gardens, FL
Visionaries Incorporated, Lauderhill, FL
Vulcan Charity Golf Foundation, Inc., Birmingham, AL
W. H. Roberts Foundation, Inc., Coconut Grove, FL
Walthal County Animal Shelter, Tylertown, MS
Wayne Johnsons Pre-School, Inc., Oxford, MS
Wesley Youth Foundation, Inc., Jackson, MS
Wiregrass STEP Foundation, Dothan, AL
Witnesses for the Eucharistic Jesus Foundation, Jackson, MS
Women Fighters for Democracy Corp., Miami, FL
Womens Coalition for the Disadvantaged, Inc., Plantation, FL
Womens Institute for Creativity, Inc., Miami, FL
Wonder Education, Inc., Miami, FL
World Nature Preserve, Inc., Miami, FL
Youth Philharmonic Orchestra, Inc., Miami, FL

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

## Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

## Announcement 2001–95

The name of an organization that no longer qualifies as an organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on September 24, 2001, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

San Diego World Heritage Foundation, Inc., San Diego, CA

## Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organization listed below has recently filed timely declaratory judgment suit under section 7428 of the Code, challenging revocation of it's status as an eligible donee under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

San Diego World Heritage Foundation, Inc., San Diego, CA

# Part III. Administrative, Procedural, and Miscellaneous

## Voluntary Closing Agreement Program for Tax-Exempt Bonds

## Notice 2001–60

SECTION 1. PURPOSE

This Notice provides information about a voluntary closing agreement program for tax-exempt bonds ("TEB VCAP"). In particular, the Notice sets forth procedures whereby issuers of tax-exempt bonds can resolve violations of the Internal Revenue Code through closing agreements with the Internal Revenue Service. The Tax Exempt Bonds Outreach, Planning and Review ("TEB OPR") function of Tax Exempt and Government Entities (TE/GE) is developing new outreach and education initiatives to insure compliance by issuers of tax-exempt bonds with applicable provisions of the Code. TEB VCAP is part of the TEB OPR outreach and education initiatives and provides appropriate remedies when issuers voluntarily come forward and express a desire to resolve violations of the Code. TEB VCAP is intended to encourage issuers and conduit borrowers to exercise due diligence in complying with the Code and to provide a vehicle to correct violations of the Code. It is the continuing policy of the Internal Revenue Service to attempt to resolve violations of the Code without taxing bondholders. TEB VCAP reflects this policy.

The Service anticipates that more detailed procedures about the program will be provided as the program is refined and comments are received. For example, standardized closing agreement terms and amounts may be specified for particular violations. Accordingly, this Notice requests comments on TEB VCAP as well as comments on how the Service can expand its efforts to encourage compliance with the Code.

SECTION 2. BACKGROUND

Gross income does not include interest on any state or local bond that meets the requirements of section 103 and related provisions of the Code. Under certain circumstances, an issuer may take remedial action under provisions such as sections 1.141–12, 1.142–2, 1.144–2, 1.145–2, and 1.147–2 of the Income Tax Regulations in order to cure a violation of the Code and to prevent interest on a bond from becoming includible in gross income.

The Service has previously provided formal tax-exempt bond closing agreement programs such as the program described in Rev. Proc. 97–15 (1997–1 C.B. 635). Violations of section 103 and related provisions of the Code that cannot be remediated under existing remedial action provisions or other tax-exempt bond closing agreement programs contained in regulations or other published guidance may be resolved by entering into a closing agreement under TEB VCAP.

Section 7121 of the Code and the regulations thereunder authorize the Commissioner to enter into written closing agreements with any person in connection with the tax liability of such person (or of the person or estate for whom he acts). Section 301.7121–1 of the Income Tax Regulations provides, in part, that a closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or if good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner that the United States will sustain no disadvantage through consummation of such an agreement.

SECTION 3. SCOPE OF TEB VCAP

Under TEB VCAP, an issuer or its authorized representative may request a closing agreement with respect to violations of section 103 and related provisions of the Code. TEB VCAP is not available when:

(a) Absent extraordinary circumstances, the violation can be remediated under existing remedial action provisions or tax-exempt bond closing agreement programs contained in regulations or other published guidance.

(b) The bond issue is under examination. A bond issue is generally treated as under examination on the date a letter opening an examination on the bond issue is sent.

(c) The tax-exempt status of the bonds is at issue in any court proceeding or is being considered by the IRS Office of Appeals.

(d) The Service determines that the violation was due to willful neglect.

SECTION 4. PROCEDURES FOR REQUESTING A CLOSING AGREEMENT UNDER TEB VCAP

(a) Information Required in Requests. An issuer or its authorized representative requesting a closing agreement must submit the following information relating to the issue:

(i) A statement, or statements, under penalty of perjury, certifying:

a. A description of the violation, including its nature, when it occurred and the events surrounding it, and a statement about when and how the issuer discovered the violation;

b. The procedures and policies which will be instituted to assure future compliance with the Code;

c. That the bond issue is not under examination;

d. That the tax-exempt status of the bond issue is not at issue in any court proceeding and is not being considered by the IRS Office of Appeals;

e. That, on the issue date, the issuer reasonably expected to comply with section 103 and related provisions of the Code;

f. That the violation was not due to willful neglect;

g. That the request for a closing agreement was promptly undertaken upon discovery of the violation by the issuer or the conduit borrower; and

h. That the payment of the closing agreement amount, if any, will not be made with proceeds of bonds described in section 103(a).

(ii) A statement setting forth proposed closing agreement terms based on the model closing agreement language contained in IRM 7.6.2 and, if applicable, a computation of the proposed closing agreement amount.

(iii) The name and phone number of a person to contact for additional information.

(b) Additional Information for Requests. Additional information may be required depending on the facts and circumstances.

(c) Penalty of Perjury Statement. The following declaration, signed by the party making the submission, must accompany a TEB VCAP 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 statements, and to the best of my knowledge and belief, the submission contains all the relevant facts relating to the request, and such facts are true, correct, and complete."

(d) Anonymous Closing Agreement Requests. An issuer or its authorized representative may initiate discussions regarding the appropriate terms of a closing agreement on an anonymous basis. An anonymous request may be made on behalf of a group of similarly situated issuers, but the execution of the closing agreement and all terms therein must be consistent with section 7121 of the Code. Until the name of the bond issue is disclosed to the Service, a request for a closing agreement under TEB VCAP will not prevent the Service from beginning an examination of the bond issue. An issue for which a request has been submitted under this paragraph (d) that has been placed under examination prior to the date the issue is identified to the Service will no longer be eligible for TEB VCAP.

(e) TEB VCAP Mailing Address. TEB VCAP submissions should be mailed to:

Internal Revenue Service
Attn: T:GE:TEB:O, Rm. 5T2
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

SECTION 5. CLOSING AGREEMENT TERMS

Closing agreements under TEB VCAP will generally follow the model closing agreement in IRM 7.6.2. Specific closing agreement terms will depend on the facts and circumstances of the case, including the degree of diligence exercised by the issuer and any conduit borrower. Any standardized closing agreement terms that are developed for TEB VCAP will be set forth in the Internal Revenue Manual and/or other published guidance.

SECTION 6. EFFECT OF CLOSING AGREEMENT EXECUTED UNDER TEB VCAP

The closing agreement will protect bondholders from including in their gross income any interest on the bonds during a period specified in the agreement for any violation described in the agreement. A closing agreement executed under section 7121 of the Code shall be final and conclusive except that 1) the matter it relates to may be reopened in the event of fraud, malfeasance, or misrepresentation of a material fact, 2) it is subject to the sections of the Code that expressly provide that effect be given to their provisions (including any stated exception for section 7122 of the Code) notwithstanding any other law or rule of law, and 3) it is subject to any law, enacted after the date of the agreement, that applies to a tax period ending after the date of the agreement covered by the agreement.

SECTION 7. REQUESTS FOR COMMENTS

We anticipate that TEB VCAP will be expanded and refined over time based on experience and public comment. The Service welcomes comments regarding the format and operation of TEB VCAP. The Service requests comments on the existing remedial action provisions and existing closing agreement programs and procedures contained in regulations and other published guidance. The Service welcomes suggestions with regard to the general framework of closing agreement terms including whether standardized closing agreement terms and amounts should be specified for particular violations. The Service also requests comments regarding whether any of the provisions of the model closing agreement set forth in IRM 7.6.2 should be changed.

Comments should be submitted in writing within six months from the date this Notice appears in the Internal Revenue Bulletin. Comments should be sent to the following address:

Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224
Attn: Susan D. Ruth T:GE:TEB:O, Rm. 5T2.

Comments may also be sent electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, by submitting comments directly to the IRS Internet site at *http://www.irs.gov/prod/tax_regs/comments.html*, or by e-mailing them to *notice.comments@m1.irs.counsel.gov*.

SECTION 8. EFFECTIVE DATE

TEB VCAP is effective immediately.

SECTION 9. DRAFTING INFORMATION

The principal author of this Notice is Cliff Gannett of Tax Exempt Bonds Outreach, Planning and Review of the Office of the Director, Tax Exempt Bonds, Tax Exempt/Government Entities. For further information regarding this Notice, contact Mr. Gannett at (202) 283-2999 (not a toll-free call).

## Disaster Relief for Taxpayers Affected by the September 11, 2001 Terrorist Attack.

## Notice 2001–61

PURPOSE

This notice provides tax relief under sections 6081, 6161, and 7508A of the Internal Revenue Code for taxpayers affected by the September 11, 2001, terrorist attack, which included the destruction of the two World Trade Center towers and other buildings in the World Trade Center complex, damage to the Pentagon, and the airplane crash in Pennsylvania on Tuesday, September 11, 2001. The President issued federal disaster declarations on September 11 and 13, 2001. The September 11, 2001, declaration covers five New York counties: Bronx, Kings, New York (boroughs of Brooklyn and Manhattan), Queens, and Richmond. The September 13, 2001, declaration covers Arlington County in Virginia, where the Pentagon is located. These counties constitute a "covered disaster area" within the meaning of section 301.7508A–1(d)(2) of the Procedure and Administration Regulations. In addition, the Internal Revenue Service has determined that other taxpayers affected (as defined below) by the terrorist attack are also entitled to relief, regardless of where they reside.

Taxpayers who believe they are entitled to relief under this notice should mark "September 11, 2001 Terrorist Attack" in red ink on the top of their return and other documents submitted to the IRS.

BACKGROUND

Section 6081 provides that the Secretary may grant a reasonable extension of time (generally not to exceed 6 months) for filing any return, declaration, statement, or other document required by the Internal Revenue Code or by regulations thereunder.

Section 6161 provides that the Secretary may grant a reasonable extension of time (generally not to exceed 6 months) for paying the amount (or any installments) of tax shown or required to be shown on any return or declaration required by the Code or by regulations thereunder.

Section 7508A provides the Secretary with authority to postpone the time for performing certain acts under the internal revenue laws for a taxpayer affected by a Presidentially declared disaster as defined in section 1033(h)(3). Pursuant to section 7508A(a) and section 301.7508A–1 of the regulations, a period of up to 120 days may be disregarded in determining whether the performance of certain acts is timely under the internal revenue laws. Section 301.7508A–1(c)(1) lists seven acts performed by taxpayers for which section 7508A relief may apply. Among these acts are the filing of certain tax returns; the payment of certain taxes; the making of deductible contributions to certain retirement plans and individual retirement arrangements; the filing of a Tax Court petition; the filing of a claim for credit or refund of tax; and the bringing of a lawsuit upon a claim for credit or refund of tax.

Section 301.7508A–1(d)(1) describes the seven types of "affected taxpayers" eligible for the 120 day postponement. These taxpayers include any individual whose principal residence, and any business entity whose principal place of business, is located in the covered disaster area; any individual who is a relief worker affiliated with a recognized government or philanthropic organization and who is assisting in the covered disaster area; any individual whose principal residence, and any business entity whose principal place of business, is not located in the covered disaster area, but whose records necessary to meet a filing or paying deadline are maintained in the covered disaster area; any estate or trust that has tax records necessary to meet a filing or paying deadline in a covered disaster area; and any spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife. Therefore, taxpayers located outside of the covered disaster area may qualify for relief if they are covered by one of the above mentioned categories.

Additionally, under section 301.7508A –1(d)(1)(vii) of the regulations, the Internal Revenue Service may determine that any other person is affected by a Presidentially declared disaster. Accordingly, the Internal Revenue Service has determined that the following persons are also affected by the disaster: (1) victims of the crash (including those on the plane and those on the ground) of the four commercial jet airplanes hijacked on September 11, 2001; (2) all workers assisting in the relief activities in the covered disaster areas and in Pennsylvania, regardless of whether they are affiliated with recognized government or philanthropic organizations; and (3) taxpayers whose place of employment is located within the Presidentially declared disaster area. In addition, taxpayers who have difficulty in meeting their federal tax obligations because of disruptions in the transportation and delivery of documents by mail or private delivery services resulting from the terrorist attack, and who do not otherwise qualify under section 7508A, are affected taxpayers only for purposes of relief as described in (5) of the Grant of Relief section below. The perpetrators of the attack, and anyone aiding the attack, will not qualify for relief under this notice.

GRANT OF RELIEF

(1) Individuals located in the affected counties and other individuals who are "affected taxpayers" as defined by section 301.7508A–1(d)(1) of the regulations and by this notice that have extended the time for filing their tax year 2000 federal individual income tax return beyond September 10, 2001, will have a postponement to February 12, 2002, to file their returns. A similar postponement to pay the amount of tax (or any installment of tax) shown or required to be shown on those returns is generally not permitted. This is because the tax was originally due on the due date of the 2000 return, April 16, 2001, and, generally an extension of time to pay is not granted; however, a period of 120 days from September 11, 2001, until January 9, 2002, will be disregarded in the calculation of any failure to pay penalty. Thus, the penalty for failure to pay the tax due would start accruing once again if the tax is not paid by January 9, 2002. These returns include individual income tax returns (Forms 1040, 1040A, 1040EZ, 1040NR, or 1040NR-EZ) and gift tax returns (Forms 709 and 709-A). See section 301.7508A–1(c)(1) for a list of affected returns.

(2) Affected taxpayers as defined by section 301.7508A–1(d)(1) of the regulations *other than individuals* are granted both a 120 day postponement under section 7508A and a six month extension under sections 6081 and 6161 to file certain federal tax returns otherwise originally due on or after September 11, 2001, and on or before November 30, 2001, and to pay the tax shown or required to be shown on those returns. The 120 day postponement and the six-month extension run consecutively. In addition, affected calendar year corporations and other entities that are currently on a six-month extension of time to file their federal tax return that expires between September 11, 2001, and November 30, 2001, will have an additional 120 days to file their returns under section 7508A. Thus, the tax year 2000 return for an affected calendar year corporation that has been extended to September 17, 2001 (September 15, 2001, is a Saturday), will now be due by January 15, 2002. A similar postponement to pay the amount of tax (or any installment of tax) shown or required to be shown on those returns is generally not permitted. This is because the tax was originally due on the due date of the 2000 return, March 15, 2001, for a calendar year corporation and generally, an extension of time to pay is not granted. A period of 120 days from September 11, 2001, until January 9, 2002, will be disregarded in the calculation of any failure to pay penalty. Thus, the penalty for failure to pay the tax due would start accruing once again if the tax was not paid by Jan-

uary 9, 2002. These returns include partnership returns, corporate income tax returns, estate and trust income tax returns, estate tax returns, annual returns filed by tax-exempt organizations, certain excise tax returns and employment tax returns. See section 301.7508A–1(c)(1) for a list of affected returns.

(3) The due date of any estimated tax payment for tax year 2001 originally due on or after September 11, 2001, and before January 15, 2002, for taxpayers located in the affected counties, and other affected taxpayers, is postponed under section 7508A until January 15, 2002. This applies to estimated tax payments made by individuals, corporations, estates, and trusts. Thus, for individuals, the third estimated tax payment for tax year 2001, due on September 17, 2001, is postponed until January 15, 2002. For a calendar year corporation, the third estimated tax payment for tax year 2001, due on October 1, 2001, is postponed until January 15, 2002. Affected taxpayers will not be subject to penalties for failure to pay estimated tax installments for tax year 2001 with respect to installments that were originally due on or after September 11, 2001, and before January 15, 2002, as long as such installments are paid by January 15, 2002.

(4) In addition, the Internal Revenue Service has granted a 120 day postponement of time to the affected taxpayers to perform the other acts described in section 301.7508A–1(c)(1) of the regulations. The postponement applies to acts required to be performed within the period beginning on September 11, 2001, and ending on November 30, 2001.

(5) Taxpayers who have difficulty in meeting their federal tax obligations because of disruption in the transportation and delivery of documents by mail or private delivery services resulting from the terrorist attack, and who do not otherwise qualify for relief as described above, will have until November 15, 2001, to file returns and make payments required to be made from September 11, 2001, through October 31, 2001.

(6) As a result of the terrorist attack, taxpayers may have difficulty in making timely federal tax deposits in accordance with section 6302 and the regulations thereunder. The time for making federal tax deposits, however, cannot be extended under section 6081 or postponed under section 7508A. For deposits required to be made from September 11, 2001, through October 31, 2001, however, the Internal Revenue Service will waive the addition to tax under section 6656 for the failure to timely make any deposit of tax if the deposit is made on or before November 15, 2001, because reasonable cause for the failure exists during this period. The relief from the failure to timely deposit addition to tax under this paragraph is only applicable to taxpayers who are unable to meet their deposit obligations because their (or their service provider's) records, computers, or other essential supporting services were damaged, or essential personnel were injured, by the attack.

DRAFTING INFORMATION

The principal author of this notice is Charles Hall of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, you may call (202) 622-4940 (not a toll-free call).

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## Designated Private Delivery Services

## Notice 2001–62

This notice updates the list of designated private delivery services ("designated PDSs") set forth in Notice 99–41 (1999–2 C.B. 325) for purposes of the timely mailing treated as timely filing/paying rule of section 7502 of the Internal Revenue Code, effective September 1, 2001. The Internal Revenue Service (IRS) is adding two new delivery services to the list of designated PDSs. Also, this notice modifies Rev. Proc. 97–19 (1997–1 C.B. 644) to provide a new address for a PDS to submit its written application for designation. This new address will also be used to request administrative review of a letter of denial of designation, appeal a letter confirming the denial of designation, provide written notification of any change in application information, and appeal a proposed revocation letter.

Section 7502(f) authorizes the Secretary to designate certain PDSs for the timely mailing treated as timely filing/paying rule of section 7502. Rev. Proc. 97–19 provides the criteria currently applicable for designation of a PDS. Notice 97–26 (1997–1 C.B. 413) provides special rules to determine the date that will be treated as the postmark date for purposes of section 7502. Notice 97–50 (1997–2 C.B. 305) modifying Rev. Proc. 97–19 and Notice 97–26, provides that each year there will be only one application period to apply for designation, which will end on June 30th. Notice 99–41 provides that the IRS will publish a subsequent notice providing a new list of designated PDSs only if a designated PDS (or service) is added to, or removed from, the current list.

Effective September 1, 2001, the list of designated PDSs is as follows:

1. Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, and Second Day Service;
2. DHL Worldwide Express (DHL): DHL "Same Day" Service and DHL USA Overnight;
3. Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, and FedEx 2 Day; and
4. United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.

UPS Worldwide Express Plus and UPS Worldwide Express are added to the list published in Notice 99–41. Both of these services provide delivery services to the United States from foreign countries. Airborne, DHL, FedEx, and UPS are not designated with respect to any type of delivery service not identified above. The list of designated PDSs and services set forth above will remain in effect until further notice. The IRS will publish a subsequent notice setting forth a new list only if a designated PDS (or service) is added to, or removed from, the current list, or if there is a change to the application and/or appeal procedures. Delivery services that wish to be designated in time for an upcoming filing season must continue to submit applications by June 30th of the year preceding that filing season, as required by Rev. Proc. 97–19 (as modified by Notice 97–50). Notice 97–26 continues to provide special rules used to determine the date that will be treated as the postmark date for purposes of section 7502.

As a result of the IRS's reorganization, the application addresses listed in section

6 of Rev. Proc. 97–19 are no longer correct. Section 6 of Rev. Proc. 97–19 is modified to provide that a PDS may now submit its written application by mailing it to:

Internal Revenue Service
Attn: Director, Submission Processing
W:CAS:SP
New Carrollton Federal Building
5000 Ellin Road
Lanham, MD 20706

Applications will no longer be accepted by hand delivery at the Courier's Desk located at 1111 Constitution Avenue, N.W. The above address is also where a PDS may write to: (1) obtain administrative review of a letter of denial of designation under section 9.03 of Rev. Proc. 97–19; (2) appeal a letter confirming the denial of designation under section 9.06 of Rev. Proc. 97–19; (3) provide prompt written notification to the IRS of any change in application information under section 10.01 of Rev. Proc. 97–19; and (4) appeal the issuance of a proposed revocation letter under section 12.03 of Rev. Proc. 97–19.

EFFECT ON OTHER DOCUMENTS

Revenue Procedure 97–19 is modified. Notice 99–41 is modified and, as so modified, is superseded.

EFFECTIVE DATE

This notice is effective on September 1, 2001.

FOR FURTHER INFORMATION

The principal author of this notice is Charles A. Hall of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, contact Charles A. Hall at (202) 622-4940 (not a toll-free call).

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## Additional Disaster Relief for Taxpayers on Account of the September 11, 2001, Terrorist Attack

## Notice 2001–63

The Treasury Department and the Internal Revenue Service recognize that the continuing disruption to the nation's financial markets, transportation system, and telecommunication and computer networks, and continuing security concerns have made it difficult for many taxpayers to meet their September 17, 2001, filing and payment requirements, and for their representatives to assist them in doing so. This notice provides additional tax relief under sections 6081, 6161, and 7508A for taxpayers who, regardless of their location, are continuing to experience difficulties in meeting their filing and tax payment requirements on account of events related to the September 11, 2001, terrorist attack. The Internal Revenue Service has determined that the due date for all federal tax obligations falling between September 10, 2001, and September 24, 2001, is postponed to September 24, 2001. This postponement of time covers the filing of returns and claims for refund, the payment of tax (including estimated tax payments), making elections, and filing any other federal tax documents. The postponement does not apply to deposits of federal taxes. For relief with respect to deposits of federal taxes, see Notice 2001–61 on page 305 of this Bulletin and IRS News Release IR-2001–79.

The relief provided by this notice is in addition to the relief provided in Notice 2001–61 and IRS News Release IR-2001–79.

DRAFTING INFORMATION

The principal author of this notice is Charles Hall of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, you may call (202) 622-4940 (not a toll-free call).

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*26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.*

## Rev. Proc. 2001–48

SECTION 1. PURPOSE

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 1999. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 1999. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96 (1989–2 C.B. 417). For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies' liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 1998, see Rev. Proc. 2000–32 (2000–33 I.R.B. 172).

SECTION 2. CHANGES

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 2000. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 1999, the relevant domestic asset/liability percentages are:

114.2 percent for foreign life insurance companies, and

201.6 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 2000. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 1999, the relevant domestic investment yields are:

8.2 percent for foreign life insurance companies, and

5.6 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 2000. The section 842(b) percentages to be used for the 2000 tax year are based on tax return data following the same methodology used for the 1999 year.

SECTION 3. APPLICATION — ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 1999, a foreign insurance company must compute its estimated tax payments by adding to its income, other than net investment income, the greater of (i) its net investment income as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the publication of this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 2000–32 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 1999.

DRAFTING INFORMATION

The principal author of this revenue procedure is Garrett D. Gregory of the Office of the Associate Chief Counsel (International). For further information regarding this revenue procedure, please contact Mr. Gregory at (202) 622-4461 (not a toll-free call), or write to the Internal Revenue Service, Office of the Associate Chief Counsel (International), 1111 Constitution Avenue, NW, Washington, DC 20224, Attention: CC:INTL:Br5, Room 4554.

# Part IV. Items of General Interest

## Foundations Status of Certain Organizations

## Announcement 2001–97

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

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

21st Century Economic Development Corporation, Detroit, MI
A Family Affair by Jessie, Inc., Lauderdale Lakes, FL
Abused Womens Abode Kindling Education, Inc., Salem, AR
Acorn Educational Foundation, Santa Rosa, CA
Ahkami Foundation, Inc., Clifton, NJ
Aids Interfaith Network of Sacramento Valley & the Foothills, Sacramento, CA
Angelhouse Corp., Petaluma, CA
Angolacare, Inc., Washington, DC
Arena Theatre and School, Inc., Minneapolis, MN
Arkadelphia Housing Authority Resident Organization, Arkadelphia, AR
Arts Awareness Project, Rolla, MO
Asia Pacific Management Association, Long Beach, CA
Autistic Childrens Project for Humane Education, Mill Valley, CA
Biodrama Institute of San Francisco, Mill Valley, CA
Boys & Girls Clubs of the Keys Area, Inc., Key West, FL
Brentwood 202 Senior Housing, Inc., Oakland, CA
British American Theatre Company, San Rafael, CA
Brues Academy, Oakland, CA
Buffalo River Stewardship Foundation, Ltd., Harrison, AR
Butterflies for Kids, Erie, PA
Camp Me and My Family, Calistoga, CA
Capital City Boys & Girls Club, Jefferson City, MO
Childrens Explorium, Inc., Cottekill, NY
Christian Youth Fund, Eureka, CA
C.J.I. Association, Inc., Little Rock, AR
Clarke Training High School Alumni Association-Chicagoland Connection, Chicago, IL
Colusa County Youth Education Foundation, Inc., Colusa, CA
Community Coalition Corporation, Fort Smith, AR
Community Outreach & Reentry Services for Men, Inc., Vallejo, CA
Consortium for the Advancement of Children, Richmond, CA
Cornerstone Shady Oaks Corporation, Sacramento, CA
Corporacion Para el Desarrollo Integral de Hormigueros CD, Hormigueros, PR
Crucian Sea Kids, Inc., St. Croix, VI
Dade Teamworks, Inc., Coral Gables, FL
David L. Snead Scholarship Foundation, Detroit, MI
Del Norte Youth Football, Inc., Crescent City, CA
DeQueen Sevier County Caring and Sharing Fund, DeQueen, AR
Diamonds in the Rough Community Service Corporation of Greater, Little Rock, AR
Doris Tate Crime Victims Foundation, San Rafael, CA
Dragonmaker Productions, Portland, OR
Dream Quest, Inc., Little Rock, AR
Fall River Wild Trout Foundation, Sacramento, CA
First Responders of Minot, Minot, ME
Forest Sentinels in Science, Inc., McCloud, CA
Friends of California Parks, Sacramento, CA
Fulton County Child Abuse Prevention Council, Rochester, IN
GC&G Corporation, Jacksonville, AR
Glorious Communications Network, Berkley, CA
Golden Angels Club LJ, Sweethome, AR
Grant County Amateur Radio Club, Inc., Sheridan, AR
Grass Valley Police Activities League, Inc., Grass Valley, CA
Greater Goals Foundation, Inc., San Diego, CA
Help for a New Day, W. Helena, AR
His Ideas, Inc., Red Bluff, CA
Historic Farmhouse Foundation, Gold River, CA
Historic First Presbyterian Church Preservation Foundation, Napa, CA
Historic Research Foundation, Kansas City, MO
Homes II U, Inc., Jonesboro, AR
Homeward Bound, Inc., Penryn, CA
Hope Pregnancy Care Center, Blyteville, AR
Hot Springs Aids Resource Center, Hot Springs, AR
Hyperbaric Oxygen Medical Foundation, Glendale, CA
Inspirations, Little Rock, AR
International Feline Foundation, Santa Ana, CA
Isaiah 55 Feeding Ministry, Pittsburg, CA
Jefferson Reeves Sr. Health Center, Inc., Miami, FL
Kneady Hands, Bay Point, CA
Kolobok Arts Inspiration Assn., Mercer Island, WA
LA Best Care, Los Angeles, CA
Leadership and Development for Children of the South, Inc., West Memphis, AR
Light for the Nations, Inc., Yuba City, CA
Lions Club of Oakland Foundation, Lafayette, CA
Love One Plaza, Inc., Miami, FL
Luciel Beasley Foundation, Vallejo, CA
Mandala Institute, Inc., Sacramento, CA
Melanoma Society of America, Walnut Creek, CA
Military Heritage Foundation, Eureka, CA
Ministries of Jesus Christ, Benton, AR
Mitochondrial Disorders Foundation of America, Concord, CA
Multi-Cultural Theater Group, Fairfield, CA
Music for Seniors & the Disabled, Inc., Arroyo Grande, CA
Nadias Ministry for the Middle East, Inc., Oakland Park, FL
Napa Pain Resources, Inc., Napa, CA
National Day of Prayer of Russellville AR, Russellville, AR

Natomas Animal Rescue, Sacramento, CA
New World Youth Ballet, Arcata, CA
North Bay Performing Arts Association, Petaluma, CA
Northern California Regional Computer Network, Chico, CA
Nurseoptions Foundation, Concord, CA
Omnilife, Inc., Sacramento, CA
Our Brothers Keeper, Santa Rosa, CA
Owasso Animal Defense Fund–OADF, Owasso, OK
Paddling to Atlanta 1996, Inc., Santa Rosa, CA
Palm Tree Enterprises, Menlo Park, CA
People Helping People of South Charleston Ohio, Inc., South Charleston, OH
Philbricks Place A California Non-Profit Public Benefit Corp., Yuba City, CA
Positive Alternative, Inc., Miami, FL
Positive Self Esteem for Supportive Services, Stockton, CA
Power of Gods Word Ministries, Placerville, CA
Power Surge, Vallejo, CA
Pulaski County Crime Stoppers, N. Little Rock, AR
Radio Hope, Phoenix, AZ
Rainbow Real Estate Professionals, Sacramento, CA
Random Acts of Kindness Foundation, Berkeley, CA
Reliable Medical Transportation, Inc., Star City, AR
Restoring Sight International, Inc., New York, NY
Rio Linda Pro. Rodeo, Inc., Rio Linda, CA
Royal Stuarts Scottish Performers Guild, Salinas, CA
RPC Net, Rohnert Park, CA
Rural Medicaid Transportation, Inc., Warren, AR
Russellville Youth Baseball Association, Inc., Russellville, AR
Safaris, Inc., Broken Arrow, OK
Service First of Northern California, Stockton, CA
Shakespeare at the Beach, Stinson Beach, CA
Shem Tov, Inc., Brooklyn, NY
Sierra Foothills All Weather Track Project, Inc., Cedar Ridge, CA
Sierra Theatre Arts Growth Exchange, Davis, CA
Society of Grumpy Old Men and Friends, Little Rock, AR
Solar Connections, Fort Bragg, CA
Solutions, Lodi, CA
Sonoma-Chambolle Musigny Sister Cities, Inc., Sonoma, CA
South Valley Behavioral Counseling Services, Phoenix, AZ
Southeast Fayetteville Community Center, Inc., Fayetteville, AR
St. Christopher Childrens Pre-Teen Educational and Medical Foundation, Renton, WA
St. Francis Elderly Haven of Rest, Stockton, CA
Summer Street, Springdale, AR
T.M.J. Society of California, Cameron Park, CA
Tri-County Medicaid Transportation, Inc., Warren, AR
Tucker Financial Management, Lodi, CA
Twin Counties Swim League, Inc. Benicia, CA
Twin Lakes Yaba Scholarship Fund, Mountain Home, AR
Under the Spotlight, Antioch, CA
Underground Gold Miners of California Museum, Alleghany, CA
United Pastors of Sacramento, Sacramento, CA
Vallejo Crimestoppers, Inc., Vallejo, CA
Viking Boys Basketball Organization, Antelope, CA
Washington Deming Study Group, Rockville, MD
Weecare Too, Inc., Yellville, AR
Women in Telecommunications, Alamo, CA
Woodland House of Mercy, Woodland, CA
Worldwide Christian Church Ministries, Inc., Alhambra, CA
Youth Dream Video Productions, Sacramento, CA

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

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

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

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

The adjusted applicable federal long-term rate is set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, on this page.

## Section 882(c).—Allowance of Deductions and Credits

The IRS and the Treasury Department are soliciting comments on the appropriate method for allocating interest to certain types of financial positions that may constitute integrated financial transactions. See Notice 2001–59, page 315.

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

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

**Federal Rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for October 2001.

## Rev. Rul. 2001–49

This revenue ruling provides various prescribed rates for federal income tax purposes for October 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2001–49 TABLE 1

Applicable Federal Rates (AFR) for October 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| *Short-Term* | | | | |
| AFR | 3.58% | 3.55% | 3.53% | 3.52% |
| 110% AFR | 3.95% | 3.91% | 3.89% | 3.88% |
| 120% AFR | 4.31% | 4.26% | 4.24% | 4.22% |
| 130% AFR | 4.67% | 4.62% | 4.59% | 4.58% |
| *Mid-Term* | | | | |
| AFR | 4.59% | 4.54% | 4.51% | 4.50% |
| 110% AFR | 5.05% | 4.99% | 4.96% | 4.94% |
| 120% AFR | 5.52% | 5.45% | 5.41% | 5.39% |
| 130% AFR | 5.99% | 5.90% | 5.86% | 5.83% |
| 150% AFR | 6.93% | 6.81% | 6.75% | 6.72% |
| 175% AFR | 8.11% | 7.95% | 7.87% | 7.82% |
| *Long-Term* | | | | |
| AFR | 5.39% | 5.32% | 5.29% | 5.26% |
| 110% AFR | 5.94% | 5.85% | 5.81% | 5.78% |
| 120% AFR | 6.48% | 6.38% | 6.33% | 6.30% |
| 130% AFR | 7.04% | 6.92% | 6.86% | 6.82% |

REV. RUL. 2001–49 TABLE 2

Adjusted AFR for October 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| Short-Term adjusted AFR | 2.72% | 2.70% | 2.69% | 2.68% |
| Mid-term adjusted AFR | 3.57% | 3.54% | 3.52% | 3.51% |
| Long-term adjusted AFR | 4.71% | 4.66% | 4.63% | 4.62% |

REV. RUL. 2001–49 TABLE 3

Rates Under Section 382 for October 2001

| | |
|---|---|
| Adjusted federal long-term rate for the current month | 4.71% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 4.94% |

REV. RUL. 2001–49 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for October 2001

| | |
|---|---|
| Appropriate percentage for the 70% present value low-income housing credit | 8.16% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.50% |

| REV. RUL. 2001–49 TABLE 5 | |
|---|---|
| Rate Under Section 7520 for October 2001 | |
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | 5.60% |

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, page 312.

## Section 3221.—Rate of Tax

## Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning October 1, 2001, shall be at the rate of 26 cents.

In accordance with directions in section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning October 1, 2001, 38.7 percent of the taxes collected under sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 61.3 percent of the taxes collected under such sections 3211(b) and 3221(c) plus 100 percent of the taxes collected under section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated September 14, 2001.
By Authority of the Board.

Beatrice Ezerski,
*Secretary to the Board.*

(Filed by the Office of the Federal Register on September 20, 2001, 8:45 a.m., and published in the issue of the Federal Register for September 21, 2001, 66 F.R. 48721)

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, page 312.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2001. See Rev. Rul. 2001–49, page 312.

# Part III. Administrative, Procedural, and Miscellaneous

## Request for Comments on Regulations That May Be Adopted on Interest Allocation.

## Notice 2001–59

SECTION 1. PURPOSE

This notice requests comments on whether the interest expense allocation and apportionment rules of §§1.861–9T, 1.861–10T, and 1.882–5 of the Income Tax Regulations should be modified to provide integrated treatment (such as netting of interest expense and income and/or assets and liabilities) of certain financial transactions.

SECTION 2. THE INTEREST EXPENSE ALLOCATION RULES OF SECTIONS 864(e) AND 882(c)(1)(A)

Section 864(e) requires taxpayers that are members of an affiliated group to allocate and apportion interest expense as if all members of such group are a single corporation, and based on assets rather than gross income. The basic approach of the interest allocation rules is that because money is fungible, most borrowing contributes to the financing of all of an affiliated group's activities and property. Thus, gross interest expense generally is allocated based on all the assets of an affiliated group, regardless of the specific purpose for any particular borrowing. *See* §1.861–9T(a).

Section 882(c)(1)(A) provides that a foreign corporation engaged in a trade or business within the United States is allowed deductions in computing its tax liability under §11 only to the extent that the deductions are connected with the conduct of such trade or business. Section 882(c)(1)(A) further provides that the proper allocation and apportionment of deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary. Pursuant to §1.882–5(a)(1)(i), foreign corporations must apply the interest expense allocation rules of §1.882–5, rather than those of §1.861–9T, to determine the amount of interest expense that is deductible under §882(c)(1)(A). The interest allocation rules of §1.882–5, like the rules of §1.861–9T, allocate interest expense based on the value of assets.

Although interest expense generally is allocated and apportioned based on all assets, §864(e)(7)(B) provides that the Secretary shall prescribe regulations as may be necessary and appropriate to carry out the purposes of such section, including regulations providing for the direct allocation of interest expense incurred to carry out an "integrated financial transaction" to any interest (or interest-type income) derived from such transaction. *See also* Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986*, 99th Cong., 2nd Sess. 948 (1987) ("In the case of an integrated financial transaction such as a debt-financed acquisition of foreign currency debt obligations or similar arbitrage transactions, the Act authorizes the Secretary to provide for the direct allocation of interest expense incurred on funds borrowed to acquire these assets against income from the assets involved in the integrated transaction, if appropriate.") Sections 1.861–10T(c) and 1.882–5(a)(1)(ii) provide for direct allocation of interest expense on a borrowing to income generated by an asset if certain conditions are met. The value of any asset to which interest expense is directly allocated under these rules then is reduced to take into account the principal amount of the indebtedness to which the directly allocated interest relates (for purposes of applying the general rules for the allocation and apportionment of interest expense not subject to the direct allocation rules). *See* §§1.861–10T(d)(2), 1.861–9T(g)(2)(iii), and 1.882–5(a)(1)(ii)(A). These rules for integrated financial transactions do not apply, however, to interest expense and indebtedness of a "financial services entity" as that term is defined in §1.904–4(e)(3). *See* §1.861–10T(c)(2)(vi).

SECTION 3. RELATED FINANCIAL INSTRUMENTS

Treasury and the Service are considering whether to provide, in certain circumstances, for the direct allocation of interest expense to income and for adjustments to the value of assets to reflect directly allocated liabilities. Such circumstances may include situations in which a taxpayer holds financial instruments that, although formally separate, are economically closely related. One possible example is the case of a financial institution that maintains a matched book of securities repurchase (repo) and reverse repurchase (reverse repo) transactions, which are treated as secured loans that give rise to interest expense (in a repo) and interest income (in a reverse repo) for federal tax purposes. *See*, *e.g.*, Rev. Rul. 74–27 (1974–1 C.B. 24). Similar issues may arise in the case of other financial instruments, including instruments that do not produce interest expense or interest-type income, but for which netting of the assets and the liabilities may be appropriate (*e.g.* notional principal contracts).

SECTION 4. REQUEST FOR COMMENTS

Comments are requested on whether §§1.861–9T, 1.861–10T, and 1.882–5 should be modified to apply integrated treatment (such as netting of interest expense and income and/or assets and liabilities) to other financial transactions and, if so, the circumstances in which such integrated treatment should apply. In particular, comments are requested on: (1) whether the rules for integrated financial transactions in §1.861–10T(c) should be made applicable to financial services entities; (2) whether the definition of an integrated financial transaction should be expanded; (3) the criteria that should apply in determining whether financial transactions are sufficiently related to make integrated treatment appropriate; and (4) the administrative and record keeping requirements that may be appropriate. Comments also are requested regarding whether an integrated or similar approach for related financial transactions is appropriate under other provisions of the Code. *See*, *e.g.*, §1.1296–6(i) of the Proposed Income Tax Regulations.

SECTION 5. SUBMISSION OF COMMENTS

Taxpayers may submit comments to: CC:ITA:RU (OGI-130836-01), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (OGI-130836-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html.*

DRAFTING INFORMATION

The principal author of this notice is Kenneth Christman of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this notice, contact Kenneth Christman at (202) 622-3870 (not a toll-free call).

## Disguised Sales of Partnership Interests—Request for Comments

## Notice 2001–64

The Internal Revenue Service and the Treasury Department are considering issuing proposed regulations under § 707(a)(2)(B) of the Internal Revenue Code relating to disguised sales of partnership interests. As part of this consideration, comments are being solicited concerning the scope and substance of this guidance.

Effective April 24, 1991, the Service and Treasury issued final regulations adding new regulations § 1.707–0 and § 1.707–2 through § 1.707–9 to the Income Tax Regulations (26 CFR part 1) under section 707(a)(2). These regulations apply to transfers described in § 707(a)(2)(A) and (B). Section 1.707–7 was reserved for rules on disguised sales of partnership interests.

The legislative history of § 707(a)(2) indicates that the provision was adopted as a result of Congress' concern that taxpayers were deferring or avoiding tax on sales of partnership property, including sales of partnership interests, by characterizing sales as contributions of property, including money, followed or preceded by a related partnership distribution. See H.R. Rep. No. 861, 98th Cong., 2nd Sess. 861 (1984), 1984–3 (Vol. 2) C.B. 115. Specifically, Congress was concerned about court decisions that allowed tax-free treatment in cases that were economically indistinguishable from sales of property to a partnership or another partner and believed that these transactions should be treated for tax purposes in a manner consistent with their underlying economic substance. See H.R. Rep. No. 432, 98th Cong., 2nd Sess. 1218 (1984), and S. Prt. No. 169 (Vol. I), 98th Cong., 2nd Sess. 225 (1984) (discussing *Communications Satellite Corp. v. United States*, 625 F.2d 997 (Ct. Cl. 1980), and *Jupiter Corp. v. United States*, 2 Cl. Ct. 58 (1983), both of which involved the disguised sale of a partnership interest).

Comments are requested on the scope and substance of guidance concerning disguised sales of partnership interests, including any applicable safe harbors or exceptions. Prior to the issuance of regulations, the determination of whether a transaction is a disguised sale of a partnership interest under § 707(a)(2)(B) is to be made on the basis of the statute and its legislative history.

Direct all written comments to Internal Revenue Service, Attn: CC:MSP:R (NT 2001–64), Room 5228, CC:PSI:01, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8:00 a.m. and 5:00 p.m. to the courier's desk at 1111 Constitution Avenue, NW, Washington, DC, or submitted electronically to: *Notice.Comments@m1.irs.cousel.treas.gov.* Please submit comments by March 31, 2002. All submissions will be open to public inspection.

The principal author of this notice is Carolyn Gray of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice, contact Carolyn Gray at (202) 622-3050 (not a toll-free call).

# Part IV. Items of General Interest

## New Form 5306-A, *Application for Approval of Prototype Simplified Employee Pension (SEP) or Savings Incentive Match Plan for Employees of Small Employers (SIMPLE IRA Plan)*

### Announcement 2001–96

New Form 5306-A is now available for immediate use. The new form is to be used by sponsors of prototype simplified employee pensions (SEPs) and prototype SIMPLE IRA plans to apply for opinion letters on these documents. Form 5306-A replaces Form 5306-SEP, *Application for Approval of Prototype Simplified Employee Pension - SEP*. The Service will continue to accept applications submitted using Form 5306-SEP until December 31, 2001.

The Service will not issue opinion letters covering EGTRRA changes to SEPs and SIMPLE IRA plans until further notice.

You can obtain Form 5306-A by telephone or by using IRS electronic information services.

| *Request by* | *Number or address* |
|---|---|
| Telephone | **1-800-TAX-FORM** (1-800-829-3676) |
| Personal computer: | |
| IRS Web Site | ***www.irs.gov*** |
| File transfer protocol | **ftp.irs.gov** |

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## Changes to the Requirements for Excise Tax Returns, Payments, and Deposits, Effective for Calendar Quarters Beginning After September 30, 2001

### Announcement 2001–98

**Purpose**

The IRS has issued final regulations on the requirements for excise tax returns, payments, and deposits, effective for calendar quarters beginning after September 30, 2001. This announcement is to advise taxpayers who file Form 720, *Quarterly Federal Excise Tax Return*, of the revised filing and deposit requirements. These changes will be reflected on the 4th quarter Form 720 and its instructions.

**Filing Dates**

All Forms 720 must be filed by the last day of the month following the quarter for which the return is made. The returns are due by April 30, July 31, October 31, and January 31. The one-month filing extension that was allowed for returns relating to communications, air transportation, and ozone-depleting chemicals has been eliminated.

**Deposit Threshold**

No deposit is required for taxes listed in Part I of Form 720 if the net tax liability does not exceed $2,500 for the quarter. The threshold previously was $2,000.

**Deposit Dates**

One deposit rule applies for all taxes other than those deposited under the alternative method. There are two methods under which deposits can be made: The regular method and the alternative method. The classes of tax, which were referred to as the 9-day rule, 14-day rule, and 30-day rule, have been eliminated.

Under the regular method, deposits for a semimonthly period are due by the 14th day of the following semimonthly period. Generally, this is the 29th day of the month for the first semimonthly period and the 14th day of the following month for the second semimonthly period. If the 14th day is a Saturday, Sunday, or legal holiday, the deposit is due the immediately **preceding** day that is not a Saturday, Sunday, or legal holiday. There is no change to deposit dates for taxes deposited under the alternative method.

**Amount To Deposit and Safe Harbor Rules**

In general, the deposit of tax for each semimonthly period must be at least 95% of the amount of net tax liability incurred during the semimonthly period. This replaces the requirement to deposit 100% of the net tax liability and the current liability safe harbor rule. The look-back quarter liability safe harbor rule still applies.

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## Foundations Status of Certain Organizations

### Announcement 2001–100

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

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

20th Century Unlimited, Santa Fe, NM
ABM Sports, Inc., Austin, TX
Academy of Restaurant Training, Inc., Bala Cynwyd, PA
Acadian Centre Acadien, Inc., Abbeville, LA
Acadiana Soccer Association, Inc., Opelousas, LA
Access Information Fund, Inc., White Plains, NY
Activecare, Inc., Moriarty, NM
Adoption Information Foundation, Tulsa, OK
African American Scholarship Foundation, New Orleans, LA
African and African American Business Foundation, Gary, IN
African and American Organization Corporation, Bronx, NY
African Queens Community Foundation, Inc., Austin, TX
Agape Community Health Services, Inc., Monroe, LA
Albert H. and Constance Saunders Foundation, Silver Spring, MD
Alliance for Medical Care, Great Falls, VA

American Boxer Rescue Association, Tulsa, OK
American Computer Education, Inc., Lucas, OH
Americas Theatre Group Corp., Coral Gables, FL
Art & Understanding, Inc., Albany, NY
Arts India Council, Baton Rouge, LA
Augustus Straker Bar Foundation, Troy, MI
Austin Great Wall Chinese School AGCS, Austin, TX
Barron Foundation, Los Angeles, CA
Bay Area Female Executives Association, Corpus Christi, TX
Bella Vista Public Library Foundation, Bella Vista, AR
BFL Foundation, Oceanside, CA
Bienville Foundation, New Orleans, LA
BioSafe Donor Registry, Inc., Lake Forest, IL
Biscayne Bay Foundation, Inc., Coconut Grove, FL
Boys & Girls Club of the Choctaw Nation, Inc., Talihina, OK
Brother to Brother, Beaumont, TX
Caribbean-American Educational Foundation, Del City, OK
Caring Hands of Central Louisiana, Inc., Alexandria, LA
Caring Strokes, Inc., Los Angeles, CA
Carl Albert Foundation, Oklahoma City, OK
Catholic Scholarship Fund, Inc., Kenner, LA
CCCarts, Inc., Oklahoma City, OK
Centex Club 12, Inc., Waco, TX
Central Oklahoma Clinical Forensic Consultants, Inc., Oklahoma City, OK
Centro Chicano, Inc., El Paso, TX
Choctaws for Democracy, Inc., Antlers, OK
Christ is Lord Child Care Food Program, Baton Rouge, LA
Christian Family Development Association, Clinton, OK
Citizens Programs Corporation, Boston, MA
Claras Little Lambs Preschool Academy, Inc., New Orleans, LA
Clark Trails Associations, Inc., Otisco, IN
Claud Gill Arena Association, Duncan, OK
Colorado Preservation Housing Corporation, Greeley, CO
Comanche Cultural Compact, Inc., Apache, OK
Community in Schools of Oklahoma, Inc., Shawnee, OK
Community Visions Unlimited, New Orleans, LA
Conservation Foundation for Polk County, Inc., West Des Moines, IA
Crosslink, Inc., Bryan, TX
Cuero New Generation Community Theatre, Cuero, TX
Cypress Black Bayou Zoological Association Garden, Inc., Benton, LA
Dawn, Inc., Baton Rouge, LA
Deaf Culture Project, Cleveland, OH
Decision Healthcare, Baton Rouge, LA
Dolby Providers, Inc., New Orleans, LA
Double Eagle Resources Development Corporation, El Paso, TX
Downtown Jacksonville, Inc., Jacksonville, AR
Drug-Free Wimberley, Inc., Wimberley, TX
East Harlem Renewal Homes-Housing Development Fund Company, Inc., Hellgate Station, NY
Eastwood Area Community Development Corporation, Houston, TX
EcoTelesis International, Inc., Agoura Hills, CA
El Paso Hispanic Chamber of Commerce Educational Development, El Paso, TX
El Shaddai Enterprises, Los Angeles, CA
End-Time Christian Evangelical Ministry, Bensalem, PA
End Time Messengers, Inc., Adair, OK
Endwar, Olympia, WA
Environmental Education Institute, Inc., Tampa, FL
Ernest Kelly Outreach, Inc., Midway, GA
E.T.W. Ministries, Inc., Tulsa, OK
Exodus 20, Pueblo, CO
Expect a Miracle Foundation, Dana Point, CA
Eye Light Publishing, Inc., Minneapolis, MN
Faith Hope & Love Ministries, Inc., Norman, OK
Faith Ministries, Inc., Baton Rouge, LA
Family Life Community, Inc., Abbeville, LA
Family Making, Pleasanton, CA
Feather Awards, Inc., Mission Viejo, CA
Feed-A-Child, Inc., New Orleans, LA
Foresight Affordable Housing-Vineland, Inc., Rockville, MD
Four Pines Care and Transitional Center, Inc., Houston, TX
Free Spirit Community Development Corporation, New Orleans, LA
Friends for Waialua Town, Waialua, HI
Friends in Unity Social, Tulsa, OK
Friends of the Shin Enkan, Inc., Bartlesville, OK
Friends of Yerevan State University, Farmington Hills, MI
Friendship Relief, Inc., San Antonio, TX
Gabriel Assistance Ministries, Inc., Victoria, TX
Gamma Rho International Educational Foundation, Inc., Tallahassee, FL
Gateway Vocational and Restoration Center, Carson, CA
Geary Avenue Homeless Mission, Inc., Oklahoma City, OK
Geronimo Monument, Incorporated, Portal, AZ
Global One, Casa Grande, AZ
Gods Monument Bible Excursion World USA, Phillipsburg, NJ
Gods News Publications, Channelview, TX
Goldbeck Towers Good Samaritan Housing, Inc., Sioux Falls, SD
Golden Rule Clothes Closet & More, Ft. Smith, AR
Gonzales Independence Homes, Inc., San Antonio, TX
Grass Roots Investments, Inc., New Orleans, LA
Greater New Orleans Health Center, New Orleans, LA
Greater Trinity Christian Learning Academy, Everett, WA
Green Country Assistance Program, Inc., Porter, OK
Gujarati Samaj of Oklahoma, Inc., Oklahoma City, OK
Healthy Lifestyles, Inc., Shreveport, LA
Heartland of America Fund, Inc., Oklahoma City, OK
Heartland Sailing Foundation, Oklahoma City, OK
Heartland Volunteers Recognition Association, Oklahoma City, OK
Helping Hands in Hardin, Inc., Hardin, MT
Helpline Soul Rescue Ministry, Inc., Baldwin, NY
Highway Dog Animal Help, Inc., Riesel, TX
Hunter's Brotherhood Alumni Alumnae, Inc., New Orleans, LA
In the Mighty Name of Jesus Christ Ministry, Cleveland, OH
Incarcerated Hearts, Corpus Christi, TX
Indo American Charities, Inc., Vidalia, GA

Institute for Community Development, Inc., Silver Spring, MD
Institute for Inner Peace, Maryville, IL
Institute for Substainable Power, Inc., Highlands Ranch, CO
Interagency Commission for Youth, Inc., Pine Bluff, AR
Interfaith Volunteer Caregivers of Southwest Louisiana, Inc., Lake Charles, LA
International Aviation Ministry, Inc., Tulsa, OK
International Film Fund, Broken Arrow, OK
Iranian Cultural Community of Austin, Inc., Austin, TX
Jacksonville Chamber Foundation, Inc., Little Rock, AR
James H. Young Foundation for the Support of Experimental Therapies, Harahan, LA
Kansas Little League, Incorporated, Kansas, OK
Kenner Club, Inc., Kenner, LA
Kent House, Inc., New Orleans, LA
Lafayette Youth Organization, Lafayette, LA
LHM, Inc., Shreveport, LA
McCurtain County Bar Association Scholarship Fund, Inc., Idabel, OK
Mother Goose Day Care, Inc., Natchez, MS
Muscle Music, Inc., Austin, TX
Nana Kwadwo Adu II Foundation for Ghana, New Orleans, LA
National Guard Association of OK Scholarship Foundation, Inc., Oklahoma City, OK
New Life Mens Ministries, Inc., Broken Arrow, OK
New Mummers Repertory, Inc., Oklahoma City, OK
New Orleans Area Literacy Coalition, Inc., New Orleans, LA
New Orleans Center for Living, Inc., New Orleans, LA
New Orleans Sister Cities, Inc., Mandeville, LA
New Year Coalition, New Orleans, LA
Nigerian Union Tulsa, Incorporated, Tulsa, OK
Oklahoma Center for Grief and Loss and Life Transition, Inc., Oklahoma City, OK
Oklahoma Code Enforcement Association, Del City, OK
Oklahoma Emergency Medical Technicians Association Foundation, Tulsa, OK
Oklahoma Oil & Gas Museum, Inc., Yukon, OK
Oklahoma Railway Heritage Association, Inc., Oklahoma City, OK
Old Sallisaw High School Association, Sallisaw, OK
Ouachita Valley Heritage Museum and Society, W. Monroe, LA
Pioneer Technology Center Foundation, Inc., Ponca City, OK
Project Mobilization International, Inc., Bixby, OK
Rae Valley School, Burton, TX
Randolph Drug Abuse Resistance Education, Randolph AFB, TX
Rauch, Inc., New Orleans, LA
Real Life Ministries, San Antonio, TX
Recycled Computers for Kids, Inc., Baton Rouge, LA
Riviera Volunteer Fire Dept., Inc., Riviera, TX
Roots and Wings Foundation, Oklahoma City, OK
Saving Kids Unlimited, Inc., New Orleans, LA
Seekers of Wisdom, Inc., Oklahoma City, OK
Slidell Liver Support Group, Inc., Slidell, LA
South Side Community Improvement Association, Inc., Monroe, LA
Southern Providers, Inc., Harvey, LA
Southside Restoration, Inc., Jennings, LA
Southwestern Louisiana Homeless Coalition, Inc., Lake Charles, LA
Sports Club of Jennings, Jennings, LA
SSAFE Foundation, Shawnee, OK
St. Bernard Community Outreach, Violet, LA
St. Martin Deporres Ministry for the Poor, New Orleans, LA
Star Medical Transportation, Inc., Athens, LA
Sue Eakin Institute for the Study of Plantation Life, Inc., Palmetto, LA
Suno School of Social Work Graduate Alumni, Inc., New Orleans, LA
Taking Action, Incorporated, Austin, TX
Teen Town Council, Inc., Vinita, OK
Temple of Truth of the Gospel of Jesus Christ of the Apostolic Faith, Inc., Broken Arrow, OK
Thrift Town, Llano, TX
Tots Day Care and Preschool, Inc., New Orleans, LA
Treme Historical Development Corporation, New Orleans, LA
Tulsa Area Aquatic Alliance, Inc., Tulsa, OK
Tulsa Senior Citizens Center for the Deaf, Inc., Tulsa, OK
Vacherie Youth Organization, Vacherie, LA
Virginia Miniex Memorial Scholarship Fund, Lafayette, LA
Vision Evangelism, Inc., Tulsa, OK
Wagoner Band Booster Club, Wagoner, OK
Webb Alliance, Inc., San Antonio, TX
Webbers Falls Historical Society Museum, Webbers Falls, OK
WINGS Youth Outreach, Mission, TX
Working Womens Money University, Oklahoma City, OK
Youth Haven, Inc., Laredo, TX
Zion Hill Development Education Center, Grambling, LA
Zion Human Resources and Development Corporation, New Orleans, LA
Zion Travelers Baptist Church Outreach Ministries, Inc., Reserve, LA

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

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

## Section 62.—Adjusted Gross Income Defined

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

Rules are set forth under which reimbursement or other expense allowance arrangement for the cost of lodging, meal, and incidental expenses or meal and incidental expenses incurred by an employee while traveling away from home will satisfy the requirement of § 62(c) of the Code as to substantiation of the amount of the expense. See Rev. Proc. 2001–47, page 332.

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## Section 162.—Trade or Business Expenses

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

Rules are set forth for substantiating the amount of a deduction or an expense for lodging, meal, and incidental expenses or meal and incidental expenses incurred while traveling away from home. See Rev. Proc. 2001–47, page 332.

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## 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. 2001–47, page 332.

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## Section 274.—Disallowance of Certain Entertainment, etc., Expenses

*26 CFR 1.274–5: Substantiation requirements.*

Rules are set forth for an optional method for substantiating the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or meal and incidental expenses incurred while traveling away from home when a payor provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Rules are also set forth for an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. See Rev. Proc. 2001–47, page 332.

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## Section 301.—Distributions of Property

*26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property.*

## T.D. 8964

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Liabilities Assumed in Certain Corporate Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the assumption of liabilities in certain corporate transactions under section 301 of the Internal Revenue Code. These final regulations affect corporations and their shareholders. Changes to the applicable law were made by the Miscellaneous Trade and Technical Corrections Act of 1999.

DATES: *Effective Date*: These regulations are effective September 27, 2001.

*Applicability Date*: For dates of applicability, see the Effective Date portion of the preamble under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Douglas Bates (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Background and Explanation of Provisions

Changes to the applicable law were made by the Miscellaneous Trade and Technical Corrections Act of 1999, Public Law 106-36 (113 Stat. 127). On January 4, 2001, temporary regulations (T.D. 8924, 2001–6 I.R.B. 489) were published in the **Federal Register** (66 FR 723) under section 301 of the Internal Revenue Code, relating to liabilities assumed in connection with a distribution of property made by a corporation with respect to its stock. A notice of proposed rulemaking cross-referencing the temporary regulations (REG–106791–00, 2001–6 I.R.B. 521) was published in the **Federal Register** for the same day (66 FR 748). No public hearing was requested or held.

No written comments responding to the notice were received. This document adopts, without substantive change, final regulations with respect to the notice of proposed rulemaking.

### Effective Date

The regulations apply generally to distributions occurring after January 4, 2001. The regulations also apply to distributions occurring on or prior to January 4, 2001, if the distribution is made as part of a transaction described in, or substantially similar to, the transaction in Notice 99–59 (1999–2 C.B. 761), including transactions designed to reduce gain. Under section 7805(b)(3), the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse. These regulations are being applied retroactively to prevent the abuse described in Notice 99–59. No inference should be drawn regarding the tax treatment of distributions not covered by these regulations.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It is hereby certified that these final regulations do not have a significant economic impact on a substantial number of small entities. These final regulations under section 301 address distributions by corporations in which liabilities are assumed by the shareholders or in which the distributed property is subject to liabilities. These final regulations provide that the amount of a distribution under section 301 will be reduced by the amount of any liability that is treated as assumed by the distributee within the meaning of section 357(d).

These regulations apply to persons receiving distributions of property in which the property is subject to a liability, or in which liabilities are assumed by the distributee. These regulations, however, will affect only those persons described in the preceding sentence that would have, but for the regulations, considered liabilities to have been assumed in circumstances other that those described in section 357(d). Therefore, most businesses will not be affected by the final regulations in any given year. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking accompanying these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

**Drafting Information**

The principal author of these regulations is Michael N. Kaibni of the Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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**Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.301–1 also issued under 26 U.S.C. 357(d)(3). * * *

Par. 2. Section 1.301–1 is amended by revising paragraph (g) to read as follows:

*§1.301–1 Rules applicable with respect to distributions of money and other property.*

* * * * *

(g) *Reduction for liabilities* - - (1) *General rule*. For the purpose of section 301, no reduction shall be made for the amount of any liability, unless the liability is assumed by the shareholder within the meaning of section 357(d).

(2) *No reduction below zero*. Any reduction pursuant to paragraph (g)(1) of this section shall not cause the amount of the distribution to be reduced below zero.

(3) *Effective dates* — (i) *In general*. This paragraph (g) applies to distributions occurring after January 4, 2001.

(ii) *Retroactive application*. This paragraph (g) also applies to distributions made on or before January 4, 2001, if the distribution is made as part of a transaction described in, or substantially similar to, the transaction in Notice 99–59 (1999–2 C.B. 761), including transactions designed to reduce gain (see § 601.601(d)(2) of this chapter). For rules for distributions on or before January 4, 2001 (other than distributions on or before that date to which this paragraph (g) applies), see rules in effect on January 4, 2001 (see §1.301–1(g) as contained in 26 CFR Part 1 revised April 1, 2001).

* * * * *

**§ 1.301–1T [Removed]**

Par. 3. Section 1.301–1T is removed.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

Approved September 17, 2001.

Mark Weinberger,
*Assistant Secretary of the Treasury for Tax Policy.*

(Filed by the Office of the Federal Register on September 26, 2001, 8:45 a.m., and published in the issue of the Federal Register for September 27, 2001, 66 F.R. 49278)

## Section 368(a)(1)(A).—Definitions Relating to Corporate Reorganizations

*26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.*

**Step transaction.** Under the facts presented, if, pursuant to an integrated plan, a newly formed wholly owned subsidiary of an acquiring corporation merges into a target corporation, followed by the merger of the target corporation into the acquiring corporation, the transaction is treated as a single statutory merger of the target corporation into the acquiring corporation that qualifies as a reorganization under section 368(a)(1)(A).

## Rev. Rul. 2001–46

ISSUE

Under the facts described below, what is the proper tax treatment if, pursuant to an integrated plan, a newly formed wholly owned subsidiary of an acquiring corporation merges into a target corporation, followed by the merger of the target corporation into the acquiring corporation?

FACTS

*Situation (1).* Corporation X owns all the stock of Corporation Y, a newly formed wholly owned subsidiary. Pursuant to an integrated plan, X acquires all of the stock of Corporation T, an unrelated corporation, in a statutory merger of Y into T (the "Acquisition Merger"), with T surviving. In the Acquisition Merger, the T shareholders exchange their T stock for consideration, 70 percent of which is X voting stock and 30 percent of which is cash. Following the Acquisition Merger and as part of the plan, T merges into X in a statutory merger (the "Upstream Merger"). Assume that, absent some prohibition against the application of the step transaction doctrine, the step transaction doctrine would apply to treat the Acquisition Merger and the Upstream Merger as a single integrated acquisition by X of all the assets of T. Also assume that the single integrated transaction would satisfy the nonstatutory requirements of a reorganization under § 368(a) of the Internal Revenue Code.

*Situation (2).* The facts are the same as in Situation (1) except that in the Acquisition Merger the T shareholders receive solely X voting stock in exchange for their T stock, so that the Acquisition Merger, if viewed independently of the Upstream Merger, would qualify as a reorganization under § 368(a)(1)(A) by reason of § 368(a)(2)(E).

LAW

Section 338(a) provides that if a corporation makes a qualified stock purchase and makes an election under that section, then the target corporation (i) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value and (ii) shall be treated as a new corporation which purchased all of its assets as of the beginning of the day after the acquisition date. Section 338(d)(3) defines a qualified stock purchase as any transaction or series of transactions in which stock (meeting the requirements of § 1504(a)(2)) of one corporation is acquired by another corporation by purchase during a 12-month acquisition period. Section 338(h)(3) defines a purchase generally as any acquisition of stock, but excludes acquisitions of stock in exchanges to which § 351, § 354, § 355, or § 356 applies.

Rev. Rul. 90–95 (1990–2 C.B. 67) (Situation 2), holds that the merger of a newly formed wholly owned domestic subsidiary into a target corporation with the target corporation shareholders receiving solely cash in exchange for their stock, immediately followed by the merger of the target corporation into the domestic parent of the merged subsidiary, will be treated as a qualified stock purchase of the target corporation followed by a § 332 liquidation of the target corporation. As a result, the parent's basis in the target corporation's assets will be the same as the basis of the assets in the target corporation's hands. The ruling explains that even though "the step-transaction doctrine is properly applied to disregard the existence of the [merged subsidiary]," so that the first step is treated as a stock purchase, the acquisition of the target corporation's stock is accorded independent significance from the subsequent liquidation of the target corporation and, therefore, is treated as a qualified stock purchase regardless of whether a § 338 election is made.

Section 1.338–3(d) of the Income Tax Regulations incorporates the approach of Rev. Rul. 90–95 into the regulations by requiring the purchasing corporation (or a member of its affiliated group) to treat certain asset transfers following a qualified stock purchase (where no § 338 election is made) independently of the qualified stock purchase. In the example in § 1.338–3(d)(5), the purchase for cash of 85 percent of the stock of a target corporation, followed by the merger of the target corporation into a wholly owned subsidiary of the purchasing corporation, is treated (other than by certain minority shareholders) as a qualified stock purchase of the stock of the target corporation followed by a § 368 reorganization of the target corporation into the subsidiary. As a result, the subsidiary's basis in the target corporation's assets is the same as the basis of the assets in the target corporation's hands.

Section 368(a)(1)(A) defines the term "reorganization" as a statutory merger or consolidation. Section 368(a)(2)(E) provides that a transaction otherwise qualifying under § 368(a)(1)(A) shall not be disqualified by reason of the fact that stock of a corporation (controlling corporation), which before the merger was in control of the merged corporation, is used in the transaction if (i) after the transaction, the corporation surviving the merger holds substantially all of its properties and the properties of the merged corporation, and (ii) in the transaction, former shareholders of the surviving corporation exchange, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation.

In Rev. Rul. 67–274 (1967–2 C.B. 141), Corporation Y acquires all of the stock of Corporation X in exchange for some of the voting stock of Y and, thereafter, X completely liquidates into Y. The ruling holds that because the two steps are parts of a plan of reorganization, they cannot be considered independently of each other. Thus, the steps do not qualify as a reorganization under § 368(a)(1)(B) followed by a liquidation under § 332, but instead qualify as an acquisition of X's assets in a reorganization under § 368(a)(1)(C).

ANALYSIS

*Situation (1)*

Because of the amount of cash consideration paid to the T shareholders, the Acquisition Merger could not qualify as a reorganization under § 368(a)(1)(A) and § 368(a)(2)(E). If the Acquisition Merger and the Upstream Merger in Situation (1) were treated as separate from each other, as were the steps in Situation (2) of Rev. Rul. 90–95, the Acquisition Merger would be treated as a stock acquisition that is a qualified stock purchase, because the stock is not acquired in a § 354 or § 356 exchange. The Upstream Merger would qualify as a liquidation under § 332.

However, if the approach reflected in Rev. Rul. 67–274 were applied to Situation (1), the transaction would be treated as an integrated acquisition of T's assets by X in a single statutory merger (without a preliminary stock acquisition). Accordingly, unless the policies underlying § 338 dictate otherwise, the integrated asset acquisition in Situation (1) is properly treated as a statutory merger of T into X that qualifies as a reorganization under § 368(a)(1)(A). *See King Enterprises, Inc. v. United States*, 418 F.2d 511 (Ct. Cl. 1969) (in a case that predated § 338, the court applied the step transaction doctrine to treat the acquisition of the stock of a target corporation followed by the merger of the target corporation into the acquiring corporation as a reorganization under § 368(a)(1)(A)); *J.E. Seagram Corp. v. Commissioner*, 104 T.C. 75 (1995) (same). Therefore, it is necessary to determine whether the approach reflected in Rev. Rul. 90–95 applies where the step transaction doctrine would otherwise apply to treat the transaction as an asset acquisition that qualifies as a reorganization under § 368(a).

Rev. Rul. 90–95 and § 1.338–3(d) reject the approach reflected in Rev. Rul. 67–274 where the application of that approach would treat the purchase of a target corporation's stock without a § 338 election followed by the liquidation or merger of the target corporation as the purchase of the target corporation's assets resulting in a cost basis in the assets under § 1012. The rejection of step integration in Rev. Rul. 90–95 and § 1.338–3(d) is based on Congressional intent that § 338 "replace any nonstatutory treatment of a stock purchase as an asset purchase under the *Kimbell-Diamond* doctrine." H.R. Rep. No. 760, 97th Cong., 2d Sess. 536 (1982), 1982–2 C.B. 600, 632. (In *Kimbell-Diamond Milling Co. v. Commissioner*, 14 T.C. 74, *aff'd per curiam*, 187 F.2d 718 (1951), *cert. denied*, 342 U.S. 827 (1951), the court held that the purchase of the stock of a target corporation for the purpose of obtaining its assets through a prompt liquidation should be treated by the purchaser as a purchase of the target corporation's assets with the purchaser receiving a cost basis in the assets.) Rev. Rul. 90–95 and § 1.338–3(d) treat the acquisition of the stock of the target corporation as a qualified stock purchase followed by a separate carryover basis transaction in order to preclude any nonstatutory treatment of the steps as an integrated asset purchase.

The policy underlying § 338 is not violated by treating Situation (1) as a single statutory merger of T into X because such treatment results in a transaction that qualifies as a reorganization under § 368(a)(1)(A) in which X acquires the assets of T with a carryover basis under § 362, and does not result in a cost basis for those assets under § 1012. Thus, in Situation (1), the step transaction doctrine applies to treat the Acquisition Merger and the Upstream Merger not as a stock acquisition that is a qualified stock purchase followed by a § 332 liquidation, but instead as an acquisition of T's assets through a single statutory merger of T into X that qualifies as a reorganization under § 368(a)(1)(A). Accordingly, a § 338 election may not be made in such a situation.

*Situation (2)*

Situation (2) differs from Situation (1) only in that the Acquisition Merger, if viewed independently of the Upstream Merger, would qualify as a reorganization under § 368(a)(1)(A) by reason of § 368(a)(2)(E). This difference does not change the result from that in Situation (1). The transaction is treated as a single statutory merger of T into X that qualifies as a reorganization under § 368(a)(1)(A) without regard to § 368(a)(2)(E).

HOLDING

Under the facts presented, if, pursuant to an integrated plan, a newly formed wholly owned subsidiary of an acquiring corporation merges into a target corporation, followed by the merger of the target corporation into the acquiring corporation, the transaction is treated as a single statutory merger of the target corporation into the acquiring corporation that qualifies as a reorganization under § 368(a)(1)(A).

APPLICATION

Pursuant to § 7805(b)(8), the Service will not apply the principles of this revenue ruling to challenge a taxpayer's position with respect to the treatment of a multi-step transaction, one step of which, viewed independently, is a qualified stock purchase if:

(1) a timely (including extensions) and valid (without regard to whether there was a qualified stock purchase under the principles of this revenue ruling) election under § 338(h)(10) or § 338(g) (Election) is or was filed with respect to the acquisition of the stock of the target corporation; and

(2) either

(a) the acquisition date for the target corporation is on or before September 24, 2001; or

(b) the acquisition of stock of the target corporation meeting the requirements of § 1504(a)(2) by the purchasing corporation is pursuant to a written agreement that (subject to customary conditions) is binding on September 24, 2001, and at all times thereafter until the acquisition date; and

(3) such taxpayer does not take a position for U.S. tax purposes that is inconsistent with the treatment of the acquisition as a qualified stock purchase with respect to which the Election was made.

Further, the Service and the Treasury are considering whether to issue regulations that would reflect the general principles of this revenue ruling, but would allow taxpayers to make a valid election under § 338(h)(10) with respect to a step of a multi-step transaction that, viewed independently, is a qualified stock purchase if such step is pursuant to a written agreement that requires, or permits the purchasing corporation to cause, a § 338(h)(10) election in respect of such step to be made. The Service and the Treasury request comments regarding the adoption of such an approach.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 67–274 is amplified and Rev. Rul. 90–95 is distinguished.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Reginald Mombrun and Joseph M. Calianno of the Office of the Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Mr. Mombrun at (202) 622-7750 (not a toll-free call) or Mr. Calianno at (202) 622-7930 (not a toll-free call).

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

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

**LIFO; price indexes; department stores.** The August 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, August 31, 2001.

## Rev. Rul. 2001–45

The following Department Store Inventory Price Indexes for August 2001 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46 (1986–2 C.B. 739), for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, August 31, 2001.

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

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

| Groups | Aug. 2000 | Aug. 2001 | Percent Change from Aug. 2000 to Aug. 2001[1] |
|---|---|---|---|
| 1. Piece Goods | 509.2 | 485.7 | –4.6 |
| 2. Domestics and Draperies | 617.9 | 591.8 | –4.2 |
| 3. Women's and Children's Shoes | 618.3 | 655.4 | 6.0 |
| 4. Men's Shoe | 913.2 | 856.4 | –6.2 |
| 5. Infants' Wear | 619.8 | 609.5 | –1.7 |
| 6. Women's Underwear | 570.2 | 567.5 | –0.5 |
| 7. Women's Hosiery | 334.7 | 354.8 | 6.0 |
| 8. Women's and Girls' Accessories | 532.0 | 547.2 | 2.9 |
| 9. Women's Outerwear and Girls' Wear | 370.5 | 361.6 | –2.4 |
| 10. Men's Clothing | 605.4 | 579.2 | –4.3 |
| 11. Men's Furnishings | 612.9 | 583.9 | –4.7 |
| 12. Boys' Clothing and Furnishings | 473.0 | 469.2 | –0.8 |
| 13. Jewelry | 936.5 | 936.3 | 0.0 |
| 14. Notions | 785.9 | 793.0 | 0.9 |
| 15. Toilet Articles and Drugs | 971.0 | 969.9 | –0.1 |
| 16. Furniture and Bedding | 687.9 | 633.9 | –7.8 |
| 17. Floor Coverings | 603.2 | 623.8 | 3.4 |
| 18. Housewares | 778.5 | 767.6 | –1.4 |
| 19. Major Appliances | 230.9 | 226.9 | –1.7 |
| 20. Radio and Television | 58.8 | 53.4 | –9.2 |
| 21. Recreation and Education[2] | 92.2 | 89.3 | –3.1 |
| 22. Home Improvements[2] | 129.2 | 125.8 | –2.6 |
| 23. Auto Accessories[2] | 106.2 | 109.4 | 3.0 |
| Groups 1 – 15: Soft Goods | 585.3 | 575.5 | –1.7 |
| Groups 16 – 20: Durable Goods | 437.2 | 421.8 | –3.5 |
| Groups 21 – 23: Misc. Goods[2] | 99.8 | 98.2 | –1.6 |
| Store Total[3] | 529.7 | 518.8 | –2.1 |

[1] Absence of a minus sign before the percentage change in this column signifies a price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

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

## Section 872. — Gross Income

*(Also sections 883, 894.)*
*26 CFR 1.872–2: Exclusions from gross income of nonresident alien individuals.*
*(Also 26 CFR 1.883–1.)*

This revenue ruling updates the list of countries that grant a reciprocal exemption for income from the international operation of ships or aircraft to U.S. persons for purposes of sections 872(b) and 883 of the Code.

## Rev. Rul. 2001–48

PURPOSE

The purpose of this revenue ruling is to assist foreign persons who derive income from the international operation of ships or aircraft in determining whether such income is exempt from U.S. taxation under section 872(b) or 883(a) of the Internal Revenue Code of 1986, by providing a current list of countries that grant United States persons equivalent exemptions from tax for various categories of income from the international operation of ships and aircraft. This revenue ruling modifies and supersedes Rev. Rul. 89–42 (1989–1 C.B. 234), as supplemented by Rev. Rul. 97–31 (1997–2 C.B. 77).

Section 872(b) of the Code provides that gross income shall not include income from the international operation of a ship or ships or aircraft, and such income shall be exempt from U.S. Federal income taxation, if the income is derived by an individual resident of a foreign country, and such foreign country grants an equivalent exemption to individual residents of the United States. Section 883(a) provides a similar exemption for such income derived by corporations organized in a foreign country that grants an equivalent exemption to corporations organized in the United States. For purposes of sections 872(b) and 883(a), a foreign country may grant an equivalent exemption from tax through an exchange of diplomatic notes or other agreement, by not imposing a tax on income from the international operation of ships or aircraft, or by a decree or specific statutory exemption.

Part A of Table I provides a list of the countries that grant exemptions through diplomatic notes exchanged with the United States.

Part B of Table I provides a list of the countries for which the Service has determined, upon examination of their domestic law, that an equivalent exemption is granted by statute or decree, or by not imposing a tax on income from the international operation of ships or aircraft. This determination is made on a country-by-country basis and relies upon information submitted to the Internal Revenue Service by the foreign country regarding the foreign law in effect at the time of the submission. The date of the Service's review is reflected in the first column of Part B of Table I. Since its initial review, the Service has not attempted to determine whether any of the foreign laws of the countries listed in Part B of Table I have been amended or repealed. Therefore, taxpayers should independently verify the accuracy of the information in Part B of Table I at such time that a determination is relevant.

Part B of Table I does not represent an exclusive list of countries the domestic law of which provides an equivalent exemption. Other countries that have not submitted the information necessary for the Service to make a determination also may grant an equivalent exemption. In those cases, an individual resident of, or a corporation organized in, such a foreign country may be treated as a resident of, or a corporation organized in, a foreign country that grants an equivalent exemption, even though the foreign country is not included in Part B of Table I. Consistent with past practice, the Service will entertain a request from a foreign government to determine whether the domestic law of the country provides an equivalent exemption. Accordingly, taxpayers may seek to have the relevant foreign government request a determination that the particular country qualifies as an equivalent-exemption jurisdiction.

Table II provides a list of countries that grant an exemption under the shipping and aircraft article or capital gains article of an income tax convention to which the United States is a party. Table II is provided to assist a foreign corporation organized in one of the countries listed in Table I in demonstrating that it also meets the ownership requirements of section 883(c). In general, a foreign corporation can demonstrate that it meets the ownership requirements of section 883(c) if the corporation can show that more than 50 percent of the value of the stock of the corporation is owned by individuals who are residents of countries that grant an equivalent exemption to corporations organized in the United States. For the sole purpose of determining if an individual shareholder's country of residence grants an equivalent exemption for purposes of section 883(c), a foreign country will also be considered to grant an equivalent exemption if it grants such an exemption through an income tax convention with the United States.

Accordingly, Table II is relevant only in determining whether a shareholder of a foreign corporation seeking an exemption from tax under section 883 is a shareholder that qualifies under section 883(c)(1) because the shareholder's country of residence grants an equivalent exemption under an income tax convention with the United States. Table II is not relevant in determining whether a nonresident alien individual or a foreign corporation itself is eligible to claim an exemption under section 872(b) or 883(a), respectively.

Table II includes a summary of the requirements for the exemption, such as whether the exemption is based solely on residence, or, as in the case of certain older income tax conventions, the exemption has an additional requirement of documentation or registration. Table II does not set forth other benefits relating to a shipping or an air transport business that may be provided under articles covering business profits, rentals and royalties, and other income because such benefits are not relevant for purposes of section 883(c).

These Tables are intended only as a summary. The full text of any relevant diplomatic note, foreign law, or income tax convention should be consulted. It may be necessary to consult the technical explanation of an income tax convention, including any protocol thereto, any agreement, or any diplomatic note accompanying a convention, to determine the items of income exempted. Income tax conventions and diplomatic notes are published in the Cumulative Bulletin and Internal Revenue Bulletins. These Tables will continue to be updated periodically.

**CHANGES TO REV. RUL. 97–31**

The changes to the table published in Rev. Rul. 89–42, as supplemented by Rev. Rul. 97–31, are summarized below.

The table in the prior rulings has been reorganized to clarify the limited relevance of Part I of that table, relating to treaties, as discussed above. Accordingly, in this revenue ruling Part II of the prior table (diplomatic notes) has become Part A of Table I; Part III (domestic law) of the prior table has become Part B of Table I; and Part I of the prior table (treaties) has become Table II.

In Part A of Table I, Bahrain, Ethiopia, Saudi Arabia, and the United Arab Emirates have been added to the list of countries that have exchanged diplomatic notes with the United States. Although a diplomatic note was signed with Bolivia in November 1987, that note required ratification by the Bolivian Government to enter into force. The diplomatic note was ratified on March 24, 1999, and officially became effective upon publication in the official Gazette on March 31, 1999, for income earned after that date. Therefore, Bolivia also has been added to the list.

In Part B of Table I, Aruba, Peru (with respect to aircraft), and the Republic of Surinam have been added to the list of countries whose domestic law has been determined to provide an equivalent exemption.

In Table II, the following countries have been added to the list of countries that provide an exemption under an income tax convention: Estonia, Latvia, Lithuania, Slovenia, South Africa, Thailand, Turkey, the Ukraine, and Venezuela. The following countries have entered into new income tax conventions with the United States that supersede prior income tax conventions reported in Rev. Rul. 97–31: Austria, Denmark, Ireland, Luxembourg, and Switzerland.

## TO CLAIM AN EXEMPTION

Taxpayers claiming an exemption from U.S. Federal income tax under section 872(b) of the Code must file a return on Form 1040NR (*U.S. Income Tax Return of a Nonresident Alien*). Taxpayers claiming an exemption from U.S. Federal income tax under section 883 must file a return on Form 1120F (*U.S. Income Tax Return of a Foreign Corporation*). Both must comply with the relevant provisions of section 8 of Rev. Proc. 91–12 (1991–1 C.B. 473).

## EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 97–31 and Rev. Rul. 89–42 are modified and superseded.

## DRAFTING INFORMATION

The principal author of this revenue ruling is Patricia A. Bray of the Office of Associate Chief Counsel (International). For information regarding this revenue ruling, contact Ms. Bray at (202) 622-3880 (not a toll-free call).

**TABLE I**

***Countries Currently Granting Equivalent Exemptions For Income From The International Operation of Ships and Aircraft***

***PART A - EXCHANGE OF NOTES[1]***

| | | ***TYPES OF SHIPPING AND AIRCRAFT INCOME EXEMPTED[2]*** | | | | |
|---|---|---|---|---|---|---|
| **Countries and Territories** | **Cumulative Bulletin Or Internal Revenue Bulletin Citation** | **Operating Income** | **Full Rental (Time or voyage charter)** | **Bare-Boat Rental** | **Container Rental[3]** | **Capital Gains[3]** |
| **Argentina** | **1988-1 C.B. 456** | X | X | X | X | X |
| **Bahamas** | **1988-1 C.B. 458** | X | X | X | X | - |
| **Bahrain** | **2000-46 I.R.B. 475** | X | X | X | X | X |
| **Belgium** | **1988-1 C.B. 459** | X | X | - | X | - |
| **Bolivia[4]** | **1988-1 C.B. 460** | X | X | X | X | - |
| **Chile[5]** | **1991-1 C.B. 304** | X | X | X[3] | X | - |
| **Colombia** | **1988-1 C.B. 461** | X | X | X | X | - |
| **Cyprus** | **1989-2 C.B. 332** | X | X | X | X | - |
| **Denmark** | **1988-1 C.B. 462** | X | X | X | X | - |
| **El Salvador[5]** | **1988-1 C.B. 463** | X | X | X | X | X |
| **Ethiopia** | **1999-1 C.B. 1134** | X | X | X | X | X |
| **Fiji** | **1996-2 C.B. 202** | X | X | X | X | X |
| **Finland** | **1989-2 C.B. 334** | X | X | X | X | - |
| **Greece** | **1988-2 C.B. 366** | X | X | X | X | - |
| **Hong Kong[6/7]** | **1995-1 C.B. 228** | X | X | X | X | X |
| **India** | **1990-2 C.B. 316** | X | X | X[3] | X | X |
| **Isle of Man[6]** | **1990-2 C.B. 317** | X | X | X | X | X |
| **Japan** | **1990-2 C.B. 318** | X | X | X | X | - |
| **Jordan** | **1996-2 C.B. 202** | X | X | X | X | - |
| **Liberia** | **1988-1 C.B. 463** | X | X | X | X | X |
| **Luxembourg** | **1996-2 C.B. 203** | X | X | X | X | - |
| **Malaysia** | **1990-2 C.B. 319** | X | X | X[3] | X | X |

TABLE I—Continued

*Countries Currently Granting Equivalent Exemptions For Income From The International Operation of Ships and Aircraft*

*PART A - EXCHANGE OF NOTES*[1]

| Countries and Territories | Cumulative Bulletin Or Internal Revenue Bulletin Citation | TYPES OF SHIPPING AND AIRCRAFT INCOME EXEMPTED[2] Opera-ting Income | Full Rental (Time or voy-age char-ter) | Bare-Boat Rental | Con-tainer Rental[3] | Capital Gains[3] |
|---|---|---|---|---|---|---|
| Malta | 1997-1 C.B. 314 | X | X | X | X | X |
| Marshall Islands | 1990-2 C.B. 321 | X | X | X | X | X |
| Norway | 1991-1 C.B. 304 | X | X | X | X | X |
| Pakistan[6] | 1991-1 C.B. 305 | X[8] | - | - | - | - |
| Panama | 1988-2 C.B. 366 | X | X | X | X | - |
| Peru[6] | 1989-2 C.B. 335 | X | X | X[3] | X | - |
| Saudi Arabia[9] | 2000-22 I.R.B. 1126 | X | X | X | X | X |
| St. Vincent & Grenadines | 1989-2 C.B. 336 | X | X | X | X | - |
| Singapore | 1990-2 C.B. 323 | X | X | X | X | - |
| Sweden | 1988-1 C.B. 466 | X | X | X[3] | X | - |
| Taiwan | 1989-2 C.B. 337 | X | X | X | X | - |
| United Arab Emirates | 1998-2 C.B. 528 | X | X | X | X | X |
| Venezuela | 1988-1 C.B. 467 | X | X | X[3] | X | X |

*PART B - DOMESTIC LAW*

| Countries and Territories | Date Foreign Law Reviewed | TYPES OF SHIPPING AND AIRCRAFT INCOME EXEMPTED[2] Opera-ting Income | Full Rental (Time or voy-age char-ter) | Bare-Boat Rental | Con-tainer Rental[3] | Capital Gains[3] |
|---|---|---|---|---|---|---|
| Antigua & Barbuda[6] | NOV 1991 | X | X | X | X | X |
| Aruba | JUNE 1999 | X | X | X | X | - |
| Barbados | OCT 1989 | X | X | X | X | X |
| Bermuda | NOV 1988 | X | X | X | X | X |
| Brazil[10] | DEC 1988 | X | X | X[3] | X | - |
| Bulgaria | FEB 1989 | X | X | X | X | X |
| Cayman Islands[11] | JAN 1987 | X | X | X | X | X |
| Chile[6] | OCT 1988 | X | X | X | X | X |
| Ecuador[6/12] | DEC 1989 | X | X | X[3] | X | X |
| Israel | FEB 1991 | X | X | X | X | X |

TABLE I—Continued

*Countries Currently Granting Equivalent Exemptions For Income From The International Operation of Ships and Aircraft*

*PART B - DOMESTIC LAW—Continued*

| Countries and Territories | | Date Foreign Law Reviewed | *TYPES OF SHIPPING AND AIRCRAFT INCOME EXEMPTED*[2] Operating Income | Full Rental (Time or voyage charter) | Bare-Boat Rental | Container Rental[3] | Capital Gains[3] |
|---|---|---|---|---|---|---|---|
| Netherlands | | OCT 1988 | X | X | X[3] | X | - |
| Netherlands Antilles | | MAY 1988 | X | X | X | X | X |
| Peru[5] | | SEPT 1995 | X | X | X | X | X |
| Portugal[10] | Ships | JUNE 1989 | X | X | X | - | - |
| | Aircraft | FEB 1989 | X | X | X | - | - |
| Qatar[5] | | AUG 1994 | X[8] | - | - | - | - |
| Spain[13] | | DEC 1988 | X | X | - | X | - |
| Surinam | | NOV 1999 | X | X | X | X | X |
| Turkey[14] | | JAN 1987 | X | - | - | X | - |
| Turks & Caicos[11] | | FEB 1990 | X | X | X | X | X |
| U.S. Virgin Islands | | OCT 1988 | X | X | X | X | X |
| Vanuatu | | MAY 1987 | X | X | X | X | X |

TABLE II

*Countries Currently Granting by Income Tax Convention Equivalent Exemptions For Purposes of Qualifying a Shareholder Under Section 883(c)(1)*[15]

| Countries and Territories | *BASIS FOR EXEMPTION* Residence Based No Flag | Residence & Flag Reciprocal | Residence & Flag Unilateral | *TYPES OF SHIPPING AND AIRCRAFT INCOME EXEMPTED*[2] Operating Income | Full Rental (Time or voyage charter) | Bare-Boat Rental | Container Rental | Capital Gains |
|---|---|---|---|---|---|---|---|---|
| Australia | X | | | X | X[16] | X[17] | X[17] | X[3/18] |
| Austria[19] | X | | | X | X[20] | X[20] | X | X |
| Barbados | X | | | X | X[20] | X[20] | X | X |
| Belgium | | X[21] | | X | X[3] | X[3] | X[3] | X[3] |
| Canada | X | | | X | X | X | X | X |
| China[22] (Peoples Republic) | X | | | X | X[20] | X[20] | X | X |
| Cyprus | X | | | X | X[20] | X[20] | X | X |

**TABLE II—Continued**

***Countries Currently Granting by Income Tax Convention Equivalent Exemptions For Purposes of Qualifying a Shareholder Under Section 883(c)(1)[15]***

| | *BASIS FOR EXEMPTION* | | | *TYPES OF SHIPPING AND AIRCRAFT INCOME EXEMPTED[2]* | | | | |
|---|---|---|---|---|---|---|---|---|
| **Countries and Territories** | **Residence Based No Flag** | **Residence & Flag Reciprocal** | **Residence & Flag Unilateral** | **Operating Income** | **Full Rental (Time or voyage charter)** | **Bare-Boat Rental** | **Container Rental** | **Capital Gains** |
| **Czech Republic** | X | | | X | X | X[3] | X | X |
| **Denmark[19]** | X | | | X | X | X[20] | X | X |
| **Egypt** | X | | | X | X[3] | X[3] | X[3] | - |
| **Estonia[19]** | X | | | X | X | X[3] | X | X |
| **Finland** | X | | | X | X[3] | X[3] | X[23] | X |
| **France** | X | | | X | X | X[20] | X[3] | X[3] |
| **Germany[24]** | X | | | X | X | - | X | X |
| **Greece** | | X | | X[8] | - | - | - | - |
| **Hungary** | X | | | X | X[3] | X[3] | X | X |
| **Iceland** | | | X[25] | X | X[3] | X[3] | X[3] | X |
| **India** | X | | | X | X[3] | X[3] | X | X[3/26] |
| **Indonesia** | X | | | X | X | X[27] | X[3] | X |
| **Ireland[19]** | X | | | X | X | X[20] | X | X |
| **Israel** | X | | | X | X[3] | X[3] | X[3] | X[3] |
| **Italy[28/29]** | | | X[25] | X | X[30] | X[3] | X | X[3] |
| **Jamaica** | X | | | X | X[20] | X[20] | X | X[3] |
| **Japan[28]** | | X[31] | | X | X[3] | X[3] | X[3] | X[3] |
| **Kazakhstan** | X | | | X | X | X[20] | X | X |
| **Korea** | X | | | X | X[32] | - | X[3] | - |
| **Latvia[19]** | X | | | X | X | X[17] | X | X |
| **Lithuania[19]** | X | | | X | X | X[17] | X[3] | X |
| **Luxembourg[19]** | X | | | X | X | X[20] | X | X |
| **Mexico** | X | | | X | X | X[23] | X | X |
| **Morocco** | | X[21] | | X[8] | - | - | - | X[3] |
| **Netherlands** | X | | | X | X[3] | X[3] | - | X |
| **New Zealand** | X | | | X | X | X[3] | X[3] | X[18] |
| **Norway[28]** | X | | | X | X[32] | X[3] | X[3] | X |
| **Pakistan[5]** | | X | | X[8] | - | - | - | - |
| **Philippines[6]** | X | | | - | - | - | - | X[3] |

**TABLE II—Continued**

***Countries Currently Granting by Income Tax Convention Equivalent Exemptions For Purposes of Qualifying a Shareholder Under Section 883(c)(1)[15]***

| Countries and Territories | *BASIS FOR EXEMPTION* Residence Based No Flag | Residence & Flag Reciprocal | Residence & Flag Unilateral | *TYPES OF SHIPPING AND AIRCRAFT INCOME EXEMPTED[2]* Operating Income | Full Rental (Time or voyage charter) | Bare-Boat Rental | Container Rental | Capital Gains |
|---|---|---|---|---|---|---|---|---|
| **Poland** | | | X[25] | X | X[3] | X[3] | X[3] | X |
| **Portugal** | X | | | X | X | X[3] | - | X |
| **Romania** | | X | | X | X[3] | X[3] | X[3] | X |
| **Russian Federation** | X | | | X | X | X[20] | X | X |
| **Slovak Republic** | X | | | X | X | X[3] | X | X |
| **Slovenia[19]** | X | | | X | X | X[20] | X | X |
| **South Africa[19]** | X | | | X | X | X[20] | X | X |
| **Spain** | X | | | X | X | X[3] | X | X |
| **Sweden** | X | | | X | X | X[3] | X | X |
| **Switzerland[19]** | X | | | X | X[33] | X[3] | - | X |
| **Thailand[19]** | X[5] | | | X | X | X[3] | X[3] | X |
| | X[6] | | | - | - | - | - | X |
| **Trinidad & Tobago** | | | X[25] | X | X[3] | X[3] | - | X |
| **Tunisia** | X | | | X | X[20] | X[20] | X[3] | X |
| **Turkey[19]** | X | | | X | X | X[3] | X | X |
| **Ukraine[19]** | X | | | X | X | X[20] | X | X[3] |
| **USSR/NIS[34]** | | X | | X[8] | - | - | - | X[3] |
| **U.K.[29]** | | | X[25] | X | X | X[3] | X | X[3] |
| **Venezuela[19]** | X | | | X | X | X[20] | X | X |

[1] Notes signed prior to the Technical and Miscellaneous Revenue Act of 1988 will be interpreted in accordance with Technical Corrections enacted by that Act.
[2] Unless otherwise footnoted, an "X" indicates full exemption whether or not there is a permanent establishment.
[3] The tax exemption is available only if the income is incidental to operating income.
[4] The note was ratified by the Bolivian Congress and signed by the Bolivian President. The note and exemption officially became effective upon publication in the official Gazette on March 31, 1999, for income earned after that date.
[5] This exemption applies to aircraft only.
[6] This exemption applies to shipping only.
[7] This diplomatic note applies to Hong Kong before July 1, 1997, and pursuant to Notice 97-40 (1997-2 C.B. 287), to the Hong Kong Special Administrative Region of the People's Republic of China on or after July 1, 1997. The note does not apply with respect to the People's Republic of China, which will continue to be treated as a separate country for purposes of the Internal Revenue Code.
[8] Operating income is not defined.
[9] The note is effective for all taxable years beginning on or after January 1, 1999, and for all prior open taxable years.

[10] Brazilian and Portuguese statutes exempt only companies.
[11] The country generally imposes no income tax.
[12] This exemption is generally effective for all open years beginning on or after January 1, 1987.
[13] The Spanish statute exempts only corporations.
[14] See generally Rev. Rul. 87-18 (1987-1 C.B. 178) (explaining the application of Turkey's domestic-law exemption).
[15] Table II is relevant only in determining whether a shareholder of a foreign corporation seeking an exemption from tax under section 883 is a shareholder that qualifies under section 883(c)(1) because the shareholder's country of residence grants an equivalent exemption under an income tax convention with the United States. Table II is not relevant in determining whether a nonresident alien individual or foreign corporation itself is eligible to claim an exemption under section 872(b) or 883(a), respectively.
[16] Lessor must either regularly lease ships or aircraft on a full basis or operate them in international traffic.
[17] This exemption applies if the ships or aircraft are operated in international traffic by the lessee, and the rental income is incidental to the operation of ships or aircraft in international traffic by the lessor.
[18] Except to the extent depreciation has been allowed in the other country.
[19] The following income tax treaties were ratified after the publication of Rev. Rul. 97-31 and are generally effective on the following dates:

| | |
|---|---|
| Austria | January 1, 1999 |
| Denmark | January 1, 2001 |
| Estonia | January 1, 2000 |
| Ireland | January 1, 1998 |
| Latvia | January 1, 2000 |
| Lithuania | January 1, 2000 |
| Luxembourg | January 1, 2001 |
| Slovenia | January 1, 2002 |
| South Africa | January 1, 1998 |
| Switzerland | January 1, 1998 |
| Thailand | January 1, 1998 |
| Turkey | January 1, 1998 |
| Ukraine | January 1, 2001 |
| Venezuela | January 1, 2000 |

The U.S.-Slovenia tax treaty entered into force on June 22, 2001. The treaty applies, with respect to taxes withheld at source, in respect of amounts paid or credited on or after September 1, 2001, and, with regard to other taxes, in respect of taxable years beginning on or after January 1, 2002.
[20] This exemption applies if the ships or aircraft are operated in international traffic by the lessee, or the rental income is incidental to the operation of ships or aircraft in international traffic by the lessor.
[21] In the case of aircraft only, the registration may be in the country of residence or in any country with a treaty providing a reciprocal exemption between such country and the country of residence.
[22] Pursuant to Notice 97-40 (1997-2 C.B. 287), the treaty between the United States and the People's Republic of China (China) will continue to apply only to China and will not apply to the Hong Kong Special Administrative Region of the People's Republic of China.
[23] The exemption applies except where the containers are used solely between places within the other Contracting State.
[24] This treaty is effective for the eastern States of Germany (the former East Germany) from January 1, 1991.
[25] Documentation or registration required for ships or aircraft of United States residents only.
[26] This treaty exempts gains derived by an enterprise of a Contracting State if the ships, aircraft or containers are owned and operated by the enterprise and the income from them is taxable only in that State.
[27] Income from the bareboat rental of aircraft used in international traffic is exempt. Income from the bareboat rental of ships also is exempt if the ship is operated in international traffic and if the lessee is not a resident of, or does not have a permanent establishment in, the other Contracting State.
[28] See also the diplomatic notes or protocol accompanying this treaty.
[29] The United States has entered into new treaties with Italy and the United Kingdom, but neither treaty has entered into force as of the date of publication of this ruling.
[30] This exemption applies if the ship or aircraft is operated in international traffic or if the rental income is incidental to income from such international operation.
[31] With regard to residents of Japan, the ships or aircraft need not be registered in Japan if the ships or aircraft are leased by such a resident.
[32] As a result of correspondence, it was clarified that income from the international operation of ships or aircraft includes this category of income.
[33] This exemption applies if the ships or aircraft are used by the lessee in international traffic.
[34] The U.S. - U.S.S.R. income tax treaty signed June 20, 1973, continues to apply to the New Independent States (NIS) of Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan, and Uzbekistan.

## Section 883.—Exclusions From Gross Income

This revenue ruling updates the Table of countries that grant a reciprocal exemption for income from the international operation of ships or aircraft to U.S. persons for purposes of sections 872(b) and 883 of the Code. See Rev. Rul. 2001–48, page 324.

## Section 894.—Income Affected By Treaty

This revenue ruling updates the Table of countries that grant a reciprocal exemption for income from the international operation of ships or aircraft to U.S. persons for purposes of sections 872(b) and 883 of the Code. See Rev. Rul. 2001–48, page 324.

*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. 2001–47

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2000–39 (2000–41 I.R.B. 340), by providing rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home will be deemed substantiated under § 1.274–5 of the Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. This revenue procedure also provides an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. Use of a method described in this revenue procedure is not mandatory, and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meal and incidental expenses.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct expenses paid or incurred while traveling away from home in pursuit of a trade or business. However, under § 262, no portion of such travel expenses that is attributable to personal, living, or family expenses is deductible.

.02 Section 274(n) generally limits the amount allowable as a deduction under § 162 for any expense for food, beverages, or entertainment to 50 percent of the amount of the expense that otherwise would be allowable as a deduction. In the case of any expenses for food or beverages consumed while away from home (within the meaning of § 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, § 274(n)(3) gradually increases the deductible percentage to 80 percent for taxable years beginning in 2008. For taxable years beginning in 2001, the deductible percentage for these expenses is 60 percent. For taxable years beginning in 2002, the deductible percentage for these expenses is 65 percent.

.03 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 for any traveling expense (including meals and lodging while away from home) unless the taxpayer complies with certain substantiation requirements. The section further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by such regulations.

.04 Section 1.274–5(g) of the regulations, in part, grants the Commissioner the authority to prescribe rules relating to reimbursement arrangements or *per diem* allowances for ordinary and necessary expenses paid or incurred while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such arrangements or allowances, if in accordance with reasonable business practice, will be regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel expenses for purposes of § 1.274–5(c), and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of such travel expenses for purposes of § 1.274–5(f).

.05 For purposes of determining adjusted gross income, § 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 62(c) further provides that the substantiation requirements described therein shall not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for such expense.

.07 Under § 1.62–2(c)(1) a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) or 1.274–5(j)(1) will be treated as substantiation of the amount of such expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing *per diem* allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance that relates to days of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a *per diem* allowance that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to days of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g) or § 1.274–5(j)(1), and that the employee is not required to return, is subject to withholding and payment of employment taxes. See §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this portion.

.09 Under § 1.62–2(h)(2)(i)(B)(*4*), the Commissioner may, in his or her discretion, prescribe special rules regarding the timing of withholding and payment of employment taxes on *per diem* allowances.

.10 Section 1.274–5(j)(1) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals paid or incurred while traveling away from home in lieu of substantiating the actual cost of meals.

.11 Section 5.04 of this revenue procedure contains revisions to the list of high-cost localities and to the high-low rates for purposes of section 5.

.12 Sections 3.02, 4.04(5), and 5.06 provide transition rules for the last 3 months of calendar year 2001 due to changes in the effective date of the CONUS rates published by GSA.

SECTION 3. DEFINITIONS

.01 *Per diem allowance*. The term "*per diem* allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62–2(c)(1) and that is

(1) paid with respect to ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses or for meal and incidental expenses for travel away from home in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at or below the applicable federal *per diem* rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.02 *Federal per diem rate and federal M&IE rate*.

(1) *General rule*. The federal *per diem* rate is equal to the sum of the applicable federal lodging expense rate and the applicable federal meal and incidental expense (M&IE) rate for the day and locality of travel.

(a) *CONUS rates*. The rates for localities in the continental United States ("CONUS") are set forth in Appendix A to 41 C.F.R. ch. 301. However, in applying section 4.01, 4.02, or 4.03 of this revenue procedure, taxpayers may continue to use the CONUS rates in effect for the first 9 months of 2001 for expenses of all CONUS travel while away from home that are paid or incurred during calendar year 2001 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, 2001, through December 31, 2001.

(b) *OCONUS rates*. The rates for localities outside the continental United States ("OCONUS") are established by the Secretary of Defense (rates for non-foreign localities, including Alaska, Hawaii, Puerto Rico, the Northern Mariana Islands, and the possessions of the United States) and by the Secretary of State (rates for foreign localities), and are published in the Per Diem Supplement to the Standardized Regulations (Government Civilians, Foreign Areas) (updated on a monthly basis).

(c) *Internet access to the rates*. The CONUS and OCONUS rates may be found on the Internet at www.policyworks.gov/perdiem.

(2) *Locality of travel*. The term "locality of travel" means the locality where an employee traveling away from home in connection with the performance of services as an employee of the employer stops for sleep or rest.

(3) *Incidental expenses*. The term "incidental expenses" includes, but is not limited to, expenses for laundry, cleaning and pressing of clothing, and fees and tips for services, such as for porters and baggage carriers. The term "incidental expenses" does not include taxicab fares, lodging taxes, or the costs of telegrams or telephone calls.

.03 *Flat rate or stated schedule*.

(1) *In general*. Except as provided in section 3.03(2) of this revenue procedure, an allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 3.01 of this revenue procedure. Such allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, an hourly payment to cover meal and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule. Likewise, a payment based on the number of miles traveled (*e.g.*, cents per mile) to cover meal and incidental expenses paid to an over-the-road truck driver who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

(2) *Limitation*. For purposes of this revenue procedure, an allowance that is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced) does not meet the business connection requirement of § 1.62–2(d), is not a *per diem* allowance, and is not paid at a flat rate or stated schedule, unless, as of December 12, 1989, (a) the allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the allowance, or (b) an allowance computed on that basis was commonly used in the industry in which the employee is employed. See § 1.62–2(d)(3)(ii).

SECTION 4. *PER DIEM* SUBSTANTIATION METHOD

.01 *Per diem allowance*. If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for such day or the amount computed at the federal *per diem* rate (see section 3.02 of this revenue procedure) for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.02 *Meals only per diem allowance*. If a payor pays a *per diem* allowance only for meal and incidental expenses in lieu of reimbursing actual expenses for meal and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for such day or the amount computed at the federal M&IE rate (see section 3.02 of this revenue procedure) for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure). A *per diem* allowance is treated as paid only for meal and incidental expenses if (1) the payor pays the employee for actual expenses for lodging based on receipts submitted to the payor, (2) the payor provides the lodging in kind, (3) the payor pays the actual expenses for lodging directly to the provider of the lodging, (4) the payor does not have a reasonable belief that lodging expenses were or will be incurred by the employee, or (5) the allowance is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced).

.03 *Optional method for meals only deduction*. In lieu of using actual expenses, employees and self-employed individuals, in computing the amount allowable as a deduction for ordinary and necessary meal and incidental expenses paid or incurred for travel away from home, may use an amount computed at the federal M&IE rate (see section 3.02 of this revenue procedure) for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee or self-employed individual is away from home. Such amount will be deemed substantiated for purposes of paragraphs (b)(2) (travel away from home) and (c) of § 1.274–5, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel expenses in accordance with those regulations.

.04 *Special rules for transportation industry*.

(1) *In general*. This section 4.04 applies to (a) a payor that pays a *per diem* allowance only for meal and incidental expenses for travel away from home as described in section 4.02 of this revenue procedure to an employee in the transportation industry, or (b) an employee or self-employed individual in the transportation industry who computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 of this revenue procedure.

(2) *Rates*. A taxpayer described in section 4.04(1) of this revenue procedure may treat $38 as the federal M&IE rate for any locality of travel in CONUS, and/or $42 as the federal M&IE rate for any locality of travel OCONUS. A payor that uses either (or both) of these special rates with respect to an employee must use the special rate(s) for all amounts subject to section 4.02 of this revenue procedure paid to that employee for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. Similarly, an employee or self-employed individual that uses either (or both) of these special rates must use the special rate(s) for all amounts computed pursuant to section 4.03 of this revenue procedure for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. See section 4.04(5) of this revenue procedure for transition rules.

(3) *Periodic rule*. A payor described in section 4.04(1) of this revenue procedure may compute the amount of the employee's expenses that is deemed substantiated under section 4.02 of this revenue procedure periodically (not less frequently than monthly), rather than daily, by comparing the total *per diem* allowance paid for the period to the sum of the amounts computed at the federal M&IE rate(s) for the localities of travel for the days (or partial days, see section 6.04 of this revenue procedure) the employee is away from home during the period. For example, assume an employee in the transportation industry travels away from home within CONUS on 17 days (including partial days, see section 6.04 of this revenue procedure) during a calendar month and receives a *per diem* allowance only for meal and incidental expenses from a payor that uses the special rule under section 4.04(2) of this revenue procedure. The amount deemed substantiated under section 4.02 of this revenue procedure is equal to the lesser of the total *per diem* allowance paid for the month or $646 (17 days at $38 per day).

(4) *Transportation industry defined*. For purposes of this section 4.04 of this revenue procedure, an employee or self-employed individual is "in the transportation industry" only if the employee's or individual's work (a) is of the type that directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and (b) regularly requires travel away from home which, during any single trip away from home, usually involves travel to localities with differing federal M&IE rates. For purposes of the preceding sentence, a payor must determine that an employee or a group of employees is "in the transportation industry" by using a method that is consistently applied and in accordance with reasonable business practice.

(5) *Transition rules*. Under the calendar-year convention provided in section 4.04(2), a taxpayer who used the federal M&IE rates during the first 9 months of calendar year 2001 to substantiate the amount of an individual's travel expenses under sections 4.02 or 4.03 of Rev. Proc. 2000–39 may not use, for that individual, the special transportation industry rates provided in this section 4.04 until January 1, 2002. Similarly, a taxpayer who used the special transportation industry rates during the first 9 months of calendar year 2001 to substantiate the amount of an individual's travel expenses may not use, for that individual, the federal M&IE rates until January 1, 2002.

## SECTION 5. HIGH-LOW SUBSTANTIATION METHOD

.01 *General rule*. If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home and the payor uses the high-low substantiation method described in this section 5 for travel within CONUS, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for such day or the amount computed at the rate set forth in section 5.02 of this revenue procedure for the locality of travel for such 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 $204 for travel to any "high-cost locality" specified in section 5.03 of this revenue procedure, or $125 for travel to any other locality within CONUS. Whichever *per diem* rate applies, it is applied as if it were the federal *per diem* rate for the locality of travel. For purposes of applying the high-low substantiation method and the § 274(n) limitation on meal expenses (see section 6.05 of this revenue procedure), the federal M&IE rate shall be treated as $42 for a high-cost locality and $34 for any other locality within CONUS.

.03 *High-cost localities*. The following localities have a federal *per diem* rate of $165 or more, and are high-cost localities for all of the calendar year or the portion of the calendar year specified in parenthesis under the key city name, except as provided in section 5.06 of this revenue procedure:

| *Key city* | *County or other defined location* |
|---|---|
| California | |
| Napa (April 1-November 15) | Napa |
| Palm Springs (January 1-May 31) | Riverside |
| San Francisco | San Francisco |
| San Mateo/Redwood City | San Mateo |
| Sunnyvale/Palo Alto/San Jose | Santa Clara |
| Tahoe City | Placer |
| Colorado | |
| Aspen (January 1-April 30) | Pitkin |
| Silverthorne/Keystone | Summit |
| Telluride (December 20-September 30) | San Miguel |
| Vail (December 1-March 31) | Eagle |
| District of Columbia | |
| Washington, D.C. | Washington, D.C.; the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, in Virginia; and the counties of Montgomery and Prince George's in Maryland |
| Florida | |
| Key West (January 1-April 30) | Monroe |
| Palm Beach (January 1-April 30) | Cities of Boca Raton, Delray Beach, Jupiter, Palm Beach Gardens, Palm Beach Shores, Singer Island, and West Palm Beach |
| Idaho | |
| Sun Valley | City limits of Sun Valley |
| Illinois | |
| Chicago | Cook and Lake |
| Louisiana | |
| New Orleans/St. Bernard (January 1-May 31) | Orleans, St. Bernard, Plaquemine, and Jefferson Parishes |
| Maine | |
| Kennebunk/Kittery/Sanford (June 15-October 31) | York |

| *Key city* | *County or other defined location* |
|---|---|
| Maryland | |
| (For the counties of Montgomery and Prince George's, see District of Columbia) | |
| Ocean City (June 15-October 31) | Worcester |
| Massachusetts | |
| Boston | Suffolk |
| Cambridge | Middlesex County (except Lowell) |
| Martha's Vineyard (June 1-October 15) | Dukes |
| Nantucket (June 15-October 15) | Nantucket |
| Michigan | |
| Mackinac Island | Mackinac |
| Traverse City | Grand Traverse |
| Montana | |
| Big Sky | Gallatin (except West Yellowstone Park) |
| Nevada | |
| Stateline | Douglas |
| New Jersey | |
| Atlantic City (June 1-November 30) | Atlantic |
| Cape May (June 1-November 30) | Cape May (except Ocean City) |
| Edison | Middlesex (except Piscataway) |
| Newark | Essex, Bergen, Hudson and Passaic |
| Ocean City (June 15-September 15) | City limits of Ocean City |
| Piscataway/Belle Mead | Somerset; and City limits of Piscataway |
| Princeton/Trenton | Mercer County |
| New York | |
| The Bronx/Brooklyn/Queens | The boroughs of The Bronx, Brooklyn, and Queens |
| Manhattan | Manhattan |
| Nassau County/Great Neck | Nassau County |
| Suffolk County | Suffolk County |
| White Plains | City limits of White Plains |
| Pennsylvania | |
| Hershey (June 1-September 15) | City limits of Hershey |
| Utah | |
| Ogden/Layton/Davis County (January 1-February 28) | Weber and Davis |
| Park City (December 15-March 31) | Summit |
| Provo (January 15-February 28) | Utah |
| Salt Lake City (January 15-February 28) | Salt Lake, Dugway Proving Ground, and Tooele Army Depot |
| Virginia | |
| (For the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, see District of Columbia) | |
| Wintergreen | Nelson |

.04 *Changes in high-cost localities*. The list of high-cost localities in section 5.03 of this revenue procedure differs from the list of high-cost localities in section 5.03 of Rev. Proc. 2000–39.

(1) The following localities (listed by key cities) have been added to the list of high-cost localities: Napa, California; San Mateo/Redwood City, California; Palm Beach, Florida; Kennebunk/Kittery/Sanford, Maine; Nantucket, Massachusetts; Stateline, Nevada; Atlantic City, New Jersey; Edison, New Jersey; Newark, New Jersey; Ogden/Layton/Davis County, Utah; Provo, Utah; and Salt Lake City, Utah.

(2) The portion of the year for which the following are high-cost localities (listed by key cities) has been changed: Telluride, Colorado; Vail, Colorado; Big Sky, Montana; and Park City, Utah.

(3) The following locality has been removed from the list of high-cost localities: Philadelphia, Pennsylvania.

.05 *Specific limitation*.

(1) Except as provided in section 5.05(2) of this revenue procedure, a payor that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid to that employee for travel away from home within CONUS during the calendar year. See section 5.06 of this revenue procedure for transition rules.

(2) With respect to an employee described in section 5.05(1) of this revenue procedure, the payor may reimburse actual expenses or use the meals only *per diem* method described in section 4.02 of this revenue procedure for any travel away from home, and may use the *per diem* substantiation method described in section 4.01 of this revenue procedure for any OCONUS travel away from home.

.06 *Transition rules*. A payor who used the substantiation method of section 4.01 of Rev. Proc. 2000–39 for an employee during the first 9 months of calendar year 2001 may not use the High-Low Substantiation Method in section 5 of this revenue procedure for that employee until January 1, 2002. A payor who used the High-Low Substantiation Method of section 5 of Rev. Proc. 2000–39 for an employee during the first 9 months of calendar year 2001 must continue to use the High-Low Substantiation Method for the remainder of calendar year 2001 for that employee. A payor described in the previous sentence may use the rates and high-cost localities published in section 5 of Rev. Proc. 2000–39, 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, 2001, and before January 1, 2002, if those rates and localities are used consistently during this period for all employees reimbursed under this method.

## SECTION 6. LIMITATIONS AND SPECIAL RULES

.01 *In general*. The federal *per diem* rate and the federal M&IE rate described in section 3.02 of this revenue procedure for the locality of travel will be applied in the same manner as applied under the Federal Travel Regulations, 41 C.F.R. Part 301–11 (2000), except as provided in sections 6.02 through 6.04 of this revenue procedure.

.02 *Federal per diem rate*. A receipt for lodging expenses is not required in determining the amount of expenses deemed substantiated under section 4.01 or 5.01 of this revenue procedure. See section 7.01 of this revenue procedure for the requirement that the employee substantiate the time, place, and business purpose of the expense.

.03 *Federal per diem or M&IE rate*. A payor is not required to reduce the federal *per diem* rate or the federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that meal and incidental expenses were or will be incurred by the employee.

.04 *Proration of the federal per diem or M&IE rate*. Pursuant to the Federal Travel Regulations, in determining the federal *per diem* rate or the federal M&IE rate for the locality of travel, the full applicable federal M&IE rate is available for a full day of travel from 12:01 a.m. to 12:00 midnight. For purposes of determining the amount deemed substantiated under section 4 or 5 of this revenue procedure with respect to partial days of travel away from home, either of the following methods may be used to prorate the federal M&IE rate to determine the federal *per diem* rate or the federal M&IE rate for the partial days of travel:

(1) Such rate may be prorated using the method prescribed by the Federal Travel Regulations. Currently the Federal Travel Regulations allow three-fourths of the applicable federal M&IE rate for each partial day during which the employee or self-employed individual is traveling away from home in connection with the performance of services as an employee or self-employed individual; or

(2) Such rate may be prorated using any method that is consistently applied and in accordance with reasonable business practice. For example, if an employee travels away from home from 9 a.m. one day to 5 p.m. the next day, a method of proration that results in an amount equal to 2 times the federal M&IE rate will be treated as being in accordance with reasonable business practice (even though only 1 1/2 times the federal M&IE rate would be allowed under the Federal Travel Regulations).

.05 *Application of the appropriate § 274(n) limitation on meal expenses*. All or part of the amount of an expense deemed substantiated under this revenue procedure is subject to the appropriate limitation under § 274(n) (see section 2.02 of this revenue procedure) on the deductibility of food and beverage expenses.

(1) When an amount for meal and incidental expenses is computed pursuant to section 4.03 of this revenue procedure, the taxpayer must treat such amount as an expense for food and beverages.

(2) When a *per diem* allowance is paid only for meal and incidental expenses, the payor must treat an amount equal to the lesser of the allowance or the federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure) as an expense for food and beverages.

(3) When a *per diem* allowance is paid for lodging, meal, and incidental expenses, the payor must treat an amount equal to the federal M&IE rate for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee is away from home as an expense for food and beverages. For purposes of the preceding sentence, when a *per diem* allowance for lodging, meal, and incidental expenses is paid at a rate that is less than the federal *per diem* rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure), the payor may treat an amount equal to 40 percent of such allowance as the federal M&IE rate

for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.06 *No double reimbursement or deduction*. If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses or for meal and incidental expenses in accordance with section 4 or 5 of this revenue procedure, any additional payment with respect to such expenses is treated as paid under a nonaccountable plan, is included in the employee's gross income, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. Similarly, if an employee or self-employed individual computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 or 4.04 of this revenue procedure, no other deduction is allowed to the employee or self-employed individual with respect to such expenses. For example, assume an employee receives a *per diem* allowance from a payor for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home. During that trip, the employee pays for dinner for the employee and two business associates. The payor reimburses as a business entertainment meal expense the meal expense for the employee and the two business associates. Because the payor also pays a *per diem* allowance to cover the cost of the employee's meals, the amount paid by the payor for the employee's portion of the business entertainment meal expense is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes.

.07 *Related parties*. Sections 4.01 and 5 of this revenue procedure will not apply in any case in which a payor and an employee are related within the meaning of § 267(b), but for this purpose the percentage of ownership interest referred to in § 267(b)(2) shall be 10 percent.

SECTION 7. APPLICATION

.01 If the amount of travel expenses is deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place, and business purpose of the travel expenses in accordance with paragraphs (b)(2) (travel away from home) and (c) (other than subparagraph (2)(iii)(A) thereof) of § 1.274–5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5(c). See § 1.62–2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.02 An arrangement providing *per diem* allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of such an allowance that relates to days of travel not substantiated, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance *per diem* allowance for meal and incidental expenses of $200, based on an anticipated 5 days of business travel at $40 per day to a locality for which the federal M&IE rate is $34, and the employee substantiates 3 full days of business travel. The requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) the portion of the allowance that is attributable to the 2 unsubstantiated days of travel ($80), even though the employee is not required to return the portion of the allowance ($18) that exceeds the amount of the employee's expenses deemed substantiated under section 4.02 of this revenue procedure ($102) for the 3 substantiated days of travel. However, the $18 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 7.04 of this revenue procedure.

.03 An employee is not required to include in gross income the portion of a *per diem* allowance received from a payor that is less than or equal to the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the *per diem* allowance in accordance with section 7.01 of this revenue procedure. *See* § 1.274–5(f)(2)(i). In addition, such portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W-2, and is exempt from the withholding and payment of employment taxes. *See* § 1.62–2(c)(2) and (c)(4).

.04 An employee is required to include in gross income only the portion of the *per diem* allowance received from a payor that exceeds the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the *per diem* allowance in accordance with section 7.01 of this revenue procedure. *See* § 1.274–5(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.05 If the amount of the expenses that is deemed substantiated under the rules provided in section 4.01, 4.02, or 5 of this revenue procedure is less than the amount of the employee's business expenses for travel away from home, the employee may claim an itemized deduction for the amount by which the business travel expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business travel expenses, includes on Form 2106, *Employee Business Expenses*, the deemed substantiated portion of the *per diem* allowance received from the payor, and includes in gross income the portion (if any) of the *per diem* allowance received from the payor that exceeds the amount deemed substantiated. *See* § 1.274–5(f)(2)(iii). However, for purposes of claiming this itemized deduction with respect to meal and incidental expenses, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the amount computed under section 4.03 of this revenue procedure minus the amount deemed substantiated under sections 4.02 and 7.01 of this revenue procedure. The itemized deduction is subject to the appropriate limitation (*see* section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.06 An employee who does not receive a *per diem* allowance for meal and incidental expenses may deduct an amount computed pursuant to section 4.03 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the appropriate limitation (*see* section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.07 A self-employed individual may deduct an amount computed pursuant to section 4.03 of this revenue procedure in determining adjusted gross income under § 62(a)(1). This deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n).

.08 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. Thus, such payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(3), (c)(5), and (h)(2).

SECTION 8. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a *per diem* allowance, if any, that relates to the days of business travel substantiated and that exceeds the amount deemed substantiated for those days under section 4.01, 4.02, or 5 of this revenue procedure is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

.02 In the case of a *per diem* allowance paid as a reimbursement, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes in the 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(3) of this revenue procedure, the excess of the *per diem* allowance paid for the period over the amount deemed substantiated for the period under section 4.02 of this revenue procedure (after applying section 4.04(3) of this revenue procedure), is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. *See* § 1.62–2(h)(2)(i)(B)(*4*).

.05 For example, assume that an employer pays an employee a *per diem* allowance to cover business expenses for meals and lodging for travel away from home at a rate of 120 percent of the federal *per diem* rate for the localities to which the employee travels. The employer does not require the employee to return the 20 percent by which the reimbursement for those expenses exceeds the federal *per diem* rate. The employee substantiates 6 days of travel away from home: 2 days in a locality in which the federal *per diem* rate is $100 and 4 days in a locality in which the federal *per diem* rate is $125. The employer reimburses the employee $840 for the 6 days of travel away from home (2 x (120% x $100) + 4 x (120% x $125)), and does not require the employee to return the excess payment of $140 (2 days x $20 ($120-$100) + 4 days x $25 ($150-$125)). For the payroll period in which the employer reimburses the expenses, the employer must withhold and pay employment taxes on $140. *See* section 8.02 of this revenue procedure.

SECTION 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2000–39 is hereby superseded (except to the extent specified in sections 4.04(5) and 5.06 of this revenue procedure) for *per diem* allowances that are paid both (1) to an employee on or after October 1, 2001, and (2) with respect to lodging, meal, and incidental expenses or with respect to meal and incidental expenses paid or incurred for travel while away from home on or after October 1, 2001. Rev. Proc. 2000–39 is also hereby superseded (except to the extent specified in section 4.04(5) of this revenue procedure) for purposes of computing the amount allowable as a deduction for meal and incidental expenses paid or incurred by an employee or self-employed individual for travel while away from home on or after October 1, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is John L. Trevey, Jr., of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Trevey at (202) 622-4970 (not a toll-free call).

# Part IV. Items of General Interest

## Archer MSAs

## Announcement 2001–99

**PURPOSE**

Sections 220(i) and (j) of the Internal Revenue Code provide that if the number of Medical Savings Account (MSA) returns filed for 2000 or a statutorily specified projection of the number of MSA returns that will be filed for 2001 exceeds 750,000, then October 1, 2001, is a "cut-off" date for the Archer MSA pilot project. The Internal Revenue Service (IRS) has determined that the applicable number of MSA returns filed for 2000 is 36,250 and that the applicable number of MSA returns projected to be filed for 2001 is 76,035 (after reduction in each case for statutorily specified exclusions, such as the exclusion for previously uninsured taxpayers). Consequently, October 1, 2001, is not a "cut-off" date and 2001 is not a "cut-off" year for the Archer MSA pilot project.

**BACKGROUND**

The Health Insurance Portability and Accountability Act of 1996 added section 220 to the Code to permit eligible individuals to establish Archer MSAs under a pilot project effective January 1, 1997. The pilot project, as amended by The Community Renewal Tax Relief Act of 2000, has a scheduled "cut-off" year of 2002, but may have an earlier "cut-off" year if the number of individuals who have established Archer MSAs exceeds certain numerical limitations. See sections 220(i) and (j).

If a year is a "cut-off" year, section 220(i)(1) generally provides that no individual will be eligible for a deduction or exclusion for Archer MSA contributions for any taxable year beginning after the "cut-off" year unless the individual (A) was an active MSA participant for any taxable year ending on or before the close of the "cut-off" year, or (B) first became an active MSA participant for a taxable year ending after the "cut-off" year by reason of coverage under a high deductible health plan of an MSA-participating employer.

Section 220(j)(2)(A) provides that the numerical limitation for 2001 is exceeded if the number of MSA returns filed on or before April 15, 2001, for taxable years ending with or within the 2000 calendar year, plus the Secretary's estimate of the number of MSA returns for those taxable years which will be filed after April 15, 2001, exceeds 750,000. For this purpose, section 220(j)(2)(A) provides that a tax return is an MSA return for a taxable year if any exclusion is claimed under section 106(b) or any deduction is claimed under section 220 for that taxable year. Section 220(j)(2)(B) provides, as an alternative test, that the numerical limitation for 2001 is also exceeded if the sum of 90 percent of the MSA returns for 2000 plus the product of 2.5 and the number of Archer MSAs for taxable years beginning in 2001 that are established during the portion of 2001 preceding July 1 (based on reports by Archer MSA trustees and custodians), exceeds 750,000.

Under section 220(j)(3), in determining whether any calendar year is a "cut-off" year, the Archer MSA of any previously uninsured individual is not taken into account. In addition, section 220(j)(4)(D) specifies that, to the extent practical, all Archer MSAs established by an individual are aggregated and two married individuals opening separate Archer MSAs are to be treated as having a single Archer MSA for purposes of determining the number of Archer MSAs.

A total of 54,979 tax returns reporting an excludable or deductible contribution to an Archer MSA for the 2000 taxable year were filed by April 15, 2001. Of this total, 22,968 taxpayers were reported as being previously uninsured. It has been estimated that an additional 7,253 tax returns reporting Archer MSA contributions for the 2000 taxable year have been or will be filed after April 15, 2001, including 3,014 taxpayers who were previously uninsured. Accordingly, it has been determined that there were 62,232 (54,979 plus 7,253) MSA returns for 2000. Of this total, 25,982 (22,968 plus 3,014) were for taxpayers reported as being previously uninsured. As a result, 36,250 (62,232 minus 25,982) MSA returns count toward the applicable statutory limitation for 2001 MSA returns of 750,000.

Based on the Forms 8851 filed on or before August 1, 2001, by Archer MSA trustees and custodians, it has been determined that 22,640 taxpayers who did not have Archer MSA contributions for 2000 established Archer MSAs for 2001 during the portion of 2001 preceding July 1. Of this total, 4,967 taxpayers were reported by trustees and custodians as previously uninsured, and therefore are not taken into account in determining whether 2001 is a "cut-off" year. In addition, 272 taxpayers were reported by trustees and custodians as excludable from the count because their spouse also established an Archer MSA, and 37 taxpayers had more than one account. Accordingly, the applicable number of Archer MSAs established from January 1, 2001, through June 30, 2001, is 17,364 (22,640 minus (4,967 plus 272 plus 37)). The alternative limitation for 2001 (90 percent of the applicable number of MSA returns for 2000 plus the product of 2.5 and the number of applicable Archer MSAs established from January 1, 2001, through June 30, 2001) is 76,035 (90 percent of 36,250 plus 2.5 times 17,364), which is less than the statutory limit of 750,000. Thus, 2001 is not a "cut-off" year for the Archer MSA pilot project by reason of either the 2000 MSA returns test of section 220(j)(2)(A) or the alternative test of section 220(j)(2)(B) of the Code.

Questions regarding this announcement may be directed to Felix Zech in the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622-6080 (not a toll-free number).

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## Foundations Status of Certain Organizations

## Announcement 2001–102

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the

Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

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

A.C. Milan Futbol Club, Plano, TX
Aids Prevention Education and Advocacy Resource, Austin, TX
Alumni Association of Martin Luther King, Jr. High School, New York, NY
Anew a Renewal Center for Men and Women, Los Angeles, CA
Anointed Voices, Corpus Christi, TX
Austin Revitalization Authority, Austin, TX
Austin Sign Language Theatre Academy, Austin, TX
Baptist Ministries of South Texas, Inc., San Antonio, TX
Beta Education Foundation, Austin, TX
Bible Memory Challenge Ministries, San Antonio, TX
Bishop College Historical Society, Inc., Dallas, TX
Bridge the Gap, Inc., Fort Worth, TX
Buckingham Terrace, Inc., Atlanta, GA
Burleson County Reserve Law Enforcement Officers Association, Caldwell, TX
Cadillac Power Hitters Association, Kaufman, TX
Calvary Center, Inc., Laredo, TX
Centro De Inmigracion, Dallas, TX
CFIDS Walk-A-Thon Committee, Hicksville, NY
Cherokees of North Texas, Dallas, TX
Childrens Life Link, Inc., Waco, TX
Chinese Broadcasting Network, Inc., Richardson, TX
Colorado Museum of Contemporary Arts, Inc., Denver, CO
Colorado Volunteer Victim Advocate Program, Arvada, CO
Court Appointed Special Advocates of Upshur County, Inc., Gilmer, TX
Denton Public School Foundation, Inc., Denton, TX
Divine Health Care Systems, Inc., San Antonio, TX
East Texas Critical Incident Stress Management Team, Inc., Tyler, TX
Ecotema, Davis, CA
El Paso Charities Community Chest, El Paso, TX
El Paso Million Man March Initiative, Inc., El Paso, TX
El Paso Minority Supplier Development Council, Inc., El Paso, TX
Elite Credit Services, Inc., Dallas, TX
Emergency Assistance Alliance, Inc., Fort Worth, TX
Environmental Mobility, Inc., Corpus Christi, TX
Everyman Project, Austin, TX
Fillmore Civic Arts Council, Inc., Fillmore, UT
First Motion, Inc., Mokena, IL
Forth Worth Rugby Football Corporation, Ft. Worth, TX
Foundation for Aquatic Safety and Training, Dallas, TX
Foundation of Behavior Education Modification FBEM, Fort Worth, TX
Friends Who Care Foundation, Georgetown, TX
Gambian Association of Massachusetts, Somerville, MA
Gamma Education Foundation, Austin, TX
Gay and Lesbian Leaders Outreach Project Gallop, Dallas, TX
Good News Music Ministry, Bryan, TX
Grace Vocational Academy, Post, TX
Griggs Foundation, Inc., Dallas, TX
Hatzolah Jerusalem, Inc., Brooklyn, NY
Helping Hands for Life, Inc., Austin, TX
HFJ Community Services, Tacoma, WA
Hispanic Women for Progress, Big Spring, TX
Houston Musicians Benefit Foundation, Houston, TX
Human Potential Development Corp., Texarkana, TX
Imagination Young Peoples Center for Science Music and Movement in East Austin, Austin, TX
Institute for Learning and Communication Strategies, Inc., Austin, TX
Institute of New Physics, Inc., Los Angeles, CA
Internet Archive, San Francisco, CA
Jaguar Museum for British Car History a NJ Non-Profit Corp., Mahwah, NJ
Johnson County Business Development Corporation, Tecumseh, NE
Joshua Community Development, Inc., Joshua, TX
Kathleen Akin Scholarship Fund, Rockport, TX
Kids Voting California, San Jose, CA
Killeen Amateur Boxing Association, Kileen, TX
King Preservation Corporation, Chicago, IL
Knights of Malta Sovereign Order of Hospitallers of St. John of Jerusalem, Gallatin, TN
Kosher Kesher, Inc., Brooklyn, NY
KPCH, Inc., Winston-Salem, NC
La Habra High School Volleyball Boosters, La Habra, CA
La Junta Housing Development Corporation, La Junta, CO
Lake State Community Housing, Inc., St. Joseph, MI
Lake Villa Township Youth Football, Lake Villa, IL
Lazarus Alliance, Draper, UT
Learning Safari, Great Falls, VA
Lets Help Sunray, Inc., Dumas, TX
Life Match, Waco, TX
Liga Pan Americana Aguilas, Inc., San Antonio, TX
Lilies of the Field, Walnut, CA
Lillian J. Robinson Community Development Corporation, Bryan, TX
Living Word Outreach, Inc., Fairburn, GA
Love of Life Pregnancy Center, Inc., El Paso, TX
Love on 4 Paws, Ennis, TX
Love the Animals Charitable Trust, El Cerrito, CA
Maggies Playhouse, Dallas, TX
Manos Extendidas, Kent, WA
Mary Starke Harper Foundation, Inc., Tuscaloosa, AL
Massachusetts Vietnam Veterans Foundation, Inc., W. Springfield, MA
Mercy Wings International, Inc., Caddo Mills, TX
Mica League, Inc., Philadelphia, PA
Migala Foundation, Duncanville, TX
Mingeikan USA Tour, Fort Worth, TX
Minnesota Housing Initiative, Brooklyn Park, MN
Mohawk Area Development Corporation, Cincinnati, OH
Montgomery Times Foundation, Inc., Rockville, MD
Morgantown Lacrosse Club, Inc., Morgantown, WV
Morning Mist Ranch, Lubbock, TX
National Sexual Trauma Center, Inc., Pass Christian, MS
NCOA Student Civic Action Program, Inc., Mcghee Tyson, TN

Neighborhood in Action, Austin, TX
Neighborhoods Acting Together, San Antonio, TX
New Directions Network, Inc., Galveston, TX
New Life Ministries of the Rio Grande Valley, Inc., Harlingen, TX
New Millennium Educational Institute, Redwood City, CA
Nicaraguan - American Childrens Foundation, Inc., Miami, FL
North Bay Volunteer Medical Clinic, Inc., Ingleside, TX
North Texas Junior Golf & Education Foundation, Dallas, TX
Northeast Alamo Community Development Corporation, San Antonio, TX
Old East Dallas Neighborhood Association, Dallas, TX
Omega Education Foundation, Georgetown, TX
Organization for the Enrichment of Human Resource, Fairfield, CA
Pacific Actors Company, Sonoma, CA
Parker County Child Protective Services Board, Weatherford, TX
Pedastal Gardens Residents Association, Baltimore, MD
Peoples First Intermediate Care, Phoenix, IL
Pioneer Mountain Foundation, Inc., Ketchum, ID
Plano Lacrosse Association, Plano, TX
Player Service Foundation, Newport, RI
Playground For All, Inc., Azle, TX
PPBA Scholarship Foundation, Inc., Toledo, OH
Pro-Action, El Paso, TX
Professional Outreach Ministries, Inc., San Antonio, TX
Project Hope Tenants Assoc., Inc., Bronx, NY
Project Wheelbarrow, Inc., Canton, OH
Quitman Foundation of Perpetual Scholastic Funds, Quitman, TX
Raymine, Dallas, TX
Reaching & Identifying Special Kids-R.I.S.K., Picayune, MS
Real Solution Living Program, San Antonio, TX
Reconciled Ministries, Inc., San Antonio, TX
Recovery Haven Drug Recovery Center, Medaryville, IN
Rediscover Opportunity, Inc., Louisville, CO
Rhythm of Life Foundation, Los Angeles, CA
Rifled Arms Historical Association, Wallkill, NY
Robbie Cave Ministries, Austin, TX
Roger Brown Benefit Fund, Inc., Greensboro, NC
Romanian Childrens Connection, Inc., Alexandria, VA
Running Creek Animal Refuge, Inc., San Antonio, TX
Ryan Dietzman Memorial Scholarship Fund, Justin, TX
San Antonio Public Theatre, San Antonio, TX
Sandy Ford Junior Shooters, Inc., Streator, IL
Save Our Kids Boxing Association, Cleburne, TX
Save the World Ministries, Berkeley, CA
Scurry Youth Center, Snyder, TX
Seagraves-Loop Youth Association, Seagraves, TX
Senior Care Careers, Inc., Schaumburg, IL
Shades of the African-American Woman, Austin, TX
Share the Wealth Ministries, Mt. Airy, GA
Shenango Presbyterian Senior Housing, Inc., Oakmount, PA
Sierra Community Healthcare Foundation, Las Vegas, NV
Silver City Jazz Society, Silver City, NM
Sisters of Safety, Buena Vista, CO
Southeastern Connecticut Mental Health Authority, Inc., Norwich, CT
Southern Oregon Family Consortium, Medford, OR
Southside Virginia Wildlife Rehabilitation Center, Inc., South Hill, VA
Special Events for Aids, Inc., Sterling Hgts., MI
Springbrook Farm Corporation, Stow, MA
SSG Richard A. Fitts Veterans Transitional Center, Inc., Braintree, MA
St. Louis Bombers Rugby Football Club, Inc., St. Louis, MO
Step-Save the Earth and Its People, Inc., Jasper, GA
Street Light Productions, Inc., San Antonio, TX
Surgery Education Fund, Ann Arbor, MI
Synergy Local Development Corporation, Philadelphia, PA
Taskmates, Providence, RI
Taylors Charities Program, Dallas, TX
Telees Kids, Inc., Dallas, TX
Texas Hunter Education Instructors Association, Inc., Georgetown, TX
Texas Pride Baseball, Fort Worth, TX
Texas Society for Medical Staff Services, Austin, TX
Texas Socratic Foundation, Austin, TX
Theatre on Elm Street Toes, Dallas, TX
Thomas G. Daugherty Memorial Scholarship Fund, Sacramento, CA
Three Rivers Housing Development Corporation, Rome, GA
Transitional Services and Housing, Inc., Beavercreek, OH
Twla Gibson Transplant Fund, Victoria, TX
Tyler County, Woodville, TX
U.I.S.D. Campus Crime Stoppers, Inc., Laredo, TX
Umoja, Inc., Fort Worth, TX
Unified Resident Council of Chandler, Chandler, AZ
Unity Foundation, San Antonio, TX
Unlimited Access Educational Services, Ann Arbor, MI
UPCOD, Inc., Freer, TX
Vaad Ahavas Chinum, Inc., Baltimore, MD
Venture Outreach International, Fort Worth, TX
Virology Institute, San Antonio, TX
Visions of North Carolina, Greensboro, NC
Washington Times Foundation, Inc., Washington, DC
Weiss & Weiss Aquatics, Austin, TX
Wetstone Integrated Community Services, San Diego, CA
Where Hearts Can Mend, San Antonio, TX
Women & Youth Supporting Each Other, Los Angeles, CA
Yucca Corridor Coalition of Property Owners & Managers, Inc., Hollywood, CA
Zion Arts Institute, Inc., San Antonio, TX
Zions Treatment Center, Inc., Miami, FL

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

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

## Section 1374.—Tax Imposed on Certain Built-In Gains

*26 CFR 1.1374–4: Recognized built-in gain or loss.*

**Built-in gains tax.** The built-in gains tax under § 1374 will not apply to the timber, coal and domestic iron ore transactions described in the four situations in the ruling.

## Rev. Rul. 2001–50

ISSUE

Is the S corporation's gain recognized in each of the situations described below recognized built-in gain for purposes of § 1374 of the Internal Revenue Code?

FACTS

*Situation 1*: An S corporation holds timber property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires timber property with built-in gain from a C corporation in a transaction to which § 1374(d)(8) applies). During the 10-year period beginning with the first day of the first taxable year for which the corporation was an S corporation (or beginning on the day of the § 1374(d)(8) transaction) (the recognition period), the S corporation cuts the timber and sells the resulting wood products and recognizes that built-in gain in a transaction to which § 631 does not apply.

*Situation 2*: An S corporation holds timber property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires timber property with built-in gain from a C corporation in a transaction to which § 1374(d)(8) applies). During the recognition period, the S corporation recognizes that built-in gain on cutting the timber pursuant to an election under § 631(a).

*Situation 3*: An S corporation holds timber property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires timber property with built-in gain from a C corporation in a transaction to which § 1374(d)(8) applies). During the recognition period, the S corporation recognizes that built-in gain on the disposal of the timber under a contract to which § 631(b) applies.

*Situation 4*: An S corporation holds coal or domestic iron ore property with built-in gain on the date its election to convert from a C corporation to an S corporation is effective (or acquires coal or domestic iron ore property with built-in gain from a C corporation in a transaction to which § 1374(d)(8) applies). During the recognition period, the S corporation recognizes that built-in gain on the disposal of the coal or domestic iron ore under a contract to which § 631(c) applies.

LAW AND ANALYSIS

Section 1374 imposes a corporate-level tax on an S corporation's net recognized built-in gain during the recognition period in the case of a C corporation's conversion to S corporation status (§ 1374(a)) or an S corporation's acquisition of assets in a transaction in which the S corporation's basis in the acquired assets is determined by reference to the basis of such assets in the hands of a C corporation (§ 1374(d)(8)). Recognized built-in gain includes any gain recognized on the disposition of an asset during the recognition period, except to the extent the S corporation establishes that it did not hold the asset on the conversion date or § 1374(d)(8) transaction date, or that the gain recognized was greater than the excess of the asset's fair market value over its adjusted basis on the conversion date or § 1374(d)(8) transaction date (§ 1374(d)(3)). Section 1374(d)(3) applies to any gain recognized during the recognition period in a transaction treated as a sale or exchange for Federal income tax purposes (§ 1.1374–4(a) of the Income Tax Regulations). In Example 1 of § 1.1374–4(a)(3), X is a C corporation that elects to become an S corporation effective January 1, 1996. On that date, X owns a working interest in an oil and gas property with a fair market value of $250,000 and an adjusted basis of $500,000. During the recognition period, X produces and sells oil extracted from the oil and gas property for $75,000. The example concludes that the $75,000 is not recognized built-in gain under § 1374 because, as of the beginning of the recognition period, X held only a working interest in the oil and gas property, and not the oil itself.

Section 631(a) provides that, under certain circumstances, a taxpayer's cutting of timber is treated as a sale or exchange of the timber in the year it is cut. Section 631(b) provides that, under certain circumstances, a taxpayer's disposition of timber shall be treated as giving rise to gain or loss on a sale of such timber. Section 631(c) provides that, under certain circumstances, a taxpayer's disposition to unrelated parties of coal or domestic iron ore shall be treated as giving rise to gain or loss on a sale of such coal or iron ore. In general, § 631 permits a taxpayer to benefit from capital gain treatment in circumstances that would otherwise give rise to ordinary income.

If an S corporation holds timber property on the date its election to convert from a C corporation to an S corporation is effective and, during the recognition period, cuts the timber and sells the resulting wood products in a transaction to which § 631 does not apply, the tax consequences to the S corporation under § 1374 are determined using the same analysis contained in Example 1 of § 1.1374–4(a)(3). The wood products sold as inventory during the recognition period did not constitute separate assets held by the S corporation on the conversion date and thus their production and sale do not constitute a partial disposition of the timber property. See Rev. Rul. 72–515 (1972–2 C.B. 466) (treating growing timber as part of the underlying real property for purposes of § 1031). Accordingly, the S corporation's income on the sale of the resulting wood products during the recognition period is not recognized built-in gain within the meaning of § 1374(d)(3) and is not taxed under § 1374.

Notwithstanding the treatment accorded income under § 631, the income received from the sale of the resulting wood product, produced coal, or produced iron ore involves the receipt of normal operating business income in the nature of rent or royalties. See Rev. Rul. 77–109 (1977–1 C.B. 87) (holding that payments received from a disposal of coal to which § 631(c) does not apply is ordinary income). The receipt of normal operating business income in the nature of rents and royalties is not subject to tax under § 1374. There is no indication that Congress intended the capital gain tax rate benefits provided by section § 631 to cause normal operating business income from the cutting of timber or the extraction of minerals to be subject to tax under § 1374. Moreover, § 631(c) is designed to favor domestic production of iron ore and sales of coal and iron ore to unrelated parties. Applying § 1374 to income taxed under § 631(c) could have the anomalous effect of taxing sales of domestic iron ore more heavily than sales of foreign production and taxing sales of coal and iron to unrelated parties more heavily than sales to related parties. Accordingly, an S corporation's gain recognized pursuant to § 631(a), § 631(b), or § 631(c) during the recognition period is not recognized built-in gain within the meaning of § 1374(d)(3).

HOLDINGS

The S corporation's gain recognized in the transactions described in Situation 1, 2, 3, and 4 is not recognized built-in gain for purposes of § 1374.

See also Rev. Proc. 2001–51 (2001–43 I.R.B. 369), which modifies Rev. Proc. 2001–3 (2001–1 I.R.B. 111), by deleting therefrom section 5.06 (the no-rule under § 1374, regarding the tax imposed on certain built-in gains).

DRAFTING INFORMATION

The principal author of this revenue ruling is Cristian P. Silva of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Mr. Silva at (202) 622-7750 (not a toll-free call).

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## Section 6221.—Tax Treatment Determined at Partnership Level

*26 CFR 301.6221–1: Tax treatment determined at partnership level.*

## T.D. 8965

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Parts 301 and 602

## Unified Partnership Audit Procedures

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the unified partnership audit procedures added to the Internal Revenue Code by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), and amended by the Taxpayer Relief Act of 1997 (1997 Act) and the Internal Revenue Service Restructuring and Reform Act of 1998 (1998 Act). The unified partnership audit procedures provide administrative rules for the auditing of a partnership and its partners.

*EFFECTIVE DATES:* These regulations are effective October 4, 2001.

FOR FURTHER INFORMATION CONTACT: William Heard at (202) 622-7950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545-0790. Responses to these collections of information are both mandatory and voluntary and are required to receive a benefit.

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

The collections of information required by §§ 301.6222(b)–1, 301.6227(c)–1, and 301.6227(d)–1 are reflected on Form 8082, *"Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)."* The burden associated with them is reflected on that form.

The remaining collections of information: §§ 301.6222(a)–2, 301.6222(b)–2, 301.6222(b)–3(a)(2), 301.6223(b)–1(b), 301.6223(c)–1(a), 301.6223(e)–2(a), 301.6223(g)–1, 301.6223(h)–1, 301.6224(b)–1(b), 301.6224(c)–1(c), 301.6224(c)–3(c), 301.6229(b)–2(b), 301.6230(b)–1, 301.6230(e)–1, 301.6231(a)(1)–1(b), 301.6231(a)(7)–1, 301.6231(c)–1(d), 301.6231(c)–2(d), are not reflected on the Form 8082. The estimated annual burden per respondent varies from .25 hours to .75 hours, depending on individual circumstances, with an estimated average of .5 hours.

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

### Background

These regulations finalize the regulations proposed December 13, 1984 (L.R. 242–84, 1984–2 C.B. 917 [49 FR 48573]), April 18, 1986 (L.R. 205–82, 1986–1 C.B. 782 [51 FR 13231]), and January 26, 1999 (REG–106564–98, 1999–1 C.B. 714 [64 FR 3886]) and issued as temporary regulations on December 13, 1984 (T.D. 7996, 1985–1 C.B. 357 [49 FR 48536]), March 5, 1987 (T.D. 8128, 1987–1 C.B. 325 [52 FR 6779]), and January 26, 1999 (T.D. 8808, 1999–1 C.B. 682 [64 FR 3837]). On January 26, 1999, proposed regulations (REG–106564–98, 1999–1 C.B. 714) were published in the **Federal Register** (64 FR 3886). These regulations implemented the amendments to the unified partnership audit rules made by the 1997 and 1998 Acts. In addition, the preamble to those proposed regulations stated that the IRS planned on finalizing all of the unified partnership audit procedure regulations as part of this project (*i.e.*, those regulations proposed on December 13, 1984, and April 18, 1986). No written comments were received in response to the January 26, 1999, notice of proposed rulemaking. Contemporaneous with the issuance of proposed regulations, Treasury and the IRS issued temporary regulations containing substantially similar rules. Taxpayers and the IRS have been operating under these rules since they were promulgated as temporary regulations.

The proposed regulations under §§ 301.6221 thru 301.6233 are adopted, as revised by this Treasury decision.

### Explanation of Provisions

These final regulations contain regulations substantially similar to the previously proposed and currently effective temporary regulations under sections 6221 through 6231, inclusive. The substantive changes from the provisions in the proposed and temporary regulations are as follows:

1. *Clarification of § 301.6223(a)–2T*

Section 6223 requires the IRS to provide partners with notice of partnership proceedings. Under section 6223, the IRS must notify each partner of the beginning of an administrative proceeding by sending out a notice of the beginning of an administrative proceeding (NBAP). Under § 301.6223(a)–2T, if the IRS has issued an NBAP but decides not to propose any adjustments to the partnership return as filed, the IRS has 45 days to withdraw the NBAP. If the IRS does not withdraw the NBAP, however, it is not required to issue a notice of final partnership administrative adjustment (FPAA). This has led to some confusion among partnerships who postpone raising adjustments that may result in refunds or offsets while they await the outcome of the partnership-level audit. The issue of whether the IRS is required to issue an FPAA after issuance of an NBAP was litigated in *Atlantic Richfield Co. v. Dept. of Treasury*, 1996 U.S. Dist. LEXIS 19891, (D.D.C. Dec. 31, 1996). In that case, the court held that the IRS is not required to issue an FPAA even if it does not withdraw the NBAP. If the IRS does not issue an FPAA the partners will be unable to request favorable adjustments unless they have filed a timely administrative adjustment request (AAR) seeking a change in the treatment of partnership items. Accordingly, a sentence has been added to § 301.6223(a)–2 to explicitly inform taxpayers that the IRS does not have to issue an FPAA notwithstanding the issuance of (and failure to withdraw) an NBAP.

2. *Elections Made Under § 301.6223(e)–2T*

As stated above, section 6223 requires the IRS to provide partners with an NBAP and an FPAA. If the IRS fails to provide a partner with timely notice, the partner may, under § 301.6223(e)–2T(c)(2), elect to have either the FPAA, a court decision, a consistent settlement agreement, or conversion to nonpartnership items apply to that partner's partnership items. That election must be mailed within 45 days after "that notice was mailed." Section 301.6223(e)–2T(c)(2). To remove any ambiguity regarding which notice triggers the right to make an election under section 6223(e), the final regulations amend the temporary regulations to make it clear that the 45-day period for making the election under section 6223(e) relates to the mailing of the FPAA, not the NBAP. The final regulations also clarify that, in accordance with *Wind Energy Technology Associates III v. Commissioner*, 94 T.C. 787 (1990), the issuance of an NBAP fewer than 120 days before the issuance of the FPAA does not invalidate the FPAA. Instead, a taxpayer will have 45 days from the mailing of the FPAA to make the elections provided in section 6223(e).

3. *Effect of a Nonresident Alien Partner on the Small Partnership Exception of Section 6231(a)(1)(B)(i)*

For purposes of the unified partnership audit rules, section 6231(a)(1)(B)(i) contains an exception from the definition of a *partnership* for certain small partnerships. Under this rule, a *partnership* does not include any partnership having 10 or fewer partners, each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner. The proposed regulations stated that "the 10 or fewer limitation . . . is applied to the number of natural persons (other than nonresident aliens) . . ." Some practitioners have read this provision to mean that a nonresident alien can be a partner in a small partnership that is not subject to the unified partnership audit rules, but that such partners are not counted toward the 10 partner limitation. To clarify that a partnership that has a nonresident alien partner cannot qualify for the small partnership exception of section 6231(a)(1)(B)(i), this parenthetical has been removed in § 301.6231(a)(1)–1(a)(1) of the final regulations.

4. *Definition of Affected Item*

Under the unified partnership audit rules, special procedures apply with respect to affected items, that is, items that are affected by partnership items. Section 301.6231(a)(5)–1T defines the term *affected item* as including, among other things, a partner's basis in the partner's partnership interest, the application of the section 465 at-risk rules to a partner, and any addition to tax or additional amount to the extent that they are not partnership items. Generally, affected items are directly assessed following partnership proceedings. If the item requires partner-level determinations, however, the IRS must assert changes to affected items in a partner-level deficiency proceeding following the completion of the partnership-level proceeding.

The IRS promulgated § 301.6231(a)(5)–1T before the enactment of section 469, the passive loss rules. Because the application of the passive loss rules to a partner is similar to the existing list of affected items, the final regulations provide that the application of the passive loss rules under section 469 to a partner with respect to a loss flowing from a partnership is an affected item to the extent it is not a partnership item.

5. *Husbands and Wives Owning Partnership Interests Separately or Jointly*

The temporary regulations under section 6231 describe the treatment of spouses under the unified partnership audit rules where: (1) a married couple owns an interest in a partnership as joint property; and (2) a married individual owns an interest in a partnership as separate property. Section 301.6231(a)(12)–1T applies when a married couple owns a partnership interest as joint property. It provides that, with limited exceptions, spouses holding a joint interest in a partnership are both treated as partners for purposes of subchapter C of chapter 63 of the Internal Revenue Code. This regulation interprets section 6231(a)(12), which provides that a husband and wife who have a joint interest in a partnership shall be treated as one person, except as otherwise provided in regulations.

Section 301.6231(a)(2)–1T applies when one spouse owns a partnership interest as separate property. It provides that, with limited exceptions, a spouse who files a joint return with an individual holding a separate interest in a partnership is treated as a partner for purposes of subchapter C of chapter 63. This regulation interprets section 6231(a)(2), which provides that the term *partner* includes any person whose income tax liability is determined in whole or in part by taking into account directly or indirectly partnership items.

In *Callaway v. Commissioner*, 231 F.3d 106 (2d Cir. 2000), the U.S. Court of Appeals for the Second Circuit considered § 301.6231(a)(2)–1T in holding that a wife was not bound by the outcome of a unified partnership proceeding where her husband's partnership items converted to nonpartnership items during the proceeding. The partnership interest at issue in *Callaway* was the husband's separate property. The court reasoned that the wife was treated as a partner under the regulation only because she filed a joint return with a person who owned a partnership interest; therefore, her tax liability was determined in part by taking into account partnership items. Once the husband's partnership items converted to nonpartnership items, the wife's tax liability was no longer affected by any partnership items and there was no longer any reason for her to participate in or be bound by the partnership proceedings.

In so holding, the Callaway court distinguished *Dubin v. Commissioner*, 99 T.C. 325 (1992). In *Dubin*, the Tax Court held that a wife was bound by the outcome of a unified partnership audit proceeding even though her husband's partnership items converted to nonpartnership items prior to the conclusion of the proceeding. In *Dubin*, unlike *Callaway*, the husband and wife owned the interest as joint property. Therefore, each was treated as having a share of partnership items that could be affected by the partnership proceeding independently of the other's share.

To resolve questions concerning the treatment of partnership items when a conversion event occurs with respect to a spouse, §§ 301.6231(a)(2)–1T and 301.6231(a)(12)–1T have been amended to be consistent with the *Callaway* opinion.

6. *Partnership-Level Determinations of Penalties*

Before the 1997 Act, the IRS could impose penalties on a partner only through the application of the deficiency procedures after the completion of a partnership-level proceeding. Forcing the IRS to open deficiency proceedings against the individual partners was inconsistent with the efficiency goal of the partnership audit rules. The 1997 Act cured this problem by providing that, for partnership taxable years ending after August 5, 1997, partnership-level proceedings include the determination of applicable penalties at the partnership level. Partners may now raise any partner-level defenses to the imposition of penalties only in a subsequent refund action.

The temporary regulations issued on January 26, 1999 (the 1999 Regulations), revised §§ 301.6221–1T, 301.6224(c)–3T(b)(1), and 301.6231(a)(6)–1T to conform those regulations to the statutory change. The revised regulations mandate that the partnership's penalty defenses are to be resolved during the partnership proceeding; individual defenses can only be brought by the partner in a subsequent refund action. In addition, the 1999 Regulations modify the computational adjustment rules to allow the IRS to assess penalties under those procedures. Finally, the 1999 Regulations specify that partnership-level determinations of a penalty may be the subject of a settlement agreement between the IRS and a partner in a partnership. If they are, then the IRS must offer consistent settlement terms with respect to those partnership-level determinations of the penalty (and other settled partnership items) to other partners in the partnership, subject to the limitations of section 6224(c)(2) and the regulations thereunder.

The final regulations make additional changes to the regulations under subchapter C of chapter 63 to conform those regulations to the new statutory treatment of penalties. Specifically, the final regulations amend § 301.6224(c)–1T to clarify that a settlement agreement between the tax matters partner and the IRS with respect to penalties, like a settlement agreement with respect to partnership items, binds partners other than notice partners and members of a notice group. Similarly, the final regulations amend § 301.6224(c)–2T to clarify that a settlement agreement between a pass-thru partner and the IRS with respect to penalties binds indirect partners, as would a settlement agreement with respect to partnership items. In addition, the final regulations amend § 301.6229(f)–1T to clarify that the rules applicable to partial settlements of partnership items also apply to partnership-level determinations of penalties.

The final regulations also amend § 301.6226(f)–1T to reflect the 1997 Act changes to section 6226(f). The 1997 Act grants courts jurisdiction to determine penalties, additions to tax, or additional amounts relating to an adjustment to partnership items. The final regulations do not, however, amend § 301.6226(e)–1T to require that a partnership contesting an FPAA, in a United States district court or the United States Court of Federal Claims, deposit tax attributable to partnership-level determinations of penalties as a condition of bringing the proceeding. Because the 1997 Act amends section 6226(f), but not section 6226(e), it appears that Congress did not intend to require a deposit of penalties attributable to partnership-level determinations as a condition of bringing such an action. This rule is applicable to civil actions beginning on or after October 4, 2001.

Treasury and the IRS also amended § 301.6226(e)–1T to clarify that, in the case of a petition filed by a 5-percent group or pass-thru partner, the members of the group or the indirect partners holding an interest in the partnership through the pass-thru partner must deposit the aggregate amount by which their tax liabilities would be increased if the treatment of partnership items on the partners' returns were made consistent with the treatment of partnership items on the partnership return. This clarification is applicable to civil actions beginning on or after March 30, 2002.

7. *Applicability Dates*

This document contains final regulations relating to the unified partnership audit procedures added to the Internal Revenue Code by TEFRA, and amended by the 1997 Act and the 1998 Act. Proposed regulations were published on December 13, 1984, April 18, 1986, and January 26, 1999. Temporary regulations were published on December 13, 1984 (effective December 10, 1984), March 5, 1987 (effective September 3, 1982), and January 26, 1999 (effective January 26, 1999). The final regulations published in this document apply to unified partnership proceedings with respect to partnership taxable years beginning on or after October 4, 2001. For unified partnership proceedings with respect to partnership taxable years beginning before October 4, 2001, taxpayers and practitioners are directed to the temporary regulations that were in effect for the period in question.

**Effective Date**

These regulations are effective as of October 4, 2001.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information in

§ 301.6229(b)–2(b) does not have a significant impact on a substantial number of small entities. This certification is based on the fact that the notification is only required for the few partnerships whose Tax Matters Partners are debtors in a bankruptcy proceeding under Title 11 of the United States Code. Moreover, the time required to prepare and file the notification is minimal and will not have a significant impact on those few small entities that file the notification. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required for § 301.6229(b)–2(b).

The other information collections imposed by this Treasury decision are not subject to the Regulatory Flexibility Act because the notice of proposed rulemaking with respect to these requirements was published prior to March 29, 1996. Nevertheless, we believe that these information collections will not have a significant impact on a substantial number of small entities. This is based on the fact that most of the information collections only apply to entities under audit, and the remaining information collections apply only to a small number of small businesses, namely small partnerships who elect to have the provisions of subchapter C of chapter 63 apply, and small business partners that report partnership items inconsistently with the reporting of that item on the partnership return. Moreover, the time required to prepare and file the required statements is minimal on those few small entities that file the statements.

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

**Drafting Information**

The principal author of these regulations is Horace Howells, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

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

PART 301 - - PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

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

Section 301.6231(c)–1 also issued under 26 U.S.C. 6231(c)(1) and (3).

Section 301.6231(c)–2 also issued under 26 U.S.C. 6231(c)(1) and (3). * * *

Par. 2. Section 301.6221–1 is added to read as follows:

*§ 301.6221–1 Tax treatment determined at partnership level.*

(a) *In general*. A partner's treatment of partnership items on the partner's return may not be changed except as provided in sections 6222 through 6231 and the regulations thereunder. Thus, for example, if a partner treats an item on the partner's return consistently with the treatment of the item on the partnership return, the IRS generally cannot adjust the treatment of that item on the partner's return except through a partnership-level proceeding. Similarly, the taxpayer may not put partnership items in issue in a proceeding relating to nonpartnership items. For example, the taxpayer may not offset a potential increase in taxable income based on changes to nonpartnership items by a potential decrease based on partnership items.

(b) *Restrictions inapplicable after items become nonpartnership items*. Section 6221 and paragraph (a) of this section cease to apply to items arising from a partnership with respect to a partner when those items cease to be partnership items with respect to that partner under section 6231(b).

(c) *Penalties determined at partnership level*. Any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item shall be determined at the partnership level. Partner-level defenses to such items can only be asserted through refund actions following assessment and payment. Assessment of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item shall be made based on partnership-level determinations. Partnership-level determinations include all the legal and factual determinations that underlie the determination of any penalty, addition to tax, or additional amount, other than partner-level defenses specified in paragraph (d) of this section.

(d) *Partner-level defenses*. Partner-level defenses to any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item may not be asserted in the partnership-level proceeding, but may be asserted through separate refund actions following assessment and payment. See section 6230(c)(4). Partner-level defenses are limited to those that are personal to the partner or are dependent upon the partner's separate return and cannot be determined at the partnership level. Examples of these determinations are whether any applicable threshold underpayment of tax has been met with respect to the partner or whether the partner has met the criteria of section 6664(b) (penalties applicable only where return is filed), or section 6664(c)(1) (reasonable cause exception) subject to partnership-level determinations as to the applicability of section 6664(c)(2).

(e) *Cross-references*. See §§ 301.6231(c)–1 and 301.6231(c)–2 for special rules relating to certain applications and claims for refund based on losses, deductions, or credits from abusive tax shelter partnerships.

(f) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6221–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6221–1T [Removed]**

Par. 2a. Section 301.6221–1T is removed.

Par. 3. Section 301.6222(a)–1 is added to read as follows:

*§ 301.6222(a)–1 Consistent treatment of partnership items.*

(a) *In general*. The treatment of a partnership item on the partner's return must be consistent with the treatment of that item by the partnership on the partnership return in all respects including the amount, timing, and characterization of the item.

(b) *Treatment must be consistent with partnership return*. The treatment of a partnership item on the partner's return must be consistent with the treatment of that item on the partnership return. Thus, a partner who treats an item consistently with a schedule or other information furnished to the partner by the partnership has not satisfied the requirement of paragraph (a) of this section if the treatment of that item is inconsistent with the treatment of the item on the partnership return actually filed. For rules relating to the election to be treated as having reported the inconsistency where the partner treats an item consistently with an incorrect schedule, see § 301.6222(b)–3.

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

*Example 1*. B is a partner of Partnership P. Both B and P use the calendar year as the taxable year. In December 2001, P receives an advance payment for services to be performed in 2002 and reports this amount as income for calendar year 2001. However, B reports B's distributive share of this amount on B's income tax return for 2002 and not on B's return for 2001. B's treatment of this partnership item is inconsistent with the treatment of the item by P.

*Example 2*. Partnership P incurred certain start-up costs before P was actively engaged in its business. P capitalized these costs. C, a partner in P, deducted C's proportionate share of these start-up costs. C's treatment of the partnership expenditure is inconsistent with the treatment of that item by P.

*Example 3*. D is a partner in partnership P. P reports a loss of $100,000 on its return, $5,000 of which it reports on the Schedule K-1 attached to its return as D's distributive share. However, P reports $15,000 as D's distributive share of P's loss on the Schedule K-1 furnished to D. D reports the $15,000 loss on D's income tax return. D has not satisfied the consistent reporting requirement. See, however, § 301.6222(b)–3 for an election to be treated as having reported the inconsistency.

(d) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6222(a)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6222(a)–1T [Removed]**

Par. 3a. Section 301.6222(a)–1T is removed.

Par. 4. Section 301.6222(a)–2 is added to read as follows:

*§ 301.6222(a)–2 Application of consistent reporting and notification rules to indirect partners.*

(a) *In general*. The consistent reporting requirement of § 301.6222(a)–1 is generally applied with respect to the source partnership. For purposes of this section, the term *source partnership* means the partnership (within the meaning of section 6231(a)(1)) from which the partnership item originates.

(b) *Indirect partner files consistently with source partnership*. An indirect partner who treats an item from a source partnership in a manner consistent with the treatment of that item on the source partnership's return satisfies the consistency requirement of section 6222(a) regardless of whether the indirect partner treats that item in a manner consistent with the treatment of that item by the pass-thru partner through which the indirect partner holds the interest in the source partnership. Under these circumstances, therefore, the Internal Revenue Service shall not send to the indirect partner the notice described in section 6231(b)(1)(A).

(c) *Indirect partner files inconsistently with source partnership*—(1) *Indirect partner notifies the Internal Revenue Service of inconsistency*. An indirect partner who—

(i) Treats an item from a source partnership in a manner inconsistent with the treatment of that item on the source partnership's return; and

(ii) Files a statement identifying the inconsistency with the source partnership in accordance with § 301.6222(b)–1, shall not be subject to a computational adjustment to conform the treatment of that item to the treatment of that item on the return of the source partnership.

(2) *Indirect partner does not notify the Internal Revenue Service of inconsistency*. Except as provided in paragraph (c)(3) of this section, an indirect partner who—

(i) Treats an item from a source partnership in a manner inconsistent with the treatment of that item on the source partnership's return; and

(ii) Fails to file a statement identifying the inconsistency with the source partnership in accordance with § 301.6222(b)–1, is subject to a computational adjustment to conform the treatment of that item to the treatment of that item on the return of the source partnership.

(3) *Indirect partner files consistently with a pass-thru partner that notifies the Internal Revenue Service of the inconsistency*. If an indirect partner treats an item from a source partnership in a manner consistent with the treatment of that item by a pass-thru partner through which the indirect partner holds the interest in the source partnership and that pass-thru partner—

(i) Treats that item in a manner inconsistent with the treatment of that item on the source partnership's return; and

(ii) Files a statement identifying the inconsistency with the source partnership in accordance with § 301.6222(b)–1, the indirect partner is not subject to a computational adjustment to conform to the treatment of that item on the return of the source partnership.

(d) *Examples*. The following examples illustrate the principles of this section:

*Example 1*. One of the partners in Partnership A is Partnership B, which has four equal partners C, D, E, and F. Both A and B are partnerships within the meaning of section 6231(a)(1). On its return, A reports $100,000 as B's distributive share of A's ordinary income. B, however, reports only $80,000 as its distributive share of the income and does not notify the Internal Revenue Service of this inconsistent treatment with respect to A. C reports $20,000 as its distributive share of the item. Although C reports the item consistently with B, C is subject to a computational adjustment to conform the treatment of that item on C's return to the treatment of that item on A's return.

*Example 2*. Assume the same facts as in *Example 1*, except that B notified the Internal Revenue Service of its inconsistent treatment with respect to source partnership A. C is not subject to a computational adjustment.

*Example 3*. Assume the same facts as in *Example 1*. D reports only $15,000 as D's distributive share of the income and does not report the inconsistency. F reports only $9,000 as its distributive share of the item but reports this inconsistency with respect to source partnership A. D is subject to a computational adjustment to conform the treatment of that item on D's return to the treatment of that item on A's return. F is not subject to a computational adjustment.

*Example 4*. Assume the same facts as in *Example 3*, except that F reported the inconsistency with respect to B and did not report the inconsistency with respect to source partnership A. F is subject to a computational adjustment to conform the treatment of that item on F's return to the treatment of that item on A's return.

*Example 5*. Assume the same facts as in *Example 1*. E reports $25,000 as its distributive share of the item. Regardless of whether E reports the inconsistency between its treatment of the item and that by B, E is neither subject to a computational adjustment to conform E's treatment of that item to that of B nor subject to the notice described in section 6231(b)(1)(A) with respect to any such notification of inconsistent treatment.

(e) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6222(a)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6222(a)–2T [Removed]**

Par. 4a. Section 301.6222(a)–2T is removed.

Par. 5. Section 301.6222(b)–1 is added to read as follows:

*§ 301.6222(b)–1 Notification to the Internal Revenue Service when partnership items are treated inconsistently.*

(a) *In general*. The statement identifying an inconsistency described in section 6222(b)(1)(B) shall be filed by filing the form prescribed for that purpose in accordance with the instructions accompanying that form.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6222(b)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6222(b)–1T [Removed]**

Par. 5a. Section 301.6222(b)–1T is removed.

Par. 6. Section 301.6222(b)–2 is added to read as follows:

*§ 301.6222(b)–2 Effect of notification of inconsistent treatment.*

(a) *In general*. Generally, if a partner treats a partnership item on the partner's return in a manner inconsistent with the treatment of that item on the partnership return, the Internal Revenue Service may make a computational adjustment to conform the treatment of the item by the partner with the treatment of that item on the partnership return. Any additional tax resulting from that computational adjustment may be assessed without either the commencement of a partnership proceeding or notification to the partner that all partnership items arising from that partnership will be treated as nonpartnership items. However, if a partner notifies the Internal Revenue Service of the inconsistent treatment of a partnership item in the manner prescribed in § 301.6222(b)–1, the Internal Revenue Service generally may not make an adjustment with respect to that partnership item unless the Internal Revenue Service—

(1) Conducts a partnership-level proceeding; or

(2) Notifies the partner under section 6231(b)(1)(A) that all partnership items arising from that partnership will be treated as nonpartnership items. See, however, §§ 301.6231(c)–1 and 301.6231(c)–2 for special rules relating to certain applications and claims for refund based on losses, deductions, or credits from abusive tax shelter partnerships.

(b) *Partner protected only to extent of notification*. (1) A partner who reports the inconsistent treatment of partnership items on the partner's return is protected from computational adjustments under section 6222(c) only with respect to those partnership items the inconsistent treatment of which is reported. Thus, if a partner notifying the Internal Revenue Service with respect to one item fails to report the inconsistent treatment of another item, the partner is subject to a computational adjustment with respect to that other item.

(2) The following example illustrates the principles of this paragraph (b):

*Example*. Partner A of Partnership P treats a deduction and a capital gain arising from P on A's return in a manner that is inconsistent with the treatment of those items by P. A reports the inconsistent treatment of the deduction but not of the gain. A is subject to a computational adjustment under section 6222(c) with respect to the gain.

(c) *Adjustments in a separate proceeding not limited to conforming adjustments*. (1) If the Internal Revenue Service conducts a separate proceeding with a partner whose partnership items are treated as nonpartnership items under section 6231(b), the Internal Revenue Service is not limited to making adjustments that merely conform the partner's return to the partnership return.

(2) *Example*. The following example illustrates the principles of this paragraph (c):

*Example*. Partnership P allocates to E, one of its partners, a loss of $8,000. E, however, claims a loss of $9,000 and reports the inconsistent treatment. The Internal Revenue Service notifies E that it will treat all of E's partnership items arising from P as nonpartnership items. As a result of a separate proceeding with E, the Internal Revenue Service may issue a deficiency notice which could include reducing the loss to $3,000.

(d) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6222(b)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6222(b)–2T [Removed]**

Par. 6a. Section 301.6222(b)–2T is removed.

Par. 7. Section 301.6222(b)–3 is added to read as follows:

*§ 301.6222(b)–3 Partner receiving incorrect schedule.*

(a) *In general*. A partner shall be treated as having complied with section 6222(b)(1)(B) and § 301.6222(b)–1 with respect to a partnership item if the partner—

(1) Demonstrates that the treatment of the partnership item on the partner's return is consistent with the treatment of that item on the schedule prescribed by the Internal Revenue Service and furnished to the partner by the partnership showing the partner's share of income, credits, deductions, etc.; and

(2) Elects in accordance with the rules prescribed in paragraph (b) of this section to have this section apply with respect to that item.

(b) *Election provisions*—(1) *Time and manner of making election*. The election described in paragraph (a) of this section shall be made by filing a statement with the Internal Revenue Service office issuing the notice of computational adjustment within 30 days after the notice is mailed to the partner.

(2) *Contents of statement*. The statement described in paragraph (b)(1) of this section shall be—

(i) Clearly identified as an election under section 6222(b)(2);

(ii) Signed by the partner making the election; and

(iii) Accompanied by copies of the schedule furnished to the partner by the partnership and of the notice of computational adjustment. The partner need not enclose a copy of the notice of computational adjustment, however, if the partner clearly identifies the notice of computational adjustment. Generally, the requirement described in paragraph (a)(1) of this section will be satisfied by attaching to the statement a copy of the schedule furnished to the partner by the partnership. However, if it is not clear from the information contained on the schedule that the treatment of the partnership item on the schedule is consistent with the partner's treatment of such item on the partner's return, the statement shall also include an explanation of how the treatment of such item on the schedule is consistent with the treatment on the partner's return with respect to the characterization, timing, and amount of such item.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6222(b)–3T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6222(b)–3T [Removed]**

Par. 7a. Section 301.6222(b)–3T is removed.

Par. 8. Section 301.6223(a)–1 is added to read as follows:

*§ 301.6223(a)–1 Notice sent to tax matters partner.*

(a) *In general*. For purposes of subchapter C of chapter 63 of the Internal Revenue Code, a notice is treated as mailed to the tax matters partner on the earlier of—

(1) The date on which the notice is mailed to "THE TAX MATTERS PARTNER" at the address of the partnership (as provided on the partnership return, except as updated under § 301.6223(c)–1); or

(2) The date on which the notice is mailed to the person who is the tax matters partner at the address of that person (as provided on the partner's return, except as updated under § 301.6223(c)–1) or the partnership. See § 301.6223(c)–1 for rules relating to the information used by the Internal Revenue Service in providing notices, etc.

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

*Example*. Partnership P designates B as its tax matters partner in accordance with § 301.6231(a)(7)–1(b). On December 1, a notice of the beginning of an administrative proceeding is mailed to "THE TAX MATTERS PARTNER" at the address of P. On January 10, a copy of the notice is mailed to B at B's address. December 1 is treated as the date that the notice was mailed to the tax matters partner.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(a)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(a)–1T [Removed]**

Par. 8a. Section 301.6223(a)–1T is removed.

Par. 9. Section 301.6223(a)–2 is added to read as follows:

*§ 301.6223(a)–2 Withdrawal of notice of the beginning of an administrative proceeding.*

(a) *In general*. If the Internal Revenue Service, within 45 days after the day on which the notice specified in section 6223(a)(1) is mailed to the tax matters partner, decides not to propose any adjustments to the partnership return as filed, the Internal Revenue Service may withdraw the notice specified in section 6223(a)(1) by mailing a letter to that effect to the tax matters partner within that 45-day period. Even if the Internal Revenue Service does not withdraw the notice specified in section 6223(a)(1), the Internal Revenue Service is not required to issue a notice of final partnership administrative adjustment. If the Internal Revenue Service withdraws the notice specified in section 6223(a)(1), neither the Internal Revenue Service nor the tax matters partner is required to furnish any notice with respect to that proceeding to any other partner. Except as provided in paragraph (b) of this section, a notice specified in section 6223(a)(1) which has been withdrawn shall be treated for purposes of subchapter C of chapter 63 of the Internal Revenue Code as if that notice had never been mailed to the tax matters partner.

(b) *Internal Revenue Service may not reissue notice except under certain circumstances*. If the notice specified in section 6223(a)(1) was mailed to the tax matters partner with respect to a partnership taxable year and that notice was later withdrawn as provided in paragraph (a) of this section, the Internal Revenue Service shall not mail a second notice specified in section 6223(a)(1) with respect to that taxable year unless—

(1) There is evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact;

(2) The prior proceeding involved the misapplication or erroneous interpretation of an established Internal Revenue Service position existing at the time of the previous examination, or the failure to make an adjustment based on such a position; or

(3) Other circumstances exist which indicate that failure to reissue the notice would be a serious administrative omission.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(a)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(a)–2T [Removed]**

Par. 9a. Section 301.6223(a)–2T is removed.

Par. 10. Section 301.6223(b)–1 is added to read as follows:

*§ 301.6223(b)–1 Notice group.*

(a) *In general*. If a group of partners having in the aggregate a 5 percent or more interest in the profits of a partnership requests and designates one of their members to receive the notices described in sections 6223(a)(1) and (2), the member so designated shall be treated as a partner to whom section 6223(a) applies. Thus, the designated representative is entitled to receive any notice described in section 6223(a) that is mailed to the tax matters partner 30 days or more after the day on which the Internal Revenue Service receives the request from the group.

(b) *Request for notice*—(1) *In general*. The Internal Revenue Service shall mail to the member of the notice group designated to receive such notice any notice described in section 6223(a) that is mailed to the tax matters partner 30 days or more after the day on which the Internal Revenue Service receives the request for notice from the group if such request for notice is made in accordance with the rules prescribed in this paragraph (b).

(2) *Content of request*. The request for notice from a notice group shall—

(i) Identify the partnership by name, address, and taxpayer identification number;

(ii) Specify the taxable year or years for which the notice group is formed;

(iii) Designate the member of the group to receive the notices;

(iv) Set out the name, address, taxpayer identification number, and profits interest of each member of the group; and

(v) Be signed by all partners comprising the notice group.

(3) *Place for filing*. The request for notice from a notice group generally must be filed with the service center where the partnership return is filed. However, if the notice group representative knows that the notice described in section 6223(a)(1) (beginning of an administrative proceeding) has already been mailed to the tax matters partner, the statement should be filed with the Internal Revenue Service office that mailed that notice.

(4) *Copy to be sent to the tax matters partner*. A copy of the request for notice from a notice group shall be provided to the tax matters partner by the notice group representative within 30 days after the request is filed with the Internal Revenue Service.

(5) *Years covered by request*. A request for notice by a notice group may relate only to partnership taxable years that have ended before the request is filed. A request, however, may relate to more than one partnership taxable year if the 5 percent or more profits interest requirement of section 6223(b)(2) is satisfied for each year to which the request relates.

(c) *Composition of notice group*—(1) *In general*. A notice group shall be comprised only of persons who were partners at some time during the partnership taxable year for which the group is formed. If a notice group is formed for more than one taxable year, each member of the group must have been a partner at some time during at least one of the taxable years for which the group is formed. A notice group may include a partner entitled to separate notice. See section 6231(d) and § 301. 6231(d)–1 for rules relating to determining the interest of a partner in the profits of a partnership for a partnership taxable year for purposes of section 6223(b). See paragraph (c)(6) of this section for rules relating to indirect and pass-thru partners.

(2) *Partner may be a member of only one group*. A partner cannot be a member of more than one notice group with respect to the same partnership for the same partnership taxable year. See paragraph (c)(6) of this section for rules relating to indirect and pass-thru partners.

(3) *Partner may join group after formation*. A partner may join a notice group at any time after the formation of that group by filing, with the Internal Revenue Service office where the notice group filed its request, a statement that it is joining the notice group. The statement shall identify the partner joining the notice group, the partnership, and the members of the notice group by name, address, and taxpayer identification number and shall be signed by the joining partner. A copy of the statement shall be provided by the joining partner to both the tax matters partner and the notice group representative within 30 days after the request is filed with the Internal Revenue Service. The partner shall become a member of the notice group for each partnership taxable year for which the group was formed and for which the partner was a partner at any time during such partnership taxable year.

(4) *Date on which a partner becomes a member of notice group*. A partner shall become a member of a notice group on the 30th day after the day on which the Internal Revenue Service receives—

(i) A request for notice from a notice group that identifies that partner as a member of that notice group; or

(ii) A statement filed in accordance with paragraph (c)(3) of this section that states that the partner is joining the notice group.

(5) *No withdrawal from notice group*. A partner who has signed a notice group request filed with the Internal Revenue Service remains a member of that notice group until the group terminates. A partner cannot withdraw from the notice group.

(6) *Indirect and pass-thru partners*—(i) *Pass-thru partners and unidentified indirect partners*. A pass-thru partner may become a member of a notice group as provided in this section. For purposes of applying the aggregate interest requirement specified in paragraph (a) of this section to a pass-thru partner, the partnership interest held by the pass-thru partner shall not include any interest held through the pass-thru partner by an indirect partner that has been identified as provided in section 6223(c)(3) and § 301.6223(c)–1 before the date on which the pass-thru partner becomes a member of the notice group.

(ii) *Indirect partners identified before the pass-thru partner joins a notice group*. An indirect partner may become a member of a notice group with respect to a partnership taxable year only if—

(A) The indirect partner held an interest in the partnership (either directly or through one or more pass-thru partners) at some time during that taxable year; and

(B) The indirect partner was identified as provided in section 6223(c)(3) and § 301.6223(c)–1 on or before the date on which the pass-thru partner became a member of a notice group.

(d) *Termination of notice group*. Unless the original request for notice from the notice group or a subsequent statement filed by the representative (in accordance with paragraphs (b)(3) and (4) of this section) designates a successor to the designated group representative, the group terminates if the representative dies (or, in the case of an entity, if the entity is dissolved), resigns, or is adjudicated incompetent.

(e) *Notice group is not a 5-percent group*. The forming of a notice group under this section does not constitute the forming of a 5-percent group for purposes of litigation. A notice group is formed solely for the purpose of receiving notices. A 5-percent group is formed solely for the purpose of filing a petition for judicial review or appealing a judicial determination. See § 301.6226(b)–1. Thus, a member of a notice group may choose not to join a 5-percent group formed by other members of the notice group.

(f) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(b)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(b)–1T [Removed]**

Par. 10a. Section 301.6223(b)–1T is removed.

Par. 11. Section 301.6223(c)–1 is added to read as follows:

*§ 301.6223(c)–1 Additional information regarding partners furnished to the Internal Revenue Service* .

(a) *In general*. In addition to the names, addresses, and profits interests as shown on the partnership return, the Internal Revenue Service will use additional information as provided in this section for purposes of administering subchapter C of chapter 63 of the Internal Revenue Code.

(b) *Procedure for furnishing additional information*—(1) *In general.* Any person may furnish additional information at any time by filing a written statement with the Internal Revenue Service. However, the information contained in the statement will be considered for purposes of determining whether a partner is entitled to a notice described in section 6223(a) only if the Internal Revenue Service receives the statement at least 30 days before the date on which the Internal Revenue Service mails the notice to the tax matters partner. Similarly, information contained in the statement generally will not be taken into account for other purposes by the Internal Revenue Service until 30 days after the statement is received.

(2) *Where statement must be filed*. A statement furnished under this section generally must be filed with the service center where the partnership return is filed. However, if the person filing the statement knows that the notice described in section 6223(a)(1) (beginning of an administrative proceeding) has already been mailed to the tax matters partner, the statement should be filed with the Internal Revenue Service office that mailed such notice.

(3) *Contents of statement*. The statement shall—

(i) Identify the partnership, each partner for whom information is supplied, and the person supplying the information by name, address, and taxpayer identification number;

(ii) Explain that the statement is furnished to correct or supplement earlier information with respect to the partners in the partnership;

(iii) Specify the taxable year to which the information relates;

(iv) Set out the corrected or additional information; and

(v) Be signed by the person supplying the information.

(c) *No incorporation by reference to previously furnished documents*. Incorporation by reference of information contained in another document previously furnished to the Internal Revenue Service will not be given effect for purposes of section 6223(c) or 6229(e). For example, reference to a return filed by a pass-thru partner which contains identifying information with respect to the indirect partners of that pass-thru partner is not sufficient to identify the indirect partners unless a copy of the document referred to is attached to the statement. Furthermore, reference to a prior general notification to the Internal Revenue Service that a partner who would otherwise be the tax matters partner is a debtor in a bankruptcy proceeding or has had a receiver appointed for the partner in a receivership proceeding is not sufficient unless a copy of the notification document referred to is attached to the statement.

(d) *Information supplied by a person other than the tax matters partner*. The Internal Revenue Service may require appropriate verification in the case of information furnished by a person other than the tax matters partner. The 30-day period referred to in paragraph (b)(1) of this section shall not begin until that verification is supplied.

(e) *Power of attorney—(1) In general*. This paragraph (e) applies to powers of attorney with respect to proceedings under subchapter C of chapter 63 of the Internal Revenue Code (chapter 63C) that begin on or after January 2, 2002.

(2) *Specifically for purposes of subchapter C of chapter 63 of the Internal Revenue Code*. A power of attorney specifically for purposes of subchapter C of chapter 63 of the Internal Revenue Code shall be furnished in accordance with paragraph (b)(2) of this section.

(3) *Existing power of attorney*. A power of attorney granted to another person by a partner for other tax purposes shall not be given effect for purposes of subchapter C of chapter 63 unless the partner specifically requests that the power be given such effect in a statement furnished to the Internal Revenue Service in accordance with paragraph (b) of this section.

(f) *Internal Revenue Service may use other information*. In addition to the information on the partnership return and that supplied on statements filed under this section, the Internal Revenue Service may use other information in its possession (for example, a change in address reflected on a partner's return) in administering subchapter C of chapter 63 of the Internal Revenue Code. However, the Internal Revenue Service is not obligated to search its records for information not expressly furnished under this section.

(g) *Effective date*. Except as provided in paragraph (e)(1) of this section, this section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(c)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(c)–1T [Removed]**

Par. 11a. Section 301.6223(c)–1T is removed.

Par. 12. Section 301.6223(e)–1 is added to read as follows:

*§ 301.6223(e)–1 Effect of Internal Revenue Service's failure to provide notice.*

(a) *Notice group*. Section 6223(e)(1)(B)(ii) applies with respect to a notice group only if the request for notice described in § 301.6223(b)–1 is received by the Internal Revenue Service at least 30 days before the notice is mailed to the tax matters partner.

(b) *Indirect partners*—(1) *In general*. For purposes of section 6223(e), the Internal Revenue Service's failure to provide notice to a pass-thru partner entitled to notice under section 6223(b) is deemed a failure to provide notice to indirect partners holding an interest in the partnership through the pass-thru partner. However, this rule does not apply if the indirect partner—

(i) Receives notice from the Internal Revenue Service;

(ii) Is identified as provided in section 6223(c)(3) and § 301.6223(c)–1 at least 30 days before the notice is mailed to the tax matters partner; or

(iii) Is a member of a notice group entitled to notice under paragraph (a) of this section.

(2) *Examples*. The provisions of paragraph (b)(1) of this section may be illustrated by the following examples:

*Example 1*. Partnership ABC has as one of its partners, A, a partnership with three partners, X, Y, and Z. ABC does not have more than 100 partners, and partnership A is entitled to notice under section 6223(a). In addition, Z was identified as provided in section 6223(c)(3) and § 301.6223(c)–1 on May 1, 2002. The Internal Revenue Service mailed a notice to the tax matters partner of ABC on July 1, 2002, but failed to provide notice to partnership A. Notwithstanding the Internal Revenue Service's notice to the tax matters partner, the Internal Revenue Service is deemed to have failed to provide notice to X and Y. The Internal Revenue Service's failure to provide notice to A, however, has no effect on Z; whether notice was provided to Z is determined independently.

*Example 2*. Assume the same facts as in *Example 1*, except that the Internal Revenue Service provided notice to partnership A but did not provide separate notice to Z. Notwithstanding the Internal Revenue Service's notice to partnership A, the Internal Revenue Service is deemed to have failed to provide notice to Z.

*Example 3*. Assume the same facts as in *Example 1*, except that partnership ABC has more than 100 partners and partnership A is entitled to notice under section 6223(b) because it had at least a 1 percent profits interest in partnership ABC. In addition, X became a member of a notice group on June 1, 2002, and the Internal Revenue Service mailed a notice to the designated member of that notice group. The Internal Revenue Service also mailed a separate notice to Z. The Internal Revenue Service's failure to provide notice to partnership A only affects Y, who is deemed not to have been provided notice by the Internal Revenue Service.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(e)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(e)–1T [Removed]**

Par. 12a. Section 301.6223(e)–1T is removed.

Par. 13. Section 301.6223(e)–2 is added to read as follows:

*§ 301.6223(e)–2 Elections if Internal Revenue Service fails to provide timely notice.*

(a) *In general*. This section applies in any case in which the Internal Revenue Service fails to timely mail any notice described in section 6223(a) of the Internal Revenue Code to a partner entitled to such notice within the period specified in section 6223(d). The failure to issue any notice within the period specified in section 6223(d) does not invalidate the notice of the beginning of an administrative proceeding or final partnership administrative adjustment (FPAA). An untimely FPAA enables the recipient of the untimely notice to make the elections described in paragraphs (b), (c), and (d) of this section. The period within which to make the elections described in paragraphs (b), (c), and (d) of this section commences with the mailing of an FPAA to the partner. In the absence of an election, paragraphs (b) and (c) of this section provide for the treatment of a partner's partnership items.

(b) *Proceeding finished*. If at the time the Internal Revenue Service mails the partner an FPAA—

(1) The period within which a petition for review of the FPAA under section 6226 may be filed has expired and no petition has been filed; or

(2) The decision of a court in an action begun by such a petition has become final, the partner may elect in accordance with paragraph (d) of this section to have that adjustment, that decision, or a settlement agreement described in section 6224(c)(2) with respect to the partnership taxable year to which the adjustment relates apply to that partner. If the partner does not make an election in accordance with paragraph (d) of this section, the partnership items of the partner for the partnership taxable year to which the proceeding relates shall be treated as having become nonpartnership items as of the day on which the Internal Revenue Service mails the partner the FPAA.

(c) *Proceeding still going on*. If at the time the Internal Revenue Service mails the partner an FPAA, paragraphs (b)(1) and (2) of this section do not apply, the partner shall be a party to the proceeding unless the partner elects, in accordance with paragraph (d) of this section, to have—

(1) A settlement agreement described in section 6224(c)(2) with respect to the partnership taxable year to which the proceeding relates apply to the partner; or

(2) The partnership items of the partner for the partnership taxable year to which the proceeding relates treated as having become nonpartnership items as of the day on which the Internal Revenue Service mails the partner the FPAA.

(d) *Election*—(1) *In general*. The election described in paragraph (b) or (c) of this section shall be made in the manner prescribed in this paragraph (d). The election shall apply to all partnership items for the partnership taxable year to which the election relates.

(2) *Time and manner of making election*. The election shall be made by filing a statement with the Internal Revenue Service office mailing the FPAA within 45 days after the date on which the FPAA was mailed to the partner making the election.

(3) *Contents of statement*. The statement shall—

(i) Be clearly identified as an election under section 6223(e)(2) or (3);

(ii) Specify the election being made (that is, application of final partnership administrative adjustment, court decision, consistent settlement agreement, or nonpartnership item treatment);

(iii) Identify the partner making the election and the partnership by name, address, and taxpayer identification number;

(iv) Specify the partnership taxable year to which the election relates; and

(v) Be signed by the partner making the election.

(e) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(e)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(e)–2T [Removed]**

Par. 13a. Section 301.6223(e)–2T is removed.

Par. 14. Section 301.6223(f)–1 is added to read as follows:

*§ 301.6223(f)–1 Duplicate copy of final partnership administrative adjustment.*

(a) *In general*. Section 6223(f) does not prohibit the Internal Revenue Service from issuing a duplicate copy of the notice of final partnership administrative adjustment (for example, in the event the original notice is lost).

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(f)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(f)–1T [Removed]**

Par. 14a. Section 301.6223(f)–1T is removed.

Par. 15. Section 301.6223(g)–1 is added to read as follows:

*§ 301.6223(g)–1 Responsibilities of the tax matters partner.*

(a) *Notices described in section 6223(a)*—(1) *Notice of beginning of proceeding*. Except as otherwise provided in § 301.6223(a)–2, the tax matters partner shall, within 75 days after the Internal Revenue Service mails the notice specified in section 6223(a)(1), forward a copy of that notice to each partner not entitled to notice from the Internal Revenue

Service under section 6223. See § 301.6230(e)–1 for information to be furnished to the Internal Revenue Service.

(2) *Notice of final partnership administrative adjustment*. The tax matters partner shall, within 60 days after the Internal Revenue Service mails the notice specified in section 6223(a)(2), forward a copy of that notice to each partner not entitled to notice from the Internal Revenue Service under section 6223.

(3) *Requirement inapplicable in certain cases*. The tax matters partner is not required to send notice to a partner if—

(i) Before the expiration of the applicable 75-day or 60-day period, the partnership items of that partner have become nonpartnership items (for example, by settlement);

(ii) That partner is an indirect partner and has not been identified to the tax matters partner at least 30 days before the tax matters partner is required to send such notice;

(iii) That partner is treated as a partner solely by virtue of § 301.6231(a)(2)–1;

(iv) That partner was a member of a notice group as of the date on which the notice was mailed to the tax matters partner (see § 301.6223(b)–1(c)(4) for the date on which a partner becomes a member of a notice group);

(v) The notice has already been provided to that partner by another person; or

(vi) The notice is withdrawn by the Internal Revenue Service under § 301.6223(a)–2.

(b) *Other notices or information*—(1) *In general*. The tax matters partner shall furnish to the partners specified in paragraph (b)(2) of this section information with respect to the following—

(i) Closing conference with the examining agent;

(ii) Proposed adjustments, rights of appeal, and requirements for filing of a protest;

(iii) Time and place of any Appeals conference;

(iv) Acceptance by the Internal Revenue Service of any settlement offer;

(v) Consent to the extension of the period of limitations with respect to all partners;

(vi) Filing of a request for administrative adjustment (including a request for substituted return treatment under § 301.6227(c)–1) on behalf of the partnership;

(vii) Filing by the tax matters partner or any other partner of any petition for judicial review under sections 6226 or 6228(a);

(viii) Filing of any appeal with respect to any judicial determination provided for in sections 6226 or 6228(a); and

(ix) Final judicial redetermination.

(2) *Partners to be notified*. The tax matters partner shall provide information with respect to any action or other matter specified in paragraph (b)(1) of this section to all notice group representatives and all other partners except partners—

(i) Whose partnership items become nonpartnership items before the expiration of the period specified in paragraph (b)(3) of this section for furnishing that information;

(ii) Who are indirect partners and who are not identified to the tax matters partner at least 30 days before the tax matters partner is required to provide the information;

(iii) Who are treated as partners solely by virtue of § 301.6231(a)(2)–1;

(iv) Who are members of a notice group as of the date on which the tax matters partner takes that action or receives information with respect to that matter (see § 301.6223(b)–1(c)(4) for the date on which a partner becomes a member of a notice group); or

(v) Who have already received information with respect to the action or matter from any other person.

(3) *Time for furnishing information*. The tax matters partner shall furnish information with respect to an action or other matter described in paragraph (b)(1) of this section within 30 days of taking the action or receiving information with respect to that matter.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(g)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(g)–1T [Removed]**

Par. 15a. Section 301.6223(g)–1T is removed.

Par. 16. Section 301.6223(h)–1 is added to read as follows:

*§ 301.6223(h)–1 Responsibilities of pass-thru partner.*

(a) *In general*. The pass-thru partner shall, within 30 days of receiving notice or any other information regarding a partnership proceeding from the Internal Revenue Service, the tax matters partner, or another pass-thru partner, forward a copy of that notice or information to the person or persons holding an interest through the pass-thru partner in the profits or losses of the partnership for the partnership taxable year to which the notice or information relates. In the case of a pass-thru partner that is a partnership within the meaning of section 6231(a)(1), the tax matters partner of such partnership shall forward copies of the notice or information to the partners of such partnership.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6223(h)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6223(h)–1T [Removed]**

Par. 16a. Section 301.6223(h)–1T is removed.

Par. 17. Section 301.6224(a)–1 is added to read as follows:

*§ 301.6224(a)–1 Participation in administrative proceedings.*

(a) *In general*. Every partner in the partnership, including an indirect partner, has the right to participate in any phase of administrative proceedings. However, except as provided in section 6223 and the regulations thereunder, neither the Internal Revenue Service nor the tax matters partner is required to provide notice of any proceeding to the partners. Consequently, a partner who wishes, for example, to be present during a preliminary discussion between an examining agent and the tax matters partner should make special arrangements with the tax matters partner to obtain information as to the time and place of the discussion. The Internal Revenue Service and the tax matters partner will determine the time and place for all administrative proceedings. Arrangements will generally not be changed merely for the convenience of another partner.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6224(a)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6224(a)–1T [Removed]**

Par. 17a. Section 301.6224(a)–1T is removed.

Par. 18. Section 301.6224(b)–1 is added to read as follows:

*§ 301.6224(b)–1 Partner may waive rights.*

(a) *In general*. A partner may at any time waive any right that the partner has or any restriction on action by the Internal Revenue Service under subchapter C of chapter 63 of the Internal Revenue Code.

(b) *Form and manner of making waiver*. The waiver described in paragraph (a) of this section shall be made by a written statement. If the Internal Revenue Service furnishes a form to be used for this purpose, the partner may make the waiver by completing the form in accordance with the form's instructions. If such a form is not furnished, the statement shall—

(1) Be clearly identified as a waiver under section 6224(b);

(2) Identify the partner and the partnership by name, address, and taxpayer identification number;

(3) Specify the right or restriction being waived and the taxable year(s) to which the waiver applies;

(4) Be signed by the partner making the waiver; and

(5) Be filed with the service center where the partnership return is filed. However, if the person filing the statement knows that the notice described in section 6223(a)(1) (beginning of an administrative proceeding) has already been mailed to the tax matters partner, the statement shall be filed with the Internal Revenue Service office that mailed such notice.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6224(b)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6224(b)–1T [Removed]**

Par. 18a. Section 301.6224(b)–1T is removed.

Par. 19. Section 301.6224(c)–1 is added to read as follows:

*§ 301.6224(c)–1 Tax matters partner may bind nonnotice partners.*

(a) *In general*. In the absence of a showing of fraud, malfeasance, or misrepresentation of fact, if the tax matters partner enters into a settlement agreement with the Internal Revenue Service with respect to partnership items, including partnership-level determinations relating to any penalty, addition to tax, or additional amounts that relate to adjustments to partnership items, and expressly states that the agreement shall be binding on the other partners, then that agreement shall be binding on all partners except those who—

(1) Are, as of the day on which the agreement is entered into, either notice partners or members of a notice group (see § 301.6223(b)–1(c)(4) for the date on which a partner becomes a member of a notice group); or

(2) Have, at least 30 days before the day on which the agreement is entered into, filed with the Internal Revenue Service the statement described in paragraph (c) of this section.

(b) *Indirect partners*—(1) *In general*. If, under paragraph (a) of this section, a pass-thru partner is not bound by an agreement entered into by the tax matters partner, all indirect partners holding an interest in the partnership through that pass-thru partner shall not be bound by that agreement. If, however, the pass-thru partner is bound by an agreement entered into by the tax matters partner, paragraph (a) of this section shall be applied separately to each indirect partner holding an interest in the partnership through the pass-thru partner to determine whether the indirect partner is also bound by the agreement.

(2) *Example*. The following example illustrates the principles of this section:

*Example*. Partnership P has over 100 partners. Partnership J is a partner in partnership P with a profits interest of less than 1 percent. Partnership J has three partners, A, B, and C. A is a member of a notice group with respect to partnership P, but B and C are not. On July 1, 2002, B filed the statement described in paragraph (c) of this section not to be bound by any settlement agreement entered into by the tax matters partner of partnership P. On August 1, 2002, the tax matters partner of partnership P enters into a settlement agreement with the Internal Revenue Service and states that the agreement is binding on other partners as provided in section 6224(c)(3). Because partnership J is bound by the settlement agreement, paragraph (a) of this section is applied separately to each of the indirect partners to determine whether they are bound. A is not bound by the agreement because A was a member of a notice group on the day the agreement was entered into and B is not bound because B filed the statement not to be bound at least 30 days before the agreement was entered into. C is bound by the settlement agreement.

(c) *Statement not to be bound*—(1) *Contents of statement*. The statement referred to in paragraph (a)(2) of this section shall—

(i) Be clearly identified as a statement to deny settlement authority to the tax matters partner under section 6224(c)(3)(B);

(ii) Identify the partner and partnership by name, address, and taxpayer identification number;

(iii) Specify the taxable year or years to which the statement applies; and

(iv) Be signed by the partner filing the statement.

(2) *Place where statement is to be filed*. The statement described in paragraph (c)(1) of this section generally shall be filed with the Internal Revenue Service service center where the partnership return is filed. However, if the partner knows that the notice described in section 6223(a)(1) (beginning of an administrative proceeding) has already been mailed to the tax matters partner, the statement shall be filed with the Internal Revenue Service office that mailed that notice.

(3) *Consolidated statements*. The statement described in paragraph (c)(1) of this section may be filed with respect to more than one partner if the requirements of that paragraph (c)(1) (including signatures) are satisfied with respect to each partner.

(d) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6224(c)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6224(c)–1T [Removed]**

Par. 19a. Section 301.6224(c)–1T is removed.

Par. 20. Section 301.6224(c)–2 is added to read as follows:

*§ 301.6224(c)–2 Pass-thru partner binds indirect partners.*

(a) *Pass-thru partner binds unidentified indirect partners*—(1) *In general*. If a pass-thru partner enters into a settlement agreement with the Internal Revenue Service with respect to partnership items, that agreement binds all indirect partners holding an interest in that partnership through the pass-thru partner except those indirect partners who have been identified as provided in section 6223(c)(3) and § 301.6223(c)–1 at least 30 days before the date on which the agreement is entered into. A settlement with respect to partnership items includes partnership-level determinations relating to any penalty, addition to tax, and additional amounts that relate to adjustments to partnership items. However, if, in addition to the interest in the partnership held through the pass-thru partner entering into a settlement agreement, an indirect partner holds a separate interest in that partnership, either directly or indirectly through a different pass-thru partner, then the indirect partner shall not be bound by that settlement agreement with respect to the interests held directly or indirectly through a pass-thru partner other than the pass-thru partner entering into the settlement agreement.

(2) *Example*. The provisions of paragraph (a)(1) of this section may be illustrated by the following example:

*Example*. Partnership J is a partner in partnership P. C is a partner in J but has not been identified as provided in section 6223(c)(3) and § 301.6223(c)–1. The only interest that C holds in P is through J. The tax matters partner of J enters into a settlement agreement with the Internal Revenue Service with respect to partnership items arising from P. C is bound by the settlement agreement entered into by the tax matters partner of J.

(b) *Person in pass-thru partner authorized to enter into settlement agreement that binds indirect partners*. In the case of a pass-thru partner that is—

(1) A partnership within the meaning of section 6231(a)(1), the tax matters partner of that partnership;

(2) A partnership other than a partnership described in paragraph (b)(1) of this section, any general partner of that partnership;

(3) An S corporation, any officer of that S corporation; or

(4) A trust, estate, or nominee, any person authorized in writing to act on behalf of that trust, estate, or nominee, may enter into a settlement agreement with the Internal Revenue Service on behalf of its respective entity that would bind the unidentified indirect partners that hold a partnership interest through the pass-thru partner.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6224(c)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6224(c)–2T [Removed]**

Par. 20a. Section 301.6224(c)–2T is removed.

Par. 21. Section 301.6224(c)–3 is added to read as follows:

*§ 301.6224(c)–3 Consistent settlements.*

(a) *In general*. If the Internal Revenue Service enters into a settlement agreement with any partner with respect to partnership items, whether comprehensive or partial, the Internal Revenue Service shall offer to any other partner who so requests in accordance with paragraph (c) of this section, settlement terms consistent with those contained in the settlement agreement entered into.

(b) *Requirements for consistent settlement terms*—(1) *In general*. Consistent settlement terms are those based on the same determinations with respect to partnership items. However, consistent settlement terms also may include partnership-level determinations of any penalty, addition to tax, or additional amount that relates to partnership items. Settlements with respect to partnership items shall be self-contained; thus, a concession by one party with respect to a partnership item may not be based upon a concession by another party with respect to any item that is not a partnership item other than a partnership-level determination of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. Consistent agreements must be identical to the original settlement (that is, the settlement upon which the offered settlement terms are based). A consistent agreement must mirror the original settlement and may not be limited to selected items from the original settlement. Once a partner has settled a partnership item, or a partnership-level determination of any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item, that partner may not subsequently request settlement terms consistent with a settlement that contains the previously settled item. The requirement for consistent settlement terms applies only if—

(i) The items were partnership items (or a partnership-level determination of any related penalty, addition to tax, or additional amount) for the partner entering into the original settlement immediately before the original settlement; and

(ii) The items are partnership items (or a partnership-level determination of any related penalty, addition to tax, or additional amount) for the partner requesting the consistent settlement at the time the partner files the request.

(2) *Effect of consistent agreement*. Consistent settlement terms are reflected in a consistent agreement. A consistent agreement is not a settlement agreement that gives rise to further consistent settlement rights because it is required to be given without volitional agreement of the Secretary. Therefore, a consistent agreement required to be offered to a requesting taxpayer is not a settlement agreement under section 6224(c)(2) or paragraph (c)(3) of this section which starts a new period for requesting consistent settlement terms. For all other purposes of the Internal Revenue Code, however, (*e.g.*, binding effect under section 6224(c)(1) and conversion to nonpartnership items under section 6231(b)(1)(C)), a consistent agreement is treated as a settlement agreement.

(c) *Time and manner of requesting consistent settlements—(1) In general*. A partner desiring settlement terms consistent with the terms of any settlement agreement entered into between any other partner and the Internal Revenue Service shall submit a written statement to the Internal Revenue Service office that entered into the settlement.

(2) *Contents of statement*. Except as otherwise provided in instructions to the taxpayer from the Internal Revenue Service, the written statement described in paragraph (c)(1) of this section shall—

(i) Identify the statement as a request for consistent settlement terms under section 6224(c)(2);

(ii) Contain the name, address, and taxpayer identification number of the partnership and of the partner requesting the settlement offer (and, in the case of an indirect partner, of the pass-thru partner through which the indirect partner holds an interest);

(iii) Identify the earlier agreement to which the request refers; and

(iv) Be signed by the partner making the request.

(3) *Time for filing request*. The statement shall be filed not later than the later of—

(i) The 150th day after the day on which the notice of final partnership administrative adjustment is mailed to the tax matters partner; or

(ii) The 60th day after the day on which the settlement agreement was entered into.

(d) *Examples*. The following examples illustrate the principles of this section:

*Example 1*. The Internal Revenue Service seeks to disallow a $100,000 loss reported by Partnership P $20,000 of which was allocated to partner X, and $10,000 of which was allocated to partner Y. The Internal Revenue Service agrees to a settlement with X in which the Internal Revenue Service allows $12,000 of the loss, accepts the treatment of all other partnership items on the partnership return, and imposes a penalty for negligence related to the $8,000 loss disallowance. Partner Y requests settlement terms consistent with the settlement made between X and the Internal Revenue Service. The items are partnership items (or a related penalty) for X immediately before X enters into the settlement agreement and are partnership items (or a related penalty) for Y at the time of the request. The Internal Revenue Service must offer Y settlement terms allowing a $6,000 loss, a negligence penalty on the $4,000 disallowance, and otherwise reflecting the treatment of partnership items on the partnership return.

*Example 2*. F files inconsistently with Partnership P and reports the inconsistency. The Internal Revenue Service notifies F that it will treat all partnership items arising from P as nonpartnership items with respect to F. Later, the Internal Revenue Service enters into a settlement with F on these items. The Internal Revenue Service is not required to offer the other partners of P settlement terms consistent with the settlement reached between F and the Internal Revenue Service because the items arising from P are not partnership items with respect to F.

*Example 3*. G, a partner in Partnership P, filed suit under section 6228(b) after the Internal Revenue Service failed to allow an administrative adjustment request with respect to a partnership item arising from P for a taxable year. Under section 6231(b)(1)(B), the partnership items of G for the partnership taxable year became nonpartnership items as of the date G filed suit. After G filed suit, another partner and the Internal Revenue Service entered into a settlement agreement with respect to items arising from P in that year. G is not entitled to consistent settlement terms because, at the time of the settlement, the items arising from P are no longer partnership items with respect to G.

(e) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6224(c)–3T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6224(c)–3T [Removed]**

Par. 21a. Section 301.6224(c)–3T is removed.

Par. 22. Section 301.6226(a)–1 is added to read as follows:

*§ 301.6226(a)–1 Principal place of business of partnership.*

(a) *In general*. The principal place of a partnership's business for purposes of determining the appropriate district court in which a petition for a readjustment of partnership items may be filed is its principal place of business as of the date the petition is filed.

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

*Example*. The principal place of Partnership A's business on the day that the notice of the final partnership administrative adjustment was mailed to A's tax matters partner was Cincinnati, Ohio. However, by the day on which a petition seeking judicial review of that adjustment was filed, A had moved its principal place of business to Louisville, Kentucky. For purposes of section 6226(a)(2), A's principal place of business is Louisville.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6226(a)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6226(a)–1T [Removed]**

Par. 22a. Section 301.6226(a)–1T is removed.

Par. 23. Section 301.6226(b)–1 is added to read as follows:

*§ 301.6226(b)–1 5-percent group.*

(a) *In general*. All members of a 5-percent group shall join in filing any petition for judicial review. The designation of a partner as a representative of a notice group does not authorize that partner to file a petition for a readjustment of partnership items on behalf of the notice group.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6226(b)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6226(b)–1T [Removed]**

Par. 23a. Section 301.6226(b)–1T is removed.

Par. 24. Section 301.6226(e)–1 is added to read as follows:

*§ 301.6226(e)–1 Jurisdictional requirement for bringing an action in District Court or United States Court of Federal Claims.*

(a) *Amount to be deposited*—(1) *In general*. The jurisdictional amount that the filing partner (or, in the case of a petition filed by a 5-percent group, each member of the group, or, for civil actions beginning on or after March 30, 2002, in the case of a petition filed by a pass-thru partner, each indirect partner holding an interest through the pass-thru partner) shall deposit is the amount by which the tax liability of the partner would be increased if the treatment of the partnership items on the partner's return were made consistent with the treatment of partnership items on the partnership return, as adjusted by the notice of final partnership administrative adjustment. The partner is not required to pay other outstanding liabilities in order to deposit a jurisdictional amount.

(2) *Example*. The provisions of paragraph (a)(1) of this section may be illustrated by the following example:

*Example*. A files a petition for readjustment of partnership items in the United States Court of Federal Claims. A's tax liability would be increased by $4,000 if partnership items on A's return were conformed to the partnership return, as adjusted by the notice of final partnership administrative adjustment. A has an unpaid liability of $10,000 attributable to nonpartnership items. A is required to deposit $4,000 in order to satisfy the jurisdictional requirement.

(b) *Deposit taken into account in computing interest*. The amount deposited is treated as a payment of tax for purposes of chapter 67 of the Internal Revenue Code (relating to interest).

(c) *Deposit generally not treated as payment of tax*. Except as provided in paragraph (b) of this section, an amount deposited under section 6226(e) shall not be treated as a payment of tax. Thus, the Internal Revenue Service may proceed against the depositor for a deficiency based on nonpartnership items without regard to this deposit.

(d) *Amount deposited may be applied against assessment*. If the restriction on assessment provided under section 6225(a) lapses with respect to a deficiency attributable to partnership items for a partnership taxable year while an amount is on deposit under section 6226(e) in connection with a petition relating to those items, the Internal Revenue Service may apply the amount deposited against any such deficiency that is assessed.

(e) *Effective date*. Except as otherwise provided in paragraph (a)(1) of this section, this section is applicable to civil actions beginning on or after October 4, 2001. For civil actions beginning prior to October 4, 2001, see § 301.6226(e)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6226(e)–1T [Removed]**

Par. 24a. Section 301.6226(e)–1T is removed.

Par. 25. Section 301.6226(f)–1 is added to read as follows:

*§ 301.6226(f)–1 Scope of judicial review.*

(a) *In general*. A court reviewing a notice of final partnership administrative adjustment has jurisdiction to determine all partnership items for the taxable year to which the notice relates and the proper allocation of such items among the partners. Thus, the review is not limited to the items adjusted in the notice. In addition, the court has jurisdiction in the partnership-level proceeding to determine any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. However, the court does not have jurisdiction in the partnership-level proceeding to consider any partner-level defenses to any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. See section 6230(c)(4) and § 301.6221–1(c) and (d).

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

*Example*. The Internal Revenue Service issues a notice of final partnership administrative adjustment with respect to Partnership ABC in which the only item adjusted is depreciation. A petition for judicial review of that notice is filed. During the judicial proceeding, a partner of ABC, in accordance with the applicable court rules, raises an issue relating to the treatment of intangible drilling costs. The court reviewing the notice has jurisdiction to determine the intangible drilling cost issue in addition to the depreciation issue.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6226(f)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6226(f)–1T [Removed]**

Par. 25a. Section 301.6226(f)–1T is removed.

**§ 301.6227(b)–1T [Removed]**

Par. 26. Section 301.6227(b)–1T is removed.

Par. 26a. Section 301.6227(c)–1 is added to read as follows:

*§ 301.6227(c)–1 Administrative adjustment request by the tax matters partner on behalf of the partnership.*

(a) *In general*. A request for an administrative adjustment filed by the tax matters partner on behalf of the partnership shall be filed on the form prescribed by the Internal Revenue Service for that purpose in accordance with that form's instructions. Except as otherwise provided in that form's instructions, the request shall be—

(1) Filed with the service center where the original partnership return was filed (but, if the notice described in section 6223(a)(1) (beginning of an administrative proceeding) has already been mailed to the tax matters partner, the statement should be filed with the Internal Revenue Service office that mailed such notice);

(2) Signed by the tax matters partner; and

(3) Accompanied by revised schedules showing the effects of the proposed changes on each partner and an explanation of the changes.

(b) *Denied request for treatment as a substituted return remains administrative adjustment request*. An administrative adjustment request filed by the tax matters partner on behalf of the partnership for which substituted return treatment is requested but not granted remains an administrative adjustment request. Thus, for example, the tax matters partner may file suit under section 6228(a) if the Internal Revenue Service fails to take timely action on the request.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6227(b)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6227(c)–1T [Removed]**

Par. 27. Section 301.6227(c)–1T is removed.

Par. 27a. Section 301.6227(d)–1 is added to read as follows:

*§ 301.6227(d)–1 Administrative adjustment request filed on behalf of a partner.*

(a) *In general*. A request for an administrative adjustment on behalf of a partner shall be filed on the form prescribed by the Internal Revenue Service for that purpose in accordance with that form's instructions. Except as otherwise provided in that form's instructions, the request shall—

(1) Be filed in duplicate, the original copy filed with the partner's amended income tax return (on which the partner computes the amount by which the partner's tax liability should be adjusted if the request is granted) and the other copy filed with the service center where the partnership return is filed (but, if the notice described in section 6223(a)(1) (beginning of an administrative proceeding) has already been mailed to the tax matters partner, the statement should be filed with the Internal Revenue Service office that mailed such notice);

(2) Identify the partner and the partnership by name, address, and taxpayer identification number;

(3) Specify the partnership taxable year to which the administrative adjustment request applies;

(4) Relate only to partnership items; and

(5) Relate only to one partnership and one partnership taxable year.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6227(c)–1T contained in 26 CFR part 1, revised April 1, 2001.

Par. 28. Section 301.6229(b)–1 is added to read as follows:

*§ 301.6229(b)–1 Extension by agreement.*

(a) *In general*. Any partnership may authorize any person to extend the period described in section 6229(a) with respect to all partners by filing a statement to that effect with the service center where the partnership return is filed (but, if the notice described in section 6223(a)(1) (beginning of an administrative proceeding) has already been mailed to the tax matters partner, the statement should be filed with the Internal Revenue Service office that mailed such notice). The statement shall—

(1) Provide that it is an authorization for a person other than the tax matters partner to extend the assessment period with respect to all partners;

(2) Identify the partnership and the person being authorized by name, address, and taxpayer identification number;

(3) Specify the partnership taxable year or years for which the authorization is effective; and

(4) Be signed by all persons who were general partners (or, in the case of an LLC, member-managers, as those terms are defined in § 301.6231(a)(7)–2(b)) at any time during the year or years for which the authorization is effective.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6229(b)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6229(b)–1T [Removed]**

Par. 28a. Section 301.6229(b)–1T is removed.

Par. 29. Section 301.6229(b)–2 is added to read as follows:

*§ 301.6229(b)–2 Special rule with respect to debtors in Title 11 cases.*

(a) *In general*. Notwithstanding any other law or rule of law, if an agreement is entered into under section 6229(b)(1)(B), and the agreement is signed by a person who would be the tax matters partner but for the fact that, at the time that the agreement is executed, the person is a debtor in a bankruptcy proceeding under Title 11 of the United States Code, such agreement shall be binding on all partners in the partnership unless the Internal Revenue Service has been notified of the bankruptcy proceeding in accordance with paragraph (b) of this section.

(b) *Procedures for notifying the Internal Revenue Service of a partner's bankruptcy proceeding*. (1) The Internal Revenue Service shall be notified of the bankruptcy proceeding of the tax matters partner in accordance with the procedures set forth in § 301.6223(c)–1.

(2) In addition to the information specified in § 301.6223(c)–1, notification that a person is (or was) a debtor in a bankruptcy proceeding shall include the date the bankruptcy proceeding was filed, the name and address of the court in which the bankruptcy proceeding exists (or took place), the caption of the bankruptcy proceeding (including the docket number or other identification number used by the court), and the status of the proceeding as of the date of notification.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6229(b)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6229(b)–2T [Removed]**

Par. 29a. Section 301.6229(b)–2T is removed.

Par. 30. Section 301.6229(e)–1 is added to read as follows:

*§ 301.6229(e)–1 Information with respect to unidentified partner.*

(a) *In general*. A partner who is not properly identified on the partnership return (including an indirect partner) remains an unidentified partner for purposes of section 6229(e) until identifying information is furnished as provided in § 301.6223(c)–1.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6229(e)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6229(e)–1T [Removed]**

Par. 30a. Section 301.6229(e)–1T is removed.

Par. 31. Section 301.6229(f)–1 is added to read as follows:

*§ 301.6229(f)–1 Special rule for partial settlement agreements.*

(a) *In general*. If a partner enters into a settlement agreement with the Internal Revenue Service with respect to the treatment of some of the partnership items or partnership-level determinations of any penalty, addition to tax, or additional amount in dispute for a partnership taxable year, but one or more other partnership items or determinations remain in dispute, the period of limitations for assessing any tax attributable to the settled items shall be determined as if such agreement had not been entered into.

(b) *Other items remaining in dispute*. Pursuant to section 6226(c), a partner is a party to a partnership-level judicial proceeding with respect to partnership items and partnership-level determinations of penalties, additions to tax or additional amounts. When a partner settles partnership items, the settled partnership items convert to nonpartnership items under section 6231(b)(1)(C) and will not be subject to any future or pending partnership-level proceeding pursuant to section 6226(d)(1). The remaining unsettled partnership items, as well as any unsettled penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item (regardless of whether the partnership item to which it relates has been settled), however, will remain subject to determination under partnership-level administrative and judicial procedures. Consequently, any remaining unsettled items, including any unsettled penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item, will be deemed to remain in dispute. Thus, the period for assessing any tax attributable to the settled items will be governed by the period for assessing any tax attributable to the remaining unsettled items.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6229(f)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6229(f)–1T [Removed]**

Par. 31a. Section 301.6229(f)–1T is removed.

Par. 32. Section 301.6230(b)–1 is added to read as follows:

*§ 301.6230(b)–1 Request that correction not be made.*

(a) *In general*. The request that a correction not be made under section 6230(b)(2) shall be in writing and shall—

(1) State that it is a request that a correction not be made under section 6230(b);

(2) Identify the partnership and the partner filing the request by name, address, and taxpayer identification number;

(3) Be signed by the partner filing the request; and

(4) Be filed with the Internal Revenue Service office that provided the notice of the correction of the error.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6230(b)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6230(b)–1T [Removed]**

Par. 32a. Section 301.6230(b)–1T is removed.

Par. 33. Section 301.6230(c)–1 is added to read as follows:

*§ 301.6230(c)–1 Claim arising out of erroneous computation, etc.*

(a) *In general*. A claim for refund under section 6230(c) shall state the grounds for the claim and shall be filed with the service center where the partner's return is filed.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6230(c)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6230(c)–1T [Removed]**

Par. 33a. Section 301.6230(c)–1T is removed.

Par. 34. Section 301.6230(e)–1 is added to read as follows:

*§ 301.6230(e)–1 Tax matters partner required to furnish names.*

(a) *In general*. If a notice of the beginning of an administrative proceeding is mailed to the tax matters partner with respect to any partnership taxable year, the tax matters partner shall furnish to the Internal Revenue Service office that issued the notice the name, address, profits interest, and taxpayer identification number of each person who was a partner in the partnership at any time during that taxable year if that information was not provided on the partnership return filed for that year.

(b) *Revised or additional information*. If the tax matters partner discovers that any information furnished to the Internal Revenue Service on the partnership return or under paragraph (a) of this section was incorrect or incomplete, the tax matters partner shall furnish revised or additional information to the Internal Revenue Service within 15 days of discovering that the information furnished to the Internal Revenue Service was incorrect or incomplete.

(c) *Information required with respect to indirect partners*. The requirements of this section for identifying information apply with respect to indirect partners to the extent that the tax matters partner has such information.

(d) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6230(e)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6230(e)–1T [Removed]**

Par. 34a. Section 301.6230(e)–1T is removed.

Par. 35. Section 301.6231(a)(1)–1 is added to read as follows:

*§ 301.6231(a)(1)–1 Exception for small partnerships.*

(a) *In general*. For purposes of the exception for small partnerships under section 6231(a)(1)(B), the rules contained in this section shall apply.

(1) *10 or fewer*. The 10 or fewer limitation described in section 6231(a)(1)(B)(i) is applied to the number of natural persons, C corporations, and estates of deceased partners that were partners at any one time during the partnership taxable year. Thus, for example, a partnership that at no time during the taxable year had more than 10 partners may be treated as a small partnership even if, because of transfers of interests in the partnership, 11 or more natural persons, C corporations, or estates of deceased partners owned interests in the partnership for some portion of the taxable year. See section 1361(a)(2) for the definition of a *C corporation*. For purposes of section 6231(a)(1)(B) and this section, a husband and wife (and their estates) are treated as one person.

(2) *Pass-thru partner*. The exception provided in section 6231(a)(1)(B) does not apply to a partnership for a taxable year if any partner in the partnership during that taxable year is a pass-thru partner as defined in section 6231(a)(9). For purposes of this paragraph (a)(2), an estate shall not be treated as a pass-thru partner.

(3) *Determination made annually*. The determination of whether a partnership meets the requirements for the exception for small partnerships under section 6231(a)(1)(B) and this paragraph (a) shall be made with respect to each partnership taxable year. Thus, a partnership that does not qualify as a small partnership in one taxable year may qualify as a small partnership in another taxable year if the requirements for the exception under section 6231(a)(1)(B) and this paragraph (a) are met with respect to that other taxable year.

(b) *Election to have subchapter C of chapter 63 apply*—(1) *In general*. Any partnership that meets the requirements set forth in section 6231(a)(1)(B) and paragraph (a) of this section (relating to the exception for small partnerships) may elect under paragraph (b)(2) of this section to have the provisions of subchapter C of chapter 63 of the Internal Revenue Code apply with respect to that partnership.

(2) *Method of election*. A partnership shall make the election described in paragraph (b)(1) of this section by attaching a statement to the partnership return for the first taxable year for which the election is to be effective. The statement shall be identified as an election under section 6231(a)(1)(B)(ii), shall be signed by all persons who were partners of that partnership at any time during the partnership taxable year to which the return relates, and shall be filed at the time (determined with regard to any extension of time for

filing) and place prescribed for filing the partnership return. However, for any partnership taxable year for which the due date of the return (determined without regard to extensions) is before January 2, 2002, the partnership may file the statement described in the preceding sentence on or before the date which is one year before the date specified in section 6229(a) for the expiration of the period of limitations with respect to that partnership (determined with regard to extensions of that period under section 6229(b)).

(3) *Years covered by election*. The election shall be effective for the partnership taxable year to which the return relates and all subsequent partnership taxable years unless revoked with the consent of the Commissioner.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(a)(1)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(a)(1)–1T [Removed]**

Par. 35a. Section 301.6231(a)(1)–1T is removed.

Par. 36. Section 301.6231(a)(2)–1 is added to read as follows:

*§ 301.6231(a)(2)–1 Persons whose tax liability is determined indirectly by partnership items.*

(a) *Spouse filing joint return with individual holding a separate interest*—(1) *In general*. Except as otherwise provided in this paragraph (a), a spouse who files a joint return with an individual holding a separate interest in the partnership shall be treated as a partner for purposes of subchapter C of chapter 63 of the Internal Revenue Code. Thus, the spouse who files a joint return with a partner will be permitted to participate in administrative and judicial proceedings.

(2) *Counting rules*. A spouse who files a joint return with an individual holding a separate interest in the partnership shall not be counted as a partner for purposes of applying section 6223(b) (relating to special rules for partnerships with more than 100 partners) and section 6231(a)(1)(B) (relating to the exception for small partnerships).

(3) *Notice rules*—(i) *In general*. Except as provided in paragraph (a)(3)(ii) of this section, for purposes of subchapter C of chapter 63 of the Internal Revenue Code, a spouse who files a joint return with an individual holding a separate interest in the partnership shall be treated as receiving any notice received by the individual holding the separate interest.

(ii) *Spouse identified on partnership return or by statement*. Paragraph (a)(3)(i) of this section shall not apply to a spouse who files a joint return with an individual holding a separate interest in the partnership if that spouse—

(A) Is identified on the partnership return; or

(B) Is identified as a partner entitled to notice as provided in § 301.6223(c)–1(b).

(4) *Conversion of partnership items*—(i) *Individual holding a separate interest*. A spouse who files a joint return with an individual holding a separate interest in the partnership shall cease to be treated as a partner in the partnership under paragraph (a)(1) of this section upon the conversion of the partnership items of the individual holding the separate interest in the partnership to nonpartnership items pursuant to section 6231(b). If each spouse holds a separate interest in the partnership, the previous sentence shall be applied separately with respect to each partnership interest.

(ii) *Spouse who files a joint return with an individual holding a separate interest in the partnership*. A spouse who files a joint return with an individual holding a separate interest in the partnership shall cease to be treated as a partner in the partnership under paragraph (a)(1) of this section upon the occurrence of an event that would convert the partnership items of the spouse to nonpartnership items if the spouse were the owner of a separate interest.

(iii) *Examples*. The following examples illustrate the application of paragraph (a)(4) of this section:

*Example 1*. Husband owns a separate interest in ABC partnership and files a joint return with Wife. Husband files for bankruptcy. Pursuant to § 301.6231(c)–7, upon filing for bankruptcy, the partnership items of the debtor convert to nonpartnership items. Thus, Husband's partnership items converted to nonpartnership items upon the filing of Husband's bankruptcy petition. Pursuant to paragraph (a)(4)(i) of this section, Wife is no longer treated as a partner of ABC partnership as of the date the partnership items of Husband converted to nonpartnership items.

*Example 2*. Wife owns a separate interest in XYZ partnership and files a joint return with Husband. Husband files for bankruptcy. Because the filing of the bankruptcy petition by Husband is an event that would convert Husband's partnership items to nonpartnership items if Husband were the owner of a separate interest, Husband shall no longer be treated as a partner as of the filing of the bankruptcy petition. Pursuant to paragraph (a)(4)(ii) of this section, the partnership items of Wife are not affected by Husband's bankruptcy.

(5) *Cross–reference*. See § 301.6231(a)(12)–1 for special rules relating to spouses holding a joint interest in a partnership.

(b) *Shareholder of C corporation*. A shareholder of a C corporation (as defined in section 1361(a)(2)) is not a partner in a partnership merely because the C corporation is a partner in that partnership.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(a)(2)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(a)(2)–1T [Removed]**

Par. 36a. Section 301.6231(a)(2)–1T is removed.

Par. 37. Section 301.6231(a)(5)–1 is added to read as follows:

*§ 301.6231(a)(5)–1 Definition of affected item.*

(a) *In general*. The term *affected item* means any item to the extent such item is affected by a partnership item. It includes items unrelated to the items reflected on the partnership return (for example, an item, such as the threshold for the medical expense deduction under section 213, that varies if there is a change in an individual partner's adjusted gross income).

(b) *Basis in a partner's partnership interest*. The basis of a partner's partnership interest is an affected item to the extent it is not a partnership item.

(c) *At-risk limitation*. The application of the at-risk limitation under section 465 to a partner with respect to a loss incurred by a partnership is an affected item to the extent it is not a partnership item.

(d) *Passive losses*. The application of the passive loss rules under section 469 to a partner with respect to a loss incurred by a partnership is an affected item to the extent it is not a partnership item.

(e) *Penalty, addition to tax, or additional amount*—(1) *In general*. The term *affected item* includes any penalty, addition to tax, or additional amount provided by subchapter A of chapter 68 of the Internal Revenue Code of 1986 to the extent provided in this paragraph (e).

(2) *Penalty, addition to tax, or additional amount without floor*. If a penalty, addition to tax, or additional amount that does not contain a floor (that is, a threshold amount of underpayment or understatement necessary before the imposition of the penalty, addition to tax, or additional amount) is imposed on a partner as the result of an adjustment to a partnership item, the term *affected item* shall include the penalty, addition to tax, or additional amount computed with reference to the portion of the underpayment that is attributable to the partnership item adjustment(s) to which the penalty, addition to tax, or additional amount applies.

(3) *Penalty, addition to tax, or additional amount containing floor*—(i) *Floor exceeded prior to adjustment*. If a partner would have been subject to a penalty, addition to tax, or additional amount that contains a floor in the absence of an adjustment to a partnership item (that is, the partner's understatement or underpayment exceeded the floor even without an adjustment to a partnership item) the term *affected item* shall include only the portion of the penalty, addition to tax, or additional amount computed with reference to the partnership item (or affected item) adjustments.

(ii) *Floor not exceeded prior to adjustment*. In the case of a penalty, addition to tax, or additional amount that contains a floor, if the taxpayer's understatement or underpayment does not exceed the floor prior to an adjustment to a partnership item but does so after such adjustment, the term *affected item* shall include the penalty, addition to tax, or additional amount computed with reference to the entire underpayment or understatement to which the penalty, addition to tax, or additional amount applies.

(4) *Examples*. The provisions of this paragraph (e) may be illustrated by the following examples:

*Example 1*. A, a partner of P, had an aggregate underpayment of $1,000 of which $100 is attributable to an adjustment to partnership items. A is negligent in reporting the partnership items. The accuracy-related penalty under section 6662 for negligence computed with reference to the $100 underpayment attributable to the partnership item adjustments is an affected item.

*Example 2*. B, a partner of P, understated B's income tax liability attributable to nonpartnership items by $6,000. An adjustment to a partnership item resulting from a partnership proceeding increased B's income tax by an additional $2,000. Prior to the adjustment, B would have been subject to the accuracy-related penalty under section 6662 for a substantial understatement of income tax with respect to the $6,000 understatement attributable to nonpartnership items. The portion of the accuracy-related penalty under section 6662 computed with reference to the $2,000 understatement attributable to partnership items to which the accuracy-related penalty applies is an affected item. The portion of the accuracy-related penalty under section 6662 computed with reference to the $6,000 pre-existing understatement is not an affected item.

*Example 3*. C, a partner in partnership P, understated C's income tax liability attributable to nonpartnership items by $4,000. As a result of an adjustment to partnership items, that understatement is increased to $10,000. Prior to the adjustment, C would not have been subject to the accuracy-related penalty under section 6662 for a substantial understatement of income tax. The accuracy-related penalty under section 6662 computed with reference to the entire $10,000 understatement to which the accuracy-related penalty applies is an affected item.

(f) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(a)(5)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(a)(5)–1T [Removed]**

Par. 37a. Section 301.6231(a)(5)–1T is removed.

Par. 38. Section 301.6231(a)(6)–1 is added to read as follows:

*§ 301.6231(a)(6)–1 Computational adjustments.*

(a) *Changes in a partner's tax liability*—(1) *In general*. A change in the tax liability of a partner to properly reflect the treatment of a partnership item under subchapter C of chapter 63 of the Internal Revenue Code is made through a computational adjustment. A computational adjustment includes a change in tax liability that reflects a change in an affected item where that change is necessary to properly reflect the treatment of a partnership item, or any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item. However, if a change in a partner's tax liability cannot be made without making one or more partner-level determinations, that portion of the change in tax liability attributable to the partner-level determinations shall be made under the deficiency procedures (as described in subchapter B of chapter 63 of the Internal Revenue Code), except for any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item.

(2) *Affected items that do not require partner-level determinations*. Changes in a partner's tax liability with respect to affected items that do not require partner-level determinations (such as the threshold amount of medical deductions under section 213 that changes as the result of determinations made at the partnership level) are computational adjustments that are directly assessed. When making computational adjustments, the Internal Revenue Service may assume that amounts the partner reported on the partner's individual return include all amounts reported to the partner by the partnership (on the Schedule K-1s attached to the partnership's original return), absent contrary notice to the Internal Revenue Service (for example, a "Notice of Inconsistent Treatment" pursuant to § 301.6222(a)–2(c)). Such an assumption by the Internal Revenue Service does not constitute a partner-level determination. Moreover, substituting redetermined partnership items for the partner's previously reported partnership items (including partnership items included in carryover amounts) does not constitute a partner-level determination where the Internal Revenue Service otherwise accepts, for the sole purpose of determining the computational adjustment, all nonpartnership items (including, for example, nonpartnership item components of carryover amounts) as reported.

(3) *Affected items that require partner-level determinations*. Changes in a partner's tax liability with respect to affected items that require partner-level determinations (such as a partner's at-risk amount to the extent it depends upon the source from which the partner obtained the funds that the partner contributed to the partnership) are computational adjustments that are subject to the deficiency procedures. Notwithstanding the preceding sentence, any penalty, addition to tax, or additional amount that relates to an adjustment to a partnership item is not subject to the deficiency procedures, but rather may be directly assessed as part of the computational adjustment that is made following the partnership proceeding, based on de-

terminations in that proceeding, regardless of whether any partner-level determinations may be required.

(b) *Interest*. A computational adjustment includes any interest due with respect to any underpayment or overpayment of tax attributable to adjustments to reflect properly the treatment of partnership items.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(a)(6)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(a)(6)–1T [Removed]**

Par. 38a. Section 301.6231(a)(6)–1T is removed.

Par. 39. Section 301.6231(a)(7)–1 is amended by revising paragraphs (p)(2), (r)(1), and (s) to read as follows:

*§ 301.6231(a)(7)–1 Designation or selection of tax matters partner.*

* * * * *

(p) * * *

(2) *When each general partner is deemed to have no profits interest in the partnership*. If it is impracticable under paragraph (o)(2) of this section to apply the largest-profits-interest rule of paragraph (m)(2) of this section, the Commissioner will select a partner (including a general or limited partner) as the tax matters partner in accordance with the criteria set forth in paragraph (q) of this section. The Commissioner will notify, within 30 days of the selection, the partner selected, the partnership, and all partners required to receive notice under section 6223(a) of the selection of the tax matters partner, effective as of the date specified in the notice.

* * * * *

(r) * * * (1) *In general*. If the Commissioner selects a tax matters partner under the provisions of paragraph (p)(1) or (p)(3)(i) of this section, the Commissioner will notify, within 30 days of the selection, the partner selected, the partnership, and all partners required to receive notice under section 6223(a) of the selection of the tax matters partner, effective as of the date specified in the notice.

* * * * *

(s) *Effective date*. This section applies to all designations, selections, and terminations of a tax matters partner occurring on or after December 23, 1996, except for paragraphs (p)(2) and (r)(1), that are applicable on or after October 4, 2001.

**§ 301.6231(a)(7)–1T [Removed]**

Par. 39a. Section 301.6231(a)(7)–1T is removed.

Par. 40. Section 301.6231(a)(12)–1 is added to read as follows:

*§ 301.6231(a)(12)–1 Special rules relating to spouses.*

(a) *Spouses holding a joint interest*—(1) *In general.* Except as otherwise provided in this section, spouses holding a joint interest in a partnership shall be treated as separate partners for purposes of subchapter C of chapter 63 of the Internal Revenue Code. Thus, both spouses may participate in administrative and judicial proceedings. The term *joint interest* includes tenancies in common, joint tenancies, tenancies by the entirety, and community property.

(2) *Identification of joint interest*. For purposes of this section, an interest shall be treated as a joint interest in a partnership only if both spouses are identified on the partnership return or are identified as partners entitled to notice as provided in § 301.6223(c)–1(b).

(3) *Failure to identify both spouses as partners*. If both spouses are not identified as set forth in paragraph (a)(2) of this section, then the partnership interest shall be treated as separately owned by the identified spouse.

(4) *Example*. The following example illustrates the application of paragraph (a)(3) of this section:

*Example*. Wife owns an interest in ABC Partnership and is identified on the Schedule K-1 of the partnership return. Wife and Husband live in a community property state. The partnership return of ABC partnership does not identify Husband, and Husband is not identified as a partner entitled to notice as provided in § 301.6223(c)–1(b). Pursuant to paragraph (a)(3) of this section, the partnership interest of Wife shall be treated as separately owned by Wife.

(b) *Notice and counting rules*—(1) *In general*. Except as provided in paragraph (b)(2) of this section, for purposes of applying section 6223 (relating to notice to partners of proceedings) and section 6231(a)(1)(B) (relating to the exception for small partnerships), spouses holding a joint interest in a partnership shall be treated as one partner. Except as provided in paragraph (b)(2) of this section, the Internal Revenue Service or the tax matters partner may send any required notice to either spouse.

(2) *Identified spouse entitled to notice*. For purposes of applying section 6223 (relating to notice to partners of proceeding) for a partnership taxable year, an individual who holds a joint interest in a partnership with a spouse who is entitled to notice under section 6223 shall be entitled to receive separate notice under section 6223 if such individual—

(i) Is identified as a partner on the partnership return for that taxable year; or

(ii) Is identified as a partner entitled to notice as provided in § 301.6223(c)–1(b).

(c) *Conversion of partnership items*—(1) *In general*. If spouses holding a joint interest in a partnership are treated as separate partners under this section, then section 6231(b) (relating to the conversion of partnership items) shall be applied separately to each spouse.

(2) *Example*. The following example illustrates the application of paragraph (c) of this section:

*Example*. Husband and Wife own a joint interest in XYZ Partnership. The partnership return identifies both spouses on the Schedule K-1. Under this section, each spouse is treated as a separate partner. If Wife enters into a settlement agreement, Wife's partnership items convert to nonpartnership items pursuant to section 6231(b)(1)(C). Accordingly, Wife no longer has the right to participate in the partnership proceeding subsequent to entering into the settlement agreement. Pursuant to paragraph (c) of this section, however, the partnership items of Husband are not affected by the conversion of the partnership items of Wife, and Husband continues to have the right to participate in the partnership proceeding. This result is the same regardless of whether the partnership items are reported on a joint return or on separate returns.

(d) *Cross-reference*. See § 301.6231(a)(2)–1(a) for special rules relating to spouses who file joint returns with individuals holding a separate interest in a partnership.

(e) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(a)(12)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(a)(12)–1T [Removed]**

Par. 40a. Section 301.6231(a)(12)–1T is removed.

Par. 41. Section 301.6231(c)–1 is added to read as follows:

*§ 301.6231(c)–1 Special rules for certain applications for tentative carryback and refund adjustments based on partnership losses, deductions, or credits.*

(a) *Application subject to this section*. This section applies in the case of an application under section 6411 (relating to tentative carryback and refund adjustments) based on losses, deductions, or credits of a partnership if the Commissioner, or the Commissioner's delegate, determines, after review of the available relevant information, that it is highly likely that a person described in section 6700(a)(1) made, with respect to the partnership—

(1) A gross valuation overstatement; or

(2) A false or fraudulent statement with respect to the tax benefits to be secured by reason of holding an interest in the partnership that would be subject to a penalty under section 6700 (relating to penalty for promoting abusive tax shelters, etc.). This section applies only with respect to an application based upon the original reporting on the partner's income tax return of partnership losses, deductions, or credits. Thus, this section does not apply to a request for administrative adjustment under section 6227 through which a partner seeks to change the partner's reporting of partnership items on the partner's income tax return (or on an earlier request for administrative adjustment).

(b) *Determination of special enforcement area*. In the case of an application under section 6411 described in paragraph (a) of this section, precluding an assessment under section 6225 that would be permitted under section 6213(b)(3) (relating to assessments arising out of tentative carryback or refund adjustments) with respect to any amount applied, credited, or refunded as a result of the application may encourage the proliferation of abusive tax shelter partnerships and make the eventual collection of taxes due more difficult. Consequently, the Secretary hereby determines that such applications present special enforcement considerations within the meaning of section 6231(c)(1)(E).

(c) *Assessment permitted under section 6213(b)(3)*. Notwithstanding section 6225 (relating to restrictions on assessment with respect to partnership items), an assessment that would be permitted under section 6213(b)(3) with respect to any amount applied, credited, or refunded as a result of an application described in paragraph (a) of this section may be made before there is a final partnership-level determination with respect to the losses, deductions, or credits on which the application is based. As provided in section 6213(b)(1), the Internal Revenue Service shall mail notice of any such assessment to the partner filing the application. The notice shall also inform the partner of the partner's limited right to elect to treat items as nonpartnership items as provided in paragraph (d) of this section.

(d) *Limited right to elect to treat items as nonpartnership items*—(1) *In general*. A partner to whom the Internal Revenue Service mails a notice of suspension of action on a refund claim under paragraph (c) of this section may elect in accordance with this paragraph (d) to have all partnership items for the partnership taxable year in which the losses, deductions, or credits at issue arose treated as nonpartnership items.

(2) *Time and place of making election*. The election shall be made by filing a statement with the Internal Revenue Service office that mailed the notice of suspension. The statement may be filed at any time—

(i) After the date which is one year after the date on which the partnership return was filed for the partnership taxable year in which the items at issue arose; and

(ii) Before the date on which the Internal Revenue Service mails to the tax matters partner the notice of final partnership administrative adjustment for the partnership taxable year in which the items at issue arose. For purposes of this paragraph (d)(2), a partnership return filed before the last day prescribed by law for its filing (determined without regard to extensions) shall be treated as filed on the last day.

(3) *Contents of the statement*. The statement shall—

(i) Be clearly identified as an election to have partnership items treated as nonpartnership items because of notification of an assessment under section 6213(b)(3);

(ii) Identify the partnership by name, address, and taxpayer identification number;

(iii) Identify the partner making the election by name, address, and taxpayer identification number;

(iv) Specify the partnership taxable year to which the election applies; and

(v) Be signed by the partner making the election.

(e) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(c)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–1T [Removed]**

Par. 41a. Section 301.6231(c)–1T is removed.

Par. 42. Section 301.6231(c)–2 is added to read as follows:

*§ 301.6231(c)–2 Special rules for certain refund claims based on losses, deductions, or credits from abusive tax shelter partnerships.*

(a) *Claims subject to this section*. This section applies in the case of a claim for credit or refund based on losses, deductions or credits of a partnership if the Commissioner, or the Commissioner's delegate, determines, after review of available relevant information, that it is highly likely that a person described in section 6700(a)(1) made, with respect to the partnership—

(1) A gross valuation overstatement; or

(2) A false or fraudulent statement with respect to the tax benefits to be secured by reason of holding an interest in the partnership that would be subject to a penalty under section 6700 (relating to penalty for promoting abusive tax shelters, etc.). This section applies only with respect to a claim that is based upon the partner's original reporting on the partner's income tax return of partnership losses, deductions, or credits. Thus, this section does not apply to a request for administrative adjustment under section 6227 through which a partner seeks to change the partner's reporting of partnership items on the partner's income tax return (or on an earlier request for administrative adjustment). For purposes of this section, any income tax return requesting a credit or refund shall be treated as a claim for a credit or refund.

(b) *Determination of special enforcement area*. Granting a claim for credit or refund described in paragraph (a) of this section may encourage the proliferation of abusive tax shelter partnerships and make the eventual collection of taxes more difficult. Consequently, the Secretary hereby determines that such claims present special enforcement considerations within the meaning of section 6231(c)(1)(E).

(c) *Action on refund claims suspended*. In the case of a claim described in paragraph (a) of this section, the Internal Revenue Service may mail to the partner filing the claim a notice stating that no action will be taken on the partner's claim until the completion of the partnership-level proceedings. The notice shall also inform the partner of the partner's limited right to elect to treat items as nonpartnership items as provided in paragraph (d) of this section.

(d) *Limited right to elect to treat items as nonpartnership items*—(1) *In general*. A partner to whom the Internal Revenue Service mails a notice of suspension under paragraph (c) of this section may elect in accordance with this paragraph (d) to have all partnership items for the partnership taxable year in which the losses, deductions, or credits at issue arose treated as nonpartnership items.

(2) *Time and place of making election*. The election shall be made by filing a statement with the Internal Revenue Service office that mailed the notice of suspension. The statement may be filed at any time—

(i) After the date which is one year after the date on which the partnership return was filed for the partnership taxable year in which the items at issue arose; and

(ii) Before the date on which the Internal Revenue Service mails to the tax matters partner the notice of final partnership administrative adjustment for the partnership taxable year in which the items at issue arose. For purposes of this paragraph (d)(2), a partnership return filed before the last day prescribed by law for its filing (determined without regard to extensions) shall be treated as filed on the last day.

(3) *Contents of the statement*. The statement shall—

(i) Be clearly identified as an election to have partnership items treated as nonpartnership items because of notification of suspension of action on a refund claim;

(ii) Identify the partnership by name, address, and taxpayer identification number;

(iii) Identify the partner making the election by name, address, and taxpayer identification number;

(iv) Specify the partnership taxable year to which the election applies; and

(v) Be signed by the partner making the election.

(e) *Effective date*. This section applies with respect to any claim described in paragraph (a) of this section that is filed on or after October 4, 2001. For claims filed prior to October 4, 2001, see § 301.6231(c)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–2T [Removed]**

Par. 42a. Section 301.6231(c)–2T is removed.

Par. 43. Section 301.6231(c)–3 is added to read as follows:

*§ 301.6231(c)–3 Limitation on applicability of §§ 301.6231(c)–4 through 301.6231(c)–8.*

(a) *In general*. A provision of §§ 301.6231(c)–4 through 301.6231(c)–8 shall not apply with respect to partnership items arising in a partnership taxable year if, as of the date on which those items would otherwise begin to be treated as nonpartnership items under that provision—

(1) A notice of final partnership administrative adjustment with respect to those items has been mailed to the tax matters partner; and

(2) Either—

(i) The period during which an action with respect to that final partnership administrative adjustment may be brought under section 6226 has expired and no such action has been brought; or

(ii) The decision of the court in an action brought under section 6226 with respect to that final partnership administrative adjustment has become final.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(c)–3T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–3T [Removed]**

Par. 43a. Section 301.6231(c)–3T is removed.

Par. 44. Section 301.6231(c)–4 is added to read as follows:

*§ 301.6231(c)–4 Termination and jeopardy assessment.*

(a) *In general*. The treatment of items as partnership items with respect to a partner against whom an assessment of income tax under section 6851 (termination assessment) or section 6861 (jeopardy assessment) is made will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending with or within the partner's taxable year for which an assessment of income tax under section 6851 or 6861 is made shall be treated as nonpartnership items as of the moment before such assessment is made.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(c)–4T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–4T [Removed]**

Par. 44a. Section 301.6231(c)–4T is removed.

Par. 45. Section 301.6231(c)–5 is added to read as follows:

*§ 301.6231(c)–5 Criminal investigations.*

(a) *In general*. The treatment of items as partnership items with respect to a partner under criminal investigation for violation of the internal revenue laws relating to income tax will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner to which the criminal investigation relates shall be treated as nonpartnership items as of the date on which the partner is notified that the partner is the subject of a criminal investigation and written notification is sent by the Internal Revenue Service that the partner's partnership items shall be treated as nonpartnership items. The partnership items of a partner who is notified that the partner is the subject of a criminal investigation shall not be treated as nonpartnership items under this section unless and until such partner is sent written notification from the Internal Revenue Service of such treatment.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(c)–5T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–5T [Removed]**

Par. 45a. Section 301.6231(c)–5T is removed.

Par. 46. Section 301.6231(c)–6 is added to read as follows:

*§ 301.6231(c)–6 Indirect method of proof of income.*

(a) *In general*. The treatment of items as partnership items with respect to a partner whose taxable income is determined by use of an indirect method of proof of income will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the taxable year of the partner for which a deficiency notice based upon an indirect method of proof of income is mailed to the partner shall be treated as nonpartnership items as of the date on which that deficiency notice is mailed to the partner.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(c)–6T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–6T [Removed]**

Par. 46a. Section 301.6231(c)–6T is removed.

Par. 47. Section 301.6231(c)–7 is added to read as follows:

*§ 301.6231(c)–7 Bankruptcy and receivership*

(a) *Bankruptcy*. The treatment of items as partnership items with respect to a partner named as a debtor in a bankruptcy proceeding will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the bankruptcy proceeding shall be treated as nonpartnership items as of the date the petition naming the partner as debtor is filed in bankruptcy.

(b) *Receivership*. The treatment of items as partnership items with respect to a partner for whom a receiver has been appointed in any receivership proceeding before any court of the United States or of any State or the District of Columbia will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending on or before the last day of the latest taxable year of the partner with respect to which the United States could file a claim for income tax due in the receivership proceeding shall be treated as nonpartnership items as of the date a receiver is appointed in any receivership proceeding before any court of the United States or of any State or the District of Columbia.

(c) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(c)–7T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–7T [Removed]**

Par. 47a. Section 301.6231(c)–7T is removed.

Par. 48. Section 301.6231(c)–8 is added to read as follows:

*§ 301.6231(c)–8 Prompt assessment.*

(a) *In general*. The treatment of items as partnership items with respect to a partner on whose behalf a request for a prompt assessment of tax under section 6501(d) is filed will interfere with the effective and efficient enforcement of the internal revenue laws. Accordingly, partnership items of such a partner arising in any partnership taxable year ending with or within any taxable year of the partner with respect to which a request for a prompt assessment of tax is filed shall be treated as nonpartnership items as of the date that the request is filed.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(c)–8T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(c)–8T [Removed]**

Par. 48a. Section 301.6231(c)–8T is removed.

Par. 49. Section 301.6231(d)–1 is added to read as follows:

*§ 301.6231(d)–1 Time for determining profits interest of partners for purposes of sections 6223(b) and 6231(a)(11).*

(a) *Partner owns interest at close of year*. For purposes of section 6223(b) (relating to special rules for partnerships with more than 100 partners) and section 6231(a)(11) (relating to 5-percent groups), except as otherwise provided in this section, the profits interest held by a partner, directly or indirectly through one or more pass-thru partners, in a partnership (the source partnership) to which subchapter C of chapter 63 of the Internal Revenue Code applies shall be determined at the close of the source partnership's taxable year.

(b) *Partner does not own interest at close of year*. If the entire direct and indirect interest of a partner in a source partnership is terminated by virtue of a disposition by such partner of such interest (or by virtue of the disposition of an interest held by one or more pass-thru partners through which the partner holds an interest), then the profits interest of such partner in the source partnership shall be measured as of the moment before the disposition causing such termination. The preceding sentence shall not apply with respect to a termination if subsequent to such termination and before the close of the source partnership's taxable year the partner acquires a direct or indirect interest in the source partnership.

(c) *Disposition of last remaining portion of interest is disposition of entire interest*. If a partner (or a pass-thru partner through which a partner holds an interest) makes several partial dispositions of an interest in a source partnership during a taxable year of the source partnership, paragraph (b) of this section will apply with respect to the disposition which causes a termination of the partner's entire direct and indirect interest in the source partnership.

(d) *No profits interest in certain cases*. If—

(1) The interest of a partner in a partnership is entirely disposed of before the

close of the taxable year of the partnership; and

(2) No items of the partnership for that taxable year are required to be taken into account by the partner, then that partner has no profits interest in the partnership for that taxable year.

(e) *Examples*. The provisions of this section may be illustrated by the following examples. Assume in all examples that there have been no reacquisitions prior to the close of the source partnership's taxable year. The examples are as follows:

*Example 1*. B holds an interest in partnership P through T, a pass-thru partner. P uses a fiscal year ending June 30 as P's taxable year; B and T use the calendar year as the taxable year. As of the close of P's taxable year ending June 30, 2002, T holds an interest in P and B holds an interest in P through T. The profits interest held by B in P through T for that year is determined as of June 30, 2002.

*Example 2*. Assume the same facts as in *Example 1*, except that B sold the entire interest that B held in P through T on November 5, 2001. The profits interest held by B in P through T for P's taxable year ending June 30, 2002, is determined as of the moment before the sale on November 5, 2001.

*Example 3*. C holds an interest in partnership P through T, a pass-thru partner. C, P, and T all use the calendar year as the taxable year. T disposes of T's interest in P on June 5, 2002. The profits interest held by C in P through T for 2002 is determined as of the moment before the disposition on June 5, 2002.

*Example 4*. Assume the same facts as in *Example 3*, except that C sold C's entire interest in T (and, therefore, C's entire interest that C held in P through T) on March 15, 2002. The profits interest held by C in P through T for 2002 is determined as of the moment before the sale on March 15, 2002.

*Example 5*. On January 1, 2002, D held a 2 percent profits interest in partnership P. Both D and P use the calendar year as the taxable year. On August 1, 2002, D transfers three-fourths of D's profits interest in P to E. On September 1, 2002, D sells D's remaining .5 percent profits interest in P to F. For purposes of sections 6223(b) and 6231(a)(11), D had a .5 percent profits interest in P for 2002.

*Example 6*. Assume the same facts as in *Example 5*, except that on January 1, 2002, D also held a 1 percent profits interest in partnership P through T, a pass-thru partner which also uses the calendar year as the taxable year. In addition to the sale to E on August 1, 2002, D sold a portion of D's interest in T on December 1, 2002, such that after the sale, D held a .2 percent profits interest in P through T. D made no other transfers of interests in either P or T. For purposes of sections 6223(b) and 6231(a)(11), D had a .7 percent profits interest in P for 2002.

(f) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(d)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(d)–1T [Removed]**

Par. 49a. Section 301.6231(d)–1T is removed.

Par. 50. Section 301.6231(e)–1 is added to read as follows:

*§ 301.6231(e)–1 Effect of a determination with respect to a nonpartnership item on the determination of a partnership item.*

(a) *In general*. The determination of an item after it has become a nonpartnership item with respect to a partner is not controlling in the determination of that item with respect to other partners. Thus, for example, the determination by a court in a separate proceeding relating to a partner that a certain partnership expenditure was deductible does not bind either the Internal Revenue Service or the other partners in a later partnership or other proceeding.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(e)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(e)–1T [Removed]**

Par. 50a. Section 301.6231(e)–1T is removed.

Par. 51. Section 301.6231(e)–2 is added to read as follows:

*§ 301.6231(e)–2 Judicial decision not a bar to certain adjustments.*

(a) *In general*. A court decision with respect to a partner's income tax liability attributable to nonpartnership items shall not be a bar to further proceedings with respect to that partner's income tax liability if that partner's partnership items become nonpartnership items after the appropriate time to include such nonpartnership items in the earlier court proceeding has passed. Thus, the Internal Revenue Service could issue a later deficiency notice for the same taxable year with respect to that partner or that partner could bring a refund suit with respect to those items that have become nonpartnership items.

(b) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(e)–2T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(e)–2T [Removed]**

Par. 51a. Section 301.6231(e)–2T is removed.

Par. 52. Section 301.6231(f)–1 is added to read as follows:

*§ 301.6231(f)–1 Disallowance of losses and credits in certain cases.*

(a) *Application of section*. This section applies if—

(1) A partnership, whether domestic or foreign, that is required to file a return under section 6031 for a taxable year fails to file the return within the time prescribed; and

(2) At any time after the close of that taxable year, either—

(i) The tax matters partner of that partnership resides outside the United States; or

(ii) The books and records of that partnership are maintained outside the United States.

(b) *Computational adjustment permitted if return is not filed after mailing of notice*. Except as otherwise provided in paragraph (c) of this section, if—

(1) This section applies with respect to a partnership for a partnership taxable year;

(2) The Internal Revenue Service mails notice to a partner that the losses and credits arising from that partnership for that year will be disallowed to that partner unless the partnership files a return for that year within 60 days after the date on which the notice is mailed; and

(3) The partnership fails to file a return for that year within that 60-day period, the Internal Revenue Service may, without conducting a partnership-level proceeding, mail a notice of computational adjustment to that partner to reflect the disallowance of any loss (including a capital loss) or credit arising from that partnership for that year.

(c) *Restriction on notices under paragraph (b) of this section*. Neither the notice referred to in paragraph (b)(2) of this section nor the notice of computational adjustment referred to in paragraph (b) of this section may be mailed on a day on which—

(1) The tax matters partner of the partnership resides within the United States; and

(2) The books and records of the partnership are maintained within the United States. Thus, if this section applies with respect to a partnership for a taxable year solely because the tax matters partner of that partnership resided outside the United States for a period after the close of that taxable year and the tax matters partner later takes up residence within the United States, no notice may be mailed under paragraph (b) of this section while the tax matters partner resides within the United States.

(d) *No disallowance in certain circumstances*. If the person to whom the notice referred to in paragraph (b)(2) of this section is mailed establishes to the satisfaction of the Internal Revenue Service—

(1) That the losses and credits arising from the partnership for the year are proper; and

(2) That the partner has made a good faith effort to have the partnership file the required return; the Internal Revenue Service may allow the losses and credits in whole or in part.

(e) *Effective date*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6231(f)–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6231(f)–1T [Removed]**

Par. 52a. Section 301.6231(f)–1T is removed.

Par. 53. Section 301.6233–1 is added to read as follows:

*§ 301.6233–1 Extension to entities filing partnership returns.*

(a) *Entities filing a partnership return*. Except as provided in paragraph (c)(1) of this section, the provisions of subchapter C of chapter 63 of the Internal Revenue Code (subchapter C) and the regulations thereunder shall apply with respect to any taxable year of an entity for which such entity files a partnership return as well as to such entity's items for that taxable year and to any person holding an interest in such entity at any time during that taxable year. Any final partnership administrative adjustment or judicial determination resulting from a proceeding under subchapter C with respect to such taxable year may include a determination that the entity is not a partnership for such taxable year as well as determinations with respect to all items of the entity that would be partnership items, as defined in section 6231(a)(3) and the regulations thereunder, if such entity had been a partnership in such taxable year (including, for example, any amounts taxable to an entity determined to be an association taxable as a corporation). For example, a final determination under subchapter C that an entity that filed a partnership return is an association taxable as a corporation will serve as a basis for a computational adjustment reflecting the disallowance of any loss or credit claimed by a purported partner with respect to that entity.

(b) *Partnership return filed but no entity found to exist*— Paragraph (a) of this section shall apply where a partnership return is filed for a taxable year but it is determined that there is no entity for such taxable year. For purposes of applying paragraph (a) of this section, the partnership return shall be treated as if it were filed by an entity. However, any final partnership administrative adjustment or judicial determination resulting from a proceeding under subchapter C with respect to such taxable year may also include a determination that there is no entity for such taxable year.

(c) *Exceptions*. Paragraph (a) of this section shall not apply to—

(1) Entities for any taxable year in which such entity would be excepted from the provisions of subchapter C of the Internal Revenue Code under section 6231(a)(1)(B) and the regulations thereunder (relating to the exception for small partnerships) if such entity were a partnership for such taxable year; and

(2) Entities for any taxable year for which a partnership return was filed for the sole purpose of making the election described in section 761(a).

(d) *Effective dates*. This section is applicable to partnership taxable years beginning on or after October 4, 2001. For years beginning prior to October 4, 2001, see § 301.6233–1T contained in 26 CFR part 1, revised April 1, 2001.

**§ 301.6233–1T [Removed]**

Par. 53a. Section 301.6233–1T is removed.

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 54. The authority for Part 602 continues to read as follows:

Authority: 26 U.S.C.7805.

Par. 55. Section 602.101, paragraph (b) is amended by removing the entries for "301.6222(a)–2T", "301.6222(b)–1T", "301.6222(b)–2T", "301.6222(b)–3T", "301.6227(b)–1T", and adding the following entries to the table in numerical order:

*§ 602.101 OMB Control numbers.*

* * * * *

(b) * * *

| CFR part or section where identified and described | Current OMB control No. |
|---|---|
| * * * * * | |
| 301.6222(a)–2 | 1545–0790 |
| 301.6222(b)–1 | 1545–0790 |
| 301.6222(b)–2 | 1545–0790 |
| 301.6222(b)–3 | 1545–0790 |
| 301.6223(b)–1 | 1545–0790 |
| 301.6223(c)–1 | 1545–0790 |
| 301.6223(e)–2 | 1545–0790 |
| 301.6223(g)–1 | 1545–0790 |
| 301.6223(h)–1 | 1545–0790 |
| 301.6224(b)–1 | 1545–0790 |
| 301.6224(c)–1 | 1545–0790 |
| 301.6224(c)–3 | 1545–0790 |
| 301.6227(c)–1 | 1545–0790 |
| 301.6227(d)–1 | 1545–0790 |
| 301.6229(b)–2 | 1545–0790 |
| 301.6230(b)–1 | 1545–0790 |
| 301.6230(e)–1 | 1545–0790 |
| 301.6231(a)(1)–1 | 1545–0790 |
| * * * * * | |
| 301.6231(c)–1 | 1545–0790 |
| 301.6231(c)–2 | 1545–0790 |
| * * * * * | |

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue Service.*

Approved September 20, 2001.

Mark Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on October 3, 2001, 8:45 a.m., and published in the issue of the Federal Register for October 4, 2001, 66 F.R. 50541)

# Part III. Administrative, Procedural, and Miscellaneous

## Weighted Average Interest Rate Update

## Notice 2001–65

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for September 2001 is 5.48 percent.

The following rates were determined for the plan years beginning in the month shown below.

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---|---|---|---|---|
| October | 2001 | 5.76 | 5.18 to 6.05 | 5.18 to 6.34 |

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283-9702 (not a toll-free number).

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*26 CFR 601.201: Rulings and determination letters.*

## Rev. Proc. 2001–51

SECTION 1. PURPOSE AND NATURE OF CHANGE

.01 The purpose of this revenue procedure is to modify Rev. Proc. 2001–3 (2001–1 I.R.B. 111) by removing section 5.06 from the No-Rule list. Section 5.06 concerns the application of § 1374 of the Internal Revenue Code to timber, coal and domestic iron ore transactions.

SECTION 2. BACKGROUND

.01 Rev. Proc. 2001–3 sets forth those provisions of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel (Corporate), the Associate Chief Counsel (Financial Institutions & Products), the Associate Chief Counsel (Income Tax & Accounting), the Associate Chief Counsel (Passthroughs & Special Industries), the Associate Chief Counsel (Procedure and Administration), and the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) relating to issues on which the Internal Revenue Service will not issue letter rulings or determination letters.

.02 Section 5 of Rev. Proc. 2001–3 sets forth those areas under extensive study in which letter rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, or otherwise.

Section 5.06 of Rev. Proc. 2001–3 provides as follows:

Section 1374.—Tax Imposed on Certain Built-in Gains — The tax consequences under § 1374 in the following situations: (1) an S corporation holds timber property on the date it converts from a C corporation to an S corporation (or acquires timber property from a C corporation in a transaction to which § 1374(d)(8) applies) and during the recognition period (a) cuts the timber and sells resulting wood products (including any unfinished or finished products derived, manufactured, or produced from such wood products) in a transaction to which § 631 does not apply, (b) recognizes gain or loss on cutting the timber pursuant to a § 631(a) election, or (c) recognizes gain or loss on the disposal of timber under a contract to which § 631(b) applies, and (2) an S corporation holds coal or domestic iron ore property on the date it converts from a C corporation to an S corporation (or acquires coal or domestic iron ore property from a C corporation in a transaction to which § 1374(d)(8) applies) and during the recognition period recognizes gain or loss on the disposal of the coal or iron ore under a contract to which § 631(c) applies.

SECTION 3. PROCEDURE

Rev. Proc. 2001–3 is modified by deleting section 5.06.

SECTION 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2001–3 is modified.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective October 9, 2001, the date of its release to the public.

**DRAFTING INFORMATION**

The principal author of this revenue procedure is Cristian P. Silva of the Office of Associate Chief Counsel (Corporate). For further information about this revenue procedure, please contact Mr. Silva at (202) 622-7750 (not a toll-free call).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking and Notice of Public Hearing

## Constructive Transfers and Transfers of Property to a Third Party on Behalf of a Spouse

## REG–107151–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 1041 of the Internal Revenue Code relating to the tax treatment of certain redemptions, during marriage or incident to divorce, of stock owned by a spouse or former spouse. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written comments must be received by November 1, 2001. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for Friday, December 14, 2001, must be received by November 23, 2001.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–107151–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (REG–107151–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html*. The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Edward C. Schwartz (202) 622-4960; concerning submissions and the hearing, Guy Traynor (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224. Comments on the collection of information should be received by October 2, 2001. Comments are specifically requested concerning:

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

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

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

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

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

The collection of information in this proposed regulation is in § 1.1041–2(c) of these regulations. Section 1.1041–2(c) permits spouses or former spouses to treat a redemption of stock of one spouse (the first spouse) as a transfer of that stock to the other spouse (the second spouse) in exchange for the redemption proceeds and a redemption of the stock from the second spouse in exchange for the redemption proceeds if they reflect their intent to do so in a written agreement or if a divorce or separation agreement requires such treatment. This information must be retained and is required for the spouses or former spouses to report properly the tax consequences of the redemption. The likely respondents are individuals.

Estimated total annual reporting and/or recordkeeping burden: 500 hours.

Estimated average annual burden hours per respondent and/or recordkeeper: 30 minutes.

Estimated number of respondents and/or recordkeepers: 1,000

Estimated annual frequency of responses: On occasion

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

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

### Background

Section 1041 was added to the Internal Revenue Code by section 421 of the Tax Reform Act of 1984 (1984 Act), Public Law 98–369. Section 1041(a) provides that no gain or loss will be recognized on a transfer of property from an individual to (or in trust for the benefit of) a spouse or former spouse if the transfer is incident to a divorce. Under section 1041(b), for purposes of subtitle A, the transferee is treated as having acquired the property by gift from the transferor with a carryover basis from the transferor.

The House Report accompanying the 1984 Act states:

> The current rules governing transfers of property between spouses or former spouses incident to divorce have not worked well and have led to much controversy and litigation. Often the rules have proved a trap for the unwary . . . .
>
> Furthermore, in divorce cases, the government often gets whipsawed. The transferor will not report any gain

> on the transfer, while the recipient spouse, when he or she sells, is entitled under [*United States v. Davis*, 370 U.S. 65 (1962)] to compute his or her gain or loss by reference to a basis equal to the fair market value of the property at the time received.
>
> The committee believes that to correct these problems and make the tax laws as unintrusive as possible with respect to relations between spouses, the tax laws governing transfers between spouses and between former spouses should be changed. . . .
>
> The bill provides that the transfer of property to a spouse incident to a divorce will be treated, for income tax purposes, in the same manner as a gift. Gain (including recapture income) or loss will not be recognized to the transferor, and the transferee will receive the property at the transferor's basis . . . . Thus, uniform Federal income tax consequences will apply to these transfers notwithstanding that the property may be subject to differing state property laws.

H. R. Rep. No. 432, 98th Cong., 2d Sess., Part 2, at 1491–92 (1984) (House Report).

By enacting the carryover basis rules in section 1041(b), Congress has, in essence, provided spouses with a mechanism for determining between themselves which one will pay tax upon the disposition of property outside the marital unit. For example, assume Spouse A owns appreciated property that he or she wishes to sell to a third party. The spouses may agree that Spouse A will sell the property to the third party and recognize the gain. Any subsequent transfer from Spouse A to Spouse B of the sales proceeds will be nontaxable under section 1041. In the alternative, the spouses may agree that Spouse A will first transfer the property to Spouse B. This transfer is nontaxable under section 1041, with Spouse B taking a carryover basis in the transferred property. Spouse B will then recognize the gain or loss on the sale of the property to the third party because a sale to a third party is not covered by section 1041. In this latter scenario, the tax consequences of the sale are shifted to Spouse B.

Under § 1.1041–1T(c), Q&A-9, of the Temporary Income Tax Regulations (Q&A-9), section 1041 will apply to a transfer of property by the transferor spouse to a third party that is on behalf of the other spouse or former spouse (nontransferor spouse) if: (i) the transfer to the third party is required by the divorce or separation instrument; (ii) the transfer to the third party is pursuant to the written request of the nontransferor spouse; or (iii) the transferor spouse receives from the nontransferor spouse a written consent or ratification of the transfer to the third party. If Q&A-9 applies, a direct transfer of property to a third party is treated first as a transfer to the nontransferor spouse in a transaction governed by section 1041 and then as an immediate transfer by the nontransferor spouse to the third party in a transaction not governed by section 1041.

Q&A-9 has provided spouses and former spouses with the ability to shift between themselves the tax consequences of a sale of property outside the marital unit. However, the questions of what standard should be applied for purposes of determining whether a transfer of property is, or is not, "on behalf of" the nontransferor spouse for purposes of section 1041, and whether the same standard should be applied for purposes of determining the tax treatment of the transferor spouse and the nontransferor spouse under provisions of the Internal Revenue Code other than section 1041, have become the source of much confusion and litigation in the context of certain stock redemptions. For instance, the United States Court of Appeals for the Ninth Circuit in *Arnes v. United States*, 981 F.2d 456 (9th Cir. 1992) (regarding the tax treatment of the transferor spouse), and the Tax Court in *Arnes v. Commissioner*, 102 T.C. 522 (1994) (regarding the tax treatment of the nontransferor spouse), applied different standards to determine the tax treatment of the transferor spouse and the nontransferor spouse, respectively, in the context of a redemption of stock owned by the transferor spouse. Consequently, neither spouse was taxed on the redemption proceeds, a result that Congress clearly sought to avoid in enacting section 1041. See House Report at 1491.

In the *Arnes* cases, a husband and wife owned all the stock of a corporation. The divorce instrument required the wife to tender her stock to the corporation for redemption. The Ninth Circuit held that the redemption was on behalf of the husband and, therefore, was not taxable to the wife, because it found that the husband had an obligation under the property settlement to purchase the wife's stock and the husband was benefitted by the redemption. The Ninth Circuit did not address the tax treatment of the husband, although it implied that the husband might be taxable on the redemption.

The Tax Court in *Arnes* addressed whether the husband was taxable on the redemption. The Tax Court stated that the question was whether the husband had a constructive dividend; that is, whether he had a "primary and unconditional obligation" to purchase the stock. The court concluded that the husband did not have a primary and unconditional obligation to purchase the wife's stock and, therefore, the redemption of the wife's stock did not result in a constructive dividend to the husband. This conclusion, the court stated, was supported by the IRS's position in Rev. Rul. 69–608 (1969–2 C.B. 43). Rev. Rul. 69–608 holds that a corporation's redemption of its stock from a shareholder (the first shareholder) results in a constructive distribution to another shareholder (the second shareholder) if the redemption is in satisfaction of the second shareholder's primary and unconditional obligation to purchase the first shareholder's stock. The majority opinion of the Tax Court in *Arnes* expressly declined to opine as to whether the "on behalf of" standard of Q&A-9 is the same as the "primary and unconditional obligation" standard applicable to constructive distributions.

The uncertainty has persisted in subsequent cases. In *Read v. Commissioner*, 114 T.C. 14 (2000), the Tax Court rejected equating the "primary and unconditional obligation" standard with the "on behalf of" standard in Q&A-9 for purposes of determining the tax consequences of a stock redemption to the transferor spouse. The Tax Court concluded that the appropriate standard for determining whether a transfer of property to a third party by a transferor spouse was on behalf of the nontransferor spouse under Q&A-9 was whether the transferor spouse was acting "as the representative of" or "in the interest of" the nontransferor spouse or whether the transfer satisfied a liability or an obligation of the nontransferor spouse.

See also *Blatt v. Commissioner*, 102 T.C. 77 (1994).

Because of these inconsistent standards, the regulations must be amended to provide greater certainty in determining which spouse will be taxed on certain stock redemptions occurring during marriage or incident to divorce.

**Explanation of Provisions**

The proposed regulations apply where, under current law, the "primary and unconditional obligation" standard applicable to constructive distributions governs the tax consequences to one spouse or former spouse of a redemption of stock owned by the other spouse or former spouse. Accordingly, the proposed regulations provide that they apply only where the nontransferor spouse owns stock of the redeeming corporation either immediately before or immediately after the stock redemption.

The proposed regulations provide that, if a corporation redeems stock owned by a transferor spouse, and the transferor spouse's receipt of property in respect of such stock is treated, under applicable tax law, as resulting in a constructive distribution to the nontransferor spouse, then the stock redeemed is deemed first to be transferred by the transferor spouse to the nontransferor spouse and then to be transferred by the nontransferor spouse to the redeeming corporation. Section 1041 applies to the deemed transfer of the stock by the transferor spouse to the nontransferor spouse, provided the requirements of section 1041 are otherwise satisfied with respect to such deemed transfer. Section 1041 does not apply to the deemed transfer of stock from the nontransferor spouse to the redeeming corporation. Any property actually received by the transferor spouse from the redeeming corporation in respect of the redeemed stock is deemed first to be transferred by the redeeming corporation to the nontransferor spouse in exchange for the stock in a transaction to which section 1041 does not apply, and then to be transferred by the nontransferor spouse to the transferor spouse in a transaction to which section 1041 applies, provided the requirements of section 1041 are otherwise satisfied with respect to such deemed transfer. The tax consequences of the deemed transfer of stock from the nontransferor spouse to the redeeming corporation in exchange for the redemption proceeds from the redeeming corporation are determined under applicable provisions of the Internal Revenue Code (other than section 1041) as if such transfers had actually occurred.

Where applicable law does not treat a transferor spouse's receipt of property in respect of stock redeemed as resulting in a constructive distribution to the nontransferor spouse, the form of the stock redemption is respected. In other words, the transferor spouse and the redeeming corporation are respected as parties to the redemption transaction, and thus the transferor spouse, not the nontransferor spouse, is treated as a party to the redemption.

The approach of the proposed regulations recognizes that applicable tax law currently imposes the primary and unconditional obligation standard, which has its origins in well-established case law including *Wall v. United States*, 164 F.2d 462 (4th Cir. 1947), and *Sullivan v. United States*, 363 F.2d 724 (8th Cir. 1966), for determining whether a shareholder has received a constructive distribution. The proposed regulations are designed to remove inconsistencies caused by the simultaneous potential application of the on behalf of standard of Q&A-9 for one spouse and the primary and unconditional obligation standard of the case law for the other spouse. Thus, for example, if the rules of the proposed regulations had applied in the *Arnes* case, because the husband did not have a primary and unconditional obligation to purchase the wife's stock, the redemption would have been taxed in accordance with its form with the result that the wife would have incurred the tax consequences of the redemption.

The proposed regulations provide a special rule that permits spouses and former spouses to treat a redemption of the transferor spouse's stock as a deemed transfer of the redeemed stock by the transferor spouse to the nontransferor spouse and then a deemed transfer of the redeemed stock by the nontransferor spouse to the redeeming corporation, and to treat any property actually received by the transferor spouse from the redeeming corporation in respect of the redeemed stock as first transferred by the redeeming corporation to the nontransferor spouse in exchange for the stock and then to be transferred by the nontransferor spouse to the transferor spouse. The special rule will apply if a divorce or separation instrument, or a written agreement between the transferor spouse and the nontransferor spouse, requires the transferor spouse and the nontransferor spouse to file their Federal income tax returns in a manner that reflects that the transferor spouse transferred the redeemed stock to the nontransferor spouse in exchange for the redemption proceeds and the corporation redeemed the stock from the nontransferor spouse in exchange for the redemption proceeds. Such divorce or separation instrument must be effective, or the written agreement must be executed by both spouses or former spouses, prior to the date on which the nontransferor spouse files such spouse's first timely filed Federal income tax return for the year that includes the date of the redemption, but no later than the date such return is due (including extensions). The special rule is provided to give spouses and former spouses a means of ensuring the application of those Federal income tax consequences that would have resulted had applicable tax law treated the transferor spouse's stock redemption as resulting in a constructive distribution to the nontransferor spouse.

**Proposed Effective Date**

The proposed regulations are applicable to redemptions of stock on or after the date the regulations in this section are published as final regulations, except for redemptions of stock that are pursuant to instruments in effect before the date the regulations in this section are published as final regulations. For redemptions of stock before the date the regulations in this section are published as final regulations and redemptions of stock that are pursuant to instruments in effect before the date the regulations in this section are published as final regulations, see § 1.1041–1T(c), A-9. However, these regulations will be applicable to redemptions described in the preceding sentence if the spouses or former spouses execute a written agreement on or after August 3, 2001, that satisfies the requirements of paragraph (c) of these regulations with respect to such redemption.

### Special Analysis

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

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS is also interested in receiving comments regarding the proper treatment of transfers of property to third parties by a spouse or former spouse other than transfers under these proposed regulations that solely govern certain redemptions of stock owned by a spouse or former spouse. Further, comments are specifically requested concerning the effective date provisions in the proposed regulations. All comments will be available for public inspection and copying.

A public hearing has been scheduled for December 14, 2001, at 10:00 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit timely written or electronic comments and must submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by November 23, 2001.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

The principal author of these regulations is Edward C. Schwartz of the Office of the Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. In § 1.1041–1T, paragraph (c) is amended by adding a sentence at the end of A-9 to read as follows:

*§ 1.1041–1T Treatment of transfers of property between spouses or incident to divorce (temporary).*

* * * * *

(c) * * *

A-9: * * * This A-9 shall not apply to transfers to which § 1.1041–2 applies.

* * * * *

Par. 3. Section 1.1041–2 is added to read as follows:

*§ 1.1041–2 Certain redemptions of stock.*

(a) *In general* — (1) *Redemptions of stock resulting in constructive distributions*. Notwithstanding Q&A-9 of § 1.1041–1T(c), if a corporation redeems stock owned by a spouse or former spouse (transferor spouse), and the transferor spouse's receipt of property in respect of such redeemed stock is treated, under applicable tax law, as resulting in a constructive distribution to the other spouse or former spouse (nontransferor spouse), then the stock redeemed shall be deemed first to be transferred by the transferor spouse to the nontransferor spouse and then to be transferred by the nontransferor spouse to the redeeming corporation. Any property actually received by the transferor spouse from the redeeming corporation in respect of the redeemed stock shall be deemed first to be transferred by the redeeming corporation to the nontransferor spouse in exchange for the redeemed stock and then to be transferred by the nontransferor spouse to the transferor spouse.

(2) *Redemptions of stock not resulting in constructive distributions*. Notwithstanding Q&A-9 of § 1.1041–1T(c), if a corporation redeems stock owned by the transferor spouse, and the transferor spouse's receipt of property in respect of such redeemed stock is not treated, under applicable tax law, as resulting in a constructive distribution to the nontransferor spouse, then the form of the stock redemption shall be respected for Federal income tax purposes. Therefore, the transferor spouse and the redeeming corporation will be respected as engaging in a redemption transaction to which the nontransferor spouse is not a party.

(b) *Tax consequences* — (1) *Transfers described in paragraph (a)(1)*. The tax consequences of each deemed transfer described in paragraph (a)(1) of this section are determined under applicable provisions of the Internal Revenue Code as if the parties had actually made such transfers. Accordingly, section 1041 applies to any deemed transfer of the stock and redemption proceeds between the transferor spouse and the nontransferor spouse, provided the requirements of section 1041 are otherwise satisfied with respect to such deemed transfer. Section 1041, however, will not apply to any deemed transfer of stock by the nontransferor spouse to the redeeming corporation in exchange for the redemption proceeds. See section 302 for rules relating to the tax consequences of certain corporate redemptions.

(2) *Transfers described in paragraph (a)(2)*. Section 1041 will not apply to any

of the transfers described in paragraph (a)(2) of this section. See section 302 for rules relating to the tax consequences of certain stock redemptions.

(c) *Special rule*. Notwithstanding applicable tax law, a transferor spouse's receipt of property in respect of redeemed stock will be treated as resulting in a constructive distribution to the nontransferor spouse for purposes of paragraph (a)(1) of this section if a divorce or separation instrument, or a written agreement between the transferor spouse and the nontransferor spouse, requires the transferor spouse and the nontransferor spouse to file their Federal income tax returns in a manner that reflects that the transferor spouse transferred the redeemed stock to the nontransferor spouse in exchange for the redemption proceeds and the corporation redeemed the stock from the nontransferor spouse in exchange for the redemption proceeds. Such divorce or separation instrument must be effective, or written agreement must be executed by both spouses or former spouses, prior to the date on which the nontransferor spouse files such spouse's first timely filed Federal income tax return for the year that includes the date of the stock redemption, but no later than the date such return is due (including extensions).

(d) *Limited scope*. Paragraphs (a) and (c) of this section shall apply only to stock redemptions where, either immediately before or immediately after the stock redemption, the nontransferor spouse owns directly stock of the redeeming corporation.

(e) *Examples*. The provisions of this section may be illustrated by the following examples:

*Example 1*. Corporation X has 100 shares outstanding. A and B each own 50 shares. A and B divorce. The divorce instrument requires B to purchase A's shares, and A to sell A's shares to B, in exchange for $100x. Corporation X redeems A's shares for $100x. Assume that, under applicable tax law, the stock redemption results in a constructive distribution to B. Paragraph (a)(1) of this section applies to the transfers of stock and redemption proceeds in connection with the redemption transaction. Accordingly, A will be treated as transferring A's stock of Corporation X to B in a transfer to which section 1041 applies (assuming the requirements of section 1041 are otherwise satisfied). B will be treated as transferring the Corporation X stock B is deemed to have received from A to Corporation X in exchange for $100x in an exchange to which section 1041 does not apply and sections 302(d) and 301 apply, and B will be treated as transferring the $100x to A in a transfer to which section 1041 applies.

*Example 2*. Assume the same facts as *Example 1*, except that the divorce instrument requires A to sell A's shares to Corporation X in exchange for a note. B guarantees Corporation X's payment of the note. Assume that, under applicable tax law, B does not have a primary and unconditional obligation to purchase A's stock. Also assume that the special rule of paragraph (c) of this section does not apply to the transfer of stock and redemption proceeds in connection with the redemption transaction. Under applicable tax law, the stock redemption does not result in a constructive distribution to B, because B does not have a primary and unconditional obligation to purchase A's stock. Paragraph (a)(1) of this section does not apply to the transfers of stock and redemption proceeds in connection with the redemption transaction. Accordingly, under paragraphs (a)(2) and (b)(2) of this section, the tax consequences of the redemption will be determined in accordance with its form as a redemption of A's shares by Corporation X. See section 302.

*Example 3*. Assume the same facts as *Example 2*, except that the divorce instrument provides as follows: "A and B agree that A's Federal income tax return for the year that includes the date of the redemption will reflect that A transferred A's shares of Corporation X to B in exchange for the redemption proceeds of $100x and B's Federal income tax return for such year will reflect that Corporation X redeemed such shares from B in exchange for such proceeds." By virtue of the special rule of paragraph (c) of this section, the redemption is treated as resulting in a constructive distribution to B. Accordingly, A will be treated as transferring A's stock of Corporation X to B in a transfer to which section 1041 applies (assuming the requirements of section 1041 are otherwise satisfied). B will be treated as transferring the Corporation X stock B is deemed to have received from A to Corporation X in exchange for $100x in an exchange to which section 1041 does not apply and sections 302(d) and 301 apply, and B will be treated as transferring the $100x to A in a transfer to which section 1041 applies.

(f) *Effective date*. Except as otherwise provided in this paragraph, this section is applicable to redemptions of stock on or after the date these regulations are published as final regulations in the **Federal Register**, except for redemptions of stock that are pursuant to instruments in effect before the date these regulations are published as final regulations in the **Federal Register**. For redemptions of stock before the date these regulations are published as final regulations in the **Federal Register** and redemptions of stock that are pursuant to instruments in effect before the date these regulations are published as final regulations in the **Federal Register**, see § 1.1041–1T(c), A-9. However, these regulations will be applicable to redemptions described in the preceding sentence of this paragraph (f) if the spouses or former spouses execute a written agreement on or after August 3, 2001, that satisfies the requirements of paragraph (c) of this section with respect to such redemption.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on August 2, 2001, 8:45 a.m., and published in the issue of the Federal Register for August 3, 2001, 66 F.R. 40659)

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## Disaster Relief for Issuers of Tax-Exempt Bonds Affected by the September 11, 2001, Terrorist Attack

## Announcement 2001–101

PURPOSE

The purpose of this announcement is to inform issuers of tax-exempt bonds that, effective immediately, the Internal Revenue Service will put into effect procedures to provide relief to issuers affected by the September 11, 2001, Terrorist Attack.

BACKGROUND

In connection with the September 11, 2001, Terrorist Attack, the President issued federal disaster declarations with respect to certain counties and may issue additional declarations with respect to other counties (such counties are collectively referred to herein as, the "covered counties").

As a consequence of the September 11, 2001, Terrorist Attack, an affected issuer (as defined below), may not be able to comply with certain requirements of section 103 and related provisions of the Internal Revenue Code, including, but not limited to, the requirements set forth in sections 148(f) and 149(e) of the Code, with respect to certain of its bond issues.

PROCEDURES FOR REQUESTING RELIEF

(a) An affected issuer is an issuer that meets one or more of the following:

(i) It is located in one of the covered counties;

(ii) It is not located in any of the covered counties, but its records necessary to meet a filing or paying deadline for the issue are maintained in one of the covered counties;

(iii) The facilities financed with the proceeds of the issue are located in one of the covered counties;

(iv) The conduit borrower for the issue is located in one of the covered counties;

(v) The counsel to the issuer or the conduit borrower, or bond counsel for the issue, is located in one of the covered counties;

(vi) The professional on whom the issuer relies for compliance with the relevant provision of the Code is located in one of the covered counties. For example, the issuer may need to rely on one or more of the following persons in order to comply with the rebate requirement of section 148(f): the bond trustee, a financial advisor or a rebate consultant.

(b) With respect to the requirements under sections 149(e) and 148(f), an affected issuer has an additional 6 months plus 120 days to file Form 8038, Form 8038-G, Form 8038-GC, or Form 8038-T for an issue for which such form is otherwise required to be filed in accordance with an original due date that occurs on or after September 11, 2001, and on or before November 30, 2001. In the case of a Form 8038-T, the Service will not impose a penalty, including any interest portion thereof, under section 148 of the Code, on rebate payments, yield reduction payments and penalties in lieu of rebate that are originally due on or after September 11, 2001, and on or before November 30, 2001, provided such payments are made within 6 months and 120 days of the original due date of the payment. For computation purposes, such payments will be treated as paid on the last day of the computation or spending period to which they relate.

(c) When filing a form described in subsection (b) above, the affected issuer should add the following designation in red ink at the top of the form, "September 11, 2001 – Terrorist Attack, See Announcement 2001–101."

(d) In addition to the relief granted in subsection (b) above, other relief may also be granted under appropriate circumstances for affected issuers (for example, affected issuers unable to redeem their current refunded issue within 90 days of issuance of the current refunding issue). An affected issuer may request relief by contacting the Tax Exempt Bonds, Outreach, Planning and Review ("TEB OPR") function of Tax Exempt/Government Entities at (202) 283-9798, contact person: Cliff Gannett.

DRAFTING INFORMATION

The principal author of this announcement is Sunita Lough of Tax Exempt Bonds Outreach, Planning and Review of the Office of the Director, Tax Exempt Bonds, Tax Exempt/Government Entities. For further information regarding this announcement or comments as to how additional relief may be provided to affected issuers, contact Sunita Lough at (202) 283-9774 (not a toll-free call).

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## Filing of Certain Forms 5500

## Announcement 2001–103

The Internal Revenue Service (IRS), the Department of Labor's Pension and Welfare Benefits Administration (PWBA), and the Pension Benefit Guaranty Corporation (PBGC) provide relief from certain penalties relating to Forms 5500 for defined benefit and money purchase pension plans that are required to be filed on or before October 15, 2001. This announcement also includes PBGC's statement of relief from penalties relating to premiums, reporting and disclosure, and certifications.

**Background**

Section 412(a) of the Internal Revenue Code (Code) and § 302(a) of the Employee Retirement Income Security Act of 1974 (ERISA) provide that a plan meets the minimum funding standards of the Code and ERISA for a plan year if the plan does not have an accumulated funding deficiency as of the end of the plan year. Section 412(c)(10) of the Code and § 302(c)(10) of ERISA provide that, for purposes of satisfying the minimum funding requirements of the Code and ERISA, any contributions for a plan year made by an employer by the end of the 8 1/2 month period following the end of such plan year are deemed to have been made on the last day of the plan year.

Section 6058 of the Code and § 104 of ERISA require plan administrators to file an annual return/report of employee benefit plan within a specified period of time after the end of the plan year. The annual return/report of employee benefit plan is Form 5500 and Form 5500–EZ (hereinafter Form 5500). For defined benefit pension plans subject to the minimum funding standard, § 6059 of the Code requires that a periodic report of the actuary be filed with the annual return. Under § 301.6059–1 of the Procedure and Administration Regulations, the periodic report is the Schedule B, which must be signed by an enrolled actuary. In order to properly complete the Schedule B, the enrolled actuary must know whether a contribution for a plan year was made within the period specified by § 412(c)(10) of the Code and § 302(c)(10) of ERISA.

Under section 502(c)(2) of ERISA, a penalty of up to $1,100 a day may be assessed for each day a plan administrator fails or refuses to file a complete and accurate annual report and accompanying schedules. Similarly, § 6652(e) of the Code imposes a penalty of $25 a day (up to $15,000) for not filing returns for certain deferred compensation plans. Section 6692 of the Code imposes a penalty of $1,000 for not filing an actuarial report described in § 6059. Under § 301.6692–1(a) of the regulations, a failure to provide a material item of information is considered as a failure to file an actuarial report.

Because of the disruption of the financial markets caused by the events of September 11, 2001, many employers have stated they were not able to make required contributions to their pension plans on or before September 15, 2001, to satisfy the minimum funding standards.

Grant of Relief

The IRS, the PWBA, and the PBGC provide the following relief. In the case of a defined benefit or money purchase pension plan with a plan year ending on or after December 27, 2000, and on or before January 8, 2001, for which a Form 5500 is required to be filed on or before October 15, 2001, plan administrators and plan sponsors will not be treated as failing to file a complete and accurate return/report under § 6058 of the Code or § 104 of ERISA, nor will enrolled actuaries be treated as failing to file an actuarial report that satisfies the requirements of § 6059(b) of the Code, solely because contributions made on or before September 24, 2001, are included on line 3 of Schedule B of Form 5500 (showing the actual date of payment of the contribution) and line 6(b) of Schedule R of Form 5500.

In addition, the PBGC provides the following relief with respect to any plan with a plan year ending on or after December 27, 2000, and on or before January 8, 2001. The PBGC will not assess any penalties for a failure to pay PBGC premiums in a timely manner or a failure to meet a PBGC reporting or disclosure requirement, nor will it treat a certification as failing to be a valid and correct certification, solely because contributions made on or before September 24, 2001, are included in the plan's assets for purposes of PBGC premiums or are counted for purposes of determining whether any PBGC reporting or disclosure requirement applies.

Drafting Information

The principal author of this announcement is James E. Holland, Jr. of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this announcement, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500, between the hours of 8:00 a.m. and 9:30 p.m. Eastern Time, Monday through Friday (toll-free number). Mr. Holland may be reached at (202) 283-9699 (not a toll-free number).

## Issuance of GUST Opinion Letters for Master and Prototype Plans

## Announcement 2001–104

The Service has begun to issue opinion letters to sponsors of master and prototype (M&P) plans who applied for GUST[1] opinion letters by December 31, 2000. Recently, the Service completed revisions to pertinent sections of the Listing of Required Modifications and Information Package (LRM) for both defined contribution and defined benefit plans. The revisions to the LRMs are posted to the Employee Plans Internet address at *www.irs.gov/ep*.

Generally, an employer who, by the end of the 2001 plan year (December 31, 2001, for calendar-year plans), either adopts or certifies its intent to adopt a timely submitted M&P plan or volume submitter specimen plan will have until the later of December 31, 2002, or 12 months after the date of the last opinion or advisory letter issued to the M&P plan sponsor or volume submitter practitioner to adopt the GUST-approved plan. An M&P plan or volume submitter specimen plan is timely submitted if an application for a GUST opinion or advisory letter for the plan was filed by December 31, 2000. An employer who does not so adopt or certify its intent to adopt a timely submitted M&P plan or volume submitter specimen plan must amend its plan for GUST by the end of the 2001 plan year.

As provided in Announcement 2001–77 (2001–30 I.R.B. 83), the Service will soon publish on the IRS Web-page a list of the M&P plans and volume submitter specimen plans that were timely submitted for GUST opinion and advisory letters. This list will be updated periodically to indicate the dates on which letters were issued or the applications were withdrawn. The Service expects to complete the issuance of GUST opinion and advisory letters in the first quarter of calendar year 2002.

More information about GUST deadlines and filing procedures can be found in the following IRS procedures: Rev. Proc. 2000–20 (2000–6 I.R.B. 553), Rev. Proc. 2000–27 (2000–26 I.R.B. 1272), Rev. Proc. 2001–6 (2001–1 I.R.B. 194), and Notice 2001–42 (2001–30 I.R.B. 70).

[1] The term "GUST" refers to:
- The Uruguay Round Agreements Act, Pub. L. 103-465;
- The Uniformed Service Employment and Reemployment Rights Act of 1994, Pub. L. 103-353;
- The Small Business Job Protection Act of 1996, Pub. L.104-188;
- The Taxpayer Relief Act of 1997, Pub. L.105-34;
- The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L.105-206; and
- The Community Renewal Tax Relief Act of 2000, Pub. L.106-554 ("CRA").

## Foundations Status of Certain Organizations

## Announcement 2001–105

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

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

4T Ministry, Inc., San Jose, CA
75 Lyerly Residents Council, Incorporated, Houston, TX
Abundant Rain, Inc., Amarillo, TX
African Business Group ABG, Dallas, TX
A.H.S. Enterprises, Inc., Houston, TX
Akido of Santa Barbara, Santa Barbara, CA
All Star Kids Day Care, Houston, TX
Alumni Association of Brooks Institute, Santa Barbara, CA
American Indian Cultural & Business Council-AICBC, Dallas, TX
Ancient Eyes Foundation, Oxnard, CA
Antelope Valley Youth Football Association, Bakersfield, CA
Apostolate for Catholic Truth and Service, Fresno, CA
Applied Geography Conferences, Inc., Denton, TX
Asian-American Association Clothing the Needy, Stockton, CA
Asthma Watch Advocates Reinforcing and Educating Aware, Lancaster, TX
Athens-Henderson County Crimestoppers, Malakoff, TX
Beaumont Federation of Neighborhood Associations, Beaumont, TX
Believers Bible Fellowship, Inc., Missoula, MT
Bellerive Residents Council, Incorporated, Houston, TX

Benbrook Firefighters Association, Inc., Benbrook, TX
Bi Stone Economic Strategy Team, Inc., Teague, TX
Big Horn River Guide Company, Inc., Billings, MT
Big Sky Gymnastic Booster Club, Great Falls, MT
Brain Games USA, Duncanville, TX
Brothers of West Liberty Foundation, Inc., Liberty, TX
Brownwood Area Habitat for Humanity, Inc., Brownwood, TX
Buenaventura Theatre Group, Ventura, CA
California Broadcasters Foundation, Sacramento, CA
California Industrial Safety Council, Inc., Bakersfield, CA
Canyon Community Center, Inc., Hungry Horse, MT
Carmel Literacy Arts Society, Carmel, CA
Carmel Valley Trail & Saddle Club Community Foundation, Inc., Salinas, CA
Carpinteria Creek Foundation, Carpinteria, CA
Cedar Gardens Tenant Association, Fresno, CA
Center for Attitudinal Healing Dallas, Inc., Dallas, TX
Center for Hope, Inc., Tacoma, WA
Center for Internet Mail Education and Research, Santa Cruz, CA
Chances, Inc., Terrell, TX
Charles Tolbert Ministries, Inc., Midland, TX
Chestnut Corporation, Bellaire, TX
Child Support Investigations, Inc., Santa Ana, CA
Childrens Advocacy Network, Mammoth Lakes, CA
Childrens Special Moments, Inc., Conroe, TX
Chinese Physical Culture Plus, Inc., Houston, TX
Coastline Organization of People with Aids-HIV, La Marque, TX
Connie M. Pate Memorial Scholarship Fund, Beaumont, TX
Core Performance Manufactory, Dallas, TX
Corner Boxing Club, Inc., Arlington, TX
Corpus Christi Club Estates Swim Team Parents Club, Corpus Christi, TX
Corvallis Quick Response Unit, Corvallis, MT
Court Appointed Special Advocates of Angelina County, Inc., Lufkin, TX
Cup of Water International Ministries, Inc., Bay City, TX
Dallas Hispanic Criminal Justice Association, Dallas, TX
Dan McPherson Memorial Foundation, Lubbock, TX
DARE Montana, Helena, MT
Deaf Educational Access Foundation, Palo Alto, CA
Down Syndrome Partnership of Tarrant County, Inc., Fort Worth, TX
Dr. Thomas S. Mackey Educational Trust, Galveston, TX
Drum Not Guns, Inc., Dallas, TX
Eagle Fest, Emory, TX
Elks Park Scholarship and Charity Fund, Merced, CA
Emmaus House, Hollister, CA
Encouragement Ministries, Inc., Morgan Hills, CA
Envirohome, Santa Cruz, CA
Equadorables, San Jose, CA
Extended Hope Youth Program, Lancaster, TX
Fillmore FFA Booster Club, Fillmore, CA
Firstplus Employees Foundation, Dallas, TX
Fish Camp Fire Volunteers Auxiliary, Fish Camp, CA
Fort Worth Beat the Heat Racing, Fort Worth, TX
Foundation for the Development of Critical Thought, Inc., Arlington, TX
Foundation for the Missions of Coromoto, Salinas, CA
Four Corners Community Outreach, Inc., Richmond, TX
Friends of the Rink, Inc., Butte, MT
Friends of the Shelter Tobacco Valley Animal Shelter, Inc., Eureka, MT
Geriatric Assessment Plans, Inc., Irving, TX
Glacier Affordable Housing Foundation, Kalispell, MT
Golden State Human Service Continuum, Inc., New Haven, CT
Golden State Track Club, San Jose, CA
Great Race Automotive Hall of Fame, Inc., Granbury, TX
Greater Fairfield Restoration Association, Inc., Fairfield, TX
Hagerman Quick Response Unit, Inc., Hagerman, ID
Hall of Fame of Golf, Inc., The Woodlands, TX
Hazel-Lisa-McMurran Foundation, Lake Arrowhead, CA
Health and Environment International, Los Altos, CA
Health Education Alliance Foundation, Great Falls, MT
Henderson County Arts Council, Athens, TX
Hispanic Festival, Inc., Florissant, MO
Hope Restoration, Inc., Dallas, TX
Houston Council on Sexual Dependency Recovery, Houston, TX
Humble Beginnings Emergency Assistance Center, Humble, TX
Idaho Trauma System Development Coalition, Boise, ID
In Depth Ministries, Inc., Houston, TX
Indian Culture Center-Spring, Spring, TX
Indico Foundation, Fort Worth, TX
Instititute for Comprehensive Understanding, Sunnyvale, CA
Irving Together, Inc., Irving, TX
Jerusalem Ministries, Inc., Houston, TX
Jim Caruthers Ministries, Inc., Justin, TX
J.R. Richard Foundation for the Homeless, Dallas, TX
Jungle Gym Daycare, Inc., Culbertson, MT
Kalispell Dramatic Arts Company, Inc., Kalispell, MT
Kerman Bible Studies, Fresno, CA
Kerman Unified Education Foundation, Kerman, CA
Kern County Royals Baseball Club, Bakersfield, CA
Kern Musicians Association, Bakersfield, CA
Kindness Foundation, Dallas, TX
Kingdom Stewardship Ministries, Inc., Lewisville, TX
Kings Highway Ministries, Incorporated, Fresno, CA
Knights of Care, Dallas, TX
Lancelot Bell Foundation, Los Gatos, CA
Laurell Akers Ministries, Inc., Tomball, TX
Lighthouse Redemption Center, Camarillo, CA
Lisa L. Netsch Foundation, Highland Vill, TX
Livingston Area Cultural Arts and Activities Center, Inc., Livingston, MT
Love Foundation, Houston, TX
McCampbell Institute, Monterey, CA
Midlothian Amateur Baseball Association, Inc., Midlothian, TX
Ministerio Vida Y Luz, Odessa, TX
Miracle Healing Ministry, Stevensville, MT

Montana County Fire Wardens Association, Stanford, MT
Montana Mens Foundation, Bozeman, MT
Montana River Action Network Fund, Inc., Bozeman, MT
Montana Tribal Business Information Network, Incorporated, Billings, MT
Monterey County Appointed Special Advocate Association, Monterey, CA
Monterey Peninsula-Nanao Friendship Association, Marina, CA
Montessori Phoenix Projects, Inc., Gaviota, CA
Nash Country School, Inc., Toluca Lake, CA
National Association of Presidential Assistants in Higher, Washington, DC
National Disaster Search Dog Foundation, Inc., Ojai, CA
Network Ministries Fellowship, Inc., Arlington, TX
New Creation Ministry, Inc., Nacogdoches, TX
New Creations Recovery, Inc., Porterville, CA
North Grassland Wildlife Foundation, Newman, CA
North Richland Hill Citizens Police Academy Alumni Association, N. Richland Hills, TX
North Texas Housing & Management Corp., Plano, TX
North Texas Select Softball, Southlake, TX
Northern Santa Barbara County Athletic Roundtable, Inc., Santa Maria, CA
Northwest Pharmacist Recovery Network, Fircrest, WA
Oleander & Sunset Park Association, Bakersfield, CA
One Church One Child of North-North Central Texas and Surrounding, Arlington, TX
One Foundation Ministries, Inc., Dallas, TX
Opera San Joaquin, Fresno, CA
Others, Inc., Waxahachie, TX
Out of the Madness Charity, Inc., Dallas, TX
Pacific Grove Feast of Lanterns, Inc., Pacific Grove, CA
Palo Pinto County A&M Club, Mineral Wells, TX
Paso Robles Police Activities League, Paso Robles, CA
Pearl Longbines Cottage for Children, Inc., Amarillo, TX
Philippians 413 Ministries, Missoulas, MT
Phoenix Data Center of Santa Clara County, Inc., Los Gatos, CA
Proclaim Ministries, Plano, TX
Professional Football Referees Association Charities, Plano, TX
Progressive Economic Opportunity Programs for Local Efforts, Inc., Wichita Falls, TX
Prop Foundation, Inc., Missoula, MT
PTA California Congress of Parents Teachers and Students, Inc., Morgan Hill, CA
Red River Emmaus Community, Incorporated, Wichita Falls, TX
Rotarun Ski Club, Inc., Hailey, ID
Rural Community Health Centers, Lemoore, CA
San Angelo Business-Education Coalition, Inc., San Angelo, TX
San Benito County Athletic Foundation, Hollister, CA
Sandon Bailey Foundation, Coppell, TX
Santa Barbara Air Fair, Inc., Goleta, CA
Santa Barbara Sister Cities Association-Yalta, Santa Barbara, CA
Say No To Drugs, Dallas, TX
Seawind, Inc., Seaside, CA
Segeh Gospel Mission, Inc., San Jose, CA
Sensible Solutions the Institute, Inc., Missoula, MT
Services for the Medically Disadvantaged, Fort Worth, TX
Sexual Abuse Intervention Network of Dallas, Inc., Dallas, TX
Shields Valley Foundation, Inc., Clyde Park, MT
Sierra Scholarship Foundation, Inc., Bishop, CA
Somers Volunteer Firefighters Association, Inc., Somers, NY
South Texas Prison Outreach, Inc., Bay City, TX
Special Family Ministries, Irving, TX
Special Pets Incorporated, Dallas, TX
Spruce Island Foundation, Sunnyvale, CA
Storm Shelter Counseling for the Fissures of Men of Ventura County, Ventura, CA
Structural Engineers World Congress, Los Altos, CA
Stump Enrichment Ministry for Church & Family, Dallas, TX
Summitt Place, Inc., Butte, MT
Sun & Star 1996, Dallas, TX
S.Y. Larrick Memorial Library Foundation, Whitefish, MT
TCC Alumni Association, Conroe, TX
Team Aztecas Sports, Dallas, TX
Teen Court of Hopkins County, Sulphur Springs, TX
Tegloma Texas Chapter, Incorporated, Houston, TX
Total Care Living Center, Houston, TX
Transplants Are Us, Missoula, MT
Ulysses-Cora Cephas House of San Marcos Texas, Dallas, TX
Unified Charities of Texas, Inc., Austin, TX
United Kids Charity Group, Inc., Incline Village, NV
Vessels for Jesus Prison Missions, Inc., Midlothian, TX
Vietnam Helicopter Pilots Association, Mineral Wells, TX
Vineyard Press, Kalispell, MT
West Houston Community Center, Inc., Houston, TX
Westside Food Pantry, Patterson, CA
Wildwood Center for Walking, Inc., Saint Paul, MN
Wishing on the Lone Star, Inc., Mesquite, TX
Wit Foundation for Artists, Dallas, TX
Women Against Sexual Harassment, Irving, TX
Womens Resource Video Library, Somers, MT
Youth Education Systems, Inc., Sand City, CA
Youth Net Ministries, Inc., Lake Jackson, TX

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

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

## Section 172.—Net Operating Loss Deduction

### Ct. D. 2072

**SUPREME COURT OF THE UNITED STATES**

No. 00–157

UNITED DOMINION INDUSTRIES, INC. *v.* UNITED STATES

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

June 4, 2001

Syllabus

Under the Internal Revenue Code of 1954, a "net operating loss" (NOL) results from deductions in excess of gross income for a given year. 26 U.S.C. Sec. 172(c). A taxpayer may carry its NOL either backward or forward to other tax years in order to set off its lean years against its lush years. Sec. 172(b)(1)(A). The carryback period for "product liability loss[es]" is 10 years. Sec. 172(b)(1)(I). Because a product liability loss (PLL) is the total of a taxpayer's product liability expenses (PLEs) up to the amount of its NOL, Sec. 172(j)(1), a taxpayer with a positive annual income, and thus no NOL, may have PLEs but can have no PLL. An affiliated group of corporations may file a single consolidated return. Sec. 1501. Treasury Regulations provide that such a group's "consolidated taxable income" (CTI), or, alternatively, its "consolidated net operating loss" (CNOL), is determined by taking into account several items, the first of which is the "separate taxable income" (STI) of each group member. In calculating STI, the member must disregard items such as capital gains and losses, which are considered, and factored into CTI or CNOL, on a consolidated basis. Petitioner's predecessor in interest, AMCA International Corporation, was the parent of an affiliated group filing consolidated returns for the years 1983 through 1986. In each year, AMCA reported CNOL exceeding the aggregate of its 26 individual members' PLEs. Five group members with PLEs reported positive STIs. Nonetheless, AMCA included those PLEs in determining its PLL for 10-year carryback under a "single-entity" approach in which it compared the group's CNOL and total PLEs to determine the group's total PLL. In contrast, the Government's "separate-member" approach compares each affiliate's STI and PLEs in order to determine whether each affiliate suffers a PLL, and only then combines any PLLs of the individual affiliates to determine a consolidated PLL. Under this approach, PLEs incurred by an affiliate with positive STI cannot contribute to a PLL. In 1986 and 1987, AMCA petitioned the Internal Revenue Service for refunds based on its PLL calculations. The IRS ruled in AMCA's favor, but was reversed by a joint congressional committee that controls refunds exceeding a certain threshold. AMCA then filed this refund action. The District Court applied AMCA's single-entity approach, concluding that so long as the affiliated group's consolidated return reflects CNOL in excess of the group's aggregate PLEs, the total of those expenses is a PLL that may be carried back. In reversing, the Fourth Circuit applied the separate-member approach.

*Held:* An affiliated group's PLL must be figured on a consolidated, single-entity basis, not by aggregating PLLs separately determined company by company. Pp. 5–15.

(a) The single-entity approach to calculating an affiliated group's PLL is straightforward. The first step in applying Sec. 172(j)'s definition of PLL requires a taxpayer filing a consolidated return to calculate an NOL. The Code and regulations governing affiliated groups of corporations filing consolidated returns provide only one definition of NOL: "consolidated" NOL. The absence of a separate NOL for a group member in this context is underscored by the fact that the regulations provide a measure of separate NOL in a different context, for any year in which an affiliated corporation files a separate return. The exclusive definition of NOL as CNOL at the consolidated level is important. Neither the Code nor the regulations indicate that the essential relationship between NOL and PLL for a consolidated group differs from their relationship for a conventional corporate taxpayer. Comparable treatment of PLL for the group and the conventional taxpayer can be achieved only if PLEs are compared with the loss amount at the consolidated level after CNOL has been determined, for CNOL is the only NOL measure for the group. An approach based on comparable treatment is also (relatively) easy to understand and to apply. Pp. 5–7.

(b) The case for the separate-member approach is not so easily made. Because there is no NOL below the consolidated level, there is nothing for comparison with PLEs to produce a PLL at any stage before the CNOL calculation. Thus, a separate-member proponent must identify some figure in the consolidated return scheme with a plausible analogy to NOL at the affiliated corporations level. An individual member's STI is not analogous, for it excludes several items that an individual taxpayer would normally count in computing income or loss, but which an affiliated group may tally only at the consolidated level. The "separate net operating loss," Treas. Reg. Sec. 1.1502–79(a)(3), used by the Fourth Circuit fares no better. Although that figure accounts for some gains or losses that STI does not, Sec. 1.1502–79(a)(3)'s purpose is to allocate CNOL to an affiliate member seeking to carry back a loss to a year in which the member was not part of the consolidated group. Such returns are not at issue here. Pp. 8–11.

(c) Several objections to the single-entity approach—that it allows affiliated groups a double deduction, that the omission of PLEs from the series of items that Treas. Reg. Sec. 1.1502–12 requires to be tallied at the consolidation level indicates that PLEs were not meant to be tallied at that level, and that the single-entity approach would permit significant tax avoidance abuses—are rejected. Pp. 11–15.

208 F.3d 452, reversed and remanded.

SOUTER, J., delivered the opinion of the Court, in which REHNQUIST, C.J., and O'CONNOR, SCALIA, KENNEDY, THOMAS, GINSBURG, and BREYER, JJ., joined. THOMAS, J., filed a concurring opinion. STEVENS, J., filed a dissenting opinion.

## SUPREME COURT OF THE UNITED STATES

No. 00–157

UNITED DOMINION INDUSTRIES, INC., PETITIONER *v.* UNITED STATES

532 U.S. ___ (2001)

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

June 4, 2001

JUSTICE SOUTER delivered the opinion of the Court.

Under Sec. 172(b)(1)(I) of the Internal Revenue Code of 1954, a taxpayer may carry back its "product liability loss" up to 10 years in order to offset prior years' income. The issue here is the method for calculating the product liability loss of an affiliated group of corporations electing to file a consolidated federal income tax return. We hold that the group's product liability loss must be figured on a consolidated basis in the first instance, and not by aggregating product liability losses separately determined company by company.

### I

A "net operating loss" results from deductions in excess of gross income for a given year. 26 U.S.C. Sec. 172(c).[1] Under Sec. 172(b)(1)(A), a taxpayer may carry its net operating loss either backward to past tax years or forward to future tax years in order to "set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year," *Libson Shops, Inc. v. Koehler*, 353 U.S. 382, 386 (1957).

Although the normal carryback period was at the time three years, in 1978, Congress authorized a special 10-year carryback for "product liability loss[es]," 26 U.S.C. Sec. 172(b)(1)(I), since, it understood, losses of this sort tend to be particularly "large and sporadic." Joint Committee on Taxation, 95th Cong., General Explanation of the Revenue Act of 1978, 232 (Comm. Print 1979). The Code defines "product liability loss," for a given tax year, as the lesser of (1) the taxpayer's "net operating loss for such year" and (2) its allowable deductions attributable to product liability "expenses." 26 U.S.C. Sec. 172(j)(1). In other words, a taxpayer's product liability loss (PLL) is the total of its product liability expenses (PLEs), limited to the amount of its net operating loss (NOL). By definition, then, a taxpayer with positive annual income, and thus no NOL, may have PLEs but can have no PLL.[2]

Instead of requiring each member company of "[a]n affiliated group of corporations" to file a separate tax return, the Code permits the group to file a single consolidated return, 26 U.S.C. Sec. 1501, and leaves it to the Secretary of the Treasury to work out the details by promulgating regulations governing such returns, Sec. 1502. Under Treas. Regs. Secs. 1.1502–11(a) and 1.1502–21(f),[3] an affiliated group's "consolidated taxable income" (CTI), or, alternatively, its "consolidated net operating loss" (CNOL), is determined by "taking into account" several items. The first is the "separate taxable income" (STI) of each group member. A member's STI (whether positive or negative) is computed as though the member were a separate corporation (*i.e.*, by netting income and expenses), but subject to several important "modifications." Treas. Reg. Sec. 1.1502–12. These modifications require a group member calculating its STI to disregard, among other items, its capital gains and losses, charitable-contribution deductions, and dividends-received deductions. *Ibid*. These excluded items are accounted for on a consolidated basis, that is, they are combined at the level of the group filing the single return, where deductions otherwise attributable to one member (say, for a charitable contribution) can offset income received by another (from a capital gain, for example). Treas. Regs. Secs. 1.1502–11(a)(3)–(8); 1.1502–21(f)(2) to (6). A consolidated group's CTI or CNOL, therefore, is the sum of each member's STI, plus or minus a handful of items considered on a consolidated basis.

### II

Petitioner United Dominion's predecessor in interest, AMCA International Corporation, was the parent of an affiliated group of corporations that properly elected to file consolidated tax returns for the years 1983 through 1986. In each of these years, AMCA reported CNOL (the lowest being $85 million and the highest, $140 million) that exceeded the aggregate of its 26 individual members' PLEs ($3.5 million to $6.5 million). This case focuses on the PLEs of five of AMCA's member companies, which, together, generated roughly $205,000 in PLEs in 1983, $1.6 million in 1984, $1.3 million in 1985, and $250,000 in 1986. No one disputes these amounts or their characterization as PLEs. See 208 F.3d 452, 453 (CA4 2000) ("The parties agree" with respect to the amount of "the product liability expenses incurred by the five group members in the relevant years"). Rather, the sole question here is whether the AMCA affiliated group may include these amounts on its consolidated return, in determining its PLL for 10-year carryback. The question arises because of the further undisputed fact that in each of the relevant tax years, each of the five companies in question (with minor exceptions not relevant here), reported a positive STI.

AMCA answered this question by following what commentators have called a "single-entity" approach[4] to calculating its "consolidated" PLL. For each tax year, AMCA (1) calculated its CNOL pursuant to Treas. Reg. Sec. 1.1502–11(a), and (2) aggregated its individual members' PLEs. Because, as noted above, for each tax year AMCA's CNOL was greater

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954, 26 U.S.C. Sec. 1 *et seq*. (1982 ed. and Supp. V), as in effect between 1983 and 1986, the tax years here in question.

[2] If, for example, a company had $100 in taxable income, $50 in deductible PLEs, and $75 in additional deductions, its NOL would be $25 (*i.e.*, $100-$50-$75= -$25); it could count only $25 of its $50 in PLEs as PLL. If the company had $100 in income, $50 in PLEs, and $125 in additional deductions, its NOL would be $75, and it could count its entire $50 in PLEs as PLL. And, finally, if the company had $100 in income, $50 in PLEs, and $40 in additional deductions, it would have positive income and, thus, no NOL and no PLL.

[3] Unless otherwise noted, Treasury Regulation references are to the regulations in effect between 1983 and 1986, 26 CFR Sec. 1.1502-11 *et seq*. (1982-1986).

[4] Axelrod & Blank, The Supreme Court, Consolidated Returns, and 10-Year Carrybacks, 90 Tax Notes, No. 10, p. 1383 (Mar. 5, 2001) (hereinafter Axelrod & Blank).

than the sum of its members' PLEs, AMCA treated the full amount of the PLEs as consolidated PLL eligible for 10-year carryback. In AMCA's view, the fact that several member companies throwing off large PLEs also, when considered separately, generated positive taxable income was of no significance.

From the Government's perspective, however, the fact that the several affiliated members with PLEs also generated positive separate taxable income is of critical significance. According to the Government's methodology, which we will call the "separate-member" approach,[5] PLEs incurred by an affiliate with positive separate taxable income cannot contribute to a PLL eligible for 10-year carryback. Whereas AMCA compares the group's total income (or loss) and total PLEs in an effort to determine the group's total PLL, the Government compares each affiliate's STI and PLEs in order to determine whether each affiliate suffers a PLL, and only then combines any PLLs of the individual affiliates to determine a consolidated PLL amount.

In 1986 and 1987, AMCA petitioned the Internal Revenue Service for refunds of taxes based on its PLL calculations. The IRS first ruled in AMCA's favor but was reversed by the Joint Committee on Internal Revenue Taxation of the United States Congress, which controls refunds exceeding a certain threshold, 26 U.S.C. Sec. 6405(a). AMCA then filed this refund action in the United States District Court for the Western District of North Carolina. The District Court agreed with AMCA that an affiliated group's PLL is determined on a single-entity basis, and held that, so long as the group's consolidated return reflects CNOL in excess of the group's aggregate PLEs, the total of those expenses (including those incurred by members with positive separate taxable income) is a PLL that "may be carried back the full ten years." No. 3:95-CV-341-MU (June 19, 1998), App. to Pet. for Cert. 39a. The United States Court of Appeals for the Fourth Circuit reversed, and held that "determining 'product liability loss' separately for each group member is correct and consistent with [Treasury] regulations." 208 F.3d, at 458.

[5] *Ibid.*

Because the Fourth Circuit's separate-member approach to calculating PLL conflicted with the Sixth Circuit's adoption of the single-entity approach in *Intermet Corp. v. Commissioner*, 209 F.3d 901 (CA6 2000), we granted certiorari, 531 U.S. 1009 (2000).[6] We now reverse.

III

The case for the single-entity approach to calculating an affiliated group's PLL is straightforward. Section 172(j)(1) defines a taxpayer's "product liability loss" for a given tax year as the lesser of its "net operating loss for such year" and its product liability "expenses." In order to apply this definition, the taxpayer first determines whether it has taxable income or NOL, and in making that calculation it subtracts PLEs. If the result is NOL, the taxpayer then makes a simple comparison between the NOL figure and the total PLEs. The PLE total becomes the PLL to the extent it does not exceed NOL. That is, until NOL has been determined, there is no PLL.

The first step in applying the definition and methodology of PLL to a taxpayer filing a consolidated return thus requires the calculation of NOL. As United Dominion correctly points out, the Code and regulations governing affiliated groups of corporations filing consolidated returns provide only one definition of NOL: "consolidated" NOL, see Treas. Reg. Sec. 1.1502–21(f). There is no definition of separate NOL for a member of an affiliated group. Indeed, the fact that Treasury Regulations do provide a measure of separate NOL in a different context, for an affiliated corporation as to any year in which it filed a separate return, *infra*, at ___, underscores the absence of such a measure for an affiliated corporation filing as a group member. Given this apparently exclusive definition of NOL as CNOL in the instance of affiliated entities with a consolidated return (and for reasons developed below, *infra*, at ___) we think it is fair to say, as United Dominion says, that the concept of separate NOL "simply does not exist." Brief for Petitioner 15.[7] The exclusiveness of NOL at the consolidated level as CNOL is important here for the following reasons. The Code's authorization of consolidated group treatment contains no indication that for a consolidated group the essential relationship between NOL and PLL will differ from their relationship for a conventional corporate taxpayer. Nor does any Treasury Regulation purport to change the relationship in the consolidated context. If, then, the relationship is to remain essentially the same, the key to understanding it lies in the regulations' definition of net operating loss exclusively at the consolidated level. Working back from that, PLEs should be considered first in calculating CNOL, and they are: because any PLE of an affiliate affects the calculation of its STI, that same PLE necessarily affects the CTI or CNOL in exactly the same way, dollar for dollar. And because, by definition, there is no NOL measure for a consolidated return group or any affiliate except CNOL, PLEs cannot be compared with any NOL to produce PLL until CNOL has been calculated. Then, and only then in the case of the consolidated filer, can total PLEs be compared with a net operating loss. In sum, comparable treatment of PLL in the instances of the usual corporate taxpayer and group filing a consolidated return can be achieved only if the comparison of PLEs with a limiting loss amount occurs at the consolidated level after CNOL has been determined. This approach resting on comparable treatment has a further

[6] *Intermet* involved "specified liability losses" (SLLs), not PLLs. The difference, however, does not matter. The PLL was a statutory predecessor to the SLL, and PLLs were folded into the SLL provision in Sec. 11811(b)(1) of the Omnibus Budget Reconciliation Act of 1990, 104 Stat. 1388-532. Thus, "[i]n all relevant respects, the provisions on [PLLs] and SLLs are the same." Leatherman, Current Developments for Consolidated Groups, 486 PLI/Tax 389, 393, n. 5 (2000) (hereinafter Leatherman, Current Developments).

[7] In addition to Treas. Reg. Sec. 1.1502-79(a)(3), discussed *infra*, at ___, two other provisions, 26 U.S.C. Sec. 1503(f)(2) and the current version (though not the version applicable between 1983 and 1986) of Treas. Reg. Sec. 1502-21(b) (2000), refer to separate group members' NOLs. The parties here have not emphasized those provisions, and with good reason. Not only are they inapplicable to the question before us (either substantively, temporally, or both), but, as one commentator has observed, their references to separate NOLs "stem[] more from careless drafting than meaningful design." Leatherman, Are Separate Liability Losses Separate for Consolidated Groups?, 52 Tax. Law. 663, 705 (1999) (hereinafter Leatherman, Separate Liability Losses).

virtue entitled to some weight in case of doubt: it is (relatively) easy to understand and to apply.

The case for the separate-member approach, advanced (in one variant) by the Government and adopted (on a different rationale) by the Court of Appeals, is not so easily made. In the analysis of comparable treatment just set out, of course, there is no NOL below the consolidated level and hence nothing for comparison with PLEs to produce PLL at any stage before the CNOL calculation. At the least, then, a proponent of the separate-member approach must identify some figure in the consolidated return scheme that could have a plausible analogy to NOL at the level of the affiliated corporations. See A. Dubroff, J. Blanchard, J. Broadbent, & K. Duvall, Federal Income Taxation of Corporations Filing Consolidated Returns Sec. 41.04[06], p. 41–75 (2d ed. 2000) (hereinafter Dubroff) ("Even if separate entity treatment was appropriate, it is unclear how a member with [PLEs] would compute its separate NOL"). The Government and the Court of Appeals have suggested different substitute measures. Neither one works.

The Government has argued that an individual group member's STI, as determined under Treas. Reg. Sec. 1.1502–12, is analogous to a "separate" NOL, so that an affiliate's STI may be compared with its PLEs in order to determine any separate PLL. An individual member's PLL would be the amount of its separate PLEs up to the amount of its negative STI; a member having positive STI could have no PLL.

The Government claims that an STI-based comparison places the group member closest to the position it would have occupied if it had filed a separate return. But that is simply not so. We have seen already that the calculation of a group member's STI by definition excludes several items that an individual taxpayer would normally account for in computing income or loss, but which an affiliated group may tally only at the consolidated level, such as capital gains and losses, charitable-contribution deductions, and dividends-received deductions. Treas. Reg. Secs. 1.1502–12(j) to (n). Owing to these exclusions, an affiliate's STI will tend to be inflated by eliminating deductions it would have taken if it had filed separately, or deflated by eliminating an income item like capital gain.

When pushed, the Government concedes that STI is "not necessarily equivalent to the income or [NOL] figure that the corporation would have computed if it had filed a separate return." Brief for United States 21, n. 14. But, the Government claims, "[t]here has never been a taxpayer with [PLEs] who had a positive [STI] but a negative separate [NOL]." Tr. of Oral Arg. 27. In other words, the Government says that the deductions excluded from STI have never once made a difference and, therefore, that STI is, in fact, a decent enough proxy for a group member's "separate" NOL. But whether or not the excluded items have made a difference in the past, or make a difference here, they certainly could make a difference and, given the potential importance of some of the deductions involved (a large charitable contribution, for example), it is not hard to see how the difference could favor the Government.

The Court of Appeals was therefore right to reject the Government's reliance on STI as a functional surrogate for an affiliate's "separate" NOL. 208 F.3d, at 459–460. But what the Court of Appeals used in place of STI fares no better. The court relied on Treas. Reg. Sec. 1.1502–79, which contains a definition of "separate net operating loss" that the court believed to be "analogous to an individual's 'net operating loss' on a separate return." 208 F.3d at 460. Section 1.1502–79(a)(3) provides that, "[f]or purposes of this subparagraph," the "separate net operating loss of a member of the group shall be determined under Sec. 1.1502–12 . . . , adjusted for the . . . items taken into account in the computation of" the CNOL. As the Court of Appeals said, the directive of Sec. 1.1502–79(a)(3) (unlike the definition of STI) "takes into account, for example, [a] member's charitable contributions" and other consolidated deductions. 208 F.3d, at 460–461.

But this sounds too good. It is true that, insofar as Sec. 1.1502–79(a)(3) accounts for gains and losses that STI does not, it gets closer to a commonsense notion of a group member's "separate" NOL than STI does. But the fact that Sec. 1.1502–79(a)(3) improves on STI simply by undoing what Sec. 1.1502–12 requires in defining STI is suspicious, and it turns out that the suspicion is justified. Section 1.1502–79(a)(3) unbakes the cake for only one reason, and that reason has no application here. The definition on which the Court of Appeals relied applies, by its terms, only "for purposes of" Sec. 1.1502–79(a)(3), and context makes clear that the purpose is to provide a way to allocate CNOL to an affiliate member that seeks to carry back a loss to a "separate return year," that is, to a year in which the member was not part of the consolidated group. See Treas. Reg. Sec. 1.1502–79 (titled "Separate return years"); Sec. 1.1502–79(a) (titled "Carryover and carryback of [CNOL] to separate return years"); Sec. 1.1502–79(a)(1) ("[i]f a [CNOL] can be carried . . . to a separate return year . . ."). No separate return years are at issue before us; all NOL carrybacks relevant here apply to years in which the five corporations were affiliated in the group. The Court of Appeals thus applied concepts addressing separate return years to a determination for a consolidated return year, without any statutory or regulatory basis for doing so. Cf. 49 Fed. Reg. 30530 (1984) ("[A]lthough the consolidated net operating loss is apportioned to individual members for purposes of carry backs to separate return years [under Sec. 1.1502–79(a)], the apportioned amounts are not separate NOLs of each member"). Hence, while Sec. 1.1502–79 might not distort an affiliate's separate NOL in the same way that STI does, the facial inapplicability of that regulation only underscores the exclusive concern of Sec. 1.1502–11(a) with consolidated NOL.

In sum, neither method for computing PLL on a separate-member basis squares with the notion of comparability as applied to consolidated return regulations. On the contrary, by expressly and exclusively defining NOL as CNOL, the regulations support the position that group members' PLEs should be aggregated and the affiliated group's PLL determined on a consolidated, single-entity basis.

IV

Several objections have been raised to a single-entity approach to calculating PLL that we have not considered yet. First, the Government insists that a single-entity rule allows affiliated groups a "double deduction." The Government argues that because PLEs are not included among the specific items (charitable-contribution deductions, etc.) for which consolidated, single-entity treatment is required under Treas. Reg. Sec. 1.1502–12, PLEs are "consumed" or "used up" in computing members' STIs, which, pursuant to Treas. Regs. Secs. 1.1502–11(a) and 1.1502–21(f), are then used to calculate the group's CTI or CNOL. According to the Government, to permit the use of PLEs first to reduce an individual member's STI and then to contribute to an aggregate PLL for carryback purposes would be tantamount to a double deduction.

The double-deduction argument may have superficial appeal, but any appeal it has rests on a fundamental misconception of the function of STI in computing an affiliated group's tax liability. Calculation of a group member's STI is not in and of itself the basis for any tax event, and there is no separate tax saving when STI is calculated; that occurs only when deductions on the consolidated return equal income and (if they exceed income and produce a CNOL) are carried back against prior income. STI is merely an accounting construct devised as an interim step in computing a group's CTI or CNOL; it "has no other purpose." *Intermet*, 209 F.3d, at 906 ("A member's STI is simply a step along the way to calculating the group's taxable income or CNOL"). The fact that a group member's PLEs reduce its STI, which in turn either reduces the group's CTI or contributes to its CNOL "dollar for dollar," *ibid.*, is of no other moment.[8] If there were anything wrong in what AMCA proposes to do, it would be wrong in relation to AMCA's CNOL and its use for any carryback. Yet, as noted above, no one here disputes that the group members had PLEs in the total amount claimed or that the AMCA group is entitled to carry back the full amount of its CNOL to offset income in prior years. The only question is what portion, if any, of AMCA's CNOL is PLL and, as such, eligible for 10-year, as opposed to 3-year carryback treatment. There is no more of a double deduction with a 10-year carryback than one for three years.

A second objection was the reason that the Court of Appeals rejected the single-entity approach. That court attached dispositive significance to the fact that, while the Treasury Regulation we have discussed, Sec. 1.1502–12, specifically provides that several items (capital gains and losses, charitable-contribution deductions, etc.) shall be accounted for on a consolidated basis, it does not similarly provide for accounting for PLEs on a consolidated basis: "The regulations provide for blending the group members' [NOLs], and they explicitly define [CNOL] without an accompanying reference to consolidated [PLEs]. This omission . . . makes clear that blending those expenses is not permitted. . . ." 208 F.3d, at 458.

We think the omission of PLEs from the series of items that Sec. 1.1502–12 requires to be tallied at the consolidated level has no such clear lesson, however. The logic that invests the omission with significance is familiar: the mention of some implies the exclusion of others not mentioned. *Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 167 (1993) ("*Expressio unius est exclusio alterius*"). But here, as always, the soundness of that premise is a function of timing: if there was a good reason to consider the treatment of consolidated PLL at the time the regulation was drawn, then omitting PLL from the list of items for consolidated treatment may well have meant something. But if there was no reason to consider PLL then, its omission would mean nothing at all. And in fact, there was no reason. When the consolidated return regulations were first promulgated in 1966, there was no carryback provision pegged to PLEs or PLLs; those notions did not become separate carryback items until 1978, when the 10-year rule was devised. See Revenue Act of 1978, Sec. 371, 92 Stat. 2859; see also Leatherman, Current Developments 393, n. 5. Omission of PLEs or PLLs from the series set out for consolidated treatment in the 1966 regulation therefore meant absolutely nothing in 1966. The issue, then, is the significance, not of omission, but of failure to include later: has the significance of the earlier regulation changed solely because the Treasury has never amended it, even though PLL is now a separate carryback? We think that is unlikely. The Treasury's relaxed approach to amending its regulations to track Code changes is well documented. See, *e.g.*, Dubroff 41–72, n. 193; Axelrod & Blank 1391; Leatherman, Separate Liability Losses 708–709. The absence of any amendment to Sec. 1.1502–12 that might have added PLEs or PLLs to the list of items for mandatory single-member treatment therefore is more likely a reflection of the Treasury's inattention than any affirmative intention on its part to say anything at all.

Last, the Government warns that "[t]he rule that petitioner advocates would permit significant tax avoidance abuses." Brief for United States 40. Specifically:

> "Under petitioner's approach, a corporation that is currently unprofitable but that had substantial income in prior years could (i) acquire a profitable corporation with product liability expense deductions in the year of acquisition, (ii) file a consolidated return and (iii) thereby create an otherwise nonexistent 'product liability loss' for the new affiliated group that would allow the acquiring corporation to claim refunds of the tax it paid in prior years. *Ibid*.

The Government suggests, for example, that "a manufacturing company (with prior profits and current losses) that has no product liability exposure could purchase a tobacco company (with both prior and current profits) that has significant product liability expenses," and that "[t]he combined entity could . . . assert a ten-year carryback of 'product liability losses' even though the tobacco company has always made a profit and never incurred a 'loss' of any type." *Id.*, at 40–41, n. 27.

There are several answers. First, on the score of tax avoidance, the separate-member approach is no better (and is perhaps worse) than the single-entity treatment; both entail some risk of tax-motivated behavior. See Leatherman, Separate Liabil-

[8] It makes no difference whatsoever whether the affiliate's PLEs are (1) first netted against each member's income and then aggregated or (2) first aggregated and then netted against the group's combined income: under either method, AMCA's CNOL is the same. See Axelrod & Blank 1394 (noting that this conclusion follows from "the associative principle of arithmetic (which holds that the groupings of items in the case of addition and subtraction have no effect on the result)").

ity Losses 681 (Under the separate-member approach, "[d]espite sound non-tax business reasons, a group may be disinclined to form a new member or transfer assets between members, because it may worry that it would lose the benefit of a ten-year carryback," and "may be encouraged to transfer assets between members to increase its consolidated [PLL], even when those transfers would otherwise be ill-advised"). Second, the Government may, as always, address tax-motivated behavior under Internal Revenue Code Sec. 269, which gives the Secretary ample authority to "disallow [any] deduction, credit, or other allowance" that results from a transaction "the principal purpose [of] which . . . is evasion or avoidance of Federal income tax." 26 U.S.C. Sec. 269(a). And finally, if the Government were to conclude that Sec. 269 provided too little protection and that it simply could not live with the single-entity approach, the Treasury could exercise the authority provided by the Code, 26 U.S.C. Sec. 1502, and amend the consolidated return regulations.

* * *

Thus, it is true, as the Government has argued, that "[t]he Internal Revenue Code vests ample authority in the Treasury to adopt consolidated return regulations to effect a binding resolution of the question presented in this case." Brief for United States 19–20. To the extent that the Government has exercised that authority, its actions point to the single-entity approach as the better answer. To the extent the Government disagrees, it may amend its regulations to provide for a different one.

The judgment of the Court of Appeals is reversed, and the case is remanded for proceedings consistent with this opinion.

*It is so ordered.*

**SUPREME COURT OF THE UNITED STATES**

No. 00–157

UNITED DOMINION INDUSTRIES, INC., PETITIONER *v.* UNITED STATES

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

June 4, 2001

JUSTICE THOMAS, concurring.

I agree with the Court that the Internal Revenue Code provision and the corresponding Treasury Regulations that control consolidated filings are best interpreted as requiring a single-entity approach in calculating product liability loss. I write separately, however, because I respectfully disagree with the dissent's suggestion that, when a provision of the Code and the corresponding regulations are ambiguous, this Court should defer to the Government's interpretation. See *post,* at 1–2. At a bare minimum, in cases such as this one, in which the complex statutory and regulatory scheme lends itself to any number of interpretations, we should be inclined to rely on the traditional canon that construes revenue-raising laws against their drafter. See *Leavell v. Blades*, 237 Mo. 695, 700–701, 141 S.W. 893, 894 (1911) ("When the tax gatherer puts his finger on the citizen, he must also put his finger on the law permitting it"); *United States v. Merriam*, 263 U.S. 179, 188 (1923) ("If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer"); *Bowers v. New York & Albany Literage Co.*, 273 U.S. 346, 350 (1927) ("The provision is part of a taxing statute; and such laws are to be interpreted liberally in favor of the taxpayers"). Accord *American Net & Twine Co. v. Worthington*, 141 U.S. 468, 474 (1891); *Benziger v. United States*, 192 U.S. 38, 55 (1904).

**SUPREME COURT OF THE UNITED STATES**

No. 00–157

UNITED DOMINION INDUSTRIES, INC., PETITIONER *v.* UNITED STATES

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

June 4, 2001

JUSTICE STEVENS, dissenting.

This is a close and difficult case, in which neither the statute nor the regulations offer a definitive answer to the crucial textual question. Absent a clear textual anchor, I would credit the Secretary of the Treasury's concerns about the potential for abuse created by the petitioner's reading of the statutory scheme and affirm the decision of the Court of Appeals on that basis.[1]

As the majority accurately reports, during the time relevant to this case, Sec. 172(b)(1)(I) of the Internal Revenue Code of 1954 allowed any "taxpayer" who "ha[d] a product liability loss" to carry back its excess product liability losses for 10 years. The resolution of this case turns on whether, when a group of affiliated corporations files a consolidated tax return, the entire group should be considered the "taxpayer" for the purposes of implementing this provision or whether each individual corporation should be seen as a "taxpayer."

There is no obvious answer to this question. On the one hand, it is generally accepted that the rationale behind the consolidated return regulations is to allow affiliated corporations that are run as a single-entity to elect to be treated for tax purposes as a single-entity. See, *e.g.*, Brief for Petitioner 17–19 (collecting sources in which the Internal Revenue Service so stated). On the other hand, it is quite clear that each corporation in such a group remains in both a legal and a literal sense a "taxpayer," a status that has important consequences. See *Woolford Realty Co. v. Rose*, 286 U.S. 319, 328 (1932) ("The fact is not to be ignored that each of two or more corporations joining . . . in a consolidated return is none the less a taxpayer"); 26 U.S.C. Sec. 7701(a)(14) (defining a "taxpayer" as "any person subject to any internal revenue tax," where a related provision defines "person" to include corporations). As both the group and the individual corpora-

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[1] JUSTICE THOMAS accurately points to a tradition of cases construing "revenue-raising laws" against their drafter. See *ante*, at 1 (THOMAS, J., concurring). However, when the ambiguous provision in question is not one that imposes tax liability but rather one that crafts an exception from a general revenue duty for the benefit of some taxpayers, a countervailing tradition suggests that the ambiguity should be resolved in the government's favor. See, *e.g.*, *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *Interstate Transit Lines v. Commissioner*, 319 U.S. 590, 593 (1943); *Deputy v. Du Pont*, 308 U.S. 488, 493 (1940); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934); *Woolford Realty Co. v. Rose*, 286 U.S. 319, 326 (1932).

tions are considered "taxpayers" in different contexts, the statute presents a genuine ambiguity.

When a provision of the Internal Revenue Code presents a patent ambiguity, Congress, the courts, and the IRS share a preference for resolving the ambiguity via executive action. See, *e.g.*, *National Muffler Dealers Assn., Inc. v. United States*, 440 U.S. 472, 477 (1979). This is best achieved by the issuing of a Treasury Regulation resolving the ambiguity. *Ibid*. In this instance, however, the Secretary of the Treasury issued no such regulation. In the absence of such a regulation, the majority has scoured tangentially related regulations, looking for clues to what the Secretary might intend. For want of a more precise basis for resolving this case, that approach is sound.

It is at this point, however, that I part company with the majority's analysis. The fact that the regulations forward a particular method for calculating a consolidated "net operating loss" (NOL) for a group of affiliated companies, see Treas. Reg. Sec. 1.1502–21(f), tells us how the Secretary wants the NOL to be calculated whenever it is necessary to determine a consolidated NOL, but it does not tell us what provisions of the Code require the calculation of a consolidated NOL. That is a separate and prior question. Even if we were to draw some mild significance from the presence of such a regulation (and the absence, at the time these returns were filed, of a similar regulation for the calculation of corporation-specific NOL's), the power of that inference is counterbalanced by the fact that the regulations listing deductions that must be reported at the consolidated level makes no mention of product liability expenses. See Treas. Reg. Sec. 1.1502–12; see also *H. Enterprises Int'l, Inc. v. Commissioner*, 105 T.C. 71, 85 (1995) (construing Treas. Reg. Sec. 1.1502–80(a) to provide "[w]here the consolidated return regulations do not require that corporations filing such returns be treated differently from the way separate entities would be treated, those corporations shall be treated as separate entities when applying provisions of the Code"). In addition, the subsequent promulgation of a method for calculating a corporation-specific NOL (albeit for a different purpose), see Sec. 1.1502–79(a)(3) (defining "separate net operating loss"), demonstrates that there are no inherent problems implicit in undertaking such a calculation.

In short, I find no answer to this case in the text of the statute or in any Treasury Regulation.[2] However, the government does forward a valid policy concern that militates against petitioner's construction of the statute: the fear of tax abuse. See Brief for United States 40–42. Put simply, the Government fears that currently unprofitable but previously profitable corporations might receive a substantial windfall simply by acquiring a corporation with significant product liability expenses but no product liability losses. See *id*., at 40. On a subjective level, I find these concerns troubling. Cf. *Woolford Realty Co.*, 286 U.S., at 330 (rejecting "the notion that Congress in permitting a consolidated return was willing to foster an opportunity for juggling so facile and so obvious"). More importantly, however, I credit the Secretary of the Treasury's concerns about the potential scope of abuse. Perhaps the Court is correct in suggesting that these concerns can be alleviated through applications of other anti-abuse provisions of the Tax Code, see *ante*, at 15, but I am not persuaded of my own ability to make that judgment. When we deal "with a subject that is highly specialized and so complex as to be the despair of judges," *Dobson v. Commissioner*, 320 U.S. 489, 498 (1943), an ounce of deference is appropriate.

I respectfully dissent.[3]

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[2] I am also in full agreement with the Court's rejection of the Government's double-deduction argument. See *ante*, at 11-12.

[3] Because I agree with the majority that the calculation contemplated by Treas. Reg. Sec. 1.1502-79(a)(3) better approximates the NOL that each company would have had reported if filing individually than the alternative forwarded by the Government, see *ante*, at 10, I agree with the Court of Appeals' decision to adopt that measure and would affirm the decision below in its entirety.

## Section 3101.—Rate of Tax

## Ct. D. 2071

**SUPREME COURT OF THE UNITED STATES**

No. 99–1978

UNITED STATES *v.* HATTER, JUDGE, UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, ET AL.

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

May 21, 2001

Syllabus

In 1982, Congress extended Medicare to federal employees. That new law meant, *inter alia*, that then-sitting federal judges, like all other federal employees and most other citizens, began to have Medicare taxes withheld from their salaries. In 1983, Congress required all newly hired federal employees to participate in Social Security and permitted, without requiring, about 96% of the then-currently employed federal employees to participate in that program. The remaining 4%—a class consisting of the President, other high-level Government employees, and all federal judges—were required to participate, except that those who contributed to a "covered" retirement program could modify their participation in a manner that left their total payroll deduction for retirement and Social Security unchanged, in effect allowing them to avoid any additional financial obligation as a result of joining Social Security. A "covered" program was defined to include any retirement system to which an employee had to contribute, which did not encompass the noncontributory pension system for federal judges, whose financial obligations (and payroll deductions) therefore had to increase. A number of federal judges appointed before 1983 filed this suit, arguing that the 1983 law violated the Compensation Clause, which guarantees federal judges a "Compensation, which shall not be diminished during their Continuance in Office," U.S. Const., Art. III, Sec. 1. Initially, the Court of Federal Claims ruled against the judges, but the Federal Circuit reversed. On certiorari, because some Justices were disqualified and this Court failed to find a quorum, the Federal Circuit's judgment was affirmed "with the same effect as upon affirmance by an equally divided court." 519 U.S. 801. On remand, the Court of Federal Claims found that the judges' Medicare claims were time barred and that a 1984 judicial salary increase promptly cured any violation, making damages minimal. The Federal Circuit reversed, holding that the Compensation Clause prevented the Government from collecting Medicare and Social Security taxes from the judges and that the violation was not cured by the 1984 pay increase.

*Held:*

1. The Compensation Clause prevents the Government from collecting Social Security taxes, but not Medicare taxes, from federal judges who held office before Congress extended those taxes to federal employees. Pp. 6–19.

(a) The Court rejects the judges' claim that the "law of the case" doctrine now prevents consideration of the Compensation Clause because an affirmance by an equally divided Court is conclusive and binding upon the parties. *United States v. Pink*, 315 U.S. 203, 216, on which the judges rely, concerned an earlier case in which the Court heard oral argument and apparently considered the merits before affirming by an equally divided Court. The law of the case doctrine presumes a hearing on the merits. See, *e.g.*, *Quern v. Jordan*, 440 U.S. 332, 347, n. 18. When this case previously was here, due to absence of a quorum, the Court could not consider either the merits or whether to consider those merits through a grant of certiorari. This fact, along with the obvious difficulty of finding other equivalent substitute forums, convinces the Court that *Pink* does not control here. Pp. 6–7.

(b) Although the Compensation Clause prohibits taxation that singles out judges for specially unfavorable treatment, it does not forbid Congress to enact a law imposing a nondiscriminatory tax (including an increase in rates or a change in conditions) upon judges and other citizens. See *O'Malley v. Woodrough*, 307 U.S. 277, 282. Insofar as *Evans v. Gore*, 253 U.S. 245, 255, holds to the contrary, that case is overruled. See *O'Malley*, *supra*, at 283. There is no good reason why a judge should not share the tax burdens borne by all citizens. See *Evans*, *supra*, at 265, 267 (Holmes, J., dissenting); *O'Malley*, *supra*, at 281–283. Although Congress cannot *directly* reduce judicial salaries even as part of an equitable effort to reduce *all* Government salaries, a tax law, unlike a law mandating a salary reduction, affects compensation indirectly, not directly. See *United States v. Will*, 449 U.S. 200, 226. And those prophylactic considerations that may justify an absolute rule forbidding direct salary reductions are absent here, where indirect taxation is at issue. In practice, the likelihood that a nondiscriminatory tax represents a disguised legislative effort to influence the judicial will is virtually nonexistent. Hence the potential threats to judicial independence that underlie the Compensation Clause, see *Evans*, *supra*, at 251–252, cannot justify a special judicial exemption from a commonly shared tax, not even as a preventive measure to counter those threats. Because the Medicare tax is nondiscriminatory, the Federal Circuit erred in finding its application to federal judges unconstitutional. Pp. 7–13.

(c) However, because the special retroactivity-related Social Security rules enacted in 1983 effectively singled out then-sitting federal judges for unfavorable treatment, the Compensation Clause forbids the application of the Social Security tax to those judges. Four features of the law, taken together, lead to the conclusion that it discriminates in a manner the Clause forbids. First, the statutory history, context, purpose, and language indicate that the category of "federal employees" is the appropriate class against which the asserted discrimination must be measured. Second, the practical upshot of defining "covered" system in the way the law did was to permit nearly every then-current federal employee, but not federal judges, to avoid the newly imposed obligation to pay Social Security taxes. Third, the new law imposed a substantial cost on federal judges with little or no expectation of substantial benefit for most of them. Inclusion meant a deduction of about $2,000 per year, whereas 95% of the then-active judges had already qualified for Social Security (due to private sector employment) before becoming judges. And participation would benefit only the minority of judges who had not worked the quarters necessary to be fully insured under Social Security. Fourth, the Government's sole justification for the statutory distinction between judges and other high-level federal employees—*i.e.*, equalizing the financial burdens imposed by the noncontributory judicial retirement system and the contributory system to which the other employees belonged—is unsound because such equalization takes place not by offering all current federal employees (including judges) the same opportunities, but by employing a statutory disadvantage which offsets an advantage related to those protections afforded judges by the Clause, and because the two systems are not equalized with any precision. Thus, the 1983 law is very different from the nondiscriminatory tax upheld in *O'Malley*, *supra*, at 282. The Government's additional arguments—that Article III protects judges only against a reduction in stated salary, not against indirect measures that only reduce take-home pay; that there is no evidence here that Congress singled out judges for special treatment in order to intimidate, influence, or punish them; and that the law disfavored not only judges but also the President and other high-ranking federal employees—are unconvincing. Pp. 13–19.

2. The Compensation Clause violation was not cured by the 1984 pay increase for federal judges. The context in which that increase took place reveals nothing to suggest that it was intended to make whole the losses sustained by the pre-1983 judges. Rather, everything in the record suggests that the increase was meant to halt a slide in purchasing power resulting from continued and unadjusted-for inflation. Although a circumstance-specific approach is more complex than the Government's proposed automatic approach, whereby a later salary increase would terminate a Compensation Clause violation regardless of the increase's purpose, there is no reason why such relief as damages or an exemption from Social Security would prove unworkable. *Will*, *supra*, distinguished. Pp. 19–22.

203 F.3d 795, affirmed in part, reversed in part, and remanded.

BREYER, J., delivered the opinion of the Court, in which REHNQUIST, C.J., and KENNEDY, SOUTER, and GINS-

BURG, JJ., joined, and in which SCALIA, J., joined as to Parts I, II, and V. SCALIA, J., filed an opinion concurring in part and dissenting in part. THOMAS, J., filed an opinion concurring in the judgment in part and dissenting in part. STEVENS, J., and O'CONNOR, J., took no part in the consideration or decision of the case.

**SUPREME COURT OF THE UNITED STATES**

No. 99–1978

UNITED STATES, PETITIONER *v.* TERRY J. HATTER, JR., JUDGE, UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, ET AL.

532 U.S. ___(2001)

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

May 21, 2001

JUSTICE BREYER delivered the opinion of the Court.

The Constitution's Compensation Clause guarantees federal judges a "Compensation, which shall not be diminished during their Continuance in Office." U.S. Const., Art. III, Sec. 1. The Court of Appeals for the Federal Circuit held that this Clause prevents the Government from collecting certain Medicare and Social Security taxes from a small number of federal judges who held office nearly 20 years ago—before Congress extended the taxes to federal employees in the early 1980's.

In our view, the Clause does not prevent Congress from imposing a "non-discriminatory tax laid generally" upon judges and other citizens, *O'Malley v. Woodrough*, 307 U.S. 277, 282 (1939), but it does prohibit taxation that singles out judges for specially unfavorable treatment. Consequently, unlike the Court of Appeals, we conclude that Congress may apply the Medicare tax—a nondiscriminatory tax—to then-sitting federal judges. The special retroactivity-related Social Security rules that Congress enacted in 1984, however, effectively singled out then-sitting federal judges for unfavorable treatment. Hence, like the Court of Appeals, we conclude that the Clause forbids the application of the Social Security tax to those judges.

I

A

The Medicare law before us is straightforward. In 1965, Congress created a Federal Medicare "hospital insurance" program and tied its financing to Social Security. See Social Security Amendments of 1965, 79 Stat. 291. The Medicare law required most American workers (whom Social Security covered) to pay an additional Medicare tax. But it did not require Federal Government employees (whom Social Security did not cover) to pay that tax. See 26 U.S.C. Sections 3121(b)(5), (6) (1982 ed.).

In 1982, Congress, believing that "[f]ederal workers should bear a more equitable share of the costs of financing the benefits to which many of them eventually became entitled," S. Rep. No. 97–494, pt. 1, p. 378 (1982), extended both Medicare eligibility and Medicare taxes to all currently employed federal employees as well as to all newly hired federal employees, Tax Equity and Fiscal Responsibility Act of 1982, Sec. 278, 96 Stat. 559–563. That new law meant that (as of January 1, 1983) all federal judges, like all other federal employees and most other citizens, would have to contribute between 1.30% and 1.45% of their federal salaries to Medicare's hospital insurance system. See 26 U.S.C. Sections 3101(b)(4)–(6).

The Social Security law before us is more complex. In 1935, Congress created the Social Security program. See Social Security Act, 49 Stat. 620. For nearly 50 years, that program covered employees in the private sector, but it did not cover Government employees. See 26 U.S.C. Sections 3121(b)(5), (6) (1982 ed.) (excluding federal employees); Sec. 3121(b)(7) (excluding state employees). In 1981, a National Commission on Social Security Reform, convened by the President and chaired by Alan Greenspan, noting the need for "action . . . to strengthen the financial status" of Social Security, recommended that Congress extend the program to cover Federal, but not state or local, Government employees. Report of the National Commission on Social Security Reform 2–1, 2–7 (Jan. 1983). In particular, the Commission recommended that Congress *require* all incoming federal employees (those hired after January 1, 1984) to enter the Social Security system and to pay Social Security taxes. *Id.*, at 2–7. The Commission emphasized that "present Federal employees will *not* be affected by this recommendation." *Id.*, at 2–8.

In 1983, Congress enacted the Commission's recommendation into law (effective January 1, 1984) with an important exception. See Social Security Amendments of 1983, Sec. 101(b)(1), 97 Stat. 69 (amending 26 U.S.C. Sections 3121(b)(5), (6)). As the Commission had recommended, Congress *required* all newly hired federal employees to participate in the Social Security program. It also *permitted*, without requiring, almost all (about 96%) then-currently employed federal employees to participate.

Contrary to the Commission's recommendation, however, the law added an exception. That exception seemed to restrict the freedom of choice of the remaining 4% of all current employees. This class consisted of the President, Vice President, high-level Executive Branch employees, Members of Congress, a few other Legislative Branch employees, and all federal judges. See 42 U.S.C. Sections 410(a)(5)(C)–(G); see also H.R. Rep. No. 98–25, p. 39 (1983); H.R. Conf. Rep. No. 98–542, p. 13 (1983) (noting that for these current federal employees "the rules are being changed in the middle of the game"). The new law seemed to *require* this class of current federal employees to enter into the Social Security program, see 42 U.S.C. Sections 410(a)(5)(C)–(G). But, as to almost all of these employees, the new law imposed no additional financial obligation or burden.

That is because the new law then created an exception to the exception, see Federal Employees' Retirement Contribution Temporary Adjustment Act of 1983, Secs. 203(a)(2), 208, 97 Stat. 1107, 1111 (codified at note following 5 U.S.C. Sec. 8331). The exception to the exception said that any member of this small class of current high-level officials (4% of all then-current employees) who contributed to a "covered" retirement program nonetheless could choose to modify their participation in a manner that left their total payroll deduction—for retirement and Social Security—unchanged. A "covered" employee paying 7% of salary to a "covered" program could continue to pay that 7% and no more, in effect avoiding any additional financial obligation as a result of joining Social Security.

The exception to the exception defined a "covered" program to include the Civil Service Retirement and Disability System—a program long available to almost all federal employees—as well as any other retirement system to which an employee must contribute. Secs. 203(a)(2)(A), (D). The definition of "covered" program, however, did not encompass the pension system for federal judges—a system that is noncontributory in respect to a judge (but contributory in respect to a spouse).

The upshot is that the 1983 law was specifically aimed at extending Social Security to federal employees. It left about 96% of those who were currently employed free to choose not to participate in Social Security, thereby avoiding any increased financial obligation. It required the remaining 4% to participate in Social Security while freeing them of any added financial obligation (or additional payroll deduction) so long as they previously had participated in other contributory retirement programs. But it left those who could not participate in a contributory program without a choice. Their financial obligations (and payroll deductions) had to increase. And this last mentioned group consisted almost exclusively of federal judges.

B

This litigation began in 1989, when eight federal judges, all appointed before 1983, sued the Government for "compensation" in the United States Claims Court. They argued that the 1983 law, in requiring them to pay Social Security taxes, violated the Compensation Clause. Initially, the Claims Court ruled against the judges on jurisdictional grounds. 21 Cl. Ct. 786 (1990). The Court of Appeals reversed. 953 F.2d 626 (CA Fed. 1992). On remand, eight more judges joined the lawsuit. They contested the extension to judges of the Medicare tax as well.

The Court of Federal Claims held against the judges on the merits. 31 Fed. Cl. 436 (1994). The Federal Circuit reversed, ordering summary judgment for the judges as to liability. 64 F.3d 647 (1995). The Government petitioned this Court for writ of certiorari. Some Members of this Court were disqualified from hearing the matter, and we failed to find a quorum of six Justices. See 28 U.S.C. Sec. 1. Consequently, the Court of Appeals' judgment was affirmed "with the same effect as upon affirmance by an equally divided court." 519 U.S. 801 (1996); see 28 U.S.C. Sec. 2109.

On remand from the Court of Appeals, the Court of Federal Claims found (a) that the 6-year statute of limitations, see 28 U.S.C. Sections 2401(a), 2501, barred some claims, including all Medicare claims; and (b) that, in any event, a subsequently enacted judicial salary increase promptly cured any violation, making damages minimal. 38 Fed. Cl. 166 (1997). The Court of Appeals (eventually en banc) reversed both determinations. 203 F.3d 795 (CA Fed. 2000).

The Government again petitioned for certiorari. It asked this Court to consider two questions:

(1) Whether Congress violated the Compensation Clause when it extended the Medicare and Social Security taxes to the salaries of sitting federal judges; and

(2) If so, whether any such violation ended when Congress subsequently increased the salaries of all federal judges by an amount greater than the new taxes.

Given the specific statutory provisions at issue and the passage of time, seven Members of this Court had (and now have) no financial stake in the outcome of this case. Consequently a quorum was, and is, available to consider the questions presented. And we granted the Government's petition for writ of certiorari.

II

At the outset, the judges claim that the "law of the case" doctrine prevents us from now considering the first question presented, namely, the scope of the Compensation Clause. They note that the Government presented that same question in its petition from the Court of Appeals' earlier ruling on liability. They point out that our earlier denial of that petition for lack of a quorum had the "same effect as" an "affirmance by an equally divided court," 28 U.S.C. Sec. 2109. And they add that this Court has said that an affirmance by an equally divided Court is "conclusive and binding upon the parties as respects that controversy." *United States v. Pink*, 315 U.S. 203, 216 (1942).

*Pink*, however, concerned a case, *United States v. Moscow Fire Ins. Co.*, 309 U.S. 624 (1940), in which this Court had heard oral argument and apparently considered the merits prior to concluding that affirmance by an equally divided Court was appropriate. The law of the case doctrine presumes a hearing on the merits. See, *e.g.*, *Quern v. Jordan*, 440 U.S. 332, 347, n. 18 (1979). This case does not involve a previous consideration of the merits. Indeed, when this case previously was before us, due to absence of a quorum, we could not consider either the merits or whether to consider those merits through grant of a writ of certiorari. This fact, along with the obvious difficulty of finding other equivalent substitute forums, convinces us that *Pink's* statement does not control the outcome here, that the "law of the case" doctrine does not prevent our considering both issues presented, and that we should now proceed to decide them.

III

The Court of Appeals upheld the judges' claim of tax immunity upon the authority of *Evans v. Gore*, 253 U.S. 245 (1920). That case arose in 1919, when Judge Walter Evans challenged Congress' authority to include sitting federal judges within the scope of a federal income tax law that the Sixteenth Amendment had authorized a few years earlier. See Revenue Act of 1918, Sec. 213, 40 Stat. 1065 (defining "gross income" to include judicial salaries). In *Evans* itself, the Court held that the Compensation Clause barred application of the tax to Evans, who had been appointed a judge before Congress enacted the tax. 253 U.S., at 264. A few years later, the Court extended *Evans*, making clear that its rationale covered not only judges appointed before Congress enacted a tax but also judges whose appointments took place after the tax had become law. See *Miles v. Graham*, 268 U.S. 501, 509 (1925).

Fourteen years after deciding *Miles*, this Court overruled *Miles*. *O'Malley v. Woodrough*, 307 U.S. 277 (1939). But, as the Court of Appeals noted, this Court did not expressly overrule *Evans* itself.

64 F.3d, at 650. The Court of Appeals added that if "changes in judicial doctrine" had significantly undermined *Evans'* holding, this "Court itself would have overruled the case." *Ibid*. Noting that this case is like *Evans* (involving judges appointed *before* enactment of the tax), not like *O'Malley* (involving judges appointed *after* enactment of the tax), the Court of Appeals held that *Evans* controlled the outcome. 64 F.3d, at 650. Hence application of both Medicare and Social Security taxes to these pre-enactment judges violated the Compensation Clause.

The Court of Appeals was correct in applying *Evans* to the instant case, given that "it is this Court's prerogative alone to overrule one of its precedents." *State Oil Co. v. Khan*, 522 U.S. 3, 20 (1997); see also *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989). Nonetheless, the court below, in effect, has invited us to reconsider *Evans*. We now overrule *Evans* insofar as it holds that the Compensation Clause forbids Congress to apply a generally applicable, nondiscriminatory tax to the salaries of federal judges, whether or not they were appointed before enactment of the tax.

The Court's opinion in *Evans* began by explaining why the Compensation Clause is constitutionally important, and we begin by reaffirming that explanation. As *Evans* points out, 253 U.S., at 251–252, the Compensation Clause, along with the Clause securing federal judges appointments "during good Behavior," U.S. Const., Art. III, Sec. 1—the practical equivalent of life tenure—helps to guarantee what Alexander Hamilton called the "complete independence of the courts of justice." The Federalist No. 78, p. 466 (C. Rossiter ed. 1961). Hamilton thought these guarantees necessary because the Judiciary is "beyond comparison the weakest of the three" branches of government. *Id*., at 465–466. It has "no influence over either the sword or the purse." *Id*., at 465. It has "no direction either of the strength or of the wealth of the society." *Ibid*. It has "neither FORCE nor WILL but merely judgment." *Ibid*.

Hamilton's view, and that of many other Founders, was informed by first-hand experience of the harmful consequences brought about when a King of England "made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries." The Declaration of Independence, Par. 11. And Hamilton knew that "*a power over a man's subsistence amounts to a power over his will*." The Federalist No. 79, at 472. For this reason, he observed, "[n]ext to permanency in office, nothing can contribute more to the independence of the judges than a fixed provision for their support." *Ibid*.; see also *id*., No. 48 at 310 (J. Madison) ("[A]s the legislative department alone has access to the pockets of the people, and has . . . full discretion . . . over the pecuniary rewards of those who fill the other departments, a dependence is thus created in the latter, which gives still greater facility to encroachments of the former").

*Evans* properly added that these guarantees of compensation and life tenure exist, "not to benefit the judges," but "as a limitation imposed in the public interest." 253 U.S., at 253. They "promote the public weal," *id*., at 248, in part by helping to induce "learned" men and women "to quit the lucrative pursuits" of the private sector, 1 J. Kent, Commentaries on American Law *294, but more importantly by helping to secure an independence of mind and spirit necessary if judges are "to maintain that nice adjustment between individual rights and governmental powers which constitutes political liberty," W. Wilson, Constitutional Government in the United States 143 (1911).

Chief Justice John Marshall pointed out why this protection is important. A judge may have to decide "between the Government and the man whom that Government is prosecuting: between the most powerful individual in the community, and the poorest and most unpopular." Proceedings and Debates of the Virginia State Convention, of 1829–1830, p. 616 (1830). A judge's decision may affect an individual's "property, his reputation, his life, his all." *Ibid*. In the "exercise of these duties," the judge must "observe the utmost fairness." *Ibid*. The judge must be "perfectly and completely independent, with nothing to influence or contro[l] him but God and his conscience." *Ibid*. The "greatest scourge . . . ever inflicted," Marshall thought, "was an ignorant, a corrupt, or a dependent Judiciary." *Id*., at 619.

Those who founded the Republic recognized the importance of these constitutional principles. See, *e.g.*, Wilson, Lectures on Law (1791), in 1 Works of James Wilson 363 (J. Andrews ed. 1896); (stating that judges should be "completely independent" in "their salaries, and in their offices"); McKean, Debate in Pennsylvania Ratifying Convention, Dec. 11, 1787, in 2 Debates on the Federal Constitution 539 (J. Elliot ed. 1836) (the security of undiminished compensation disposes judges to be "more easy and independent"); see also 1 Kent, *supra*, at *294 ("permanent support" and the "tenure of their office" "is well calculated . . . to give [judges] the requisite independence"). They are no less important today than in earlier times. And the fact that we overrule *Evans* does not, in our view, diminish their importance.

We also agree with *Evans* insofar as it holds that the Compensation Clause offers protections that extend beyond a legislative effort directly to diminish a judge's pay, say by ordering a lower salary. 253 U.S., at 254. Otherwise a legislature could circumvent even the most basic Compensation Clause protection by enacting a discriminatory tax law, for example, that precisely but indirectly achieved the forbidden effect.

Nonetheless, we disagree with *Evans'* application of Compensation Clause principles to the matter before it—a nondiscriminatory tax that treated judges the same way it treated other citizens. *Evans*' basic holding was that the Compensation Clause forbids such a tax because the Clause forbids "all diminution," including "taxation," "whether for one purpose or another." Id., at 255. The Federal Circuit relied upon this holding. 64 F.3d, at 650. But, in our view, it is no longer sound law.

For one thing, the dissenters in *Evans* cast the majority's reasoning into doubt. Justice Holmes, joined by Justice Brandeis, wrote that the Compensation Clause offers "no reason for exonerating" a judge "from the ordinary duties of a citizen, which he shares with all others. To require a man to pay the taxes that all other men have to pay cannot possibly be made an instrument to attack his independence as a judge." *Evans*, 253 U.S., at 265. Holmes analogized the "diminution" that a tax might bring about to the burden that a state law might impose upon interstate commerce. If "there was no discrimination against such commerce, the tax constituted one of the ordinary burdens of government from which parties were not exempted." *Id*., at 267.

For another thing, this Court's subsequent law repudiated *Evans*' reasoning. In 1939, 14 years after *Miles* extended *Evans*' tax immunity to judges appointed after enactment of the tax, this Court retreated from that extension. See *O'Malley*, 307 U.S., at 283 (overruling *Miles*). And in so doing the Court, in an opinion announced by Justice Frankfurter, adopted the reasoning of the *Evans* dissent. The Court said that the question was whether judges are immune "from the incidences of taxation to which everyone else within the defined classes . . . is subjected." *Id*., at 282. Holding that judges are not "immun[e] from sharing with their fellow citizens the material burden of the government," *ibid*., the Court pointed out that the legal profession had criticized *Evans*' contrary conclusion, and that courts outside the United States had resolved similar matters differently, *id*., at 281. And the Court concluded that "a nondiscriminatory tax laid generally on net income is not, when applied to the income of a federal judge, a diminution of his salary within the prohibition of Article III." *Id*., at 282. The Court conceded that *Miles* had reached the opposite conclusion, but it said that *Miles* "cannot survive." 307 U.S., at 283. Still later, this Court noted that "[b]ecause *Miles* relied on *Evans v. Gore*, *O'Malley* must also be read to undermine the reasoning of *Evans*." *United States v. Will*, 449 U.S. 200, 227, n. 31 (1980).

Finally, and most importantly, we believe that the reasoning of Justices Holmes and Brandeis, and of this Court in *O'Malley*, is correct. There is no good reason why a judge should not share the tax burdens borne by *all* citizens. We concede that this Court has held that the Legislature cannot *directly* reduce judicial salaries even as part of an equitable effort to reduce *all* Government salaries. See 449 U.S., at 226. But a tax law, unlike a law mandating a salary reduction, affects compensation indirectly, not directly. See *ibid*. (distinguishing between measures that directly and those that indirectly diminish judicial compensation). And those prophylactic considerations that may justify an absolute rule forbidding direct salary reductions are absent here, where indirect taxation is at issue. In practice, the likelihood that a nondiscriminatory tax represents a disguised legislative effort to influence the judicial will is virtually nonexistent. Hence, the potential threats to judicial independence that underlie the Constitution's compensation guarantee cannot justify a special judicial exemption from a commonly shared tax, not even as a preventive measure to counter those threats.

For these reasons, we hold that the Compensation Clause does not forbid Congress to enact a law imposing a nondiscriminatory tax (including an increase in rates or a change in conditions) upon judges, whether those judges were appointed before or after the tax law in question was enacted or took effect. Insofar as *Evans* holds to the contrary, that case, in *O'Malley's* words, "cannot survive." 307 U.S., at 283.

The Government points out that the Medicare tax is just such a nondiscriminatory tax. Neither the courts below, nor the federal judges here, argue to the contrary. Hence, insofar as the Court of Appeals found that application of the Medicare tax law to federal judges is unconstitutional, we reverse its decision.

IV

The Social Security tax is a different matter. Respondents argue that the 1983 law imposing that tax upon then-sitting judges violates the Compensation Clause, for it discriminates against judges in a manner forbidden by the Clause, even as interpreted in *O'Malley*, not *Evans*. Cf. *O'Malley*, *supra*, at 282 (stating question as whether judges are immune "from the incidences of taxation *to which everyone else within the defined classes* . . . is subjected" (emphasis added)). After examining the statute's details, we agree with the judges that it does discriminate in a manner that the Clause forbids. Four features of the law, taken together, lead us to this conclusion.

First, federal employees had remained outside the Social Security system for nearly 50 years prior to the passage of the 1983 law. Congress enacted the law pursuant to the Social Security Commission's recommendation to bring those employees within the law. See *supra*, at 3. And the law itself deals primarily with that subject. Thus, history, context, statutory purpose, and statutory language, taken together, indicate that the category of "federal employees" is the appropriate class against which we must measure the asserted discrimination.

Second, the law, as applied in practice, in effect imposed a new financial obligation upon sitting judges, but it did not impose a new financial burden upon any other group of (then) current federal employees. We have previously explained why that is so. See *supra*, at 3–5. The law required all newly hired federal employees to join Social Security and pay related taxes. It gave 96% of all current employees (employed as of January 1, 1984 or earlier) total freedom to enter, or not to enter, the system as they chose. It gave the remaining 4% of all current employees the freedom to maintain their pre-1984 payroll deductions, provided that they were currently enrolled in a "covered" system. And it defined "covered" system in a way that included virtually all of that 4%, except for federal judges. See *supra*, at 4–5. The practical upshot is that the law permitted nearly every current federal employee, but not federal judges, to avoid the newly imposed financial obligation.

Third, the law, by including sitting judges in the system, adversely affected most of them. Inclusion meant a requirement to pay a tax of about $2,000 per year, deducted from a monthly salary check. App. 49. At the same time, 95% of the then-active judges had already qualified for Social Security (due to private sector employment) before becoming judges. See *id*., at 115. And participation in Social Security as judges would benefit only a minority. See *id*., at 116–119 (reviewing examples of individual judges and demonstrating that participation in Social Security primarily would benefit the minority of judges who had not worked the 40 quarters necessary to be fully insured). The new law imposed a substantial cost on federal judges with little or no expectation of substantial benefit for most of them.

Fourth, when measured against Compensation Clause objectives, the Government's justification for the statutory distinction (between judges, who do, and other federal employees, who do not, incur additional financial obligations) is unsound. The sole justification, according to the Government, is one of "equaliz[ing]" the retirement-related obligations that pre-1983 law imposed upon judges with the retirement-related obligations that pre-1983 law imposed upon other current high-level federal employees. Brief for United States 40. Thus, the Government says that the new financial burden imposed upon judges was meant to make up for the fact that the judicial retirement system is basically a noncontributory system, while the system to which other federal employees belonged was a contributory system. *Id.*, at 39–40; Reply Brief for United States 16.

This rationale, however, is the Government's and not necessarily that of Congress, which was silent on the matter. Cf. *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29, 50 (1983) (expressing concern at crediting *post hoc* explanation of agency action).

More importantly, the judicial retirement system is noncontributory because it reflects the fact that the Constitution itself guarantees federal judges life tenure—thereby constitutionally permitting federal judges to draw a salary for life simply by continuing to serve. Cf. *Booth v. United States*, 291 U.S. 339, 352 (1934) (holding that Compensation Clause protects salary of judge who has retired). That fact means that a contributory system, in all likelihood, would not work. And, of course, as of 1982, the noncontributory pension salary benefits were themselves part of the judge's compensation. The 1983 statute consequently singles out judges for adverse treatment solely because of a feature required by the Constitution to preserve judicial independence. At the same time, the "equaliz[ation]" in question takes place not by offering all current federal employees (including judges) the same opportunities but by employing a statutory disadvantage which offsets a constitutionally guaranteed advantage. Hence, to accept the "justification" offered here is to permit, through similar reasoning, taxes which have the effect of weakening or eliminating those constitutional guarantees necessary to secure judicial independence, at least insofar as similar guarantees are not enjoyed by others. This point would be obvious were Congress, say, to deny some of the benefits of a tax reduction to those with constitutionally guaranteed life tenure to make up for the fact that other employees lack such tenure. Although the relationships here—among advantages and disadvantages—are less distant and more complex, the principle is similar.

Nor does the statute "equaliz[e]" with any precision. On the one hand, the then-current retirement system open to all federal employees except judges required a typical employee to contribute 7% to 8% of his or her annual salary. See generally 5 U.S.C. Sec. 8334(a)(1). In return it provided a Member of Congress, for instance, with a pension that vested after five years and increased in value (by 2.5% of the Member's average salary) with each year of service to a maximum of 80% of salary, and covered both employee and survivors. See 5 U.S.C. Sections 8339, 8341. On the other hand, the judges' retirement system (based on life tenure) required no contribution for a judge who retired at age 65 (and who met certain service requirements) to receive full salary. But the right to receive that salary did not vest until retirement. The system provided nothing for a judge who left office before age 65. Nor did the law provide any coverage for a judge's survivors. Indeed, in 1984, a judge had to contribute 4.5% of annual salary to obtain a survivor's annuity, which increased in value by 1.25% of the judge's salary per year to a maximum of 40% of salary. 28 U.S.C. Sections 376(b), (*1*) (1982 ed.).

These two systems were not equal either before or after Congress enacted the 1983 law. Before 1983, a typical married federal employee other than a judge had to contribute 7 to 8% of annual salary to receive benefits that were better in some respects (vesting period, spousal benefit) and worse in some respects (80% salary maximum) than his married judicial counterpart would receive in return for a 4.5% contribution. The 1983 law imposed an added 5.7% burden upon the judge, in return for which the typical judge received little, or no, financial benefit. Viewed purely in financial equalization terms, and as applied to typical judges, the new requirement seems to over-equalize, putting the typical married judge at a financial disadvantage—though perhaps it would produce greater equality when applied to other, less typical examples.

Taken together, these four characteristics reveal a law that is special—in its manner of singling out judges for disadvantageous treatment, in its justification as necessary to offset advantages related to constitutionally protected features of the judicial office, and in the degree of permissible legislative discretion that would have to underlie any determination that the legislation has "equalized" rather than gone too far. For these reasons, the law before us is very different from the "nondiscriminatory" tax that *O'Malley* upheld. 307 U.S., at 282. Were the Compensation Clause to permit Congress to enact a discriminatory law with these features, it would authorize the Legislature to diminish, or to equalize away, those very characteristics of the Judicial Branch that Article III guarantees—characteristics which, as we have said, see *supra*, at 9–10, the public needs to secure that judicial independence upon which its rights depend. We consequently conclude that the 1983 Social Security tax law discriminates against the Judicial Branch, in violation of the Compensation Clause.

The Government makes additional arguments in support of reversal. But we find them unconvincing. It suggests that Article III protects judges only against a reduction in stated salary, not against indirect measures that only reduce take-home pay. Brief for United States 28. In *O'Malley*, however, this Court, when upholding a "nondiscriminatory" tax, strongly implied that the Compensation Clause would bar a discriminatory tax. 307 U.S., at 282. The commentators whose work *O'Malley* cited said so explicitly. See Fellman, The Diminution of Judicial Salaries, 24 Iowa L. Rev. 89, 99 (1938); see also Hall, Case Comment, 20 Ill. L. Rev. 376, 377 (1925); Corwin, Constitutional Law in 1919–1920, 14 Am. Pol. Sci. Rev. 635, 642 (1920). And in *Will*, the Court yet more strongly indicated that the Compensation Clause bars indirect efforts to reduce judges' salaries through taxes when those taxes discriminate. 449 U.S., at 226. Indeed, the Government itself "assume[s] that discriminatory taxation of judges would contravene fundamental principles underlying Article III, if not the [Compensation] Clause itself." Brief for United States 37, n. 27.

The Government also argues that there is no evidence here that Congress singled out judges for special treatment in order to intimidate, influence, or punish them. But, this Court has never insisted upon such evidence. To require it is to invite legislative efforts that embody, but lack evidence of, some such intent, engendering suspicion among the branches and consequently undermining that mutual respect that the Constitution demands. Cf. Wilson, Lectures on Law, in 1 Works of James Wilson, at 364 (stating that judges "should be removed from the most distant apprehension of being affected, in their judicial character and capacity, by anything, except their own behavior and its consequences"). Nothing in the record discloses anything other than benign congressional motives. If the Compensation Clause is to offer meaningful protection, however, we cannot limit that protection to instances in which the Legislature manifests, say, direct hostility to the Judiciary.

Finally, the Government correctly points out that the law disfavored not only judges but also the President of the United States and certain Legislative Branch employees. As far as we can determine, however, all Legislative Branch employees were free to join a covered system, and the record provides us with no example of any current Legislative Branch employee who had failed to do so. See Tr. of Oral Arg. 16–17, 37–38. The President's pension is noncontributory. See note following 3 U.S.C. Sec. 102. And the President himself, like the judges, is protected against diminution in his "[c]ompensation." See U.S. Const., Art. II, Sec. 1. These facts may help establish congressional good faith. But, as we have said, we do not doubt that good faith. And we do not see why, otherwise, the separate and special example of that single individual, the President, should make a critical difference here.

We conclude that, insofar as the 1983 statute required then-sitting judges to join the Social Security System and pay Social Security taxes, that statute violates the Compensation Clause.

V

The second question presented is whether the

> "constitutional violation ended when Congress increased the statutory salaries of federal judges by an amount greater than the amount [of the Social Security] taxes deducted from respondents' judicial salaries." Pet. for Cert. (I).

The Government argues for an affirmative answer. It points to a statutory salary increase that all judges received in 1984. It says that this increase, subsequent to the imposition of Social Security taxes on judges' salaries, cured any earlier unconstitutional diminution of salaries in a lesser amount. Otherwise, if "Congress improperly reduced judges salaries from $140,000" per year "to $130,000" per year, the judges would be able to collect the amount of the improper reduction, here $10,000, forever—even if Congress cured the improper reduction by raising salaries $20,000, to $150,000, a year later. Reply Brief for United States 18. To avoid this consequence, the Government argues, we should simply look to the fact of a later salary increase "whether or not one of Congress's purposes in increasing the salaries" was "to terminate the constitutional violation." *Ibid*.

But how could we always decide whether a later salary increase terminates a constitutional violation without examining the purpose of that increase? Imagine a violation that affected only a few. To accept the Government's position, would leave those few at a permanent salary disadvantage. If, for example, Congress reduced the salaries of one group of judges by 20%, a later increase of 30% applicable to all judges would leave the first group permanently 20% behind. And a pay cut that left those judges at a permanent disadvantage, would perpetuate the very harm that the Compensation Clause seeks to prevent.

The Court of Appeals consequently examined the context in which the later pay increases took place in order to determine their relation to the earlier Compensation Clause violation. It found "nothing to suggest" that the later salary increase at issue here sought "to make whole the losses sustained by the pre-1983 judges." 185 F.3d, at 1362–1363. The Government presents no evidence to the contrary.

The relevant economic circumstances surrounding the 1984, and subsequent, salary increases include inflation sufficiently serious to erode the real value of judicial salaries and salary increases insufficient to maintain real salaries or real compensation parity with many other private-sector employees. See Report of 1989 Commission on Executive, Legislative, and Judicial Salaries, Hearings before the Senate Committee on Governmental Affairs, 101st Cong., 1st Sess., 12–13 (1989) (testimony of Lloyd Cutler regarding effect of inflation on judges' salaries since 1969). For instance, while consumer prices rose 363% between 1969 and 1999, salaries in the private sector rose 421%, and salaries for district judges rose 253%. See American Bar Association, Federal Judicial Pay Erosion 11 (Feb. 2001). These figures strongly suggest that the judicial salary increases simply reflected a congressional effort to restore both to judges and to Members of Congress themselves some, but not all, of the real compensation that inflation had eroded. Those salary increases amounted to a congressional effort to adjust judicial salaries to reflect "fluctuations in the value of money," The Federalist No. 79, at 473 (A. Hamilton)—the kind of adjustment that the Founders believed "may be requisite," McKean, Debate in Pennsylvania Ratifying Convention, Dec. 11, 1787, in 2 Debates on the Federal Constitution, at 539; see also Rosenn, The Constitutional Guaranty Against Diminution of Judicial Compensation, 24 UCLA L. Rev. 308, 314–315 (1976).

We have found nothing to the contrary. And, we therefore agree with the Court of Appeals' similar conclusion. 185 F.3d at 1363 ("[E]verything in the record" suggests that the increase was meant to halt "the slide in purchasing power resulting from continued and unadjusted-for inflation").

The Government says that a circumstance-specific approach may prove difficult to administer. Brief for United States 43. And we concede that examining the circumstances in order to determine whether there is or is not a relation between an earlier violation and a later increase is more complex than the Government's proposed automatic approach. But we see no reason why such relief as damages or an exemption from Social Security would prove unworkable.

Finally, the Government looks to our decision in *Will* for support. In that case, federal judges challenged the constitutionality of certain legislative "freezes" that Congress had imposed upon earlier enacted Government-wide cost-of-living salary adjustments. The Court found a Compensation Clause violation in respect to the freeze for what was designated Year One (where Congress had rescinded an earlier-voted 4.8% salary increase). *Will*, 449 U.S., at 225–226. The Government points out that the *Will* Court "noted that Congress, later in that fiscal year, enacted a statutory increase in judges' salaries that exceeded the salaries that judges would have received" without the rescission. Brief for United States 41. And the Government adds that "it was unquestioned in *Will*" that the judges could not receive damages for the time subsequent to this later enactment. *Id.*, at 41–42.

The *Will* Year One example, however, shows only that, in the circumstances, and unlike the case before us, the later salary increase *was* related to the earlier salary diminishment. Regardless, the very fact that the matter was "unquestioned" in *Will* shows that it was not argued. See 449 U.S., at 206, n. 3 (noting that the judges' complaint sought relief for Year One's diminution only up to the moment of the subsequent salary increase). Hence, the Court did not decide the matter now before us.

We conclude that later statutory salary increases did not cure the preceding unconstitutional harm.

VI

Insofar as the Court of Appeals found the application of Medicare taxes to the salaries of judges taking office before 1983 unconstitutional, its judgment is reversed. Insofar as that court found the application of Social Security taxes to the salaries of judges taking office before 1984 unconstitutional, its judgment is affirmed. We also affirm the Court of Appeals' determination that the 1984 salary increase received by federal judges did not cure the Compensation Clause violation. The case is remanded for further proceedings consistent with this opinion.

*It is so ordered.*

JUSTICE STEVENS and JUSTICE O'CONNOR took no part in the consideration or decision of this case.

**SUPREME COURT OF THE UNITED STATES**

No. 99–1978

UNITED STATES, PETITIONER *v.* TERRY J. HATTER, JR., JUDGE, UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, ET AL.

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

May 21, 2001

JUSTICE SCALIA, concurring in part and dissenting in part.

I agree with the Court that extending the Social Security tax to sitting Article III judges in 1984 violated Article III's Compensation Clause. I part paths with the Court on the issue of extending the Medicare tax to federal judges in 1983, which I think was also unconstitutional.[1]

I

As an initial matter, I think the Court is right in concluding that *Evans v. Gore*, 253 U.S. 245 (1920)—holding that new taxes of general applicability cannot be applied to sitting Article III judges—is no longer good law, and should be overruled. We went out of our way in *O'Malley v. Woodrough*, 307 U.S. 277, 280–281 (1939), to catalog criticism of *Evans*, and subsequently recognized, in *United States v. Will*, 449 U.S. 200, 227, and n. 31 (1980), that *O'Malley* had "undermine[d] the reasoning of *Evans*." The Court's decision today simply recognizes what should be obvious: that *Evans* has not only been undermined, but has in fact collapsed.

II

My disagreement with the Court arises from its focus upon the issue of discrimination, which turns out to be dispositive with respect to the Medicare tax. The Court holds "that the Compensation Clause does not forbid Congress to enact a law imposing a nondiscriminatory tax . . . upon judges, whether those judges were appointed before or after the tax law in question was enacted or took effect." *Ante*, at 12. Since "the Medicare tax is just such a nondiscriminatory tax," the Court concludes that "application of [that] tax law to federal judges is [c]onstitutional." *Ante*, at 12–13.

But we are dealing here with a "Compensation Clause," not a "Discrimination Clause." See U.S. Const., Art III, Sec. 1 ("The Judges . . . shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office"). As we have said, "the Constitution makes no exceptions for 'nondiscriminatory' reductions" in judicial compensation, *Will*, *supra*, at 226. A reduction in compensation is a reduction in compensation, even if all federal employees are subjected to the same cut. The discrimination criterion that the Court uses would make sense if the only purpose of the Compensation Clause were to prevent invidious (and possibly coercive) action against judges. But as the Court acknowledges, the Clause "'promote[s] the public weal' . . . by helping to induce 'learned' men and women to 'quit the lucrative pursuits' of the private sector," *ante*, at 9 (quoting *Evans*, *supra*, at 248; 1 J. Kent, Commentaries on American Law *294). That inducement would not exist if Congress could cut judicial salaries so long as it did not do so discriminatorily.

What the question comes down to, then, is (1) whether exemption from a certain tax can constitute part of a judge's "compensation," and (2) if so, whether exemption from the Medicare tax was part of the judges' compensation here. The answer to the more general question seems to me obviously yes. Surely the term "compensation" refers to the entire "package" of benefits—not just cash, but retirement benefits, medical care, and *exemption from taxation if that is part of the employment package*. It is simply unreasonable to think than "$150,000 a year tax-free" (if that was the bargain struck) is not higher compensation than "$150,000 a year subject to taxes." Ask the employees of the World Bank.

[1] I agree with the Court, see Part II, *ante*, that the law-of-the-case doctrine does not bar our consideration of the merits. I also join the Court in holding, see Part V, *ante*, that any constitutional violation was not remedied by subsequent salary increases.

The more difficult question—though far from an insoluble one—is *when* an exemption from tax constitutes compensation. In most cases, the presence or absence of taxation upon wages, like the presence or absence of many other factors within the control of government—inflation, for example, or the rates charged by government-owned utilities, or import duties that increase consumer prices—affects the *value* of compensation, but is not an element of compensation itself. The Framers had this distinction well in mind. Hamilton, for example, wrote that as a result of "the fluctuations in the value of money," "[i]t was . . . necessary to leave it to the discretion of the legislature to vary its provisions" for judicial compensation. The Federalist No. 79, p. 473 (C. Rossiter, ed. 1961); see also *Will*, *supra*, at 227 (the Constitution "placed faith in the integrity and sound judgment of the elected representatives to enact increases" in judicial salaries to account for inflation). Since Hamilton thought that the Compensation Clause "put it out of the power of [Congress] to change the condition of the individual [judge] for the worse," The Federalist No. 79, at 473, he obviously believed that inflation does not diminish compensation as that term is used in the Constitution.

This distinction between Government action affecting compensation and Government action affecting the *value* of compensation was the basis for our statement in *O'Malley*, 307 U.S., at 282, that "[t]o subject [judges] to a general tax is merely to recognize that judges are also citizens, and that their particular function in government does not generate an immunity from sharing with their fellow citizens the material burden of the government. . . ." I agree with the Court, therefore, that *Evans* was wrongly decided—not, however, because in *Evans* there was no discrimination, but because in *Evans* the universal application of the tax *demonstrated* that the Government was not reducing the compensation of its judges but was acting as sovereign rather than employer, imposing a general tax.

But just as it is clear that a federal employee's sharing of a tax-free status that all citizens enjoy is not compensation (and elimination of that tax-free status not a reduction in compensation), so also it is clear that a tax-free status conditioned on federal employment *is* compensation, and its elimination a reduction. The Court apparently acknowledges that if a tax is *imposed* on the basis of federal employment (an income tax, for example, payable only by federal judges) it would constitute a *reduction* in compensation. It is impossible to understand why a tax that is *suspended* on the basis of federal employment (an exemption from federal income tax for federal judges) does not constitute the *conferral* of compensation—in which case its elimination is a *reduction*, whether or not federal judges end up being taxed just like other citizens. Only converting the Compensation Clause into a Discrimination Clause can explain a contrary conclusion.

And this, of course, is what has been achieved by the targeted extension of the Medicare tax to federal employees who were previously exempt. It may well be that, in some abstract sense, they are not being "discriminated against," since they end up being taxed like other citizens; but this does not alter the fact that, since exemption from the tax was part of their employment package—since they had an employment expectation of a preferential exemption from taxation—their *compensation* was being reduced. One of the benefits of being a federal judge (or any federal employee) had, prior to 1982, been an exemption from the Medicare tax. This benefit Congress took away, much as a private employer might terminate a contractual commitment to pay Medicare taxes on behalf of its employees. The latter would clearly be a cut in compensation, and so is the former.[2] Had Congress simply imposed the Medicare tax on its own employees (including judges) at the time it introduced that tax for other working people, no benefit of federal employment would have been reduced, because, with respect to the newly introduced tax, none had ever existed. But an extension to federal employees of a tax from which they had previously been exempt *by reason of their employment status*, seems to me a flat-out reduction of federal employment compensation.

[2] As the Court explains, the purpose of the Medicare tax extension was to ensure that federal workers "bear a more equitable share of the costs of financing the benefits to which many of them eventually became entitled" by reason of their own or their spouses' private-sector employment. *Ante*, at 2 (internal quotation marks and citation omitted). As with the Social Security tax, therefore, the Medicare tax aspect of this case does not present the situation in which a tax exemption has been eliminated in return for some other benefit, different in kind but equivalent in value. Cf. *Ante*, at 14 ("[P]articipation in Social Security as judges would benefit only a minority").

III

As should be clear from the above, though I agree with the Court that the extension of the Social Security tax to federal judges runs afoul of the Compensation Clause, I disagree with the Court's grounding of this holding on the discriminatory manner in which the extension occurred. In this part of its opinion, however, the Court's antidiscrimination rationale is slightly different from that which appeared in its discussion of the Medicare tax. There, the focus was on discrimination compared with ordinary citizens; here, the focus is on discrimination vis-a-vis other federal employees. (As the Court explains, federal judges, unlike nearly all other federal employees, were not given the opportunity to opt out of paying the tax). On my analysis, it would not matter if every federal employee had been made subject to the Social Security tax along with judges, so long as one of the previous entitlements of their federal employment had been exemption from that tax. Federal judges, unlike all other federal employees except the President, see Art. II, Sec. 1, cl. 7, cannot, consistent with the Constitution, have their compensation diminished. If this case involved salary cuts to pay for Social Security, rather than taxes to pay for Social Security, the irrelevance of whether other federal employees were covered by the operative legislation would be clear.

* * *

I join in the judgment that extension of the Social Security tax to sitting Article III judges was unconstitutional. I would affirm the Federal Circuit's holding that extension of the Medicare tax was unconstitutional as well.

**SUPREME COURT OF THE UNITED STATES**

No. 99–1978

UNITED STATES, PETITIONER *v.* TERRY J. HATTER, JR., JUDGE, UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, ET AL.

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

May 21, 2001

JUSTICE THOMAS, concurring in the judgment in part and dissenting in part.

I believe this Court was correct in *Evans v. Gore*, 253 U.S. 245 (1920), when it held that any tax that reduces a judge's net compensation violates Article III of the Constitution. Accordingly, I would affirm the judgment of the Court of Appeals in its entirety.

# Part III. Administrative, Procedural, and Miscellaneous

## Proposed Audit Guidance for External Auditors of Qualified Intermediaries

## Notice 2001–66

This notice requests comments on the attached proposed audit guidelines for qualified intermediaries (QI). QI's are a key component of the withholding and reporting regulations that became effective on January 1, 2001 (T.D. 8734, 1997–2 C.B. 109 and T.D. 8881, 2000–23 I.R.B. 1158).

**I. BACKGROUND**

Generally, a QI is a non-U.S. financial institution that has entered into a contractual agreement with the Internal Revenue Service (IRS). Under the agreement, the QI generally agrees to report annually certain aggregate information concerning the beneficial owners of U.S. source payments and to make any necessary tax payments to the IRS. Additionally, the QI agrees to engage an external auditor to verify that it is in compliance with the QI agreement. In return, the QI avoids the expense and burden of forwarding documentation with respect to each beneficial owner to a U.S. withholding agent in order to claim reductions in U.S. withholding tax. The QI also enjoys other significant benefits under the new rules, including the ability to rely on a collective refund procedure for its customers.

The IRS and Treasury have worked closely with the financial community in developing the QI system. The audit guidelines attached to this notice are being issued in proposed form specifically to continue the dialogue with the financial community on how to implement the audit procedures of the QI agreements in a way that minimizes costs to the QIs while preserving the compliance goals of the withholding regulations. The IRS and Treasury recognize that achieving these goals requires that the audit process preserves the cooperative nature and effectiveness of the QI system.

**II. THE PROPOSED THREE PART QI AUDIT PROCESS**

The guidelines attached to this notice reflect a three part audit process. As described further below, whether a particular QI's audit will progress through all three parts generally will depend upon the results of each part. IRS expects that, if a QI demonstrates a satisfactory level of compliance with the QI agreement in the first part of the audit process, the QI will not be required to complete any further parts in the process during that audit cycle.

**A. PART 1: Basic Fact Finding**

Part 1 consists of basic fact finding. The external auditor performs the tasks detailed in the attached audit guidelines. From these fact finding activities, the auditor will develop a report of numerical results. The attached audit guidelines contain precise directions on what numerical information must be included in the auditor's report. The auditor will send a hard copy of this initial report to the IRS. The IRS intends to develop a standard electronic report form.

If the numerical results of a particular QI's audit demonstrate a high level of compliance with the QI agreement, then it is expected that the IRS generally will notify the QI that its audit is complete and that no additional steps need to be taken. If, however, the numerical results suggest that the QI has experienced some difficulties in meeting its obligations under the agreement, then the IRS will notify the QI that it is proceeding to Part 2 of the audit process.

**B. PART 2: Follow Up Fact Finding**

In Part 2 of the audit process, the IRS will contact the auditor and ask about certain numerical results in the auditor's report. If additional information is needed, the IRS will direct the auditor to perform additional procedures and to report on the results. The goal of this step of the audit process will be to identify the cause for the numerical results and to determine whether corrective actions are readily discernible.

For example, an audit report may show that the auditor was unable to associate beneficial owner information with a specified percentage of the QI's accounts. By discussing the facts with the auditor, the IRS may be able to determine that the problem was attributable to deficient account opening procedures in one of the QI's branches. If the IRS is satisfied that the QI had taken corrective steps to ensure that the branch was appropriately opening new accounts, and if the QI has otherwise shown a high level of compliance with the QI agreement, then there would be no need to proceed to Part 3 of the audit process. Under other circumstances, however, the IRS may determine that further work must be done to resolve the issues raised in Part 1 of the audit process.

**C. PART 3: Audit Meeting with QI**

If the concerns arising from the numerical results reported in Part 1 of the audit process cannot be resolved by directed fact finding in Part 2, then the IRS will propose to meet with the QI to attempt mutually to clarify and resolve those concerns. This part is designed specifically to provide a forum where a productive dialogue between the IRS and the QI can occur. Treasury and the IRS continue to believe that the QI system, which allows the IRS's compliance goals to be met while minimizing the administrative burdens on financial institutions, is a critical component of the withholding regulations. Accordingly, the IRS will seek to develop mutually acceptable solutions to the issues that arise in the course of administering the QI agreements so that it will not become necessary to terminate a QI agreement.

**III. Key Concepts for Comment in the Attached Audit Guidelines**

The IRS and Treasury invite comments on all sections of both this Notice and the attached proposed audit guidelines. This section is intended to draw attention to particularly important aspects of the audit guidelines that are designed to lessen burdens on financial institutions serving as QIs.

**A. Submission of Audit Plans.**

Under the proposed audit guidelines, the submission of an audit plan to the IRS prior to performing the audit is not necessary if the external auditor plans to follow the audit guidelines. If, however, the external auditor plans to modify or deviate from the audit guidelines, then an audit plan should be submitted to the IRS for prior approval. For example, the external auditor may propose to use multistage, cluster, stratification or some other sampling methodology in conducting its audit. In such cases, the external auditor should submit a written audit plan and should identify, and explain the reasons for, any proposed modifications or deviations from the audit guidelines.

**B. Discretionary Waivers of External Audit.**

The proposed audit guidelines allow QIs to request that the IRS waive the performance of an audit by an external auditor in three cases. In the first case, a QI may request a waiver of the external audit if it has received not more than $250,000 in reportable payments during the year to be audited. Instead of an external audit in this case, the QI must submit copies of its Forms 1042 and 945, copies of the Forms 1042–S issued to it and filed by it, and copies of its Forms W-8IMY provided to its withholding agents, along with information about the number of its account holders of various classes.

In the second case, a QI may request a waiver of the external audit if it has made reportable payments to no more than 2000 direct and indirect account holders during the year to be audited. Instead of an external audit in this case, the QI must itself perform the audit procedures and report to the IRS in accordance with the audit guidelines. Statistical sampling will not be permitted in this case. The IRS will not agree to waive the external audit for the first audit year of the first term of the QI Agreement in this case. The IRS will not agree to waive the performance of an external audit for a Private Arrangement Intermediary (PAI).

In the third case, a QI may request a waiver of the external audit if it has a substantial and independent internal audit department and its internal audit department has audited the QI's compliance under the QI agreement for each of the three years preceding the year to be audited. Instead of an external audit in this case, the QI's internal audit department must perform the audit and report to the IRS in accordance with the audit guidelines. Statistical sampling will be permitted in this case.

Whether the IRS will waive the external audit in any case is discretionary. In the second and third cases, the IRS will not waive the external audit for more than one audit year during any one term of the QI agreement.

**C. External Auditor's Reliance on Internal Auditors.**

The proposed audit guidelines allow the external auditor to use a QI's internal audit staff and internal audit reports to any extent the external auditor chooses. Nevertheless, the external auditor remains personally responsible for the conduct of the audit. The external auditor must disclose in the audit report specifically how and when it has used internal audit staff and reports. Further, the external auditor must certify that the use of the internal audit personnel and reports has not affected the accuracy of the external auditor's report.

**D. Projection of Underwithholding.**

The QI agreement provides that if statistical sampling has been used and the auditor determines that underwithholding has occurred with respect to the sampled accounts, the IRS will determine the total amount of underwithheld tax by projecting the underwithholding over the entire population of similar accounts.

Under the proposed audit guidelines, if the auditor uses a sample and has found that underwithholding has occurred with respect to an account in the sample, the auditor must report the underwithholding in the report for step 1 of the audit. In step 2 of the audit, the IRS would direct the external auditor to perform any additional procedures necessary to collect any information required to determine whether it is appropriate to project the underwithholding and any information required to make a projection. The IRS will employ a projection method that is consistent with the sampling methodology used. In step 3 of the audit, the QI may address whether projection is appropriate and may propose a projection using another amount of underwithholding based on a more accurate population, a more accurate projection technique, or an examination of all similar accounts.

**IV. Comments.**

Written comments must be received by December 12, 2001. Send comments to CC:DOM:CORP:R (NOT–151112–01), Room 5228, Internal Revenue Service, Ben Franklin Station, Washington, DC 20224. Alternatively, comments may be hand delivered between the hours of 8:00 AM and 5:00 PM to: CC:DOM:CORP:R (NOT–151112–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave. NW, Washington, DC.

Contact Information

For further information regarding this Notice, contact Carl Cooper or Laurie Hatten-Boyd of the Office of the Associate Chief Counsel (International), Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Mr. Cooper and Ms. Hatten-Boyd may be contacted by telephone at 202-622-3840 (not a toll-free call).

APPENDIX

(PROPOSED) GUIDANCE

FOR EXTERNAL AUDITORS OF QUALIFIED INTERMEDIARIES

Section 4 of Rev. Proc. 2000–12 (2000–4 I.R.B. 387, 388) provides the final text of the Qualified Intermediary Agreement ("QI Agreement") between the Internal Revenue Service ("IRS") and a qualified intermediary ("QI"). Section 10 of the QI Agreement provides external audit procedures. In section 10, the IRS agrees not to conduct an on-site audit of the QI provided the QI engages an external auditor to conduct an audit in accordance with the procedures detailed therein. Under those procedures, the external auditor examines the QI to verify whether it is in compliance with the QI Agreement and makes a report to the IRS. Section 10 of the QI Agreement is reproduced below in bolded text for reference. Following each paragraph of section 10, procedural guidance on audit issues is provided under the heading Audit Guidance numbered to correspond to the QI Agreement. The audit guidance under sections 10.01 to 10.03 includes procedures that a QI may follow to request an IRS audit or a waiver of audit. Section 10.03(A), (B), (C), and (D) describe Part 1 of the audit process. This section includes the procedures that an external auditor should follow in examining the QI and the information to be included in the external auditor's report to the IRS. Section 10.04 provides guidance on the use of statistical sampling and projection of underwithholding. Section 10.05 provides further guidance on the form, content and submission of the external auditor's report. Section 10.06 provides guidance on Parts 2 and 3 of the audit process. The audit guidance does not amend, modify, or interpret the QI Agreement.

**QI Agreement Sec. 10.01. In General. Unless QI requests an IRS audit in lieu of an external audit, the IRS agrees not to conduct an on-site audit of QI, or any PAI with which QI has an agreement, with respect to withholding and reporting obligations covered by this Agreement provided that an external auditor designated in Appendix B of this Agreement conducts an audit of QI, and any PAI, in accordance with this section 10. QI shall permit the external auditor to have access to all relevant records of QI for purposes of performing the external audit, including information regarding specific account holders. QI shall permit the IRS to communicate directly with the external auditor and to review the audit procedures followed by the external auditor. QI represents that there are no legal prohibitions that prevent the external auditor from examining any information relevant to the external audit to be performed under this section 10 and that there are no legal prohibitions that prevent the IRS from communicating directly with the auditor. QI shall permit the IRS to examine the external auditor's work papers and reports. However, the external auditor is not required to divulge the identity of QI's account holders to the IRS**.

*Audit Guidance Sec. 10.01:*

10.01.1. *IRS Audit.* A QI that is not prohibited by law from disclosing account holder information may request an IRS onsite audit instead of an external audit. To request an IRS audit, the QI must submit a written request to the IRS before March 31 of the year following the specific year to be audited ("audit year"). The QI must send the request to the following address:

Internal Revenue Service
LMSB:FS:QI
290 Broadway
New York, NY 10007-1867
USA

If the IRS agrees to conduct an audit of the QI, the IRS will send the QI a written response within 90 days of the date the IRS received the request. In some cases, the IRS will conduct an audit by correspondence. For instance, in the case of a QI that has made reportable payments to no more than 50 accounts covered by the QI Agreement, the IRS may conduct an audit by correspondence. For purposes of this guidance, "accounts covered by the QI Agreement" are accounts maintained by the QI for its direct account holders (which include intermediaries and flow-through entities) to which the QI has made reportable payments during the audit year from the QI's accounts with withholding agents that the QI has designated as QI accounts.

10.01.2. *External Audit Waiver ($250,000 Threshold).* A QI may request that the IRS waive the performance of the audit by an external auditor for an audit year if the QI has received reportable payments during that year that do not exceed $250,000. To calculate the $250,000 threshold, the QI must aggregate all reportable payments (including payments beneficially owned by the QI) made to its accounts with withholding agents that the QI has designated as QI accounts. The QI must submit its request for a waiver to the IRS in accordance with Audit Guidance 10.01.1 (AG10.01.1).

The QI should include in its request:
(a) Copies (for the audit year) of its Forms 1042 and 945, the Forms 1042-S issued to it, the Forms 1042-S and 1099 issued by it, and the Forms W-8IMY (including summaries of withholding statements) provided by it to its withholding agents;
(b) A reconciliation of the Forms 1042-S issued to the QI and the Forms 1042-S issued by the QI; and
(c) A statement made under penalties of perjury by a person named as a responsible party for performance in the QI's application for a QI Agreement ("responsible party") that:
1. States
(i) The number of the QI's direct account holders during the audit year;
(ii) The number of the QI's indirect account holders during the audit year; and
(iii) Within each category, the number of account holders that were U.S. exempt recipients, U.S. non-exempt recipients, intermediaries, flow-through entities, and undocumented account holders;
(2) States the total amount of any underwithholding or collective refund for the audit year;
(3) States that no event of default under section 11 of the QI Agreement has occurred during the audit year;
(4) States that the QI does not refer account holders to an affiliated entity with the effect of circumventing the $250,000 threshold; and
(5) Certifies that the QI was in compliance with the QI Agreement during the audit year.

The IRS may contact the QI to request additional information. If the IRS agrees to waive the performance of the audit for the audit year, the IRS will send the QI a written response within 90 days of the date the IRS received the request. The IRS will not agree to waive the performance of an audit for a Private Arrangement Intermediary ("PAI").

10.01.3. *External Audit Waiver (2000 Account Holder Threshold).* A QI may request that the IRS waive the performance of the audit by an external auditor for an audit year if, during the audit year, the QI has made reportable payments to no more than 2000 direct and indirect account holders covered by the QI Agreement. The QI must submit its request for a waiver to the IRS in accordance with AG 10.01.1. The QI must include in its request a statement, made under penalties of perjury by the responsible party, that states:

(a) The number of account holders to which the QI has made such payments;

(b) The aggregate amount of reportable payments (including payments beneficially owned by the QI) made to its accounts with withholding agents that the QI has designated as QI accounts;
(c) The QI does not refer account holders to an affiliated entity with the effect of circumventing the 2000 account holder threshold; and
(d) That, in lieu of the external audit, the QI itself will apply the procedures set forth in section 10 of the QI Agreement. In doing so, the QI agrees to examine each account holder and to submit a report to the IRS signed by the responsible party.

The IRS may contact the QI to request additional information. The QI must agree that its performance of the audit will be governed in all respects by section 10 of the QI Agreement as if the persons conducting the audit were the external auditor referred to in that section. The IRS will not permit the use of statistical sampling by the QI. The IRS will not agree to waive the external audit for more than one audit year during any one term of the QI Agreement. If the IRS agrees to waive the performance of the audit for the audit year, the IRS will send the QI a written response within 90 days of the date the IRS receives the request. The IRS will not agree to waive the performance of an audit for a PAI. The IRS will not agree to waive the external audit for the first audit year of the first term of the QI Agreement.

10.01.4. *External Audit Waiver (Annual Internal Audits)*. A QI may request that the IRS waive the performance of the audit by an external auditor for an audit year if the QI maintains a substantial and independent internal audit staff, and the QI's internal auditors have conducted an audit of the QI's compliance with the QI Agreement each year for the three years preceding the audit year. The QI must submit its request for a waiver to the IRS in accordance with AG 10.01.1. The QI must include in its request a statement, made under penalties of perjury by the responsible party, that states:

(a) The number of direct account holders and the number of indirect account holders to which the QI has made such payments;
(b) The aggregate amount of reportable payments (including payments beneficially owned by the QI) made to its accounts with withholding agents that the QI has designated as QI accounts;
(c) How the internal audit staff is organized, including position descriptions, the number of individuals in each position, the names of the individual or individuals with overall responsibility for internal audit, the routine functions of the internal auditors within the QI, and the persons to whom the internal auditors report;
(d) In brief summaries, the procedures performed, the findings, and the conclusions or recommendations of each annual audit of the QI's compliance with the QI Agreement conducted by the QI's internal auditors in each of the three years preceding the audit year; and
(e) That, in lieu of the external audit, the QI itself will apply the procedures set forth in section 10 of the QI Agreement to those accounts.

The IRS may contact the QI to request additional information. The QI must agree that its performance of the audit will be governed in all respects by section 10 of the QI Agreement as if the persons conducting the audit were the external auditor referred to in that section. The IRS will not agree to waive the external audit for more than one audit year during any one term of the QI Agreement. If the IRS agrees to waive the performance of the audit for the audit year, the IRS will send the QI a written response within 90 days of the date the IRS receives the request. The IRS will not agree to waive the performance of an audit for a PAI.

**QI Agreement Sec. 10.02. Designation of External Auditor. QI's external auditor must be one of the auditors listed in Appendix B of this Agreement, unless QI and the IRS agree, prior to the audit, to substitute another auditor. QI shall not propose an external auditor unless it has a reasonable belief that the auditor is subject to laws, regulations, or rules that impose sanctions for failure to exercise its independence and to perform the audit competently. The IRS has the right to reject a proposed external auditor, or to revoke its acceptance of an external auditor, if the IRS, in its sole discretion, reasonably believes that the auditor is not independent or cannot perform an effective audit under this Agreement.**

*Audit Guidance Sec. 10.02:*

10.02.1. *Auditor Approval*. To obtain assurance that an external auditor will be acceptable to the IRS, the QI or the external auditor may submit a written request explaining the qualifications of the external auditor to the IRS at any time. The QI or the external auditor should send the request to the address provided in AG 10.01.1. The IRS will send the QI or the external auditor a written response within 90 days of the date the IRS receives the request.

10.02.2. *Auditor Independence*. A QI and its external auditor must disclose to the IRS any circumstances that compromise or reasonably appear to compromise the external auditor's independence or ability to perform an effective audit. To make a disclosure, the QI or the external auditor must submit a written statement explaining the circumstances and any steps taken to address them as soon as such circumstances are discovered. The disclosure must be sent to the address provided in AG 10.01.1. If the IRS determines that the external auditor is not acceptable, it will send the QI and the external auditor a written notice to that effect within 90 days of the date the IRS receives the disclosure.

**QI Agreement Sec. 10.03. Timing and Scope of External Audits. QI shall have the external auditor conduct an audit of the second full calendar year and the fifth full calendar year that this Agreement is in effect, subject to section 10.06 of this Agreement. The external auditor shall verify whether QI is in compliance with this Agreement by conducting an audit that meets the requirements of this section 10.03. The external auditor shall verify whether QI is in compliance with its QI agreement by providing a report to the IRS. The report must be received by the IRS, at the address set forth in section 12.06 of this Agreement, no later than June 30 of the year following the year being audited. The IRS may, however, upon request by the external auditor, extend the due date of the audit report**

**upon good cause. The report must disclose that the external auditor has, at a minimum, performed the following checks listed in this paragraph 10.03, and set forth how each of those checks was performed and the results of the checks. QI's (or a PAI's) external auditor is encouraged to contact the IRS at the address set forth in section 12.06 of this Agreement and submit an audit plan (which includes, if relevant, the extent to which the external auditor proposes to rely on QI's internal audit procedures) prior to performing the audit so that the audit may be conducted in the most efficient and least costly manner possible.**

*Audit Guidance Sec. 10.03:*

10.03.1. *Specifications of Audit Report*. For guidance on the form and contents of the external auditor's report, submitting the report to the IRS, the due date of the report and extensions of the due date, see AG 10.05.

10.03.2. *Submission of Audit Plan*. Submission of an audit plan to the IRS prior to performing the audit is not necessary unless the external auditor plans to modify or deviate from the procedures described in AG 10.03 and 10.04. In such circumstances, the external auditor should submit a written plan, identifying and explaining the reasons for any planned modifications or deviations from those procedures, prior to performing the audit. The external auditor should submit the audit plan to the address provided in AG 10.01.1. The IRS will send the external auditor a written response within 90 days of the date the IRS receives the audit plan.

10.03.3. *Use of Internal Audit*. The external auditor is required to perform the audit itself. The external auditor may use the QI's internal audit personnel and internal audit reports to any extent the external auditor chooses to do so. In that case, the external auditor remains responsible for the conduct of the audit as if the external auditor had personally performed the audit. In its report to the IRS, the external auditor must disclose specifically when and how it has used the QI's internal audit personnel and reports in conducting the audit and must certify that the use of the internal audit personnel and reports has not affected the accuracy of the external auditor's report.

10.03.4. *Use of Copies*. In conducting the audit, the external auditor may use copies of any account records or written materials provided by the QI. Nevertheless, the QI must permit the external auditor to have access to the complete and unaltered account holder records in the original, if the external auditor deems it necessary to examine originals.

**QI Agreement 10.03(A). Documentation. The external auditor must– (1) Verify that QI has training materials, manuals, and directives that instruct the appropriate QI employees how to request, collect, review, and maintain documentation in accordance with this Agreement;**

*Audit Guidance 10.03(A)(1):*

10.03(A)(1).1. *Review of Documentation Training*. The external auditor must:

Step 1: Identify the QI's employees that are responsible for opening and maintaining customer accounts.

Step 2: Collect any written training materials, manuals, and directives used by those employees.

Step 3: Inspect the written training materials, manuals, and directives to determine whether they contain instructions specific to accounts covered by the QI Agreement on how to request, collect, review, and maintain documentation.

10.03(A)(1).2. *Documentation Training Report*. The external auditor must specifically report:

Report 1: Whether the QI has written training materials, manuals, and directives that contain instructions specific to accounts covered by the QI Agreement on how to request, collect, review, and maintain customer documentation.

**QI Agreement Sec. 10.03(A)(2). Review QI's account opening procedures and interview QI's employees, to determine if appropriate documentation is requested from account holders and, if obtained, that it is reviewed and maintained in accordance with this Agreement;**

*Audit Guidelines 10.03(A)(2)*

10.03(A)(2).1. *Review of Account Opening Procedures*. The external auditor must:

Step 1: Identify the QI employees responsible for opening and maintaining customer accounts and select representative employees for interview.

Step 2: Ask the selected employees how accounts covered by the QI Agreement are opened, what documentation is requested, how the documentation is obtained, and how the documentation is reviewed and maintained.

10.03(A)(2).2. *Account Opening Procedures Report.* The external auditor must specifically report:

Report 1: The number of employees interviewed.

Report 2: The number of employee responses that indicate that Forms W-8 and documents listed in the Attachment to the QI Agreement are not routinely requested, reviewed, cross checked against other account information, or maintained in accordance with section 5.12 of the QI Agreement.

**QI Agreement Sec. 10.03(A)(3). Verify that QI follows procedures designed to inform account holders that claim a reduced rate of withholding under an income tax treaty about any applicable limitation on benefits procedures;**

*Audit Guidance 10.03(A)(3):*

10.03(A)(3).1. *Review Limitation on Benefits (LOB) Procedure*. The external auditor must:

Step 1: Ask the QI employees selected for interview under AG 10.03(A)(2) Step 1 how account holders that are not individuals claim a reduced rate of withholding under an income tax treaty.

10.03(A)(3).2. *LOB Procedure Report.* The external auditor must specifically report:

Report 1: The number of employee responses that indicate that such customers are not informed about any applicable limitation on benefits provisions.

**QI Agreement 10.03(A)(4). Review QI's accounts, using a valid sample of accounts for which treaty benefits are claimed, to ensure that QI is obtaining the treaty statements required by section 5.03(B);**

*Audit Guidance 10.03(A)(4):*

10.03(A)(4).1. *Review of Treaty Statements*. The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients, or select a valid sample of such accounts in accordance with AG 10.04.

Step 2: From the accounts identified or selected in Step 1, segregate the accounts for which treaty benefits are claimed.

Step 3: From the accounts for which treaty benefits are claimed, segregate the accounts for which documentary evidence has been obtained.

Step 4: From the accounts for which documentary evidence has been obtained, segregate those accounts held by account holders that are not individuals or governments.

Step 5: For the accounts segregated in Step 4, inspect each account holder's documentation to determine whether it contains a valid treaty statement described in section 5.03(B) of the QI Agreement. A valid treaty statement must be signed by the beneficial owner. A treaty statement may be incorporated into another document that is signed by the beneficial owner.

Step 6: For the accounts segregated in Step 4, identify:

(a) All accounts covered by the QI Agreement held by intermediaries or flow through entities for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement.
(b) The number in Step 6(a) that are intermediaries.
(c) The number in Step 6(a) that are flow through entities
(d) The number of indirect account holders holding through intermediaries that are direct account holders; and
(e) The number of indirect account holders holding through each flow through entity that is a direct account holder.

Step 7: (a) For purposes of Step 7 and the following sections, the external auditor must identify the indirect account holders for which recipient specific reporting is required or select a valid sample of such account holders in accordance with AG 10.04. From the indirect account holders identified or selected, segregate the indirect account holders for which treaty benefits are claimed.
(b) From the indirect account holders segregated in (a), segregate the indirect account holders for which documentary evidence has been obtained.
(c) From the indirect account holders segregated in (b), segregate indirect account holders that are not individuals or governments.
(d) For the indirect account holders segregated in (c), inspect each indirect account holder's documentation to determine whether it contains a valid treaty statement described in section 5.03(B) of the QI Agreement.

10.03(A)(4).2. *Treaty Statements Report.* The external auditor must specifically report:

Report 1: The number of accounts determined under each of Steps 1, 2, 3, and 4.

Report 2: The number of accounts segregated in Step 4 that do not contain a valid treaty statement described in section 5.03(B) of the QI Agreement.

Report 3: The number of indirect account holders determined under Step 6(a) through (e).

Report 4: The number of indirect account holders identified, selected (if sampling is used), and segregated under Step 7 (a) through (c).

Report 5: The number of indirect account holders whose documentation does not contain a valid treaty statement described in section 5.03(B) of the QI Agreement.

***QI Agreement Sec. 10.03(A)(5).* Review information, using a valid sample, contained in account holder files to determine if the documentation validity standards of section 5.10 of this Agreement are being met. For example, the external auditor must verify that changes in account holder information (*e.g.*, a change of address to a U.S. address or change of account holder status from foreign to U.S.) are being conveyed to QI's withholding agent, or, if QI assumes primary NRA withholding responsibility or primary Form 1099 reporting and backup withholding responsibility, that QI is applying the appropriate withholding rate;**

*Audit Guidance 10.03(A)(5):*

10.03(A)(5).1. *Review of Documentation Validity (Foreign Persons and U.S. Exempt Recipients)*. The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients, or use the same sample selected in AG 10.03(A)(4).1 Step 1.

Step 2: Sort those accounts according to whether they contain the following types of documentation:
(a) Form W-8BEN;
(b) Form W-8EXP;
(c) Form W-8ECI;
(d) Form W-8IMY;
(e) Form W-9;
(f) Documentary Evidence; and
(g) no documentation.

Step 3: FORM W-8BEN:

(a) For accounts documented with a Form W-8BEN, inspect Part I of the Form W-8BEN. Determine that the following lines are completed and consistent with each other:

(i) Line 1 (name of individual or organization that is the beneficial owner);

(ii) Line 2 (country of incorporation or organization), for non-individuals;

(iii) Line 3 (type of beneficial owner);

(iv) Line 4 (permanent residence address, including country) A permanent residence address cannot be a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail address (except when the beneficial owner is a financial institution); and

(v) Signature and date.

(A) Determine that December 31 of the audit year was within three full calendar years following the year of signature; and

(B) Determine that the certifications attested under penalties of perjury have not been modified.

(b) For a Form W-8BEN for which the beneficial owner has claimed treaty benefits, inspect Part II of the Form W-8BEN. Determine that the following lines are completed and consistent with each other and with Part I of the Form:

(i) Line 9a (residence certification, including name of country); and

(ii) Line 9c (section 894 and LOB certification), but only for non-individuals.

Step 4: FORM W-8EXP. For accounts documented with Form W-8EXP, inspect Form W-8EXP. Determine that the following lines are completed and consistent with each other:

(a) Line 1 (name of organization);

(b) Line 2 (country of incorporation or organization);

(c) Line 3 (type of entity);

(d) Line 4 (permanent residence address, including country), A permanent residence address cannot be a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail address (except when the beneficial owner is a financial institution);

(e) Either:

(i) Line 9a and 9b or 9c; or

(ii) Line 10 (and organization is designated by executive order under 22 U.S.C. 288 through 288(f)); or

(iii) Line 11; or

(iv) Line 12a (including date) or 12b (including attached opinion from U.S. counsel), and, for section 501(c)(3) organizations, Line12c (including affidavit) or 12d, and Line 6; or

(v) Line 13; and

(f) Signature and date.

(i) Determine that the certifications attested under penalties of perjury have not been modified.

Step 5: FORM W-8ECI. For accounts documented with Form W-8ECI, inspect the Form W-8ECI. Determine that the following lines are completed and consistent with each other:

(a) Line 1 (name of organization);

(b) Line 2 (country of incorporation or organization);

(c) Line 3 (type of entity);

(d) Line 4 (permanent residence address, including country). A permanent residence address cannot be a P.O. Box, in-care-of address, or an address at a financial institution, including a hold mail address (except when the beneficial owner is a financial institution);

(e) Line 5 (business address in the United States);

(f) Line 6 (U.S. taxpayer identification number);

(g) Line 9 (list of items of income that are effectively connected with the conduct of a trade or business in the United States); and

(h) Signature and date.

(i) Determine that December 31 of the audit year was within three full calendar years following the year of signature; and

(ii) Determine that the certifications attested under penalties of perjury have not been modified.

Step 6: FORM W-8IMY. For accounts documented with Form W-8IMY, inspect the Form W-8IMY. Determine that the following lines are completed and consistent with each other:

(a) Line 1 (name of individual or organization);

(b) Line 2 (country of incorporation or organization), for non-individuals;

(c) Line 3 (type of entity);

(d) Line 4 (permanent residence address, including country). A permanent residence address cannot be a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail address (except when the beneficial owner is a financial institution).

(e) Either:

(i) Line 9a and Line 6 (QI-EIN);

(ii) Line 10a;

(iii) Line 11 and Line 6 (EIN), and Line 12 or Line 13;

(iv) Line 14 and Line 6; or

(v) Line 15 (and, if line 3 (nonwithholding foreign grantor trust) is checked, Line 6 (EIN)); and

(f) Signature and date.

(i) Determine that the certifications attested under penalties of perjury have not been modified.

Step 7: FORM W-9. For accounts documented with Form W-9, inspect the Form W-9. Determine that the following lines are completed and consistent with each other:

(a) Name;

(b) U.S. taxpayer identification number;

(c) Part II (For U.S. payees exempt from backup withholding); and

(d) Signature and date.

(i) Determine that the certifications attested under penalties of perjury have not been modified.

Step 8: DOCUMENTARY EVIDENCE. For accounts documented with documentary evidence, inspect the documentary evidence. Determine:

(a) Whether the documentary evidence is one of the types listed in the applicable Attachment to the QI Agreement,

(b) Whether it appears to be in proper form when compared to documents of the same type listed in the Attachment,

(c) Whether it:

(i) Supports the account holder's foreign status and, for an account holder that claims treaty benefits, supports the account holder's residence in the treaty country, or

(ii) Supports the account holder's status as a U.S. exempt recipient.

(d) In the case of an international organization, whether the organization is designated by executive order under 22 U.S.C. 288 through 288(f).

(e) In the case of a foreign government or foreign central bank of issue, whether the documentary evidence supports the account holder's status as such.

Step 9: For each account determined to be documented under Steps 3 through 8, examine the account opening statement, any other account documents or memoranda and any correspondence associated with the account (for purposes of this section, "the account holder's file"). Determine:

(a) Whether the identifying information in the documentation matches the identifying information in the account holder's file (taking into account any updated information that links the identifying information in the documentation to the identifying information in the account holder's file),

(b) Whether, in the case of an account documented with documentary evidence, the documentary evidence and the account holder's file contains only: an address at a financial institution, including a hold mail instruction (except when the financial institution is the beneficial owner), an in-care-of address, or a P.O. Box, and if so, whether the QI has satisfied the additional requirements of section 5.10(B)(2)(i) of the QI Agreement.

(c) Whether the documentation or the account holder's file shows a U.S. mailing or residence address for the account holder or standing instructions to pay from the account to a U.S. address or to an account maintained in the United States, and if so, whether:

(i) The account holder is a U.S. person, or

(ii) In the case of documentary evidence, the QI has satisfied the additional requirements of section 5.10 (B)(2)(i), (ii), and (iii) of the QI Agreement or, in the case of Forms W-8, the QI has satisfied the additional requirements of section 1.1441–7(b)(5) of the regulations.

(d) For accounts where the beneficial owner has claimed treaty benefits, whether the documentation or the account holder's file shows a residence address or mailing address, or a P.O. Box, in-care-of address or an address at a financial institution, including a hold mail instruction (except when the financial institution is the beneficial owner), that is not in the applicable treaty country, or standing instructions to pay from the account to an address outside the treaty country or to an account maintained outside the treaty country, and if so, whether:

(i) In the case of documentary evidence, the QI has satisfied the additional requirements of section 5.10(B)(3) of the QI Agreement; or

(ii) In the case of Forms W-8, the QI has satisfied the additional requirements of section 1.1441–7(b)(6) of the regulations.

(e) Include in the category of accounts with no documentation (AG 10.03(A)(5).1 Step 2(g)) all accounts:

(i) That are not documented with Forms W-8BEN, W-8EXP, W-8IMY, W-8ECI, W-9 or documentary evidence that is listed in the applicable Attachment to the QI Agreement, and

(ii) That are documented with Forms W-8 or documentary evidence that is inadequate after applying the additional requirements of AG 10.03(A)(5).1 Step 9(b)–(d).

Step 10: (a) Identify all indirect account holders for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement, or use the same sample of indirect account holders selected under AG 10.03(A)(4).1 Step 7.

(b) From those indirect account holders, segregate the indirect account holders that are not U.S. non-exempt recipients.

(c) Inspect the documentation for each indirect account holder segregated in Step 10(b) to determine whether the documentation validity standards of section 5.03(C) of the QI Agreement are satisfied by performing the procedures under AG 10.03(A)(5) with the following modifications:

(i) Part II of the Form W-8BEN is not complete unless line 9b and line 6 are completed, except in the case of a claim of treaty benefits for income from a marketable security.

(ii) Documentary evidence establishing entitlement to treaty benefits must be documentary evidence described in section 5.03(A)(3) of the QI Agreement. Also, except in the case of income from a marketable security, a TIN is required.

(iii) Documentary evidence for purposes other than establishing entitlement to treaty benefits must be documentary evidence described in Treas. Reg. 1.1441–1(c)(17).

Step 11: For indirect account holders, the external auditor must apply Steps 1 through 9.

10.03(A)(5).2. *Documentation Validity Report (Foreign Persons and U.S. Exempt Recipients).* The external auditor must specifically report:

Report 1: The number of accounts identified or selected under Step 1.

Report 2: The number of accounts segregated under Step 2.

Report 3: The number of Forms W-8BEN inspected under Step 3(a) and the number of Forms W-8BEN that did not satisfy the criteria under that section.

Report 4: The number of Forms W-8BEN inspected under Step 3(b) and the number of Forms W-8BEN that did not satisfy the criteria under that section.

Report 5: The number of Forms W-8EXP inspected under Step 4 and the number of Forms W-8EXP that did not satisfy the criteria under that section.

Report 6: The number of Forms W-8ECI inspected under Step 5 and the number of Forms W-8ECI that did not satisfy the criteria under that section.

Report 7: The number of Forms W-8IMY inspected under Step 6 and the number of Forms W-8IMY that did not satisfy the criteria under that section.

Report 8: The number of Forms W-9 inspected under Step 7 and the number of Forms W-9 that did not satisfy the criteria under that section.

Report 9: The number of accounts:

(a) Documented with documentary evidence inspected under Step 8;

(b) Reviewed under Step 8 that did not satisfy criteria (a) or (b) of that section;

(c) Reviewed under Step 8 that satisfy the criteria of either section (c)(i) or (ii);

(d) Reviewed under Step 8 that did not satisfy the criteria of either (c)(i) or (ii); and

(e) Described in each of (d) and (e) of Step 8 and the number of accounts that did not satisfy the criteria of (d) and (e) of Step 8.

Report 10: The number of accounts:

(a) That did not satisfy the criteria of Step 9(a);

(b) Described in Step 9(b) and the number of accounts that did not satisfy the additional criteria of that step;

(c) Described in Step 9(c), the number of accounts described in (c)(i) of that step, and the number of accounts that did not satisfy (c)(ii) of that step; and

(d) Described in Step 9(d) and the number of accounts that did not satisfy the criteria of (d)(i) or (ii) of that step.

Report 11: The number of accounts described in each of (i) and (ii) of Step 9(e).

Report 12: For indirect account holders, the external auditor must separately complete Report 1 through 11.

**QI Agreement Sec. 10.03(A)(6). Review accounts, using a valid sample of U.S. non-exempt recipient account holders, to determine if QI is obtaining Forms W-9 from those customers whose identity is not prohibited by law from disclosure, and that QI is transmitting those forms to a withholding agent to the extent QI does not assume primary Form 1099 reporting and backup withholding responsibility with respect to reportable amounts and, if applicable, designated broker proceeds;**

*Audit Guidance 10.03(A)(6):*

10.03(A)(6).1. *Review of Documentation Validity (Disclosed U.S. Non-exempt Recipients)* The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or select a valid sample of such accounts in accordance with AG 10.04.

Step 2: From those accounts, segregate the accounts of those U.S. non-exempt recipients whose identity is not prohibited by law from disclosure, including the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.

Step 3: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary Form 1099 and backup withholding responsibility. From the accounts segregated in Step 2, segregate the accounts of U.S. non-exempt recipients for which the QI has not assumed primary Form 1099 reporting and backup withholding responsibility.

Step 4: From the accounts segregated in Step 3, segregate the accounts documented with Form W-9 and determine that each Form W-9 satisfies the criteria of AG 10.03(A)(5).1 Step 7.

Step 5: From the accounts segregated in Step 3, segregate the accounts that are not documented with Form W-9 and the accounts for which the Forms W-9 did not satisfy the criteria of AG 10.03(A)(5).1 Step 7.

Step 6: Obtain the withholding statements associated with QI's Forms W-8IMY.

Step 7: For each Form W-9 that satisfies the criteria of AG 10.03(A)(5).1 Step 7, match the name and TIN on the Form W-9 to the name and TIN on the withholding statement.

Step 8: For each account segregated in Step 5, match the name, and (if provided) address, and TIN of the U.S. non-exempt recipient to the name, address, and TIN on the withholding statement.

Step 9: (a) Identify all accounts covered by the QI Agreement for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement.
(b) Identify the indirect account holders holding through those accounts, or use the same sample selected under AG 10.03(A)(4).1 Step 7.
(c) Segregate the indirect account holders that are U.S. non-exempt recipients.
(d) Apply Steps 2 through 8.

10.03(A)(6).2. *Documentation Validity (U.S. Non-exempt Recipients) Report.* The external auditor must specifically report:

Report 1: The number of accounts segregated under each of Steps 1, 2, 3, 4, and 5.

Report 2: The number of accounts that did not satisfy the criteria of Steps 7 and 8.

Report 3: For indirect account holders, the external auditor must report:
(a) The number of indirect account holders identified and segregated under Step 9;
(b) The number of indirect account holders identified and segregated under Steps 2 through 5; and
(c) The number of indirect account holders that did not satisfy the criteria of Steps 7 and 8.

**QI Agreement Sec. 10.03(A)(7). Review accounts, using a valid sample of U.S. non-exempt recipient account holders whose identity and account information is prohibited by law, including by contract, from disclosure, to verify that–**

**(i) Such accounts exist in only rare and unusual circumstances (and detailing in the audit report the nature of such circumstances); and**

**(ii) The procedures of section 6.04 have been, and are being, followed.**

*Audit Guidance 10.03(A)(7):*

10.03(A)(7).1. *Account Review of U.S. Non-exempt Recipients (Disclosure Prohibited).* The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or use the same sample selected for AG 10.03(A)(6).

Step 2: From those accounts, segregate the accounts of those U.S. non-exempt recipients whose identity is prohibited by law from disclosure, excluding the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.

Step 3: From the accounts segregated in Step 2, segregate the accounts opened by U.S. non-exempt recipients on or after January 1, 2001.

Step 4: Obtain a letter from the responsible party explaining why the accounts in section 10.07(A)(7).1 Step 2 exist and how the procedures of section 6.04 of the QI Agreement have been and are being applied.

10.03(A)(7).2. *Account Review of U.S. Non-exempt Recipients (Disclosure Prohibited) Report.* The external auditor must specifically:

Report 1: Report the number of accounts segregated under Steps 1, 2, and 3; and

Report 2: Include a copy of the letter obtained under Step 4.

***QI Agreement Sec. 10.03(A)(8).* Review QI's agreements with its PAIs to ensure that the obligations imposed on the PAIs are identical to the obligations imposed on QI under this Agreement, except as otherwise provided in section 4.02.**

*Audit Guidance 10.03(A)(8):*

10.03(A)(8).1. *Review PAI Obligations.* The external auditor must:

Step 1: Obtain copies of the QI Agreement and all PAI agreements.

Step 2: Inspect each PAI agreement to determine whether:
(a) The PAI agreement covers all offices of the PAI located in a country listed in Appendix A of the QI Agreement;
(b) The PAI agreement provides that the QI include all reportable payments made by the PAI in the QI's Forms 945 and 1099 and 1042 and 1042-S;
(c) The PAI agreement requires the PAI to provide the QI with all information necessary for the QI to meet its obligations under the QI Agreement;
(d) There are not any provisions limiting the PAI's liability for underwithholding or reporting due to the PAI's failure to perform its obligations under the PAI agreement;
(e) The PAI agreement requires the PAI to disclose U.S. non-exempt recipients to the same extent as the QI Agreement;
(f) The PAI agreement permits the PAI to assume primary withholding responsibility or primary Form 1099 reporting and backup withholding responsibility;
(g) The PAI is subject to audit procedures that are identical to those applicable to the QI under the QI Agreement and that the PAI's designated auditor is listed in Appendix B of the QI Agreement or has been approved by the IRS for that PAI; and
(h) The PAI is subject to all other obligations of the QI under the QI Agreement.

Step 3: Obtain a copy of the notice identifying each PAI filed by the QI with the IRS described in section 4.01(B) of the QI Agreement and determine that the date of filing for each notice precedes the date of the first payment received by the PAI from the QI pursuant to the PAI agreement.

Step 4: Obtain a copy of the PAI's W-8IMY provided to the QI and determine that it satisfies the criteria of AG 10.03(A)(5).1 Step 6.

10.03(A)(8).2. *PAI Obligations Report.* The external auditor must specifically report:

Report 1: The number of PAI agreements;

Report 2: The number of PAI agreements that did not satisfy the criteria of each of Step 2(a) through (h); and

Report 3: The number of PAI agreements that did not satisfy the criteria of Step 3.

Report 4: The number of Forms W-8IMY obtained in Step 4 and the number of Forms W-8IMY that did not satisfy the criteria of Step 6.

**QI Agreement Sec. 10.03(A)(9). State in its external audit report if the auditor is aware that QI is in material violation or is under investigation for violation of any of the know-your-customer rules, practices, or procedures applicable to the offices audited.**

*Audit Guidance 10.03(A)(9):*

10.03(A)(9).1. *Knowledge of KYC Investigations*. The external auditor must:

Step 1: Obtain a letter signed by the responsible party and by the QI's legal counsel stating whether either is aware that the QI is in material violation or is under investigation for violation of any of the know-your-customer rules, practices, or procedures applicable to all branches of the QI located in countries named in the Attachments to the QI Agreement.

10.03(A)(9).2. *KYC Investigations Report.* The external auditor must specifically report:

Report 1: Whether, based on the information in the letter described in Step 1 and on its own information, the external auditor is aware of any such material violations or investigations and, if so, identify them.

Report 2: The external auditor must attach to its report:

(a) A copy of the letter described in Step 1.

***QI Agreement Sec. 10.03(A)(10).* State in its external audit report if the auditor is aware that QI removes U.S. non-exempt recipients from accounts covered by this Agreement for the purpose of circumventing the Form 1099 reporting and backup withholding provisions of this Agreement.**

*Audit Guidance 10.03(A)(10):*

10.03(A)(10).1. *Review for Removal of U.S. Non-exempt Recipients*. The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or use the sample selected in AG 10.03(A)(6).1 Step 1.

Step 2: Inspect account closing records to determine whether the account was closed during the audit year.

Step 3: Inspect account transfer records to determine whether any assets have been transferred to another account held by the same account holder during the audit year.

10.03(A)(10).2. *Removal of U.S. Non-exempt Recipients Report.* The external auditor must specifically report:

Report 1: The number of accounts covered by the QI Agreement held by U.S. non-exempt recipients that were closed during the audit year.

Report 2: Whether the external auditor is aware of any accounts with the QI not covered by the QI Agreement held by the same U.S. non-exempt recipients that were opened during the audit year, and if so, the number of such accounts.

Report 3: Whether the external auditor is aware of any transfers of assets from an account covered by the QI Agreement held by a U.S. non-exempt recipient to another account with the QI not covered by the QI Agreement held by the same U.S. non-exempt recipient, and if so, the number of accounts to which such transfers were made.

Report 4: Whether the external auditor is aware that the QI removes U.S. non-exempt recipients from accounts covered by the QI Agreement for the purpose of circumventing the Form 1099 reporting and backup withholding provisions of the QI Agreement.

**QI Agreement Sec. 10.03(B)(1). Withholding Rate Pools. The external auditor must–**

**(1) Verify that QI has training materials, manuals, and directives that instruct the appropriate QI employees how to determine withholding rate pools based on documentation and the presumption rules;**

*Audit Guidance 10.03(B)(1):*

10.03(B)(1).1. *Review of Withholding Rate Pool Training Materials*. The external auditor must:

Step 1: Identify the QI's employees that are responsible for determining withholding rate pools.

Step 2: Collect any written training materials, manuals, and directives used by those employees.

Step 3: Inspect the written training materials, manuals, and directives to determine whether they contain specific instructions on how to determine withholding rate pools based on documentation and the presumption rules.

10.03(B)(1).2. *Withholding Rate Pool Training Materials Report.* The external auditor must specifically report:

Report 1: Whether the QI has written training materials, manuals, and directives that contain specific instructions on how to determine withholding rate pools based on documentation and the presumption rules.

**QI Agreement Sec. 10.03(B)(2). Interview employees responsible for determining withholding rate pools to ascertain if they are adequately trained to**

**determine those pools and that they follow adequate procedures for determining those pools;**

*Audit Guidance 10.03(B)(2):*

10.03(B)(2).1. *Review of Personnel Training (Withholding Rate Pool)*. The external auditor must:

Step 1: Identify the QI's employees that are responsible for determining withholding rate pools and select representative employees for interview.

Step 2: Ask the selected employees whether they have received any formal or informal training on determining withholding rate pools and if so, ask the selected employees to describe the training, when it occurred, and how much time was devoted to it.

Step 3: Ask the selected employees how an account is assigned to withholding rate pools.

10.03(B)(2).2. *Personnel Training (Withholding Rate Pool) Report.* The external auditor must report:

Report 1: The number of employees interviewed.

Report 2: The number of employee responses that indicate that the employee has not received training on how to determine withholding rate pools.

Report 3: The number of employee responses that indicate that accounts are assigned to withholding rate pools without routinely referring to documentation, presumptions, the type of income earned, and the withholding rate applied.

**QI Agreement Sec. 10.03(B)(3). Review QI's procedures for preparing the withholding statements associated with QI's Forms W-8IMY and verify that the withholding statements provided to withholding agents convey complete and correct information on a timely basis;**

*Audit Guidance 10.03(B)(3):*

10.03(B)(3).1. *Review of Withholding Statements.* The external auditor must:

Step 1: Identify the QI's employees that are responsible for preparing withholding statements and providing them to withholding agents, and select representative employees for interview.

Step 2: Ask the selected employees how withholding statements are prepared and provided to withholding agents.

Step 3: Obtain copies of the withholding statements provided to withholding agents and records of payments from the withholding agents to the QI.

Step 4: Inspect the withholding statements to determine whether they are consistent with the payment records.

Step 5: Inspect the withholding statements to determine whether the withholding statement information was updated and provided to the withholding agent before the withholding agent made payments.

10.03(B)(3).2. *Withholding Statement Report*. The external auditor must report:

Report 1: The number of employees interviewed.

Report 2: The number of employee responses that indicate that withholding statement information was not routinely reviewed, updated and provided to the withholding agent before the withholding agent made payments.

Report 3: The number of payments with respect to which the withholding statements were inconsistent.

Report 4: The number of payments with respect to which the withholding statement information was not updated or provided to the withholding agent before payment.

**QI Agreement Sec. 10.03(B)(4). Perform test checks, using a valid sample of account holders assigned to each withholding rate pool, and cross check that assignment against the documentation provided by, or presumption rules that apply to, the account holder, the type of income earned, and the withholding rate applied;**

*Audit Guidance:*

10.03(B)(4).1. *Review Withholding Rate Pool Classification.* The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients, or use the same sample selected under AG 10.03(A)(4).1 Step 1.

Step 2: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary NRA withholding responsibility. For accounts covered by the QI Agreement for which the QI has not assumed such responsibility, the external auditor must perform the procedures described below.

Step 3: Obtain:

(a) The account statements and records that show the investment and the type of income earned and the amounts of withholding; and

(b) The account records that show how the QI has classified the type of income and withholding rate for purposes of its withholding rate pools.

Step 4: (a) Based on the records described in Step 3(a), classify the accounts according to the type of income paid to each account. An account to which more than one type of income has been paid must be placed into multiple income classifications.

(b) Based on the documentation for the account (after the determinations under AG 10.03(A)(4) and (5) have been made) and applicable presumptions under section 5.13 of the QI Agreement, determine the withholding rate and further classify the accounts within an income classification according to withholding rate. An account within an income classification to which more than one withholding rate has been applied must be placed into multiple withholding rate classifications.

Step 5: Determine whether the classifications under Step 4(a) and (b) match the QI's classifications in the account records described in Step 3(b).

Step 6: (a) Identify all accounts covered by the QI Agreement for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement;
(b) Identify the indirect account holders holding through those accounts, or use the same sample selected under AG 10.03(A)(4).1 Step 7.
(c) Segregate the indirect account holders that are not U.S. non-exempt recipients.
(d) Apply Steps 2 through 5 to those indirect account holders.

10.03(B)(4).2. *Withholding Rate Pool Classification Report*. The external auditor must specifically report:

Report 1: The number of accounts identified or selected as a sample in Step 1.

Report 2: The number of accounts in Report 1 classified under Step 4(a) and (b).

Report 3: The number of accounts in Report 1 for which the QI's classifications do not match the account records under Step 5.

Report 4: For indirect account holders,
(a) The number of indirect account holders under Step 6(a) through (c); and
(b) The number of indirect account holders under Step 4(a) and (b) and Step 5.

**QI Agreement Sec. 10.03(B)(5). Perform test checks, using a valid sample of accounts of U.S. non-exempt recipients, to verify that appropriate withholding rate pools are established for U.S. non-exempt recipients; and**

*Audit Guidance 10.03(B)(5):*

10.03(B)(5).1. *Review of Withholding Rate Pool Classification (U.S. Non-exempt Recipients).* The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or use the same sample selected under AG 10.03(A)(6).1 Step 1.

Step 2: From those accounts, segregate the accounts of those U.S. non-exempt recipients whose identity is not prohibited by law from disclosure, including the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.

Step 3: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary Form 1099 and backup withholding responsibility. From the accounts segregated in Step 2, segregate the accounts of U.S. non-exempt recipients for which the QI has not assumed primary Form 1099 reporting and backup withholding responsibility.

Step 4: Obtain:
(a) The account statements and records that show the investment and the type of income earned and the amounts backup withheld (if any); and
(b) The withholding statements associated with the Forms W-8IMY.

Step 5: Based on the records described in Step 4(a), classify the pools within each account according to the type of reportable payment made to each account. The external auditor must apply this Step 5 and Step 6 whether or not the QI is using the alternative procedure contained in section 6.03(B) of the QI Agreement.

Step 6: Determine whether the classifications and amounts of income and amounts backup withheld (if any) under Step 5 match classifications and amounts in the withholding statements described in Step 4(b).

Step 7: For indirect account holders:
(a) Identify all accounts covered by the QI Agreement for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement;
(b) Identify the indirect account holders holding through those accounts, or use the same sample selected under AG 10.03(A)(4).1 Step 7.
(c) From the indirect account holders identified or selected in (b), segregate the indirect account holders that are U.S. non-exempt recipients.
(d) Apply Steps 2 through 6 to the indirect account holders segregated in (c).

10.03(B)(5).2. *Withholding Rate Pool Classification (U.S. Non-exempt Recipient) Report.* The external auditor must specifically report:

Report 1: The number of accounts segregated under Steps 1, 2, and 3.

Report 2: The number of accounts for which the classifications and amounts do not match the classifications and amounts in the QI's withholding statements.

Report 3: For indirect account holders,
(a) The number of indirect account holders under Step 7(a) through (c);
(b) The number of indirect account holders under Step 2; and
(c) The number of indirect account holders for which the classifications and amounts do not match the classifications and amounts in the QI's withholding statements.

**QI Agreement Sec. 10.03(B)(6). Verify, if QI is using the alternative procedure for U.S. non-exempt recipients contained in section 6.03(B) of this Agreement, that QI is providing sufficient and timely information to withholding agents that allocates reportable payments to U.S. non-exempt recipients.**

*Audit Guidance 10.03(B)(6):*

10.03(B)(6).1. *Review of Alternative Procedure*. The external auditor must:

Step 1: Inspect the withholding statements associated with the Forms W-8IMY to determine whether the allocation information for each account was provided to the withholding agent no later than January 15 of the year following the year of payment.

10.03(B)(6).2. *Alternative Procedure Report*. The external auditor must specifically report:

Report 1: The number of accounts for which allocation information was not provided to the withholding agent by January 15 of the year following the year of payment.

**QI Agreement Sec. 10.03(C)(1). Withholding Responsibilities. The external auditor must–**

**(1) To the extent QI has assumed primary NRA withholding responsibility, perform test checks, using a valid sample of foreign account holders, to verify that QI is withholding the proper amounts;**

*Audit Guidance 10.03(C)(1):*

10.03(C)(1).1. *Review of Withholding (NRA Withholding Assumed)*. The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients, or use the same sample selected under AG 10.03(A)(4).1 Step 1.

Step 2: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary NRA withholding responsibility. For accounts covered by the QI Agreement for which the QI has assumed such responsibility, the external auditor must perform the procedures described below.

Step 3: Obtain the account statements and records that show the investment and the type of income earned and the amounts of withholding.

Step 4: (a) Based on the records described in Step 3, classify the accounts according to the type of income paid to each account. An account to which more than one type of income has been paid must be placed into multiple income classifications.

(b) Based on the documentation for the account (after the determinations under AG 10.03 (A)(4) and (5) have been made), determine the withholding rate and further classify the accounts within an income classification according to withholding rate. An account within an income classification to which more than one withholding rate has been applied must be placed into multiple withholding rate classifications.

Step 5: For each account, determine the amount (if any) by which the amount of withholding based on the classifications under Step 4(a) and Step 4(b) exceeds the amount withheld by the QI.

Step 6: (a) Identify all accounts covered by the QI Agreement for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement;

(b) Identify the indirect account holders holding through those accounts, or use the same sample selected under AG 10.03(A)(4).1 Step 7.

(c) From the indirect account holders identified or selected in (c), segregate the indirect account holders that are not U.S. non-exempt recipients.

(d) Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary NRA withholding. For accounts covered by the QI Agreement for which the QI has assumed such responsibility, the external auditor must perform the procedures described below.

(e) Complete Steps 4(a) through (c) and Step 5.

10.03(C)(1).2. *Withholding (NRA Withholding Assumed) Report.* The external auditor must report:

Report 1: The amount of underwithholding for each account examined within each withholding rate classification in Step 1.

Report 2: The amount of underwithholding for each indirect account holder examined within each withholding rate classification.

***QI Agreement 10.03(C)(2).*** **To the extent QI has not assumed primary NRA withholding responsibility, verify that QI has fulfilled its responsibilities under section 3.02 of this Agreement;**

*Audit Guidance 10.03(C)(2):*

10.03(C)(2).1. *Review of Responsibilities under Section 3.02.* The external auditor must:

Step 1: For each account required to be reported under AG 10.03(B)(4).2 Report 3 and each indirect account holder required to be reported under AG 10.03(B)(4).2 Report 4(b), determine the amount (if any) by which the amount of withholding based on the classifications under AG 10.03(B)(4).1 Step 4(a) and Step 4(b) exceeds the amount withheld.

10.03(C)(2).2. *Responsibilities under Section 3.02 Report.* The external auditor must report:

Report 1: The amount of underwithholding for each account and each indirect account holder within each withholding classification.

***QI Agreement 10.03(C)(3).*** **To the extent QI has assumed primary Form 1099 reporting and backup withholding responsibility, perform test checks using a valid sample of U.S. non-exempt recipient account holders to verify that QI backup withheld when required;**

*Audit Guidance 10.03(C)(3):*

10.03(C)(3).1. *Review of Backup Withholding (Responsibilities Assumed).* The external auditor must:

Step 1: Identify all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients, or use the same sample selected under AG 10.03(A)(6).1 Step 1.

Step 2: From the accounts identified or selected in Step 1, segregate the accounts of those U.S. non-exempt recipients whose identity is not prohibited by law from disclosure, including the accounts of U.S. non-exempt recipients that have waived the prohibitions against disclosure.

Step 3: Obtain copies of the QI's Forms W-8IMY and inspect them to determine whether the QI has assumed primary Form 1099 and backup withholding responsibility. From the accounts segregated in Step 2, segregate the accounts of U.S. non-exempt recipients for which the QI has assumed primary Form 1099 reporting and backup withholding responsibility.

Step 4: Obtain the account statements and records that show the investment and the type of income earned and the amounts backup withheld (if any).

Step 5: Based on the records described in AG 10.03(A)(6).1, determine whether account holder's file contains the account holder's TIN.

Step 6: If the account holder's file does not contain the account holder's TIN, determine whether the QI imposed backup withholding on reportable payments at the correct rate.

Step 7: (a) Identify all accounts covered by the QI Agreement for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement;
(b) Identify the indirect account holders holding through those accounts, or use the same sample selected under AG 10.03(A)(4).1 Step 7;
(c) From the indirect account holders in (b), segregate the indirect account holders that are U.S. non-exempt recipients.
(d) Apply Steps 2 through 6 to those indirect account holders.

10.03(B)(5).2. *Backup Withholding Report (Responsibilities Assumed).* The external auditor must specifically report:

Report 1: The amount of underwithholding for each account and each indirect account holder that does not contain the account holder's TIN.

***QI Agreement Sec. 10.03(C)(4).*** **To the extent QI has not assumed primary Form 1099 reporting and backup withholding responsibility, perform test checks using a valid sample of U.S. non-exempt account holders to verify that QI has fulfilled its backup withholding responsibilities under sections 3.04, 3.05, and 3.06 of this Agreement;**

*Audit Guidance 10.03(C)(4):*

10.03(C)(4).1. *Backup Withholding Review (Responsibilities Not Assumed).* The external auditor must:

Step 1: For each account required to be reported under AG 10.03(B)(5).2 Report 2 and each indirect account holder required to be reported under AG 10.03(B)(5).2 Report 3(c), determine whether backup withholding was imposed at the correct amount.

10.03(C)(4).2. *Backup Withholding Report (Responsibilities Not Assumed)* The external auditor must report:

Report 1: The amount of underwithholding for each account and each indirect account holder for which backup withholding is required.

***QI Agreement Sec. 10.03(C)(5).*** **Review the accounts of U.S. non-exempt recipient account holders whose identity is prohibited by law, including by contract, from disclosure and verify that QI or another payor is backup withholding on reportable payments made to such account holders;**

*Audit Guidance 10.03(C)(5):*

10.03(C)(5).1. *Review of Backup Withholding on Reportable Payments (Disclosure Prohibited).* The external auditor must:

Step 1: For each account required to be reported under AG 10.03(A)(7).2 Report 2, determine whether backup withholding was imposed at the correct amount.

10.03(C)(5).2. *Backup Withholding on Reportable Payments (Disclosure Prohibited) Report.* The external auditor must report:

Report 1: The amount of underwithholding for each account for which backup withholding is required.

***QI Agreement Sec. 10.03(C)(6).*** **Review a valid sample of accounts of U.S. non-exempt recipient account holders and determine if assets that generate or could generate reportable payments are held in an account of any U.S. non-exempt recipient account holders whose identity is prohibited by law, including by contract, from disclosure, and ascertain the reason why such assets have not been disposed of or the account holder disclosed**;

*Audit Guidance 10.03(C)(6):*

10.03(C)(6).1. *Review of Assets Held by U.S. Non-exempt Recipients (Disclosure Prohibited).* The external auditor must:

Step 1: For each account required to be reported under AG 10.03(A)(7).2 Report 2, obtain a letter from the responsible party explaining the reason why assets that generate or could generate reportable payments have not been disposed of or the account holder disclosed.

10.03(C)(6).2. *Assets Held by U.S. Non-exempt Recipients (Disclosure Prohibited) Report.* The external auditor must:

Report 1: Include a copy of the letter obtained in Step 1 with its report.

***QI Agreement Sec. 10.03(C)(7).*** **Verify that amounts withheld were timely deposited in accordance with section 3.08 of this Agreement.**

*Audit Guidance 10.03(C)(7):*

10.03(C)(7).1. *Review of Timely Deposits*. The external auditor must:

Step 1: Obtain the QI's records of payments covered by the QI Agreement, the QI's Form 1042 and the QI's records of tax deposits.

Step 2: Determine that the payment dates timely correspond with the deposit dates for any required deposits.

10.03(C)(7).2. *Timely Deposits Report.* The external auditor must report:

Report 1: Any payment dates that do not timely correspond with deposit dates.

***QI Agreement Sec. 10.03(D)(1).* Return Filing and Information Reporting. The external auditor must–**

**(1) Obtain copies of original and amended Forms 1042 and Forms 945, and any schedules, statements, or attachments required to be filed with those forms, and determine whether the amounts of income, taxes, and other information reported on those forms are accurate by–**

**(i) Reviewing work papers;**

**(ii) Reviewing Forms W-8IMY, together with the associated withholding statements, that QI has provided to withholding agents;**

**(iii) Reviewing copies of Forms 1042-S that withholding agents have provided QI;**

**(iv) Reviewing account statements from withholding agents;**

**(v) Reviewing correspondence between QI and withholding agents; and**

**(vi) Interviewing personnel responsible for preparing the Forms 1042 and 945 and the work papers used to prepare those forms.**

*Audit Guidance 10.03(D)(1):*

10.03(D)(1).1. *Review of Forms 1042 and 945.* The external auditor must:

Step 1: Obtain copies of:

a. The QI's Forms W-8IMY and associated withholding statements, Forms 1042 and 945, and the Forms 1042-S issued to the QI and the Forms 1042-S filed by the QI (for PAI's, obtain the reporting pool information provided to its QI); and

b. The copies of the QI's records of payments from withholding agents and of payments to the QI's reporting pools, other QI's and withholding foreign partnerships and trusts, other recipients for which recipient specific reporting is required under section 8.02 of the QI Agreement, U.S. non-exempt recipients, and U.S. exempt recipients as a class.

Step 2: Reconcile the amounts reported paid to the QI on the Forms 1042-S issued to the QI, the amounts reported paid by the QI on the Forms 1042-S filed by the QI, the amounts shown paid by the QI to U.S. non-exempt recipients on its withholding statements and in the QI's records of payments, and the amounts shown paid by the QI to U.S. exempt recipients as a class in the QI's records of payments, and the amounts reported on the QI's Forms 1042 and 945.

10.03(D)(1).2. *Forms 1042 and 945 Report*. The external auditor must report:

Report 1:
(a) The aggregate amount reported paid to the QI on the Forms 1042-S issued to the QI;
(b) The aggregate amount reported paid by the QI on Forms 1042-S to each reporting pool;
(c) The aggregate amount reported paid by the QI on Forms 1042-S to other QI's as a class;
(d) The aggregate amount reported paid by the QI on Forms 1042-S to indirect account holders;
(e) The aggregate amount shown paid by the QI to U.S. non-exempt recipients as a class;
(f) The aggregate amount shown paid by the QI to U.S. exempt recipients as a class;
(g) The total amounts withheld by the QI; and
(h) The total amounts withheld by others.

Report 2: The aggregate amount of any adjustments under section 9 of the QI agreement incorporated in each amount in Report 1.

Report 3: The aggregate amount of any other adjustments that were incorporated in the amounts reported under Report 1 in performing the reconciliation under Step 2.

Report 4: Attach a copy of the QI's Form 1042.

***QI Agreement Sec. 10.03(D)(2).* Obtain copies of original and corrected Forms 1042-S and Forms 1099 together with the work papers used to prepare those forms and determine whether the amounts reported on those forms are accurate by–**

**(i) Reviewing the Forms 1042-S received from withholding agents;**

**(ii) Reviewing the Forms W-8IMY, and the associated withholding statements, that QI has provided withholding agents;**

**(iii) Reviewing a valid sample of account statements issued by QI to account holders; and**

**(iv) Interviewing QI's personnel responsible for preparing the Forms 1042-S and, if applicable, Forms 1099, and the work papers used to prepare those forms.**

*Audit Guidance 10.03(D)(2):*

10.03(D)(2).1. *Review of Forms 1042-S and 1099.* The external auditor must:

Step 1: Obtain copies of:

(a) The QI's records of payments from withholding agents and the QI's records of payments to the QI's reporting pools and to any other QIs (or PAIs) contained in the sample selected for AG 10.03(A)(4), and

(b) The Forms 1042-S filed by the QI for each reporting pool and any such QIs.

Step 2: Match the QI's records of payments to the amounts reported for each reporting pool and any QI's described in Step 1(a) on the QI's Forms 1042-S.

Step 3: Identify:
- (a) All accounts covered by the QI Agreement for which recipient specific reporting is required under section 8.02(B) and (C) or section 8.04 of the QI Agreement; and
- (b) The indirect account holders holding through those accounts, or use the same sample selected under AG 10.03(A)(4).1 Step 7.

Step 4: Obtain copies of:
- (a) The Forms 1042-S and Forms 1099 filed by the QI for each indirect account holder;
- (b) The Forms W-8IMY and associated withholding statements applicable to each indirect account holder;
- (c) The QI's records of payments to each indirect account holder; and
- (d) The documentation for each indirect account holder.

Step 5: Match the QI's records of payments to the amounts reported for each indirect account holder on the QI's Forms 1042-S and 1099.

Step 6: (a) In the case of a QI that assumed primary Form 1099 and backup withholding responsibility, identify all accounts covered by the QI Agreement that are held by U.S. non-exempt recipients, or use the same sample as in AG 10.03(A)(6).1 Step 1.
- (b) Match the QI's records of payments to the amounts reported on each Form 1099 filed by the QI.

10.03(D)(2).2. *Forms 1042-S and 1099 Report*. The external auditor must report:

Report 1: For each pool or QI for which the amounts paid and the amounts reported do not match, the amounts of income reported on each Form 1042-S under Step 2, and the amounts paid to each pool or QI.

Report 2: The number of:
- (a) Nonqualified intermediaries and flow through entities that are direct account holders under Step 3(a);
- (b) Indirect account holders under Step 3(b);

Report 3: The number of indirect account holders for which the payments made do not match the payments reported on Forms 1042-S and on Forms 1099, and for those account holders the amounts reported on each form and the amounts paid to each indirect account holder.

Report 4: The number of non-exempt recipients for which the payments made do not match the payments reported on Forms 1099, and for those accounts the amounts reported on each form and the amounts paid to each non-exempt recipient.

***QI Agreement Sec. 10.03(D)(3).*** **Thoroughly review the statements attached to amended Forms 1042 filed to claim a refund, ascertain their veracity, and determine the causes of any overwithholding reported and ensure QI did not issue Forms 1042-S to persons whom it included as part of its collective credit or refund.**

*Audit Guidance 10.03(D)(3):*

10.03(D)(3).1. *Review of Refunds*. The external auditor must:

Step 1: Obtain:
- (a) The QI's amended Form 1042 (including the attached statements), the Forms 1042-S filed by the QI, and the Forms 1042-S issued to the QI;
- (b) The QI's records of payments from withholding agents and the QI's records of payments to the QI's reporting pools; and
- (c) The QI's records of payments to the account holders who received a refund of overwithholding from the QI.

Step 2: Inspect the QI's records of payments to determine whether overwithholding occurred and the amount of the overwithholding.

Step 3: Match the amount of income, withholding, and overwithholding with the QI's Form 1042.

Step 4: Identify the reporting pool or pools to which the overwithholding is attributable and the amount of overwithholding attributable to each pool.

Step 5: Identify the account holders who received a refund of the overwithholding from the QI.

Step 6: Identify all Forms 1042-S filed by the QI on a recipient specific basis.

Step 7: Match the account holders identified under Step 5 with the Forms 1042-S identified under Step 6.

10.03(D)(3).2. *Refund Report*. The external auditor must report:

Report 1: The total amount of overwithholding under Step 2.

Report 2: The amounts of overwithholding by each pool under Step 4.

Report 3: The number of account holders identified under Step 5.

Report 4: The number of account holders that do not match with Forms 1042-S under Step 7.

***QI Agreement Sec. 10.03(D)(4).*** **Determine, in the case of collective credits or refunds, that QI repaid the appropriate account holders prior to requesting a collective refund or credit.**

*Audit Guidance 10.03(D)(4):*

10.03(D)(4).1. *Review of Account Holder Repayment Prior to Refund*. The external auditor must:

Step 1: Obtain:
- (a) The QI's amended Form 1042 (including attached statements); and
- (b) The QI's records of payments to the account holders who received a refund of overwithholding from the QI.

Step 2: Inspect the QI's Form 1042 and records of payments to determine that the dates of payments of overwithholding made to each account holder were prior to the date of filing the Form 1042.

10.03(D)(4).2. *Account Holder Repayment Prior to Refund Report:* The external auditor must report:

Report 1: The amount of overwithholding paid to each account holder that occurred after the date of filing the Form 1042.

***QI Agreement Sec. 10.03(E).*** **Change in Circumstances. The external auditor must verify that in the course of the audit it has not discovered any significant change in circumstances, as described in section 11.03(A), (D), or (E) of this Agreement.**

*Audit Guidance 10.03(E):*

10.03(E).1. *Review of Change in Circumstance.* The external auditor must:

Step 1: Obtain a letter signed by the responsible party and by the QI's legal counsel stating:
- (a) Whether there has been an acquisition of all, or substantially all, of the QI's assets in any transaction in which the QI is not the surviving legal entity;
- (b) Any material changes in the know-your-customer rules and procedures set forth in the Attachments to the QI Agreement; and
- (c) Any significant changes in the QI's business practices that affect the QI's ability to meet its obligations under the QI Agreement.

10.03(E).2. *Change in Circumstance Report.* The external auditor must report a change in circumstances by:

Report 1: Attaching a copy of the letter under Step 1.

***QI Agreement Sec. 10.04.*** **Use of Statistical Sampling. If the external auditor is required to make a determination based on a valid sample of accounts, it shall use a statistical sampling whenever an examination of all of accounts within a particular class of accounts would be prohibitive in terms of time and expense. If it is reasonable to examine all accounts in connection with a particular issue, statistical sampling techniques shall not be used. If statistical sampling techniques are required, the external auditor must determine a sample size that provides a 95 percent confidence level. If statistical sampling has been used and the auditor determines that underwithholding has occurred with respect to the sampled accounts, the IRS will determine the total amount of underwithheld tax by projecting the underwithholding over the entire population of similar accounts. For this purpose, QI agrees to provide the IRS with the information (*e.g.*, number of accounts and amounts) required to project the underwithholding. QI shall either report and pay, in accordance with section 9.06 of this Agreement, the underwithheld tax determined under the IRS projection or propose another amount of underwithholding based on a more accurate population, a more accurate projection technique, or an examination of all similar accounts. If the IRS does not agree with the amount proposed by QI, the IRS shall assess a tax by making a return under section 6020 of the Code.**

*Audit Guidance 10.04:*

10.04.1. *When to Use Statistical Sampling.* The external auditor is permitted to select three statistical samples for use in performing the procedures in AG 10.03. These are the samples permitted to be selected in:
- (a) AG 10.03(A)(4).1 Step 1 (a sample of all accounts covered by the QI Agreement that are held by direct account holders that are not U.S. non-exempt recipients);
- (b) AG 10.03(A)(6).1 Step 1 (a sample of all accounts covered by the QI Agreement that are held by direct account holders that are U.S. non-exempt recipients); and
- (c) AG 10.03(A)(4).1 Step 7 (a sample of the indirect account holders for which recipient specific reporting is required).

The external auditor may always elect to conduct a 100 percent review instead of selecting a statistical sample. The statistical sampling methodology used in these guidelines cannot be used for any other tax purpose.

10.04.2. *Sample Size.* The external auditor is permitted to select a sample only if there are more than 50 accounts from which to select a sample in 10.04.1(a) or (b) or more than 50 indirect account holders from which to select a sample in 10.04.1(c).

10.04.3. *Sample Formula.* The external auditor must determine the sample size by using the following formula:

$$\text{Sample Size} = \frac{\dfrac{t^2\,PQ}{d^2}}{1 + \dfrac{1}{N}\left(\dfrac{t^2\,PQ}{d^2} - 1\right)}$$

where t=1.96 (confidence coefficient at 95 percent two sided)

P=5 percent (error rate)
Q=1-P
d=2 percent (precision level)
N=total population

The sample size will not exceed 456 (as determined by the formula above) or 50 percent of the population, whichever is smaller. In no event may the sample size be lower than 50.

10.04.4. *Number Generator*. The external auditor must select the sample by using a random number generator.

10.04.5. *Records of Sampling Methodology*. The external auditor is required to record its statistical sampling procedures and to maintain the ability to reconstruct the sample.

10.04.6. *Alternative Sampling Methods*. Multistage, cluster, stratification or other sampling methodology may be used with the consent of the IRS. The sample size may be adjusted to achieve a 5 percent error rate, a 2 percent precision level and a 95 percent two sided confidence level. See AG 10.03.2 (Submission of Audit Plan).

10.04.7. *Projection*. If the external auditor has used a sample and has determined that underwithholding under AG 10.03(C)(1), (2), (3), (4), or (5) has occurred, then the IRS will determine the total amount of underwithheld tax by projecting the underwithholding over the entire population of similar accounts using a projection method that is consistent with the sampling method used. For example, if a simple unrestricted random sample as provided in these guidelines has been used, then the IRS may determine the total amount of underwithheld tax by projecting the underwitholding over the entire population of similar accounts as follows:

(a) Dividing the amount of underwithholding for the sample by the number of accounts (or indirect account holders) in the sample; and

(b) Multiplying the result in (a) by the total number of accounts in the population.

(c) If the external auditor has used a sample and has determined that overwithholding has occurred, the QI may not project the amount of overwithholding in order to claim a refund. For samples of direct account holders, the IRS will offset any underwithholding in the sample against any overwithholding in the sample, provided that the QI enters into a closing agreement (Form 906) that QI will not file a claim for refund for any overwithholding that the external auditor has discovered.

(d) The IRS will determine whether it is appropriate to project an amount of underwithholding when the facts show that:
  (i) The amount is the consequence of an identified error; and
  (ii) The error was not repeated throughout the population over which it would be projected.

(e) The QI may propose that it is not appropriate to project an amount of underwithholding when the QI shows that:
  (i) The underwithholding was the consequence of an identified error,
  (ii) The QI has corrected the error in the sample in which it was discovered,
  (iii) The QI has corrected the error throughout the population from which the sample was drawn,
  (iv) The QI has established safeguards to prevent repetition of the error in the future, and
  (v) As a consequence of the correction, the facts as corrected show that there was actually no underwithholding during the audit year. (Penalties and interest may nevertheless be imposed.)

The QI may also propose an alternative projected underwithholding tax adjustment based on facts and circumstances. See Audit meeting in AG 10.06 Step 3 for procedures for making such proposals.

**Sec. 10.05. External Auditor's Report. Upon completion of the audit of QI and any PAI, the external auditor shall issue a report, or reports, of audit findings directly to the IRS by sending the original report to the IRS at the address set forth in section 12.06 of this Agreement by June 30 following the calendar year being audited, or if that date falls on a Saturday or Sunday, the next U.S. business day. The report must be in writing, in English, and currency amounts must be stated in U.S. dollars. The report must fully describe the scope of the audit, the methodologies (including sampling techniques) used to determine whether QI is in compliance with the provisions of this Agreement, and the result of each such determination. The report must also specifically address each of the items in section 10.03 of this Agreement.**

*Audit Guidance 10.05:*

10.05.1. *Auditor's Report Requirements*. The external auditor's report must:

(a) List the external auditor's name, address, contact person and contact person's telephone number.
(b) List the QI's name, address, QI-EIN, responsible party and responsible party's telephone number.
(c) List each procedure required under these Audit Guidelines in the order listed in the Audit Guidelines with a notation that the procedure was performed.
(d) Identify the audit year.
(e) List, under each procedure, the items required to be reported under these Audit Guidelines in the order listed in the Audit Guidelines.
(f) Include any items required to be attached to the report as Appendix 1. These items should be cross-referenced in the report with footnotes.
(g) Include any information that requires a narrative response and any other information that the external auditor wishes to include as Appendix 2. These

items should be cross-referenced in the report with footnotes.

(h) Contain a certification signed by the external auditor that the required procedures have been competently performed and that the information reported is accurate and complete.

10.05.2. *Electronic Report*. The IRS intends to develop a standard electronic report form. For audit reports due after the publication date of that form, the external auditor must also complete that form and send it to the IRS in the manner required by the form.

10.05.3. *Report Due Dates*. The external auditor must send the hard copy audit report to the IRS at the address set forth in section 12.06 of the QI Agreement by June 30 of the year following the audit year. The external auditor and the QI may jointly request an extension of the due date of the report by submitting a request for extension in writing signed by the external auditor and by the QI's responsible party to the IRS at the address in AG 10.01.1 by June 30 of the year following the audit year. The request should state the date to which the extension is requested, explain the reason for the extension and include telephone numbers for the external auditor's contact person and the QI's responsible party. The IRS will send the external auditor and the QI a written response as soon as practicable after receiving the request.

**Sec. 10.06. Expanding Scope and Timing of External Audit. Upon review of the external auditor's report, the IRS may request, and QI must permit, the external auditor to perform additional audit procedures, or to expand the external audit to cover some or all of the calendar years for which the period of limitations for assessment of taxes has not expired. In addition, the IRS may request, and QI agrees to permit, the external auditor to perform an audit for one or more calendar years not scheduled for audit under section 10.03 of this Agreement.**

*Audit Guidance 10.06:*

10.06.1 *IRS Review of Audit Report*. Within 90 days after the IRS receives the external auditor's report, the IRS will review the report and, if the IRS determines that no further action is necessary, then the IRS will send a written notice to the QI and the external auditor informing them of this determination.

10.06.2. *Audit Part 2: IRS Directed Procedures*. The IRS may determine that additional fact finding is necessary. In such cases, the IRS will contact the external auditor and the QI by telephone or in writing within 90 days after the IRS receives the external auditor's report. The IRS will direct the external auditor to perform specific audit procedures and to report in writing the results of those procedures. The IRS directed procedures may include instructing the external auditor to forward to the IRS certain of the external auditor's work papers and reports or instructing the external auditor to perform specific procedures (or perform an audit in accordance with these Audit Guidelines) for the audit year or for years other than the audit year. The IRS will stipulate a due date not more than 90 days from the date of its instructions to the external auditor for the external auditor's report on the results of any IRS directed procedures. The external auditor may request an extension of the due date in accordance with AG 10.05 at any time before the due date. Within 90 days after receiving the external auditor's report on the results of the initial IRS directed procedures, the IRS will contact the external auditor and the QI. If the IRS determines that additional fact finding is necessary, then the IRS may direct the external auditor to perform further additional procedures under this section until the IRS determines that the facts have been sufficiently developed. If the IRS determines that the audit is complete, the IRS will notify the external auditor and the QI in writing of the completion of the audit and of any actions that it will take as a result of the audit.

10.06.3. *Audit Part 3: Audit Meeting*. At any time after the external auditor has submitted its report on the initial IRS directed procedures and before the IRS notifies the QI and the external auditor of the completion of the audit, either the IRS or the QI may request an audit meeting between the IRS and the QI to accelerate fact finding, and to clarify and resolve concerns. To request and schedule a meeting, the IRS will contact the QI's responsible party by telephone or in writing, and the QI may contact the IRS at the address in AG 10.01 by telephone or in writing. The IRS will meet with the QI within 90 days of the date the IRS receives or makes the request, or at such other time as the IRS and the QI may agree. If the IRS and the QI agree, the employees of the external auditor who are acting in the capacity of external auditors under the QI Agreement may attend the audit meeting in that capacity, and other employees of the same firm may attend in other capacities. The IRS may continue to direct the external auditor to perform specific audit procedures under AG 10.06.2 without regard to whether an audit meeting has been scheduled or held. After the first audit meeting, either the IRS or the QI may request further audit meetings at any time before the IRS notifies the external auditor and the QI of the completion of the audit.

# Part IV. Items of General Interest

## Reporting Elective Deferral Catch–up Contributions on the 2002 Form W-2

## Announcement 2001–93

**Purpose**

This is to advise employers how to report elective deferral catch-up contributions beginning after December 31, 2001.

**Statutory Change**

The Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107–16) added section 414(v) to the Internal Revenue Code of 1986. For 2002, section 414(v) enables applicable employer plans to allow eligible participants who are age 50 or over to make additional elective deferrals, *i.e.*, "catch-up" contributions.

**Reporting on Form W-2**

For 2002, employers are required to report participants' elective pension deferrals on Form W-2 in box 12 using Codes D through H and S. For employees' qualified catch-up contributions after 2001, employers must report the elective deferral catch-up contributions in the totals reported for Codes D through H and S.

**Reporting on Form 5498**

The reporting of catch-up contributions will be addressed in the 2002 Instructions for Forms 1099-R and 5498. No major changes are anticipated.

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## Saver's Tax Credit for Contributions by Individuals to Employer Retirement Plans and IRAs

## Announcement 2001–106

This announcement describes the new "saver's credit," an income tax credit that is available to eligible taxpayers who contribute to a retirement plan or IRA. This announcement includes a sample notice that employers can give to employees explaining the credit.

Q-1: What is the saver's credit?

A-1: The saver's credit is a nonrefundable income tax credit for certain taxpayers with adjusted gross income that does not exceed $50,000. It is equal to a specified percentage of certain employee contributions made to an employer-sponsored retirement plan or of certain individual or spousal contributions to an individual retirement arrangement (IRA) for taxable years beginning after December 31, 2001, and before January 1, 2007. The saver's credit is contained in § 25B of the Internal Revenue Code, which was added by section 618 of the Economic Growth and Tax Relief Reconciliation Act of 2001.

Q-2: Who is eligible for the saver's credit?

A-2: Taxpayers who are age 18 or over before the end of their taxable year, other than full-time students or persons claimed as dependents on another taxpayer's return, are eligible for the credit.

For this purpose, students include individuals who, during some part of each of five months during the year, are (a) enrolled at a school that has a regular teaching staff, course of study, and regularly enrolled body of students in attendance, or (b) taking an on-farm training course given by such a school or a state, county, or local government. A student is a full-time student if he or she is enrolled for the number of hours or courses the school considers to be full-time.

Q-3: What is the maximum annual contribution eligible for the saver's credit?

A-3: $2,000 per year.

Q-4: Is the amount of the annual contribution eligible for the saver's credit ever reduced?

A-4: Yes. The amount of any contribution eligible for the saver's credit is reduced by the amount of any taxable distribution received by the taxpayer (or by the taxpayer's spouse if the taxpayer filed jointly with that spouse both for the year during which a distribution was made and the year for which the credit is taken) from any plan described in A-5 below during the testing period. The testing period consists of the year for which the credit is claimed, the period after the end of that year and before the due date (with extensions) for filing the taxpayer's return for that year, and the two taxable years that precede the year for which the credit is claimed. In the case of a distribution from a Roth IRA, this reduction applies to any such distribution, whether or not taxable, that is not rolled over. An amount does not count as a distribution for purposes of the reduction rule if the distribution is a return of a contribution to an IRA (including a Roth IRA) made during the tax year and (1) the distribution is made before the due date (including extensions) of the individual's tax return for that year, (2) no deduction is taken with respect to the contribution, and (3) the distribution includes any income attributable to the contribution.

For example, if an individual contributes $3,000 to a 401(k) plan during 2002, but had taken a $500 IRA withdrawal during that year and a $900 IRA withdrawal during 2001 and neither of these withdrawals was rolled over, the amount of that individual's 2002 plan contribution eligible for the credit is $1,600 ($3,000 - $500 - $900), instead of the $2,000 that would have been eligible for the credit if no withdrawals had been taken.

Q-5: What types of contributions are eligible for the saver's credit?

A-5: Salary reduction contributions to the following arrangements are eligible for the credit: a 401(k) plan (including a SIMPLE 401(k)), a section 403(b) annuity, an eligible deferred compensation plan of a state or local government (a "governmental 457 plan"), a SIMPLE IRA plan, or a salary reduction SEP. The saver's credit is also available for voluntary after-tax employee contributions to a tax-qualified retirement plan or section 403(b) annuity. For purposes of the credit, an employee contribution will be "voluntary" as long as it is not required as a condition of employment. Finally, the saver's credit is available for contributions to a traditional or Roth IRA.

An amount contributed to an individual's IRA is not a contribution eligible for the saver's credit if (1) the amount is distributed to the individual before the due date (including extensions) of the individual's tax return for the year in which the contribution was made, (2) no deduction is taken with respect to the contribution, and (3) the distribution includes any income attributable to the contribution.

Q-6: What is the saver's credit rate?

A-6: The saver's credit rate is based on the taxpayer's adjusted gross income for the taxable year for which the credit is claimed, as follows:

| Adjusted Gross Income | | | |
|---|---|---|---|
| Married filing joint | Head of household | All other filers | Credit |
| $0-$30,000 | $0-$22,500 | $0-$15,000 | 50% of contribution |
| $30,001-$32,500 | $22,501-$24,375 | $15,001-$16,250 | 20% of contribution |
| $32,501-$50,000 | $24,376-$37,500 | $16,251-$25,000 | 10% of contribution |
| Over $50,000 | Over $37,500 | Over $25,000 | credit not available |

For example, a taxpayer whose filing status is single with adjusted gross income of $15,000 may be entitled to a credit equal to 50% of his or her contributions (up to $2,000 of contributions) to a plan described in A-5 above.

Q-7: Does the saver's credit affect an eligible individual's entitlement to any deduction or exclusion that would otherwise apply to the contribution?

A-7: No. Eligible individuals entitled to deduct IRA contributions or to exclude plan contributions from gross income will be able to deduct or exclude those amounts and also claim the saver's credit.

Q-8: Can a taxpayer use the saver's credit to offset both an alternative minimum tax liability and a regular income tax liability?

A-8: Yes.

Q-9: For married taxpayers filing jointly, do contributions by or for either or both spouses give rise to the saver's credit?

A-9: Yes, contributions by or for either or both spouses, up to $2,000 per year for each spouse, can give rise to the saver's credit.

Q-10: Are salary reduction and after-tax employee contributions that are eligible for the saver's credit taken into account in the ADP and ACP nondiscrimination tests of §§ 401(k) and (m) of the Internal Revenue Code?

A-10: Yes. Salary reduction contributions to a 401(k) plan, whether or not those contributions give rise to the saver's credit, are taken into account in the nondiscrimination test for salary reduction contributions (the ADP test) for plans subject to that test. Also, voluntary after-tax employee contributions to a qualified plan, whether or not those contributions give rise to the saver's credit, are taken into account in the nondiscrimination test for employee after-tax contributions (the ACP test) for plans subject to that test.

Q-11: Can an individual claim the saver's credit for an amount contributed to a plan pursuant to automatic enrollment?

A-11: Yes. Any amount that is treated as an elective contribution on behalf of an eligible individual to an employer plan described in A-5 above can give rise to the saver's credit.

Q-12: Can an individual take a projected saver's credit into account in figuring the allowable number of withholding allowances on Form W-4?

A-12: Yes. For information on converting credits into withholding allowances, see IRS Publication 919, *"How Do I Adjust My Withholding?"*

Q-13: Is there a sample notice that employers can use to help explain the saver's credit to employees?

A-13: Yes. Employers are encouraged to tell their employees about the credit. Employers can inform employees in any way they choose, including use of the notice set out below.

### Drafting Information

The principal author of this announcement is Roger Kuehnle of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this announcement, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 9:30 p.m. Eastern Time, Monday through Friday. Mr. Kuehnle may be reached at (202) 283-9888 (not a toll-free number).

**Notice to Employees Regarding Saver's Credit:**

This notice explains how you may be able to pay less tax by contributing to [insert name of employer's plan] (the "Plan") or to an individual retirement arrangement ("IRA").

Beginning in 2002, if you make contributions to the Plan or to an IRA, you may be eligible for a tax credit, called the "saver's credit." This credit could reduce the federal income tax you pay dollar-for-dollar. The amount of the credit you can get is based on the contributions you make and your credit rate. The credit rate can be as low as 10% or as high as 50%, depending on your adjusted gross income — the lower your income, the higher the credit rate. The credit rate also depends on your filing status. See the tables at the end of this notice to determine your credit rate.

The maximum contribution taken into account for the credit for an individual is $2,000. If you are married filing jointly, the maximum contribution taken into account for the credit is $2,000 each for you and your spouse.

The credit is available to you if you:

- are 18 or older,
- are not a full-time student,
- are not claimed as a dependent on someone else's return, and
- have adjusted gross income (shown on your tax return for the year of the credit) that does not exceed:

$50,000 if you are married filing jointly,
$37,500 if you are a head of household with a qualifying person, or
$25,000 if you are single or married filing separately.

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***Example:*** Susan and John are married and file their federal income tax return jointly. For 2002, their adjusted gross income would have been $34,000 if they had not made any retirement contributions. During 2002, Susan elected to have $2,000 contributed to her employer's 401(k) plan. John made a deductible contribution of $2,000 to an IRA for 2002. As a result of these contributions, their 2002 adjusted gross income is $30,000. If their Federal income tax would have been $3,000 (after applying any other credits to which they are entitled) without having made any retirement contributions, then their federal income tax as a result of making the $4,000 retirement contributions will be only $400 after application of the saver's credit and other tax benefits for the retirement contributions. Thus, by saving $4,000 for their retirement, Susan and John have also reduced their taxes by $2,600.

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The annual contribution eligible for the credit may have to be reduced by any taxable distributions from a retirement plan or IRA that you or your spouse receive during the year you claim the credit, during the 2 preceding years, or during the period after the end of the year for which you claim the credit and before the due date for filing your return for that year. A distribution from a Roth IRA that is not rolled over is taken into account for this reduction, even if the distribution is not taxable. After these reductions, the maximum annual contribution eligible for the credit per person is $2,000.

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***Example:*** Mark's adjusted gross income for 2002 is low enough for him to be eligible for the credit that year and he defers $3,000 of his pay to his employer's 401(k) plan during 2002. During 2001, Mark took a $400 hardship withdrawal from his employer's plan and during 2002 he takes an $800 IRA withdrawal. Mark's 2002 saver's credit will be based on contributions of $1,800 ($3,000 - $400 - $800).

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The amount of your saver's credit will not change the amount of your refundable tax credits. A refundable tax credit, such as the earned income credit or the refundable amount of your child tax credit, is an amount that you would receive as a refund even if you did not otherwise owe any taxes.

The amount of your saver's credit in any year cannot exceed the amount of tax that you would otherwise pay (not counting any refundable credits or the adoption credit) in any year. If your tax liability is reduced to zero because of other nonrefundable credits, such as the Hope Scholarship Credit, then you will not be entitled to the saver's credit.

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**CREDIT RATES**

**If your income tax filing status is "married filing joint"**

| **and your adjusted gross income is:** | **Your saver's credit rate is:** |
|---|---|
| $0-$30,000 | 50% of contribution |
| $30,001-$32,500 | 20% of contribution |
| $32,501-$50,000 | 10% of contribution |
| Over $50,000 | credit not available |

**If your income tax filing status is "head of household"**

| **and your adjusted gross income is:** | **Your saver's credit rate is:** |
|---|---|
| $0-$22,500 | 50% of contribution |
| $22,501-$24,375 | 20% of contribution |
| $24,376-$37,500 | 10% of contribution |
| Over $37,500 | credit not available |

**If your income tax filing status is "single," "married filing separate," or "qualifying widow(er)"**

| **and your adjusted gross income is:** | **Your saver's credit rate is:** |
|---|---|
| $0-$15,000 | 50% of contribution |
| $15,001-$16,250 | 20% of contribution |
| $16,251-$25,000 | 10% of contribution |
| Over $25,000 | credit not available |

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## Information Reporting Program Call Site Update

## Announcement 2001–107

*IRS Martinsburg Commputing Center (MCC) Information Reporting Program Call Site Now Has a Toll-Free Telephone Number*

The Call Site is located at IRS/MCC and operates in conjunction with the Information Reporting Program. The Call Site provides service to the payer community (financial institutions, employers, and other transmitters of information returns).

The Information Reporting Program Call Site answers both magnetic media and tax law questions relating to the filing of information returns (Forms 1096, 1098, 1099, 5498, 8027, W-2G, and W-4). The Call Site also answers magnetic media questions related to Forms 1042-S, and tax law and paper filing related questions about Forms W-2 and W-3, as well as handling inquiries dealing with backup withholding and reasonable cause requirements due to missing and incorrect taxpayer identification numbers.

The Call Site accepts calls from all areas of the country. **The new toll-free number is 866-455-7438.** Payers and transmitters may still use the original telephone number, which is **304-263-8700** or Telecommunications Device for the Deaf **(TDD) 304-267-3367.** These are toll calls. *The Call Site can also be reached via email at mccirp@irs.gov.* Hours of operation for the Call Site are Monday through Friday, 8:30 a.m. to 4:30 p.m. Eastern time. The Call Site is in operation throughout the year to handle the questions of payers, transmitters, and employers. Due to the high demand for assistance at the end of January and February, it is advisable to call as soon as possible to avoid these peak filing seasons.

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## Foundations Status of Certain Organizations

## Announcement 2001–108

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

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

A-1 Universal Care, Inc., Hempstead, NY
Albany-El Cerrito Access, El Cerrito, CA
Alliance for Youth Services Project, Inc., Long Beach, CA
Amateur Baseball Association of Texas, Inc., Houston, TX
Ambassador Baptist Church of Houston, Houston, TX
American Friends of Children of Chernobyl, Inc., New York, NY
American Samoan Medical Team, Inc., Las Vegas, NV
Amigas-Assisting Mexicans in Gaining Academic Success, Houston, TX
Amos York Ministries, Inc., Houston, TX
Asian-American Culture Center, Houston, TX
Asociacion Boliviana De Houston, Inc., Houston, TX
Balance Ministries, Houston, TX
Barrett Station Youth Enrichment Project, Inc., Crosby, TX
Bay Area School Reform Collaborative, San Francisco, CA
Bevcomm Internet Technology, Davis, CA
Binghampton Revitalization Association, Inc., Memphis, TN
Brazos River Preservation Society, Sugar Land, TX
Cape Cod Discovery Museum, Inc., Dennisport, MA
Capital District Field of Dreams, Inc., Albany, NY
Caregivers Empowered, Houston, TX
Caring Neighbor Services, Inc., Jersey City, NJ
Center for Value Inquiry, St. Paul, MN
Child and Adult Development Center of Houston, Inc., Houston, TX
Children of God Ministries-Childheart Ministries International, Dallas, TX
Christ Outreach Center, Marion, OH
C.I.E.L.O. Project/Radio Ranch, Olympia, WA
Citrus 20-20, Inc., Homosassa, FL
Citywide Youth Basketball League of Houston, Inc., Houston, TX
Clinton School Committee for Curriculum Advancement, Clinton, MT
Clyde Drexler Foundation, Inc., Houston, TX
Common Sense Forum, Inc., Milwaukee, WI
Community Advocacy Foundation Fresno, CA
Community Housing and Development Fund, Torrance, CA
Community Housing and Redevelopment Trust, Inc., Homestead, FL
Creative Arts Institute, Port Hadlock, WA
Darley Park Community Association, Inc., Baltimore, MD
Desert Arts Unlimited, Lakeview, OR
Devoted Care Home, Inc., Missouri City, TX
Dunamis Connection, Inc., Brookshire, TX
Earning by Learning Stanislaus, Modesto, CA
Emmaus Ministries, Yakima, WA
Enchanted Womanhood, Inc., Baytown, TX
Encore Theatre, Houston, TX
Environmental Exchange, Inc., Forest Hills, NY
Falmouth Youth Basketball Association, Falmouth, ME
Families for Effective Autism Treatment, Inc., Minnetonka, MN
Faye and A.J. Wolf Foundation, Houston, TX
Federation of African American Contractors, Oakland, CA
Fort Bend Cultural Arts Council, Missouri City, TX
Frank Steele Foundation, Inc., Geary, OK
Fraternal Organization, Killeen, TX
Friends of Arch, Inc., New Hyde Park, NY
Friends of the Paragon Carousel, Inc., Hull, MA
GLT Foundation, Omaha, NE
Golden Shadow Associates, St. Charles, MO
Goose Creek Navy Community Foundation, Inc., Baytown, TX

Greater Houston Academic Challenge, Inc., Houston, TX
Greg Crawford Ministries, Inc., Huffman, TX
Heavenly Acres Foundation, Hugo, OK
Hematology-Oncology Assistance Resource Coalition, Kingwood, TX
Hidalgo Coordination, Inc., Lordsburg, NM
Highland Belle Booster Club, Inc., Dallas, TX
Highland Park Dance Theater Company, Fresno, CA
Hmong Foundation, Inc., Milwaukee, WI
Home Growth Program & Associates, Inc., Sacramento, CA
Hospice Lights Foundation, Inc., New Freedom, PA
Houston Pride Band, Inc., Houston, TX
Houston Roundup, Houston, TX
Human Focus, Daly City, CA
Hyde Park Foundation, Houston, TX
Independent Heights Baptist Pastors and Ministers Alliance, Inc., Houston, TX
Intellidebt Corp., Garland, TX
International Marinelife Alliance, Inc., Honolulu, HI
Jackson Hole Community Radio, Incorporated, Jackson, WY
Jackson Park Preservation Corporation, Chicago, IL
Jafria Council USA, Inc., Corona, NY
James M. Tirella Memorial Foundation for the Arts, New York, NY
James River Blues Society, Lynchburg, VA
Jehovah Jirah Outreach Ministries, Inc., Winston-Salem, NC
John F. and Annie M. Hurley Howells Family Foundation, Inc., Salt Lake City, UT
Jojo Community Vocational and Rehabilitation Services, Denver, CO
Jude-25 Christian Stewardship Fund, Inc., Palm Desert, CA
Kansas Alliance of Alcohol and Other Drug Services, Inc., Abilene, KS
Kenner Housing Authority Resident Association, Kenner, LA
Korean Civic Alliance, Incorporated, Bronx, NY
Laguna Hills Aquatics, Cathedral City, CA
Les Amis, St. Louis, MO
Light Club 8, Incorporated, Coral Springs, FL
Little Brothers & Little Sisters Program, Inc., Visalia, CA
Lucky Community Improvement Club, McMinnville, TN
Lyric Theatre, Ltd., Weehawken, NJ
Madison Township Volunteer Fire Department, Inc., Greencastle, IN
Main Thing Ministries, Houston, TX
Mark Williams Charities, Houston, TX
Masters Watchmen Ministry, Inc., Augusta, GA
Mat Rats, Inc., Hillsboro, OR
Metropolitan Children Services, Inc., Matteson, IL
Michigan Legal Foundation, Midland, MI
Mind Body and Science Institute, San Antonio, TX
Mountain View Resident Council, Big Stone Gap, VA
Muslim American Youth, Inc., Lindenhurst, NY
Na Kokua Ministries Haaii, Inc., Home Fellowship Church of Jesus, Honolulu, HI
National Collegiate Exposure Program, Houston, TX
Navajo Scouting Organization, St. Michaels, AZ
Needham Ministries, Incorporated, Houston, TX
Netday, Irvine, CA
Neurosurgical Peruvian American Foundation, Huntington Beach, CA
New Century Development, Inc., McComb, MS
New Hope Outreach Ministries, Incorporated, Lexington, NC
Newburgh Housing Authoritys Outreach Development Corp., Newburgh, NY
NWLRC Legends Rowing Club, Everett, WA
Ohitare Global for Family & Youth, Tacoma, WA
Options of Ohio, Inc., Dellroy, OH
Orange Area Boxing Club, Inc., Orange, TX
Outrage, Inc., Houston, TX
Palm Beach County Alzheimers Care Association, Inc., Boca Raton, FL
Parental Alcohol-Drug Services, Alameda, CA
Path of Life, Inc., Houston, TX
Pathways to Freedom, Inc., Brentwood, TN
Perry N. Finley Foundation, Ltd., Boston, MA
Pleasant Hill Community Development Corporation, Houston, TX
Porter County Railroad Educational & Historical Fund, Valparaiso, IN
Prehospital Advisory Board, Moline, IL
Prevention Intervention Program, Plano, TX
Pulaski Court Residents Association of Garfield, Inc., Garfield, NJ
Quality Connections, Inc., Seminole, OK
Rainbow Tribe Institution Foundation, Inc., Albany, NY
Reach Me, Inc., Houston, TX
Recovery Campuses of Texas Caring for the Indigent, Galveston, TX
Responsibility is Ours Trio, Houston, TX
Richmond Historic Preservation Committee, Richmond, TX
Rolla Area Lutheran for Life Organization, Rolla, MO
Rophe Ministries, Philadelphia, PA
Roseberg Roughnecks Football Club, Rosenburg, TX
Roz House of New Found Hope, Chicago, IL
Russell Community, Corporation, Washington, DC
Salt of the Earth A New Jersey Non-Profit Corporation, Bagota, NJ
Samskriti Society for Indian Performing Arts, Incorporated, Houston, TX
San Francisco Italian Athletic Club Foundation, San Francisco, CA
San Gabriel-Pomona Valleys Cocaine Anonymous, Arcadia, CA
Save Our Shores, Dickinson, TX
Senior Assistance Fund Elite, Houston, TX
Seymour Community School Scholarship Trust, Seymour, WI
Sharp Ministries International, Inc., Oklahoma City, OK
Social Assistance and Fundamental Education, Inc.-SAFE, Houston, TX
Societe Italiana Di Cultura, Chicago, IL
Soul Ministries, Inc., La Marque, TX
Southeast Texas Area Emissions Reduction Credit Organization, Port Arthur, TX
Southwestern Illinois Business Council, Inc., East St. Louis, IL
Space America Foundation for Education, Inc., Houston, TX
Springfield Eagles Charity, Inc., Springfield, OH
St. Stephen Christian Center, Houston, TX
Story Center, A Historical Museum and Cultural Center, Ames, IA
Success, Inc., Carpinteria, CA

Success of Minority Students, Inc., Catskill, NY
Sweeny Historical Society, Inc., Sweeny, TX
Teen Life Community Action Group, Pfafftown, NC
Teenage Incentive Program, Inc., Houston, TX
Texas Raptor & Wildlife Rehab & Education Center, Inc., Houston, TX
Thai Association of San Diego County, Excondido, CA
Three Corners Counseling Center, Concord, CA
Timberlawn Psychiatric Research Foundation, Inc., Greensboro, NC
Tomball Njotc Booster Club, Tomball, TX
Tournament Teams, Inc., Katy, TX
Tri-County Revitalization Industrialization Pac-People Again, Ellicott, MD
Trinity Gardens Integral Forces, Inc., Houston, TX
Upstate Alive 95, Inc., Greenville, SC
USA Joshinmon Shorin-Ryu Karate-Do Federation, Houston, TX
Vision Entertainment, Inc., Dallas, TX
Volunteers for Increased Public Safety, La Quinta, CA
Watts Home, Inc., Beaumont, TX
Wings for Wildlife, Denver, CO
Wolf Laurel Historical Society, Mars Hill, NC
Yorkshire Village Resident Council, Inc., Houston, TX
Ziggurratt Christian Ministries, Richland, WA

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

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

## Section 42.—Low Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, page 434.

## Section 125.—Cafeteria Plans

*26 CFR 1.125–3: Effect of the Family and Medical Leave Act (FMLA) on the operation of cafeteria plans.*

## T.D. 8966

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Effect of the Family and Medical Leave Act on the Operation of Cafeteria Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to cafeteria plans that reflect changes made by the Family and Medical Leave Act of 1993 (Act). The final regulations provide the public with guidance needed to comply with the Act and affect employees who participate in cafeteria plans.

DATES: *Effective Date*: These regulations are effective October 17, 2001.

*Applicability Date:* These regulations are applicable for cafeteria plan years beginning on or after January 1, 2002.

FOR FURTHER INFORMATION CONTACT: Shoshanna Chaiton at (202) 622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains additions to the Income Tax Regulations (26 CFR Part 1) under section 125 of the Internal Revenue Code of 1986 (Code). These additions conform the cafeteria plan regulations to the Family and Medical Leave Act of 1993 (FMLA), Public Law 103–3, 29 U.S.C. 2601 *et seq.* FMLA imposes certain requirements on employers regarding coverage, including family coverage, under group health plans for employees taking FMLA leave and regarding the restoration of benefits to employees who return from FMLA leave. Proposed regulations, EE–20–95 (1996–1 C.B. 758), published in the Federal Register on December 21, 1995 (60 FR 66229), addressed a number of the principal questions that were raised about how these FMLA requirements affect the operation of cafeteria plans (including flexible spending arrangements) maintained under section 125. These final regulations are based on the 1995 proposed regulations, and include clarifications and other changes resulting from comments received on the proposed regulations.

**Summary of Changes**

A number of comments that were made in response to the 1995 proposed regulations relate to FMLA. The requirements pertaining to FMLA leave, including the employer's obligation to maintain coverage under a group health plan during FMLA leave and to restore benefits upon return from FMLA leave, are established by FMLA, not the Code. The U.S. Department of Labor, in 29 CFR part 825, has published rules interpreting the requirements of FMLA, and the Department of Labor has jurisdiction relating to those rights or obligations. These final regulations do not interpret FMLA or the rules published by the Department of Labor. Rather, they provide guidance on the cafeteria plan rules that apply to an employee in circumstances to which FMLA and the Labor Regulations thereunder also apply. Accordingly, these final regulations include a number of changes intended to clarify which particular conditions must be satisfied to comply with FMLA and with the cafeteria plan rules.

The Department of the Treasury, including the Internal Revenue Service (IRS), discussed these final regulations with the Department of Labor to ensure that they do not conflict with, and are not inconsistent with, the provisions of FMLA or the Labor regulations thereunder, at 29 CFR Part 825. In response to those discussions and comments made by the public, these cafeteria plan regulations have been changed to clarify the circumstances under which an employer is required to maintain coverage and an employee is required to continue paying premiums. These changes are described below.

As a general matter, under FMLA, an employer has the obligation to offer coverage under any group health plan for the duration of FMLA leave, whether paid or unpaid, and under the same conditions as coverage would have been provided if the employee had been continuously working during the entire leave period. The employee has the right to keep this coverage by continuing to pay the premium. During the period of FMLA leave, the employer is required to continue payment of its share of the costs of group health insurance coverage, but may condition such continued payments on the employee paying his or her share of the costs under one of the methods set forth at 29 CFR 825.210. See also the notice requirements at 29 CFR 825.301(b)(1)(iv).

Furthermore, the employer must either allow the employee to revoke coverage while on unpaid FMLA leave, or continue coverage but allow the employee to discontinue his or her share of the premium payments while the employee is on unpaid leave. Although ordinarily health plan coverage would cease if an employee does not make his or her share of the premium payments, FMLA does not give the employee a right to require that the employer terminate coverage. The FMLA permits an employer to continue health plan coverage while the employee is on unpaid FMLA leave by paying both the employer's and the employee's share of group health plan contributions. In this event, the employer may recover the employee's share of the contributions when the employee returns from leave or, if the employee fails to return from leave, the employer may recover the employee's share of contributions and may also recover its own share as well under the circumstances set forth in 29 CFR 825.213(a). However, under the FMLA, an employee who chooses to discontinue premium payments may not be required to make contributions until the unpaid FMLA leave ends.

Upon return from leave, FMLA requires that the employee have the right to be reinstated under the same terms as if the employee had worked during the entire leave period without any break in coverage. An employee who has revoked coverage or has failed to make required payments therefore has the right to be reinstated in the group health plan upon return from leave. If the employee does not elect to be reinstated in the group health plan upon return from FMLA leave, the employer may nevertheless require the employee to resume participation if the employer also requires employees who return from unpaid non-FMLA leave to resume participation upon return from leave. This reflects a change in position from the 1995 proposed regulations, which specifically prohibited an employer from requiring an employee whose coverage has terminated while on FMLA leave to reinstate coverage under a health FSA upon return from FMLA leave. Several commentators disagreed with this position, and suggested that the FMLA regulations do not require this rule. In response to these comments, the rule has been modified as described above.

One commentator questioned whether an employee on paid FMLA leave may change or revoke an election. Whether an employer is required to permit an employee on paid FMLA leave to revoke an election is governed by the FMLA and the Labor Regulations thereunder, rather than these regulations. As described above, the FMLA permits an employer to require that the employee continue coverage during an FMLA leave if the employer is continuing the employee's pay during the FMLA leave and does not treat employees on paid FMLA leave differently from other employees on paid leave. If these two conditions are satisfied, as described in Q&A-4, an employer may require that an employee who goes on paid FMLA leave continue to pay premiums by the method normally used during any paid leave.

In response to comments, the rule in the 1995 regulations concerning the catch-up payment option was modified. Under the 1995 regulations, an employee who elected to use the catch-up payment option before going on FMLA leave was required to enter into an advance agreement with the employer specifying that the employee wanted to continue health coverage while on unpaid FMLA leave, that the employer would pay the premiums during the FMLA leave, and that the employee would repay these amounts upon return. Commentators noted that this rule did not provide enough flexibility for employers attempting to recoup payments in situations where employees originally elected the pay-as-you-go method but then were not able to make those required payments. Accordingly, the rule under the final regulations eliminates the requirement that an employee who elects the catch-up payment option enter into an advance agreement with the employer. The new rule adds flexibility and permits continued coverage because, although employees may still use either the catch-up payment option or the after-tax pay-as-you-go method from the outset, now employers may continue coverage and, under the catch-up payment option, recoup any amounts paid on an employee's behalf if the employee cannot make all the payments under the pay-as-you-go method.

The 1995 proposed regulations included a special proration rule for cases in which health coverage under a flexible spending arrangement (FSA) did not continue during an FMLA leave because the employee revoked coverage or failed to make required payments, and then the employee elects to resume the coverage when the leave ends during the same year. The proposed regulation permitted the employee's coverage to be reduced after the employee resumes work if the employee did not have coverage during the FMLA leave. Based on information provided by the Department of Labor concerning FMLA, the final regulations require that, where an employee does not have coverage under the FSA during FMLA leave because the employee chooses to revoke coverage or does not pay required premiums for any reason during FMLA leave, the employer must provide the employee upon return from FMLA leave a choice between: (1) resuming coverage at the original level and making up the unpaid premium payments or (2) resuming coverage at a level that is reduced under the proration rule and resuming premium payments at the original level. Where the employee selects the prorated method and the plan has already made disbursements to the employee that exceed the premiums that will be paid for the year, the employer may not require the employee to pay any more than the remaining premiums due. If health FSA coverage does continue during the leave (whether due to an FMLA coverage continuation election by the employee or because the employer's plan requires health FSA coverage to be continued during a leave), there would of course be no proration.

Commentators requested clarification regarding whether employers are required to obtain elections from employees who are on FMLA leave when an open enrollment period occurs. In response to this comment, the final regulations clarify that employees on FMLA leave have the same rights during the leave period as employees participating in a cafeteria plan who are not on FMLA leave. Accordingly, employers are required to give employees on FMLA leave the right to enroll in a plan or change their election while they are on leave in the same manner as for active employees, rather than waiting for the employees on FMLA leave to return to work.

These final regulations supplement the regulations that were issued at §1.125–4 (T.D. 8878, 2000–15 I.R.B. 857, issued in March of 2000 (65 FR 15548) and T.D. 8921, 2001–7 I.R.B. 532, issued in January of 2001 (66 FR 1837)) setting forth the conditions under which a cafeteria plan can permit an employee to make an election change during the year. Thus, as provided at §1.125–4(g), if an employee goes on an FMLA leave, section 125 allows a cafeteria plan to permit the employee to make an election change if the conditions in either these final regulations or the regulations at §1.125–4 are satisfied. Further, as described above, FMLA requires that an employee who goes on an FMLA leave have the same election rights under a group health plan as an employee who is not on FMLA leave. Thus, a cafeteria plan that is subject to FMLA must allow an employee who goes on an FMLA leave to be able to make the same election changes as an employee who is not on an FMLA leave.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C.

chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal author of these regulations is Christine Keller, Division Counsel/Associate Chief Counsel (Office of Tax Exempt and Government Entities). However, other personnel from the IRS and Department of the Treasury participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.125–3 is added to read as follows:

*§1.125–3 Effect of the Family and Medical Leave Act (FMLA) on the operation of cafeteria plans.*

The following questions and answers provide guidance on the effect of the Family and Medical Leave Act (FMLA), 29 U.S.C. 2601 *et. seq*., on the operation of cafeteria plans:

Q-1: May an employee revoke coverage or cease payment of his or her share of group health plan premiums when taking unpaid FMLA leave?

A-1: Yes. An employer must either allow an employee on unpaid FMLA leave to revoke coverage, or continue coverage but allow the employee to discontinue payment of his or her share of the premium for group health plan coverage (including a health flexible spending arrangement (FSA)) under a cafeteria plan for the period of the FMLA leave. See 29 CFR 825.209(e). FMLA does not require that an employer allow an employee to revoke coverage if the employer pays the employee's share of premiums. As discussed in Q&A-3, if the employer continues coverage during an FMLA leave, the employer may recover the employee's share of the premiums when the employee returns to work. FMLA also provides the employee a right to be reinstated in the group health plan coverage (including a health FSA) provided under a cafeteria plan upon returning from FMLA leave if the employee's group health plan coverage terminated while on FMLA leave (either by revocation or due to nonpayment of premiums). Such an employee is entitled, to the extent required under FMLA, to be reinstated on the same terms as prior to taking FMLA leave (including family or dependent coverage), subject to any changes in benefit levels that may have taken place during the period of FMLA leave as provided in 29 CFR 825.215(d)(1). See 29 CFR 825.209(e) and 825.215(d). In addition, such an employee has the right to revoke or change elections under §1.125–4 (*e.g.*, because of changes in status or cost or coverage changes as provided under §1.125–4) under the same terms and conditions as are available to employees participating in the cafeteria plan who are working and not on FMLA leave.

Q-2: Who is responsible for making premium payments under a cafeteria plan when an employee on FMLA leave continues group health plan coverage?

A-2: FMLA provides that an employee is entitled to continue group health plan coverage during FMLA leave whether or not that coverage is provided under a health FSA or other component of a cafeteria plan. See 29 CFR 825.209(b). FMLA permits an employer to require an employee who chooses to continue group health plan coverage while on FMLA leave to be responsible for the share of group health premiums that would be allocable to the employee if the employee were working, and, for this purpose, treats amounts paid pursuant to a pre-tax salary reduction agreement as amounts allocable to the employee. However, FMLA requires the employer to continue to contribute the share of the cost of the employee's coverage that the employer was paying before the employee commenced FMLA leave. See 29 CFR 825.100(b) and 825.210(a).

Q-3: What payment options are required or permitted to be offered under a cafeteria plan to an employee who continues group health plan coverage while on unpaid FMLA leave, and what is the tax treatment of these payments?

A-3: (a) *In general.* Subject to the limitations described in paragraph (b) of this Q&A-3, a cafeteria plan may offer one or more of the following payment options, or a combination of these options, to an employee who continues group health plan coverage (including a health FSA) while on unpaid FMLA leave; provided that the payment options for employees on FMLA leave are offered on terms at least as favorable as those offered to employees not on FMLA leave. These options are referred to in this section as pre-pay, pay-as-you-go, and catch-up. See also the FMLA notice requirements at 29 CFR 825.301(b)(1)(iv).

(1) *Pre-pay*. (i) Under the pre-pay option, a cafeteria plan may permit an employee to pay, prior to commencement of the FMLA leave period, the amounts due for the FMLA leave period. However, FMLA provides that the employer may not mandate that an employee pre-pay the amounts due for the leave period. See 29 CFR 825.210(c)(3) and (4).

(ii) Contributions under the pre-pay option may be made on a pre-tax salary reduction basis from any taxable compensation (including from unused sick days or vacation days). However, see Q&A-5 of this section regarding additional restrictions on pre-tax salary reduction contributions when an employee's FMLA leave spans two cafeteria plan years.

(iii) Contributions under the pre-pay option may also be made on an after-tax basis.

(2) *Pay-as-you-go*. (i) Under the pay-as-you-go option, employees may pay their share of the premium payments on the same schedule as payments would have been made if the employee were not on leave or under any other payment schedule permitted by the Labor Regulations at 29 CFR 825.210(c) (*e.g.*, on the same schedule as payments are made under section 4980B (relating to coverage under the Consolidated Omnibus Budget Reconciliation Act (COBRA) 26 U.S.C. 4980B), under the employer's existing rules for payment by employees on leave without pay, or under any other system voluntarily agreed to between the employer and the employee that is not incon-

sistent with this section or with 29 CFR 825.210(c)).

(ii) Contributions under the pay-as-you-go option are generally made by the employee on an after-tax basis. However, contributions may be made on a pre-tax basis to the extent that the contributions are made from taxable compensation (*e.g.*, from unused sick days or vacation days) that is due the employee during the leave period.

(iii) An employer is not required to continue the group health coverage of an employee who fails to make required premium payments while on FMLA leave, provided that the employer follows the notice procedures required under FMLA. See 29 CFR 825.212. However, if the employer chooses to continue the health coverage of an employee who fails to pay his or her share of the premium payments while on FMLA leave, FMLA permits the employer to recoup the premiums (to the extent of the employee's share). See 29 CFR 825.212(b). Such recoupment may be made as set forth in paragraphs (a)(3)(i) and (ii) of this Q&A-3. See also Q&A-6 of this section regarding coverage under a health FSA when an employee fails to make the required premium payments while on FMLA leave.

(3) *Catch-up*. (i) Under the catch-up option, the employer and the employee may agree in advance that the group coverage will continue during the period of unpaid FMLA leave, and that the employee will not pay premiums until the employee returns from the FMLA leave. Where an employee is electing to use the catch-up option, the employer and the employee must agree in advance of the coverage period that: the employee elects to continue health coverage while on unpaid FMLA leave; the employer assumes responsibility for advancing payment of the premiums on the employee's behalf during the FMLA leave; and these advance amounts are to be paid by the employee when the employee returns from FMLA leave.

(ii) When an employee fails to make required premium payments while on FMLA leave, an employer is permitted to utilize the catch-up option to recoup the employee's share of premium payments when the employee returns from FMLA leave. See, *e.g.*, 29 CFR 825.212(b). If the employer chooses to continue group coverage under these circumstances, the prior agreement of the employee, as set forth in paragraph (a)(3)(i) of this Q&A-3, is not required.

(iii) Contributions under the catch-up option may be made on a pre-tax salary reduction basis from any available taxable compensation (including from unused sick days and vacation days) after the employee returns from FMLA leave. The cafeteria plan may provide for the catch-up option to apply on a pre-tax salary reduction basis if premiums have not been paid on any other basis (*i.e.*, have not been paid under the pre-pay or pay-as-you-go options or on a catch-up after-tax basis).

(iv) Contributions under the catch-up option may also be made on an after-tax basis.

(b) *Exceptions*. Whatever payment options are offered to employees on non-FMLA leave must be offered to employees on FMLA leave. In accordance with 29 CFR 825.210(c), cafeteria plans may offer one or more of the payment options described in paragraph (a) of this Q&A-3, with the following exceptions:

(1) FMLA does not permit the pre-pay option to be the sole option offered to employees on FMLA leave. However, the cafeteria plan may include pre-payment as an option for employees on FMLA leave, even if such option is not offered to employees on non-FMLA leave-without-pay.

(2) FMLA allows the catch-up option to be the sole option offered to employees on FMLA leave if and only if the catch-up option is the sole option offered to employees on non-FMLA leave-without-pay.

(3) If the pay-as-you-go option is offered to employees on non-FMLA leave-without-pay, the option must also be offered to employees on FMLA leave. The employer may also offer employees on FMLA leave the pre-pay option and/or the catch-up option.

(c) *Voluntary waiver of employee payments*. In addition to the foregoing payment options, an employer may voluntarily waive, on a nondiscriminatory basis, the requirement that employees who elect to continue group health coverage while on FMLA leave pay the amounts the employees would otherwise be required to pay for the leave period.

(d) *Example*. The following example illustrates this Q&A-3:

*Example*. (i) Employer Y allows employees to pay premiums for group health coverage during an FMLA leave on an after-tax basis while the employee is on unpaid FMLA leave. Under the terms of Y's cafeteria plan, if an employee elects to continue health coverage during an unpaid FMLA leave and fails to pay one or more of the after-tax premium payments due for that coverage, the employee's salary after the employee returns from FMLA leave is reduced to cover unpaid premiums (*i.e.* the premiums that were to be paid by the employee on an after-tax basis during the FMLA leave, but were paid by the employer instead).

(ii) In this *Example,* Y's cafeteria plan satisfies the conditions in this Q&A-3. Y's cafeteria plan would also satisfy the conditions in this Q&A-3 if the plan provided for coverage to cease in the event the employee fails to make a premium payment when due during an unpaid FMLA leave.

Q-4: Do the special FMLA requirements concerning payment of premiums by an employee who continues group health plan coverage under a cafeteria plan apply if the employee is on paid FMLA leave?

A-4: No. The Labor Regulations provide that, if an employee's FMLA leave is paid leave as described at 29 CFR 825.207 and the employer mandates that the employee continue group health plan coverage while on FMLA leave, the employee's share of the premiums must be paid by the method normally used during any paid leave (*e.g.*, by pre-tax salary reduction if the employee's share of premiums were paid by pre-tax salary reduction before the FMLA leave began). See 29 CFR 825.210(b).

Q-5: What restrictions apply to contributions when an employee's FMLA leave spans two cafeteria plan years?

A-5: (a) No amount will be included in an employee's gross income due to participation in a cafeteria plan during FMLA leave, provided that the plan complies with other generally applicable cafeteria plan requirements. Among other requirements, a plan may not operate in a manner that enables employees on FMLA leave to defer compensation from one cafeteria plan year to a subsequent cafeteria plan year. See section 125(d)(2).

(b) The following example illustrates this Q&A-5:

*Example*. (i) Employee A elects group health coverage under a calendar year cafeteria plan maintained by Employer X. Employee A's premium for health coverage is $100 per month throughout the 12-month period of coverage. Employee A takes FMLA leave for 12 weeks beginning on October 31 after making 10 months of premium payments totaling $1,000 (10 months x $ 100 = $1,000). Employee A elects to continue health coverage while on

FMLA leave and utilizes the pre-pay option by applying his or her unused sick days in order to make the required premium payments due while he or she is on FMLA leave.

(ii) Because A cannot defer compensation from one plan year to a subsequent plan year, A may prepay the premiums due in November and December (*i.e.*, $100 per month) on a pre-tax basis, but A cannot pre-pay the premium payment due in January on a pre-tax basis. If A participates in the cafeteria plan in the subsequent plan year, A must either pre-pay for January on an after-tax basis or use another option (*e.g.*, pay-as-you-go, catch-up, reduction in unused sick days, etc.) to make the premium payment due in January.

Q-6: Are there special rules concerning employees taking FMLA leave who participate in health FSAs offered under a cafeteria plan?

A-6: (a) *In general*. (1) A group health plan that is a flexible spending arrangement (FSA) offered under a cafeteria plan must conform to the generally applicable rules in this section concerning employees who take FMLA leave. Thus, to the extent required by FMLA (see 29 CFR 825.209(b)), an employer must – –

(i) Permit an employee taking FMLA leave to continue coverage under a health FSA while on FMLA leave; and

(ii) If an employee is on unpaid FMLA leave, either – –

(A) Allow the employee to revoke coverage; or

(B) Continue coverage, but allow the employee to discontinue payment of his or her share of the premium for the health FSA under the cafeteria plan during the unpaid FMLA leave period.

(2) Under FMLA, the plan must permit the employee to be reinstated in health coverage upon return from FMLA leave on the same terms as if the employee had been working throughout the leave period, without a break in coverage. See 29 CFR 825.214(a) and 825.215(d)(1) and paragraph (b)(2) of this Q&A-6. In addition, under FMLA, a plan may require an employee to be reinstated in health coverage upon return from a period of unpaid FMLA leave, provided that employees who return from a period of unpaid leave not covered by the FMLA are also required to resume participation upon return from leave.

(b) *Coverage*. (1) Regardless of the payment option selected under Q&A-3 of this section, for so long as the employee continues health FSA coverage (or for so long as the employer continues the health FSA coverage of an employee who fails to make the required contributions as described in Q&A-3(a)(2)(iii) of this section), the full amount of the elected health FSA coverage, less any prior reimbursements, must be available to the employee at all times, including the FMLA leave period.

(2) (i) If an employee's coverage under the health FSA terminates while the employee is on FMLA leave, the employee is not entitled to receive reimbursements for claims incurred during the period when the coverage is terminated. If an employee subsequently elects or the employer requires the employee to be reinstated in the health FSA upon return from FMLA leave for the remainder of the plan year, the employee may not retroactively elect health FSA coverage for claims incurred during the period when the coverage was terminated. Upon reinstatement into a health FSA upon return from FMLA leave (either because the employee elects reinstatement or because the employer requires reinstatement), the employee has the right under FMLA: to resume coverage at the level in effect before the FMLA leave and make up the unpaid premium payments, or to resume coverage at a level that is reduced and resume premium payments at the level in effect before the FMLA leave. If an employee chooses to resume health FSA coverage at a level that is reduced, the coverage is prorated for the period during the FMLA leave for which no premiums were paid. In both cases, the coverage level is reduced by prior reimbursements.

(ii) FMLA requires that an employee on FMLA leave have the right to revoke or change elections (because of events described in §1.125–4) under the same terms and conditions that apply to employees participating in the cafeteria plan who are not on FMLA leave. Thus, for example, if a group health plan offers an annual open enrollment period to active employees, then, under FMLA, an employee on FMLA leave when the open enrollment is offered must be offered the right to make election changes on the same basis as other employees. Similarly, if a group health plan decides to offer a new benefit package option and allows active employees to elect the new option, then, under FMLA, an employee on FMLA leave must be allowed to elect the new option on the same basis as other employees.

(3) The following examples illustrate the rules in this Q&A-6:

Example 1. (i) Employee B elects $1,200 worth of coverage under a calendar year health FSA provided under a cafeteria plan, with an annual premium of $1,200. Employee B is permitted to pay the $1,200 through pre-tax salary reduction amounts of $100 per month throughout the 12-month period of coverage. Employee B incurs no medical expenses prior to April 1. On April 1, B takes FMLA leave after making three months of contributions totaling $300 (3 months x $ 100 = $300). Employee B's coverage ceases during the FMLA leave. Consequently, B makes no premium payments for the months of April, May, and June, and B is not entitled to submit claims or receive reimbursements for expenses incurred during this period. Employee B returns from FMLA leave and elects to be reinstated in the health FSA on July 1.

(ii) Employee B must be given a choice of resuming coverage at the level in effect before the FMLA leave (*i.e.*, $1,200) and making up the unpaid premium payments ($300), or resuming health FSA coverage at a level that is reduced on a *pro-rata* basis for the period during the FMLA leave for which no premiums were paid (*i.e.*, reduced for 3 months or 1/4 of the plan year) less prior reimbursements (*i.e.*, $0) with premium payments due in the same monthly amount payable before the leave (*i.e.*, $100 per month). Consequently, if B chooses to resume coverage at the level in effect before the FMLA leave, B's coverage for the remainder of the plan year would equal $1,200 and B's monthly premiums would be increased to $150 per month for the remainder of the plan year, to make up the $300 in premiums missed ($100 per month plus $50 per month ($300 divided by the remaining 6 months)). If B chooses prorated coverage, B's coverage for the remainder of the plan year would equal $900, and B would resume making premium payments of $100 per month for the remainder of the plan year.

*Example 2*. (i) Assume the same facts as *Example 1* except that B incurred medical expenses totaling $200 in February and obtained reimbursement of these expenses.

(ii) The results are the same as in *Example 1*, except that if B chooses to resume coverage at the level in effect before the FMLA leave, B's coverage for the remainder of the year would equal $1,000 ($1,200 reduced by $200) and the monthly payments for the remainder of the year would still equal $150. If instead B chooses prorated coverage, B's coverage for the remainder of the plan year would equal $700 ($1,200 prorated for 3 months, and then reduced by $200) and the monthly payments for the remainder of the year would still equal $100.

*Example 3.* (i) Assume the same facts as *Example 1* except that, prior to taking FMLA leave, B elects to continue health FSA coverage during the FMLA leave. The plan permits B (and B elects) to use the catch-up payment option described in Q&A-3 of this section, and as further permitted under the plan, B chooses to repay the $300 in missed payments on a ratable basis over the remaining 6-month period of coverage (*i.e.*, $50 per month).

(ii) Thus, B's monthly premium payments for the remainder of the plan year will be $150 ($100 + $50).

Q-7: Are employees entitled to non-health benefits while taking FMLA leave?

A-7: FMLA does not require an employer to maintain an employee's non-health benefits (*e.g.*, life insurance) during FMLA leave. An employee's entitlement to benefits other than group health benefits under a cafeteria plan during a period of FMLA leave is to be determined by the employer's established policy for providing such benefits when the employee is on non-FMLA leave (paid or unpaid). See 29 CFR 825.209(h). Therefore, an employee who takes FMLA leave is entitled to revoke an election of non-health benefits under a cafeteria plan to the same extent as employees taking non-FMLA leave are permitted to revoke elections of non-health benefits under a cafeteria plan. For example, election changes are permitted due to changes of status or upon enrollment for a new plan year. See § 1.125–4. However, FMLA provides that, in certain cases, an employer may continue an employee's non-health benefits under the employer's cafeteria plan while the employee is on FMLA leave in order to ensure that the employer can meet its responsibility to provide equivalent benefits to the employee upon return from unpaid FMLA. If the employer continues an employee's non-health benefits during FMLA leave, the employer is entitled to recoup the costs incurred for paying the employee's share of the premiums during the FMLA leave period. See 29 CFR 825.213(b). Such recoupment may be on a pre-tax basis. A cafeteria plan must, as required by FMLA, permit an employee whose coverage terminated while on FMLA leave (either by revocation or nonpayment of premiums) to be reinstated in the cafeteria plan on return from FMLA leave. See 29 CFR 825.214(a) and 825.215(d).

Q-8: What is the applicability date of the regulations in this section?

A-8: This section is applicable for cafeteria plan years beginning on or after January 1, 2002.

Par. 3. Section 1.125-4 is amended by adding a sentence at the end of paragraph (g) to read as follows:

*§ 1.125–4 Permitted election changes.*

* * * * *

(g) *Special requirements relating to the Family and Medical Leave Act.* * * * See § 1.125–3 for additional rules.

* * * * *

David A. Mader,
*Acting Deputy Commissioner of Internal Revenue.*

Approved October 9, 2001.

Mark Weinberger,
*Assistant Secretary of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on October 16, 2001, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2001, 66 F.R. 52676)

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## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, page 434.

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

The adjusted applicable federal long-term rate is set forth for the month of November 2001. See Rev. Rul. 2001–52, page 434.

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## Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, page 434.

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## Section 415.—Limitations on Benefits and Contributions Under Qualified Plans

**Limitations on benefits and contributions.** This ruling provides guidance on the limitations under section 415 of the Code, as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001.

## Rev. Rul. 2001–51

### I. Purpose

This revenue ruling provides guidance relating to the increases in the limitations of § 415 of the Internal Revenue Code (Code) enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), Pub. L. 107–16. Specifically, this revenue ruling provides questions and answers on:

- Benefit increases that may be provided as a result of the increased § 415 limitations under EGTRRA;
- Plan amendments that may be adopted to take into account the increased § 415 limitations under EGTRRA;
- The effect of the increased § 415 limitations under EGTRRA on other qualification requirements; and
- How the "sunset" provision of EGTRRA is taken into account for purposes of §§ 412 and 404.

### II. Background

*Rules in Effect Prior to EGTRRA*

Section 415 of the Code imposes limitations on contributions and benefits under qualified plans. The benefits that may be provided to a participant under a defined benefit plan must not exceed the limitations of § 415(b). Section 415(b) provides that benefits provided to a participant under a defined benefit plan must not exceed the lesser of the defined benefit dollar limitation of § 415(b)(1)(A) and the defined benefit compensation limitation of § 415(b)(1)(B), both adjusted as required under § 415(b). The defined benefit dollar limitation prior to the effective date of the EGTRRA amendment is $90,000, adjusted annually for cost-of-living increases under § 415(d), with the adjusted limit effective January 1 of the following calendar year. The defined benefit dollar limitation in effect for a calendar year (*e.g.*, $140,000, effective January 1, 2001) applies to all limitation years that end with or within the calendar year. Prior to the effective date of the EGTRRA amendment, the defined benefit dollar limitation is adjusted under § 415(b)(2) for commencement of benefits before or after a participant's social security retirement age. Under § 415(b)(5), the defined benefit dollar limitation is adjusted for less than 10 years of participation. The defined benefit compensation limitation is equal to a participant's high 3-year average compensation, adjusted, if applicable, under § 415(b)(5) for less than 10 years of service. The limitations of § 415 as in effect immediately prior to the effective date for a plan of changes enacted under

EGTRRA are referred to in this revenue ruling as the "pre-EGTRRA § 415 limitations."

Annual additions credited to a participant's account under a defined contribution plan must not exceed the limitations of § 415(c). Section 415(c) provides that annual additions credited on behalf of a participant under a defined contribution plan must not exceed the lesser of the defined contribution dollar limitation of § 415(c)(1)(A), or the defined contribution compensation limitation of § 415(c)(1)(B). Prior to the effective date of the EGTRRA amendment, the defined contribution dollar limitation is $30,000, adjusted annually under § 415(d) for cost-of-living increases, with the adjusted limit effective January 1 of the following calendar year. The defined contribution dollar limitation in effect for a calendar year (*e.g.*, $35,000, effective January 1, 2001) applies to all limitation years that end with or within the calendar year. Prior to the effective date of the EGTRRA amendment, the defined contribution compensation limitation is 25 percent of a participant's compensation.

Section 411(a) prescribes rules as to when an employee's right to his or her normal retirement benefit must become nonforfeitable under a qualified plan. Section 411(d)(6) generally prohibits a plan amendment, except for an amendment described in § 412(c)(8), that has the effect of decreasing a participant's accrued benefits under the plan.

Section 1106(h) of the Taxpayer Reform Act of 1986, Pub. L. 99–514, provides that notwithstanding any other provision of law, except as provided in regulations prescribed by the Secretary of the Treasury, a plan may incorporate by reference the limitations under § 415 of the Code. In Notice 87–21 (1987–1 C.B. 458) Q&A–11, the Service provided guidance for plans to incorporate by reference the limitations of § 415, for limitation years beginning on or after January 1, 1987.

Section 401(a)(4) prescribes nondiscrimination rules for qualified plans. Section 1.401(a)(4)–2 of the Income Tax Regulations imposes requirements relating to nondiscrimination in amount of employer contributions under a defined contribution plan. For this purpose, § 1.401(a)(4)–2(b) provides two safe harbor tests, and § 1.401(a)(4)–2(c) provides a general test. In order to satisfy either of the safe harbors, a plan must provide for either a uniform allocation formula or a uniform points allocation formula as described in the regulation.

Section 1.401(a)(4)–3 imposes requirements relating to nondiscrimination in amount of benefits under a defined benefit plan. For this purpose, § 1.401(a)(4)–3(b) provides several safe harbor tests, and § 1.401(a)(4)–3(c) provides a general test. In order to satisfy any of the safe harbors, a plan must provide for a uniform normal retirement benefit, uniform post-normal retirement benefit, and uniform subsidies. Plans that satisfy the general test may do so by testing benefits with or without the application of the § 415 limitations.

*Changes Under EGTRRA*

Section 611(a)(1) of EGTRRA increased the defined benefit dollar limitation of § 415(b) of the Code to $160,000, effective for limitation years ending after December 31, 2001. Under section 611(a)(2) of EGTRRA, effective for limitation years ending after December 31, 2001, the § 415(b) dollar limitation is reduced for commencement of benefits prior to age 62, rather than for commencement of benefits prior to a participant's social security retirement age, and no adjustment to the dollar limitation is required where a participant's benefit commences after age 62 and not later than age 65. Under section 611(a)(3) of EGTRRA, effective for limitation years ending after December 31, 2001, the § 415(b) dollar limitation is increased when benefits commence after age 65, rather than for benefits that commence after a participant's social security retirement age.

Specific amendments affecting multiemployer plans (as defined in § 414(f)) were made to §§ 415(b)(11) and 415(f) of the Code, respectively, by sections 654(a) and (b) of EGTRRA to provide, respectively, that: (1) the defined benefit compensation limit of § 415(b)(1)(B) does not apply to a multiemployer plan, effective for limitation years beginning after December 31, 2001; and (2) multiemployer plans are not combined or aggregated (a) with any other plan which is not a multiemployer plan for purposes of applying § 415(b)(1)(B) to such other plan, or (b) with any other multiemployer plan for purposes of applying the limitations of § 415, effective for limitation years beginning after December 31, 2001.

Section 611(b) of EGTRRA increased the defined contribution dollar limitation of § 415(c)(1)(A) of the Code to $40,000, effective for limitation years beginning after December 31, 2001. Section 632(a) of EGTRRA increased the "25 percent" in the defined contribution compensation limitation of § 415(c)(1)(B) of the Code to "100 percent," effective for years beginning after December 31, 2001.

Section 611 of EGTRRA also made changes to the methodology for determining cost-of-living increases under § 415(d) of the Code.

Section 901(a) of EGTRRA provides a "sunset" provision under which all provisions of, and amendments made by, EGTRRA shall not apply to taxable, plan, or limitation years beginning after December 31, 2010.

The Conference Report *(H.R.Conf. Rep. No. 84,* 107th Cong., 1st Sess. 212, 214 (2001)) that accompanies EGTRRA provides that in adopting rules regarding the application of the increases in the defined benefit plan limits, it is intended that the Secretary will apply rules similar to those adopted in Notice 99-44 (1999–2 C.B. 326) regarding benefit increases due to the repeal of the combined plan limit under former § 415(e).

**III. Questions and Answers on § 415 Changes Under EGTRRA**

**Q-1:** What is the effective date of the increase in the dollar limitation for defined benefit plans under section 611(a) of EGTRRA?

**A-1:** In accordance with section 611(i)(2) of EGTRRA, the increase in the dollar limitation for defined benefit plans under section 611(a) of EGTRRA is effective for the first limitation year ending after December 31, 2001. Thus, the defined benefit dollar limitation applicable to any limitation year ending in 2002 is $160,000.

With respect to limitation years ending after December 31, 2001, a defined benefit plan will not fail to satisfy § 415 solely because the plan provides that the benefit of any participant exceeds the pre-EGTRRA § 415(b) limitations. Accordingly, the pre-

EGTRRA § 415 limitations will not limit the benefit of a participant in a defined benefit plan whose benefit has not commenced as of the first day of the first limitation year ending after December 31, 2001. For rules regarding the application of the pre-EGTRRA § 415(b) limitations to a participant in a defined benefit plan whose benefit has commenced as of that date, see Q&A-5.

*Example 1*

Plan A is a defined benefit plan with a calendar year limitation year. When will the dollar limit applicable to the benefits of participants under Plan A be increased to $160,000 under EGTRRA?

For participants of Plan A, the increase in the dollar limitation to $160,000 is effective for the limitation year beginning January 1, 2002 (and ending December 31, 2002).

*Example 2*

Plan B is a defined benefit plan with a limitation year that begins February 1. When will the dollar limit applicable to the benefits of participants under Plan B increase to $160,000 under EGTRRA?

For participants of Plan B, the increase in the dollar limitation to $160,000 is effective for the limitation year beginning February 1, 2001 (and ending January 31, 2002).

**Q-2:** If a defined benefit plan is not amended to take into account the increased § 415 limitations under EGTRRA, how may the benefits of plan participants be affected?

**A-2:** If a defined benefit plan is not amended to take into account the increased § 415 limitations under EGTRRA, the effect on the benefits of plan participants will depend on the plan's existing provisions for applying the limitations of § 415 and any other relevant plan provisions. In some circumstances, a plan's existing provisions could result in automatic benefit increases for participants as of the effective date of the increased § 415 limitations for the plan. For example, the increased § 415 limitations under EGTRRA could result in automatic benefit increases for participants in defined benefit plans that incorporate by reference the limitations of § 415.

*Example*

Participant B, a participant in a defined benefit plan (Plan R) with a limitation year beginning March 1, 2001, and ending February 28, 2002, retires on April 1, 2001, at age 65 (Participant B's social security retirement age) and receives a single-sum distribution of his benefit on May 1, 2001. On retirement, Participant B's annual benefit in the form of an annuity under the plan formula was $170,000, but Participant B's accrued benefit under the plan was limited to $140,000 to satisfy § 415. Participant B received the single-sum equivalent of an annual benefit of $140,000. The terms of Plan R incorporate the limitations of § 415 of the Code by reference. What effect does the increase in the defined benefit dollar limitation under EGTRRA have on Participant B's benefit?

The defined benefit dollar limitation in effect for 2001 ($140,000) was used in the calculation of the single sum distributed on May 1, 2001. The increase in the defined benefit dollar limitation to $160,000 under EGTRRA is effective for Plan R for the limitation year beginning March 1, 2001, and ending February 28, 2002. Therefore, the $160,000 dollar limitation applies to Participant B's benefit, and Participant B's benefit must increase. Participant B must receive an additional lump sum amount to reflect the higher dollar limitation applicable to Participant B's benefit. The additional lump sum benefit is calculated as the actuarial equivalent of the excess of (1) Participant B's accrued benefit in the form of a straight life annuity when the dollar limitation applicable at Participant B's retirement age under EGTRRA is taken into account, over (2) Participant B's accrued benefit in the form of a straight life annuity when the pre-EGTRRA dollar limitation applicable at Participant B's retirement age is taken into account.

**Q-3:** How do the increased § 415(b) limitations under EGTRRA affect the methodology used to apply the § 415(b) limitations to a benefit under a defined benefit plan that is not payable in the form of an annual straight life annuity within the meaning of § 415(b)(2)(A)?

**A-3:** The determination as to whether such a benefit satisfies the 415(b) limitations generally follows the same steps and procedures as those used in Q&A-7 and Q&A-8, as applicable, of Rev. Rul. 98–1 (1998–1 C.B. 249), with the following modifications. As in Rev. Rul. 98–1, to satisfy the limitations of § 415(b), a participant's benefit must not exceed the lesser of the § 415(b) dollar limitation applicable to the participant and the § 415(b) compensation limitation applicable to the participant. See Rev. Rul. 98–1 for a more detailed description of the methodology used in the steps below.

***Step 1,*** the determination of the annual benefit in the form of a straight life annuity commencing at the same age that is actuarially equivalent to the plan benefit, is unchanged from Q&A-7 and Q&A-8, as applicable, of Rev. Rul. 98–1.

***Step 2,*** the determination of the § 415(b) dollar limitation that applies at the age the benefit is payable under Q&A-7 and Q&A-9, as applicable, of Rev. Rul. 98–1, is modified to reflect the increase of the defined benefit dollar limitation to $160,000, and the amendment of § 415(b)(2)(C) and § 415(b)(2)(D), as described in the following two paragraphs.

Effective for limitation years ending after December 31, 2001, § 415(b)(2)(C) as amended by EGTRRA provides that the § 415(b) dollar limitation is reduced when a participant's benefit commences prior to age 62, rather than for a benefit that commences prior to a participant's social security retirement age, and there are no age adjustments to the dollar limitation where a participant's benefit commences after age 62 and no later than age 65. Where a participant's benefit commences prior to age 62, the § 415(b) dollar limitation applicable to the participant at the earlier age is the annual benefit payable in the form of a straight life annuity commencing at the earlier age that is actuarially equivalent to the § 415(b) dollar limitation applicable to the participant at age 62, calculated using assumptions that satisfy § 415(b)(2)(E).

Effective for limitation years ending after December 31, 2001, § 415(b)(2)(D) as amended by EGTRRA provides that the § 415(b) dollar limitation is increased when a participant's benefit commences after age 65, rather than for a benefit that commences after a participant's social security retirement age. Where a participant's benefit commences after age 65, the § 415(b) dollar limitation applicable to the participant at the later age is the annual benefit payable in the form of a straight life annuity commencing at the later age that is actuarially equivalent to the § 415(b) dollar limitation applicable to the participant at age 65, calculated using assumptions that satisfy § 415(b)(2)(E).

***Step 3***, the determination of the § 415(b) compensation limitation applicable to the participant, is unchanged. However, see Q&A-8 of this revenue ruling for new rules relating to multiemployer plans.

**Q-4:** What special considerations for a defined benefit plan that has a normal retirement age less than 65 must be taken into account once the amendments to § 415 under EGTRRA are effective for the plan?

**A-4:** In the case of a defined benefit plan with a normal retirement age less than 65, the requirements for nonforfeitability of benefits and actuarial increase for delayed retirement of § 411 of the Code must be coordinated with the requirements of § 415. Under § 411, if benefits are not paid to a participant after the participant attains the plan's normal retirement age, and the plan's terms do not provide for the "suspension" of the participant's benefits in accordance with § 411(a)(3)(B) of the Code and 29 C.F.R. § 2530.203–3, then the participant's benefit must be actuarially increased for late retirement to avoid any forfeiture of the participant's benefit. However, under § 415 as amended by EGTRRA, the dollar limitation applicable to a participant does not increase between ages 62 and 65. If a participant continues to work past a plan's normal retirement age that is less than 65, and the participant's benefit equals the § 415 dollar limitation at an age between 62 and 65, any actuarial increase to the participant's benefit after that age and prior to age 65 would violate § 415. In such a case, in order to satisfy §§ 415 and 411, the terms of the plan must either provide for the in-service payment of the participant's benefit (where the participant has attained normal retirement age and has a benefit that cannot be actuarially increased without violating § 415), or provide for the suspension of benefits in accordance with § 411(a)(3)(B) of the Code and 29 C.F.R. § 2530.203–3.

**Q-5:** May a defined benefit plan provide for benefit increases to reflect the increased § 415 limitations under EGTRRA for a current or former employee who has commenced benefits under the plan prior to the effective date of such increases?

**A-5:** A defined benefit plan may provide for benefit increases to reflect the increased § 415 limitations under EGTRRA for a current or former employee who has commenced benefits under the plan prior to the effective date of the § 415 increases under EGTRRA, but only if the employee or former employee is a participant in the plan on or after that effective date. For this purpose, an employee or former employee is a participant in the plan on a date if the employee or former employee has an accrued benefit (other than an accrued benefit resulting from a benefit increase that arises solely as a result of the increases in the § 415 limitations under EGTRRA) on that date. Thus, benefit increases to reflect the increases in the § 415 limitations under EGTRRA cannot be provided to current or former employees who do not have accrued benefits under the plan on or after the effective date of the § 415 increases under EGTRRA for the plan. However, if a current or former employee accrues additional benefits under the plan that could have been accrued without regard to the increased § 415 limitations under EGTRRA (including benefits that accrue as a result of a plan amendment) on or after the effective date of the increased § 415 limitations under EGTRRA for the plan, then the current or former employee may receive a benefit arising from the increased § 415 limitations under EGTRRA.

**Q-6:** How is the maximum permissible benefit increase calculated for a current or former employee who has commenced benefits under a defined benefit plan in a form not subject to § 417(e)(3) prior to the effective date of the increased § 415 limitations under EGTRRA?

**A-6:** For any limitation year beginning on or after the effective date for the plan of the increased § 415 limitations under EGTRRA, the benefit payable to any current or former employee who has commenced benefits under the plan prior to such effective date in a form not subject to § 417(e)(3) may be increased to a benefit that is no greater than the benefit that could have been provided had the provisions of EGTRRA been in effect at the time of the commencement of benefit. Thus, the annual benefit for limitation years beginning on or after the effective date for the plan of the increased § 415 limitations under EGTRRA is limited to the § 415(b) limitation for the employee (increased for cost-of-living adjustments, if the plan provides for such adjustments) based on the employee's age at the time of commencement. Benefits attributable to limitation years beginning before the effective date for the plan of the increased § 415 limitations under EGTRRA cannot reflect benefit increases that could not be paid for those years because of § 415(b). In addition, any plan amendment to provide an increase as a result of the increased § 415 limitations under EGTRRA can be effective no earlier than the effective date of the increased § 415 limitations under EGTRRA for the plan.

*Example*

Plan A has a calendar year limitation year, and provides that retiree benefits limited by § 415 are increased as COLA adjustments are made under § 415(d). Participant S, a participant of Plan A, retired in 2000 at age 60 with 20 years of participation. Participant S's social security retirement age is 66. Participant S's annual benefit under the plan formula before limitation for § 415 was $180,000, and this benefit was limited by the defined benefit dollar limit to $85,252 (the applicable mortality table and 6 percent are used under the plan for early retirement purposes). The defined benefit compensation limitation applicable to Participant S was $200,000 and, thus, did not limit Participant S's benefit. How will Participant S's benefit be affected by the changes made to § 415 under section 611 of EGTRRA?

Following the increase in the § 415(b) dollar limit on January 1, 2001, to $140,000, Participant S's benefit was increased to $88,409 [$85,252 x ($140,000/$135,000)]. After the § 415(b) increase in the dollar limit under EGTRRA is applicable to Plan A for the limitation year beginning January 1, 2002, Participant S's annual benefit may be increased to an amount equal to the annual benefit commencing at age 60 that is actuarially equivalent (calculated using actuarial assumptions that satisfy § 415(b)(2)(E)) to an annual benefit of $160,000 payable at age 62. In other words, Participant S's benefit may be increased to an amount equal to the benefit that a 60 year old could receive if the defined benefit dollar limit is $160,000 (with no reduction in the dollar limit for benefits that commence before age 65 and on or after age 62, but reduced actuarially for benefits that commence before age 62). Participant S's annual benefit may be increased to $134,720. However, Participant S may not receive this increased benefit until January 1, 2002.

**Q-7:** How is the maximum permissible benefit increase calculated for a current or former employee under a defined benefit plan whose benefit is payable in a form subject to § 417(e)(3) prior to the effective date of the increased § 415 limitations under EGTRRA?

**A-7:** In the case of a form of benefit that is subject to § 417(e)(3), the benefit payable for any limitation year beginning on or after the effective date for the plan of the increased § 415 limitations under EGTRRA may be increased by an amount that is actuarially equivalent to the amount of increase that could have been provided had the benefit been paid in the form of a straight life annuity. Benefits attributable to limitation years beginning before the effective date for the plan of the increased § 415 limitations under EGTRRA cannot reflect benefit increases that could not be paid for those years because of § 415(b). In addition, any plan amendment to provide an increase as a result of the increased § 415 limitations under EGTRRA can be effective no earlier than the effective date of the increased § 415 limitations under EGTRRA for the plan.

*Example*

Participant D, a participant in a defined benefit plan (Plan T) with a calendar year limitation year and plan year, retires on January 1, 2001, D's 64th birthday, with 25 years of service and participation. Participant D's social security retirement age is 65. The terms of Plan T provide for increases in retiree benefits (that are limited by § 415(b)) as the § 415 limits are increased for COLAs under § 415(d). On retirement, D's annual benefit in the form of an annuity under the plan formula, before limitation for § 415, is $200,000. Participant D's accrued benefit under the plan in the form of an annuity is limited to $130,667 [(140,000) x (1–(5/9)(12)(.01)] to satisfy § 415(b). Participant D's benefit is payable in the form of 10 equal annual installments commencing January 1, 2001. For purposes of actuarial equivalence for early commencement and optional forms, the plan provides for the use of the applicable mortality table and the applicable interest rate (assumed to be 6 percent for purposes of this example). What is the maximum benefit increase that D can receive under Plan T as a result of the increased § 415 limitations under EGTRRA?

When D's benefits began, the benefit was calculated as a straight life annuity of $130,667 per year, adjusted for payment as 10 annual payments. The annuity benefit of $130,667 was multiplied by an age 64 annuity factor (calculated using the applicable mortality table and the applicable interest rate), and the resulting amount was spread over 10 years, using the applicable interest rate. Participant D has an accrued benefit under Plan T when EGTRRA becomes effective for Plan T on January 1, 2002. If Plan T is amended to provide for such increases to retired participants, then D's benefit, if payable in the form of a straight life annuity, could be increased to a straight life annuity of $160,000 in the limitation year beginning January 1, 2002. As of January 1, 2002, D has nine remaining installment payments. The remaining nine installment payments could be increased by the actuarial equivalent (spread over a period of nine years) of the value of the increase in the straight life annuity that would have been payable beginning January 1, 2002, if D had elected a straight life annuity on retirement rather than the installment payment option. That is, the maximum increase that D is permitted to receive in 2002 as a result of the § 415(b) increase under EGTRRA is the amount equal to the product of $29,333 ($160,000 – $130,667) times an age 65 annuity factor (derived using the applicable mortality table and the applicable interest rate), spread over 9 years at an assumed interest rate equal to the applicable interest rate.

**Q-8:** In addition to the changes enacted to § 415 under section 611 of EGTRRA, how did the § 415(b) limitation specifically applicable to multiemployer defined benefit plans change under EGTRRA?

**A-8:** As provided in section 654 of EGTRRA, the compensation limitation of § 415(b)(1)(B) of the Code does not apply to multiemployer defined benefit plans for limitation years beginning after December 31, 2001. Additionally, the § 415 aggregation rules affecting multiemployer plans were changed to provide that, for limitation years beginning after December 31, 2001, a multiemployer plan is not combined or aggregated (1) with a non-multiemployer plan for purposes of applying the § 415(b)(1)(B) compensation limit to the non-multiemployer plan, or (2) with any other multiemployer plan for purposes of applying the § 415 limitations.

**Q-9:** What is the effective date of the increase in the § 415(c)(1)(A) dollar limitation for defined contribution plans?

**A-9:** As provided in section 611(b) of EGTRRA, the increase in the § 415(c)(1)(A) dollar limitation for defined contribution plans under EGTRRA is effective for the first limitation year beginning after December 31, 2001.

*Example*

Plan C is a defined contribution plan with a limitation year that begins February 1. What is the § 415(c)(1)(A) limitation applicable to Plan C for the limitation years beginning February 1, 2001, and February 1, 2002?

Reg. § 1.415–6 (Limitation for defined contribution plans) provides that the dollar limitation of § 415(c)(1)(A) is adjusted for cost-of-living increases under § 415(d), and the COLA-adjusted dollar limitation is effective as of January 1 of each calendar year and applies to limitation years that end during that calendar year. The limitation year beginning February 1, 2001, ends in the calendar year 2002 (on January 31, 2002), so the defined contribution dollar limitation that applies to the limitation year is the defined contribution dollar limit in effect January 1, 2002, without regard to EGTRRA ($35,000, increased if applicable, to reflect increases in the cost-of-living, announced by the Service). The defined contribution dollar limit effective January 1, 2002, has not yet been announced. The increase in the defined contribution dollar limitation to $40,000 under EGTRRA (adjusted under § 415(d), if applicable) is first effective for Plan C for the limitation year beginning February 1, 2002, and ending January 31, 2003.

**Q-10:** What is the effective date for the increase in the compensation limitation for defined contribution plans under § 415(c)(1)(B)?

**A-10:** As provided in section 632(a) of EGTRRA, the 25 percent compensation limitation in § 415(c)(1)(B) of the Code is increased to 100 percent, effective for the first limitation year beginning after December 31, 2001.

**Q-11:** How will a defined contribution or defined benefit plan that takes into account the increased § 415 limitations under EGTRRA as of the first day of the first limitation year for which the increases are effective for the plan, satisfy the nondiscrimination in amount of benefits requirement?

**A-11:** A defined contribution or defined benefit plan that uses a safe harbor and takes into account the increased § 415 limitations under EGTRRA as of the first day of the first limitation year for which the increases are effective for the plan, will not fail to satisfy the uniformity requirements of §§ 1.401(a)(4)–2(b) or 1.401(a)(4)–3(b)(2) merely because the increased § 415 limitations under EGTRRA are taken into account under the plan.

For purposes of the general test for nondiscrimination in amount of contributions, increased contributions allocated under the terms of a defined contribution plan due to the increased § 415 limitations under EGTRRA must be taken into account in accordance with the rules of § 1.401(a)(4)–2(c)(2)(ii) for the plan year for which the increased allocations are made. For purposes of the general test for nondiscrimination in amount of benefits, increased benefits provided to an employee under the terms of a defined benefit plan due to the increased § 415 limitations under EGTRRA must be included as increases in the employee's accrued benefit (within the meaning of § 411(a)(7)(A)(i)) and the employee's most valuable optional form of payment of the accrued benefit (within the meaning of § 1.401(a)(4)–3(d)(1)(ii)) in accordance with the rules of § 1.401(a)(4)–3(d), and must be included in the computation of both the normal and most valuable accrual rates for any measurement period that includes the plan year for which the increase occurs. If the limitations of § 415 are taken into account in testing the plan for limitation years for which the increased § 415 limitations under EGTRRA are effective for the plan, those limitations must reflect the increased § 415 limitations under EGTRRA.

**Q-12:** If benefit increases are provided to employees and former employees under a plan as a result of the increased § 415 limitations under EGTRRA, how are the requirements of §§ 1.401(a)(4)–5 and 1.401(a)(4)–10 satisfied?

**A-12:** If benefit increases resulting from the increased § 415 limitations under EGTRRA are provided as of the effective date of the increased § 415 limitations under EGTRRA for the plan to either (1) all current and former employees who have an accrued benefit under the plan immediately before the effective date of the increased § 415 limitations under EGTRRA, or (2) all employees participating in the plan that have one hour of service after the effective date of the increased § 415 limitations under EGTRRA for the plan, through the adoption of a plan amendment, then the timing of such an amendment satisfies the requirements of § 1.401(a)(4)–5, and the requirements of § 1.401(a)(4)–10(b) are satisfied. If, as of the effective date of the increased § 415 limitations under EGTRRA for the plan, benefit increases are provided to either of the two groups described in the preceding sentence through the operation of the plan's existing provisions, then the requirements of §§ 1.401(a)(4)–5 and 1.401(a)(4)–10(b) are satisfied. If benefit increases due to the increased § 415 limitations under EGTRRA are provided only to a certain group of current or former employees not described in the preceding paragraph through the adoption of a plan amendment, or if a plan amendment to reflect the increased § 415 limitations under EGTRRA is effective as of a later date than the effective date of the increased § 415 limitations under EGTRRA for the plan, then the timing of such an amendment (considered in conjunction with the effect of the increased § 415 limitations under EGTRRA) must satisfy a facts-and-circumstances determination under § 1.401(a)(4)–5(a)(2), and the requirements of § 1.401(a)(4)–10 must be applied.

**Q-13:** May a plan be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the increased § 415 limitations under EGTRRA?

**A-13:** A plan may be amended to limit the extent to which a participant's benefit would otherwise automatically increase under the terms of the plan as a result of the increased § 415 limitations under EGTRRA, if the amendment is adopted before the effective date of the increased § 415 limitations for the plan. However, see Q&A-14 for certain qualification requirements that may be affected by such an amendment. A plan sponsor may wish to make a plan amendment to preclude a benefit increase that would otherwise occur as a result of the increased § 415 limitations under EGTRRA in order to provide time for the plan sponsor to consider the extent to which a benefit increase relating to the increased § 415 limitations under EGTRRA should or should not be provided at some later date consistent with all relevant qualification requirements. A plan amendment to limit the extent to which such a benefit increase would otherwise occur that is not both adopted prior to, and effective as of, the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan may fail to satisfy § 411(d)(6). Therefore, a plan amendment that is intended to limit such a benefit increase should be both adopted prior to, and effective as of, the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan. The following is an example of language that could be used by a plan sponsor, on an interim or permanent basis, in amending a defined benefit plan that would otherwise provide for a benefit increase due to the increased § 415 limitations under EGTRRA, to retain the effect of the pre-EGTRRA § 415 limitations in determining a participant's accrued benefit under the plan (without failing to satisfy § 411(d)(6)):

> *Effective as of the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan (the "Effective Date"), and notwithstanding any other provision of the Plan, the accrued benefit for any participant shall be determined by applying the terms of the Plan implementing the limitations of § 415 as if the limitations of § 415 continued to include the limitations of § 415 as in effect on the day immediately prior to the Effective Date.*

**Q-14:** Are there qualification requirements that may not be satisfied if a plan continues to limit benefits after the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan using the pre-EGTRRA § 415 limitations?

**A-14:** There are some qualification requirements that may not be satisfied if a plan continues to limit benefits using the pre-EGTRRA § 415 limitations after the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan. Any exception from the otherwise applicable qualification rules that is permitted solely in order to satisfy the maximum limitations on contributions or benefits under § 415 with respect to a participant does not apply if the participant's contributions or benefits are below the limitations of § 415. Thus, such an exception is not permitted where a plan limits benefits in a manner that is more restrictive than required under § 415. For example, at any time on or after the first day of the first limitation year beginning on or after January 1, 2002, a qualified defined contribution plan could not provide that the provisions of § 1.415–6(b)(6) would be applied to place an amount that does not exceed the limitations under § 415, but that does exceed the pre-EGTRRA § 415 limitations, in an unallocated suspense account as an excess annual addition. Similarly, a qualified cash or deferred arrangement could not provide that the provisions of § 1.415–6(b)(6)(iv) would be applied to permit the distribution of elective deferrals that do not exceed the limitations under § 415, but that exceed the pre-EGTRRA § 415 limitations. The qualification issues described in this Q&A-14 may arise whenever a lower limitation is applied under a plan in lieu of a statutory § 415 limitation that applies for the limitation year.

**Q-15:** How may a plan that continues to limit benefits after the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan, using the pre-EGTRRA § 415 limitations, satisfy the nondiscrimination in amount of benefits requirement?

**A-15:** Section 1.401(a)(4)–2(b)(4)(iv) provides that the use of safe harbors by defined contribution plans, for nondiscrimination in amount of contributions purposes, is not precluded by plan provisions (which must apply uniformly to all employees) that (1) limit allocations otherwise provided under the allocation formula to a maximum dollar amount or a maximum percentage of plan year compensation, (2) limit the dollar amount of plan year compensation taken into account in determining the amount of allocations, or (3) apply the restrictions of § 409(n) or the limits of § 415. Section 1.401(a)(4)–3(b)(6)(v) provides that the use of safe harbors by defined benefit plans, for nondiscrimination in amount of benefits purposes, is not precluded by plan provisions (which must apply uniformly to all employees) that (1) limit benefits otherwise provided under the benefit formula or accrual method to a maximum dollar amount or to a maximum percentage of average annual compensation or in accordance with § 401(a)(5)(D), (2) apply the limits of § 415, or (3) limit the dollar amount of compensation taken into account in determining benefits. Because the pre-EGTRRA § 415 limitations uniformly limit allocations or benefits to a maximum dollar amount or percentage of compensation, a plan that continues to apply the pre-EGTRRA § 415 limitations does not fail to satisfy a safe harbor solely because it continues to apply such limitations.

If a plan continues to limit benefits using the pre-EGTRRA § 415 limitations, on or after the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan, the annual additions or accrued benefits that are taken into account in performing the general tests for nondiscrimination in amount of contributions or benefits must reflect the plan provisions that limit benefits in this manner.

**Q-16:** How are the increased § 415 limitations under EGTRRA treated under the plan for purposes of § 412?

**A-16:** For purposes of § 412, any increase in the liabilities of a plan as a result of the increased § 415 limitations under EGTRRA must be treated as occurring pursuant to a plan amendment effective no earlier than the first day of the first limitation year for which the increased § 415 limitations under EGTRRA are effective for the plan (whether the increase in liabilities under the terms of the plan arises pursuant to a plan amendment, or pursuant to existing plan provisions, *i.e.*, where benefits automatically increase as of the date the increased § 415 limitations under EGTRRA are effective for the plan). Accordingly, any amortization base that is established under § 412 for an increase in liabilities under a plan resulting from the increased § 415 limitations under EGTRRA must have an amortization period of 30 years. A plan amendment that makes the increased § 415 limitations under EGTRRA effective for a plan cannot be taken into account for purposes of § 412 prior to the effective date of the increased § 415 limitations under EGTRRA for the plan.

**Q-17:** How is the sunset provision of section 901 of EGTRRA taken into account for purposes of §§ 412 and 404 of the Code, and with respect to the calculation of benefit payments that must not exceed the limitations of § 415?

**A-17:** The "sunset" provision of section 901 of EGTRRA is not taken into account for purposes of § 412 of the Code for years beginning on or before December 31, 2010. Thus, for example, projected benefits under a defined benefit plan are computed assuming that the increase in the dollar limitation to $160,000, as adjusted under § 415(d), remains in effect for limitation years beginning after December 31, 2010. Section 404(j) provides that benefits or contributions in excess of the limitations of § 415 are not taken into account in computing the amount of any deduction allowable under paragraphs (1), (2), (3), (4), (7), or (9) of § 404(a). For years beginning on or before December 31, 2010, the determination that contributions do not exceed the limitation of § 404(j) is made without regard to the sunset provision of section 901 of EGTRRA. Until further guidance is provided, a participant's benefit will be tested for satisfaction of the § 415 limitations using the limitations currently in effect and applicable to the participant.

**IV. Effect on Other Documents**

Rev. Rul. 98–1 is modified.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ann Trichilo of Employee Plans. For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500, between the hours of 8:00 a.m. and 9:30 p.m. Eastern time, Monday through Friday (a toll-free number). Ms. Trichilo may be reached at (202) 283-9695 (not a toll-free number).

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, on this page.

## Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, on this page.

## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, on this page.

## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, on this page.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, on this page.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, on this page.

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

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

**Federal Rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for October 2001.

## Rev. Rul. 2001–52

This revenue ruling provides various prescribed rates for federal income tax purposes for November 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2001–52 TABLE 1

Applicable Federal Rates (AFR) for November 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| *Short-Term* | | | | |
| AFR | 2.73% | 2.71% | 2.70% | 2.69% |
| 110% AFR | 3.00% | 2.98% | 2.97% | 2.96% |
| 120% AFR | 3.28% | 3.25% | 3.24% | 3.23% |
| 130% AFR | 3.55% | 3.52% | 3.50% | 3.49% |
| *Mid-Term* | | | | |
| AFR | 4.13% | 4.09% | 4.07% | 4.06% |
| 110% AFR | 4.55% | 4.50% | 4.47% | 4.46% |
| 120% AFR | 4.97% | 4.91% | 4.88% | 4.86% |
| 130% AFR | 5.39% | 5.32% | 5.29% | 5.26% |
| 150% AFR | 6.23% | 6.14% | 6.09% | 6.06% |
| 175% AFR | 7.29% | 7.16% | 7.10% | 7.06% |
| *Long-Term* | | | | |
| AFR | 5.31% | 5.24% | 5.21% | 5.18% |
| 110% AFR | 5.84% | 5.76% | 5.72% | 5.69% |
| 120% AFR | 6.39% | 6.29% | 6.24% | 6.21% |
| 130% AFR | 6.93% | 6.81% | 6.75% | 6.72% |

REV. RUL. 2001–52 TABLE 2

Adjusted AFR for November 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| Short-term adjusted AFR | 2.39% | 2.38% | 2.37% | 2.37% |
| Mid-term adjusted AFR | 3.41% | 3.38% | 3.37% | 3.36% |
| Long-term adjusted AFR | 4.74% | 4.69% | 4.66% | 4.64% |

REV. RUL. 2001–52 TABLE 3

Rates Under Section 382 for November 2001

| | |
|---|---|
| Adjusted federal long-term rate for the current month | 4.74% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 4.85% |

REV. RUL. 2001–52 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for November 2001

| | |
|---|---|
| Appropriate percentage for the 70% present value low-income housing credit | 8.10% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.47% |

| REV. RUL. 2001–52 TABLE 5 | |
|---|---|
| Rate Under Section 7520 for November 2001 | |
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | 5.0% |

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, page 434.

## Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, page 434.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2001. See Rev. Rul. 2001–52, page 434.

# Part III. Administrative, Procedural, and Miscellaneous

## Additional Disaster Relief for Taxpayers Affected by the September 11, 2001, Terrorist Attack – Mid-Quarter Convention Relief

## Notice 2001–70

This notice announces that the Treasury Department and the Internal Revenue Service intend to issue regulations permitting taxpayers to elect not to apply the mid-quarter convention rules contained in § 168(d)(3) of the Internal Revenue Code to certain property placed in service in the taxable year that includes September 11, 2001. This notice also provides taxpayers a mechanism for making the election before regulations are issued.

Section 168(d)(3) generally provides that, except as provided in regulations, if the aggregate basis of property placed in service during the last three months of the taxable year exceeds 40 percent of the aggregate basis of property (other than property described in § 168(d)(3)(B)) placed in service during the taxable year, the applicable depreciation convention for all property (other than property described in § 168(d)(2)) to which § 168 applies placed in service during the taxable year is the mid-quarter convention.

Many taxpayers time the acquisition and placing in service of property within a taxable year to avoid application of the mid-quarter convention. Treasury and the Service have been made aware that, as a result of events related to the September 11, 2001, terrorist attacks, many taxpayers have encountered difficulty completing the acquisition and placing in service of property in accordance with plans developed earlier in the year, and certain taxpayers would choose to delay acquisition and placing of property in service during the last quarter of their taxable year if failing to delay would result in application of the mid-quarter convention.

Accordingly, if the third quarter of the taxpayer's 2001 taxable year includes September 11, 2001, then the taxpayer may elect to apply the half-year convention to all property (other than property described in § 168(d)(2)) placed in service during the taxpayer's 2001 taxable year for purposes of § 168(d).

To make the election under this notice, a taxpayer must write "Election Pursuant to Notice 2001–70" across the top of its Form 4562, *Depreciation and Amortization*, for the taxpayer's taxable year that includes September 11, 2001.

Treasury and the Service intend to amend the regulations under § 168 to incorporate the guidance set forth in this notice. Until the regulations are amended, taxpayers may rely on the guidance set forth in this notice.

The principal author of this notice is Bernard P. Harvey of the Office of Associate Chief Counsel, Passthroughs and Special Industries. For further information regarding this notice contact Mr. Harvey at (202) 622-3110 (not a toll-free call).

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*26 CFR 601.602: Forms and instructions. (Also Part 1, Sections 220, 408, 408A, 529, 530(h), 1441, 6041, 6041A, 6042, 6043, 6044, 6045, 6047, 6049, 6050A, 6050B, 6050D, 6050E, 6050H, 6050J, 6050N, 6050P, 6050Q, 6050R, 6050S, 1.408–5, 1.408–7, 1.408A–7, 1.1441–1 through 1.1441–5, 1.6041–1, 7.6041–1, 1.6042–2, 1.6042–4, 1.6044–2, 1.6044–5, 1.6045–1, 5f.6045–1, 1.6045–2, 1.6045–4, 1.6047–1, 1.6049–4, 1.6049–6, 1.6049–7, 1.6050A–1, 1.6050B–1, 1.6050D–1, 1.6050E–1, 1.6050H–1, 1.6050H–2, 1.6050J–1T, 1.6050N–1, 1.6050P–1).*

**NOTE: This revenue procedure will be reprinted as the next revision of IRS Publication 1179, *Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 5498, W-2G (and 1042-S).***

## Rev. Proc. 2001–50

## TABLE OF CONTENTS

# Part 1
# General Information

## Section 1.1 - Overview of Revenue Procedure 2001–50

**1.1.1 Purpose**

The purpose of this revenue procedure is to set forth the requirements for the year 2001 for:

- Using official Internal Revenue Service (IRS) forms to file information returns with the IRS,
- Preparing acceptable substitutes of the official IRS forms to file information returns with the IRS, and
- Using official or acceptable substitute forms to furnish information to recipients.

**1.1.2 Which Forms Are Covered?**

This revenue procedure contains specifications for these information returns:

| Form | Title |
|---|---|
| 1096 | Annual Summary and Transmittal of U.S. Information Returns |
| 1098 | Mortgage Interest Statement |
| 1098-E | Student Loan Interest Statement |
| 1098-T | Tuition Payments Statement |
| 1099-A | Acquisition or Abandonment of Secured Property |
| 1099-B | Proceeds From Broker and Barter Exchange Transactions |
| 1099-C | Cancellation of Debt |
| 1099-DIV | Dividends and Distributions |
| 1099-G | Certain Government and Qualified State Tuition Program Payments |
| 1099-INT | Interest Income |
| 1099-LTC | Long-Term Care and Accelerated Death Benefits |
| 1099-MISC | Miscellaneous Income |
| 1099-MSA | Distributions From an Archer MSA or Medicare+Choice MSA |
| 1099-OID | Original Issue Discount |
| 1099-PATR | Taxable Distributions Received From Cooperatives |

| | |
|---|---|
| 1099-R | Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. |
| 1099-S | Proceeds From Real Estate Transactions |
| 5498 | IRA Contribution Information |
| 5498-MSA | Archer MSA or Medicare+Choice MSA Information |
| W-2G | Certain Gambling Winnings |
| 1042-S | Foreign Person's U.S. Source Income Subject to Withholding |

**1.1.3 Scope**

For purposes of this revenue procedure, a substitute form or statement is one that is not printed by the IRS. For a substitute form or statement to be acceptable to the IRS, it must conform to the official form or the specifications outlined in this revenue procedure. **Do not submit any substitute forms or statements listed above to the IRS for approval.** Privately printed forms may not state "This is an IRS approved form."

Filers making payments to certain recipients during a calendar year (or in some cases, filers receiving payments) are required by the Internal Revenue Code (the Code) to file information returns with the IRS for these payments. These filers must also provide this information to their recipients. See **Part 4** for specifications that apply to recipient statements **(generally Copy B).**

In general, section 6011 of the Code contains requirements for filers of information returns. A filer must file information returns on magnetic media, through electronic filing, or on paper. A filer who is required to file 250 or more information returns of any one type during a calendar year must file those returns by magnetic media or electronic filing.

**Exception.** Filers are not required to use magnetic media or electronic filing when filing 250 or more Forms **1098-E** or **1098-T.**

Although not required, small volume filers (fewer than 250 returns during a calendar year) and Form 1098-E and 1098-T filers may file the forms on magnetic media or electronically. See the legal requirements for filing information returns (and providing a copy to a payee) in the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G** and the **2001 Instructions for Form 1042-S.** In addition, see **Pub. 1220,** Specifications for Filing Forms 1098, 1099, 5498, and W-2G Magnetically or Electronically.

**1.1.4 For More Information**

The IRS prints and provides the forms on which various payments must be reported. Alternatively, filers may prepare substitute copies of these IRS forms and use such forms to report payments to the IRS.

- For copies of the official forms and the instruction booklet for the reporting year, call our toll-free number at **1-800-TAX-FORM (1-800-829-3676).**
- The IRS operates a central call site in Martinsburg, WV, to answer questions related to information returns, penalties, and backup withholding. Call **304-263-8700** Monday through Friday 8:30 a.m. to 4:30 p.m. eastern time. The TTY/TDD number is **304-267-3367.**

**1.1.5 Changes to the Revenue Procedure**

The following changes have been made to this year's Revenue Procedure:

- Rules and specifications for Form **1042-S,** Foreign Person's U.S. Source Income Subject to Withholding, were added to the Revenue Procedure as Section 5.1. Exhibit U also shows an example of the form.
- Form **1099-MISC** was reformatted to 2, instead of 3, forms per page. Also: New boxes 14 through 18 were added for improved processing, boxes 11 and 12 were renumbered as 16 and 17, and box 13 was labeled.
- Extra boxes for contact information were added to **Form 1096.**
- A new box 2 was added to Form **1098-E.**
- On Form **1098-T:** Boxes 1 and 2 were labeled, new box 3 was added, and boxes 3 and 4 were renumbered 4 and 5.
- New box 2c was added, and boxes 2c and 2d were renumbered 2d and 2e on Form **1099-DIV.**

- New box 4 was added, and box 4 was renumbered 5 on Form **1099-LTC.**
- New box 4 was added, a checkbox was removed from box 6, and boxes 4-10 were renumbered 5-11 on Form **5498.**

**1.1.6 Some Changes for 2002**

Some changes anticipated for the 2002 forms are:

- New Form **1099-Q,** Qualified Tuition Program Payments (Under Section 529), is being developed.
- The title of Form **1099-G** is being changed to Certain Government Payments.
- The title of Form **1099-MSA** is being changed to Distributions From an Archer MSA or Medicare+Choice MSA
- The title of Form **5498** is being changed to IRA and Coverdell ESA Contribution Information.
- The title of Form **5498-MSA** is being changed to Archer MSA or Medicare+Choice MSA Information

## Section 1.2 - General Requirements for Acceptable Substitute Forms 1096, 1098, 1099, 5498, W-2G, and 1042-S

**1.2.1 Introduction**

Paper substitutes for Form 1096 and Copy A of Forms 1098, 1099, 5498, W-2G, and 1042-S that totally conform to the specifications listed in this revenue procedure may be privately printed and filed as returns with the IRS. The reference to the Department of the Treasury - Internal Revenue Service should be included on all such forms.

If you are uncertain of any specification and want it clarified, you may submit a letter citing the specification, stating your understanding and interpretation of the specification, and enclosing an example of the form (if appropriate) to:

Internal Revenue Service
Attn: Substitute Forms Program
W:CAR:MP:FP:S:SP
1111 Constitution Ave., NW
Room 5244 IR
Washington, DC 20224

**Note:** *Allow at least 45 days for the IRS to respond.*

You may also contact the Substitute Forms Program Unit via e-mail at tfp@publish.no.irs.gov. Please enter "Substitute Forms" on the Subject Line.

Forms 1096, 1098, 1099, 5498, and W-2G are subject to annual review and possible change. Therefore, filers are cautioned against overstocking supplies of privately printed substitutes. **The specifications contained in this revenue procedure apply to 2001 forms only.**

**1.2.2 Copy A Specifications**

Proposed substitutes for Copy A that do not conform to the specifications in this revenue procedure are not acceptable. Further, if you file such forms with the IRS, you may be subject to a penalty for failure to file an information return under section 6721 of the Code. Generally, the penalty is $50 for each failure to file a form (up to $250,000) that the IRS cannot accept as a return because it does not meet the provisions in this revenue procedure. No IRS office is authorized to allow deviations from this revenue procedure.

**Caution:** Overuse of proportional fonts may cause you to be subject to penalties and delays in processing.

**1.2.3 Copy B and Copy C Specifications**

Copies B and Copies C of the following forms must contain the information in **Part 4** to be considered a "statement" or "official form" under the applicable provisions of the Code. The format of this information is at the discretion of the filer with the exception of the location of the tax year, form number, form name, and the information for **composite Form 1099 statements** as outlined under **Section 4.2.**

Copy B of the following forms are:

| Form | Recipient |
|---|---|
| 1098 | For Payer |
| 1098-E; 1099-A | For Borrower |

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

Copy C of the following forms are:

| **Form** | **Recipient** |
|---|---|
| 1099-LTC | For Insured |
| 1099-R | For Recipient's Records |
| W-2G | For Winner's Records |

**Note:** *On Copy C, Form 1099-LTC, you may reverse the locations of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.*

## Section 1.3 - Definitions

**1.3.1 Form Recipient**

**Form recipient** means the person to whom you are required by law to furnish a copy of the official form or information statement. The form recipient may be referred to by different names on various Forms 1099 and related forms ("payer," "borrower," "student," "debtor," "policyholder," "insured," "transferor," "recipient," "participant," or, in the case of Form W-2G, the "winner"). See **Section 1.2.3** earlier.

**1.3.2 Filer**

**Filer** means the person or organization required by law to file a form listed in **Section 1.1.2** with the IRS. As outlined earlier, a filer may be a payer, creditor, recipient of mortgage or student loan interest payments, educational institution, broker, barter exchange, person reporting real estate transactions, trustee or issuer of any individual retirement arrangement or medical savings account, or lender who acquires an interest in secured property or who has reason to know that the property has been abandoned.

**1.3.3 Substitute Form**

**Substitute form** means a paper substitute of Copy A of an official form listed in **Section 1.1.2** that totally conforms to the provisions in this revenue procedure.

**1.3.4 Substitute Form Recipient Statement**

**Substitute form recipient statement** means a paper statement of the information reported on a form listed in **Section 1.1.2.** This statement must be furnished to a person (form recipient), as defined under the applicable provisions of the Code and the applicable regulations.

**1.3.5 Composite Substitute Statement**

**Composite substitute statement** means one in which two or more required statements (e.g., Forms 1099-INT and 1099-DIV) are furnished to the recipient on one document. However, each statement must be designated separately and must contain all the requisite Form 1099 information except as provided under **Section 4.2.** A composite statement **may not** be filed with the IRS.

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

## Section 2.1 - Specifications

**2.1.1 General Requirements**

Form identifying numbers (e.g., 9191 for Form 1099-DIV) must be printed in nonreflective black carbon-based ink in print positions 15 through 19 using an OCR A font. The checkboxes to the right of the form identifying numbers must be 10-point boxes. The "VOID" checkbox is in print position 25. The "CORRECTED" checkbox is in position 33. Measurements are from the left edge of the paper, not including the perforated strip. See **Exhibits D and K.**

The substitute form must be an exact replica of the official IRS form with respect to layout and content. To determine the correct form measurements, see **Exhibits A through U** at the end of this publication.

Hot wax and cold carbon spots are not permitted on any of the internal form plies. These spots are permitted on the back of a mailer top envelope ply.

Use of chemical transfer paper for Copy A is acceptable.

The Government Printing Office (GPO) symbol must be deleted**.**

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**2.1.2 Color and Paper Quality**

Color and paper quality for Copy A (cut sheets and continuous pinfeed forms) as specified by JCP Code 0-25, dated November 29, 1978, must be white 100% bleached chemical wood, optical character recognition (OCR) bond produced in accordance with the following specifications.

**Note:** *Reclaimed fiber in any percentage is permitted provided the requirements of this standard are met.*

- Acidity: Ph value, average, not less than .............................................................. 4.5
- Basis Weight: 17 x 22-500 cut sheets ..................................................................... 18-20
  Metric equivalent—g/m$^2$ ....................................................................................... 75
  A tolerance of $\pm$5 pct. is allowed.
- Stiffness: Average, each direction, not less than—milligrams .............................. 50
- Tearing strength: Average, each direction, not less than—grams.......................... 40
- Opacity: Average, not less than—percent............................................................. 82
- Thickness: Average—inch ..................................................................................... 0.0038
  Metric equivalent—mm........................................................................................... 0.097
  A tolerance of +0.0005 inch (0.0127 mm) is allowed. Paper cannot vary more than 0.0004 inch (0.0102 mm) from one edge to the other.
- Porosity: Average, not less than—seconds .......................................................... 10
- Finish (smoothness): Average, each side—seconds .............................................. 20-55
  For information only, the Sheffield equivalent—units...........................................170-100
- Dirt: Average, each side, not to exceed—parts per million ................................. 8

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**2.1.3 Chemical Transfer Paper**

Chemical transfer paper is permitted for Copy A only if the following standards are met:

- Only chemically backed paper is acceptable for Copy A. Front and back chemically treated paper cannot be processed properly by machine.
- Carbon-coated forms are not permitted.
- Chemically transferred images must be black.

All copies must be **clearly legible.** Hot wax and cold carbon spots **are not** permitted for Copy A. **Interleaved carbon** should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.

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**2.1.4 Printing**

All print on **Copy A of Forms 1098, 1099, 5498,** and the print on **Form 1096** above the statement *"Please return this entire page to the Internal Revenue Service. Photocopies are not acceptable."* must be in Flint J-6983 red OCR dropout ink or an exact match. However, the four-digit form identifying number **must** be in nonreflective carbon-based **black** ink in OCR A font.

The shaded areas of any substitute form should generally correspond to the format of the official form.

The printing for the **Form 1096** statement and the following text may be in any shade or tone of black ink. Black ink should only appear on the lower part of the reverse side of Form 1096 where it will not bleed through and interfere with scanning.

**Note:** *The instructions on the front and back of **Form 1096,** which include filing addresses, must be printed.*

Separation between fields must be 0.1 inch.

**Except for Form 1099-R and 1099-MISC,** the numbered captions are printed as solid with no shaded background.

Other printing requirements are discussed below.

**2.1.5 OCR Specifications**

The contractor must initiate or have a quality control program to assure OCR ink density. Readings will be made when printed on approved 20 lb. white OCR bond with a reflectance of not less than 80%. Black ink must not have a reflectance greater than 15%. These readings are based on requirements of the "Scan-Optics Series 9000" Optical Scanner using Flint J-6983 red OCR dropout ink or an exact match.

The following testers and ranges are acceptable:

- **MacBeth PCM-II.** The tested Print Contrast Signal (PCS) values when using the MacBeth PCM-II tester on the "C" scale must range from .01 minimum to .06 maximum.
- **Kidder 082A.** The tested PCS values when using the Kidder 082A tester on the Infra Red (IR) scale must range from .12 minimum to .21 maximum. White calibration disc must be 100%. Sensitivity must be set at one (1).
- **Alternative testers.** Alternative testers must be approved by the Government so that tested PCS values can be established. You may obtain approval by writing to the following address:

Commissioner of Internal Revenue
Attn: W:CAR:MP:M:T:M, Room 1225
Tax Products
1111 Constitution Avenue, NW
Washington, DC 20224

**2.1.6 Typography**

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

**Note:** *The form identifying number must be nonreflective carbon-based black ink in OCR A font.*

**2.1.7 Dimensions**

Generally, three **Forms 1098, 1099,** or **5498 (Copy A)** are contained on a single page, 8 inches wide (without any snap-stubs and/or pinfeed holes) by 11 inches deep.

**Exceptions. Forms 1099-MISC, 1099-R, and 1042-S** contain two documents per page.

There is a .33 inch top margin from the top of the corrected box, and a .25 inch right margin. There is a 1/32 (0.0313) inch tolerance for the right margin. If the right and top margins are properly aligned, the left margin for all forms will be correct. All margins must be free of print. See **Exhibits A through U** in this publication for the correct form measurements.

These measurements are constant for all **Forms 1098, 1099, and 5498.** These measurements are shown only once in this publication, on Form 1098 (Exhibit B). Exceptions to these measurements are shown on the rest of the exhibits.

The depth of the individual trim size of each form on a page must be 3 2/3 inches, the same depth as the official form.

**Exceptions.** The depth of **Forms 1099-MISC** and **1099-R** is 5 1/2 inches.

**2.1.8 Perforation**

Copy A (three per page; two per page for **Forms 1099-MISC** and **1099-R**) of privately printed continuous substitute forms must be perforated at each 11" page depth. No perforations are allowed between the 3 2/3″ forms (5 1/2″ for Forms 1099-MISC or 1099-R) on a single copy page of Copy A.

The words "Do Not Cut or Separate Forms on This Page" must be printed in red dropout ink (as required by form specifications) between the three forms (two for **Forms 1099-MISC** or **1099-R**).

**Note:** *Perforations are required between all the other individual copies (Copies B and C, and Copies 1 and 2 for **Forms 1099-R** and **1099-MISC,** and Copy D for **Forms 1099-LTC** and **1099-R**) in the set.*

**2.1.9 What To Include**

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

The words "For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G"** *must* be printed on Copy A; **"For more information and the Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G" must** be printed on **Form 1096.**

A postal indicia may be used if it meets the following criteria:
- It is printed in the OCR ink color prescribed for the form, and
- No part of the indicia is within one print position of the scannable area.

The printer's symbol (GPO) must not be printed on substitute Copy A. Instead, the employer identification number (EIN) of the forms printer must be entered in the bottom margin on the face of each individual form of **Copy A,** or on the bottom margin on the back of each **Form 1096.**

The Catalog Number (Cat. No.) shown on the 2001 forms is used for IRS distribution purposes and need not be printed on any substitute forms.

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

**2.2.1 Recipient Information**

The form recipient's name, street address, city, state, and ZIP code information should be **typed or machine printed in black ink** in the same format as shown on the official IRS form. The city, state, and ZIP code must be on the same line.

The following rules apply to the form recipient's name(s):
- The name of the appropriate form recipient must be shown on the first or second name line in the area provided for the form recipient's name.
- No descriptive information or other name may precede the form recipient's name.
- Only **one** form recipient's name may appear on the first name line of the form.
- If the multiple recipients' names are required on the form, enter on the first name line the recipient name that corresponds to the recipient taxpayer identification number (TIN) shown on the form. Place the other form recipients' names on the second name line (only 2 name lines are allowable).

Because certain states require that trust accounts be provided in a different format, generally filers should provide information returns reflecting payments to trust accounts with the:
- Trust's employer identification number (EIN) in the recipient's TIN area,
- Trust's name on the recipient's first name line, and
- Name of the trustee on the recipient's second name line.

Although handwritten forms will be accepted, the IRS prefers that filers **type or machine print** data entries. Also, filers should insert data in the **middle of blocks** well separated from other printing and guidelines, and take measures to guarantee clear, dark black, sharp images. Carbon copies and photocopies are not acceptable.

**2.2.2 Account Number Box**

You should use the account number box for an account number designation. This number must not appear anywhere else on the form, and this box may not be used for any other item.

Showing the account number is optional. However, it may be to your benefit to include the recipient's account number or designation on paper documents if your recordkeeping system uses, for identification purposes, the account number or designation in conjunction with, or instead of, the name, social security number, or employer identification number.

If you furnish the account number, the IRS will include it in future notices to you about backup withholding. If you use window envelopes and a reduced rate to mail statements to recipients, be sure the account number does not appear in the window. Otherwise, the Postal Service may not accept them for mailing.

**2.2.3 Specifications and Restrictions**

Machine-printed forms should be printed using a 6 lines/inch option, and should be printed in 10 pitch pica (10 print positions per inch) or 12 pitch elite (12 print positions per inch). **Proportional spaced fonts are unacceptable.**

Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single sheet before they are filed with the IRS. The size specified **does not include pinfeed holes.** Pinfeed holes **must not** be present on forms filed with the IRS.

**Do not:**

- Use a felt tip marker. The machine used to "read" paper forms generally cannot read this ink type.
- Use dollar signs ($), ampersands (&), asterisks (*), commas (,), or other special characters in the numbered money boxes.
  **Exception.** Use decimal points to indicate dollars and cents (e.g., 2000.00 is acceptable).
- Fold **Forms 1096, 1098, 1099,** or **5498** mailed to the IRS. Mail these forms flat in an appropriately sized envelope or box. Folded documents cannot be readily moved through the machine used in IRS processing.
- Staple Forms 1096 to the transmitted returns. Any staple holes near the return code number may impair the IRS's ability to machine scan the type of documents.
- Type other information on **Copy A.**
- Cut or separate the individual forms on the sheet of forms of **Copy A (except Forms W-2G).**

**2.2.4 Where To File**

Mail completed paper forms to the IRS service center shown in the **Instructions for Form 1096** and in the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** Specific information needed to complete the forms mentioned in this revenue procedure are given in the specific form instructions. A chart is included in the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G giving a quick guide to which form must be filed to report a particular payment.

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

## Section 3.1 - General

**3.1.1 Purpose**

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

A filer may use a substitute Form W-2G to file with the IRS (referred to as **"substitute Copy A").** The substitute form must be an exact replica of the official form with respect to layout and content.

## Section 3.2 - Specifications for Copy A of Form W-2G

**3.2.1 Substitute Form W-2G (Copy A)**

You must follow these specifications when printing substitute Copy A of the Form W-2G.

| **Item** | **Substitute Form W-2G (Copy A)** |
|---|---|
| Paper Color and Quality | Paper for Copy A must be white chemical wood bond, or equivalent, 20 pound (basis 17 x 22-500), plus or minus 5 percent. The paper must consist substantially of bleached chemical wood pulp. It must be free from unbleached or ground wood pulp or post-consumer recycled paper. It also must be suitably sized to accept ink without feathering. |
| Ink Color and Quality | All printing must be in a high quality nongloss black ink. |
| Typography | The type must be substantially identical in size and shape to the official form. All rules on the document are either 1/2 point (.007 inch), 1 point (0.015 inch), or 3 point (0.045 inch). Vertical rules must be parallel to the left edge of the document, horizontal rules to the top edge. |
| Dimensions | The official form is 8 inches wide x 3 2/3 inches deep, exclusive of a 2/3 inch snap stub on the left side of the form. Any substitute Copy A must be the same dimensions. The snap feature is not required on substitutes. All margins must be free of print. The top and right margins must be 1/4 inch plus or minus .0313. If the top and right margins are properly aligned, the left margin for all forms will be correct. If the substitute forms are in continuous or strip form, they must be burst and stripped to conform to the size specified for a single form. |

| | |
|---|---|
| Hot Wax and Cold Carbon Spots | Hot wax and cold carbon spots are not permitted on any of the internal form plies. These spots are permitted on the back of a mailer top envelope ply. Interleaved carbons, if used, should be black and of good quality to avoid smudging. |
| Printer's Symbol | The Government Printing Office (GPO) symbol must not be printed on substitute Forms W-2G. Instead, the employer identification number (EIN) of the forms printer must be printed in the bottom margin on the face of each individual Copy A on a sheet. The form must not contain the statement "IRS approved" or any similar statement. |
| Catalog Number | The Catalog Number (Cat. No.) shown on Form W-2G is used for IRS distribution purposes and need not be printed on any substitute forms |

# Part 4
# Substitute Statements to Form Recipients and Form Recipient Copies

## Section 4.1 - Specifications

**4.1.1 Introduction**

If you do not use the official IRS form to furnish statements to recipients, you must furnish an acceptable substitute statement. To be acceptable, your substitute statement must comply with the rules in this section. In general, see Regulations sections 1.6042–4, 1.6044–5, 1.6049–6, and 1.6050N–1 to determine how certain statements must be provided to recipients (statement mailing requirements for most **Forms 1099-DIV** and **1099-INT,** all **Forms 1099-OID** and **1099-PATR,** and **Form 1099-MISC** or **1099-S** for royalties).

**Note:** *A trustee of a grantor-type trust may choose to file **Forms 1099** and furnish a statement to the grantor under Regulations sections 1.671–4(b)(2)(iii) and (b)(3)(ii). The statement required by those regulations is not subject to the requirements outlined in this section.*

**4.1.2 Substitute Statements to Recipients for Certain Forms 1099-INT and 1099-DIV, and for Forms 1099-OID and 1099-PATR**

The rules in this section apply to **Form 1099-INT** (except for interest reportable under section 6041), **1099-DIV** (except for section 404(k) dividends), **1099-OID,** and **1099-PATR only.** You may furnish form recipients with **Copy B** of the official Form 1099 or a substitute Form 1099 (form recipient statement) if it contains the same language as the official IRS form (such as aggregate amounts paid to the form recipient, any backup withholding, the name, address, and TIN of the person making the return, and any other information required by the official form). Except for state income tax withholding information, information not required by the official form should not be included on the substitute form.

You may enter a total of the individual accounts listed on the form only if they have been paid by the same payer. For example, if you are listing interest paid on several accounts by one financial institution on Form 1099-INT, you may also enter the total interest amount. You may also enter a date next to the corrected box if that box is checked.

A substitute form recipient statement for **Forms 1099-INT, 1099-DIV, 1099-OID,** or **1099-PATR** must comply with the following requirements:

1. Box captions and numbers that are applicable must be clearly identified, using the same wording and numbering as on the official form.
   **Note:** *For **Form 1099-INT,** if box 3 is not on your substitute form, you may drop "not included in box 3" from the box 1 caption.*
2. The form recipient statement must contain all applicable form recipient instructions provided on the front and back of the official IRS form. Those instructions may be provided on a separate sheet of paper.
3. The form recipient statement must contain the following in bold and conspicuous type:
   **This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.**

4. The box caption **“Federal income tax withheld”** must be in boldface type on the form recipient statement.
5. The form recipient statement must contain the Office of Management and Budget (OMB) number as shown on the official IRS form. See **Part 5.**
6. The form recipient statement must contain the tax year (e.g., 2001), form number (e.g., Form 1099-INT), and form name (e.g., Interest Income) of the official IRS Form 1099. This information must be displayed prominently together in one area of the statement. For example, the tax year, form number, and form name could be shown in the upper right part of the statement. Each copy must be appropriately labeled (such as Copy B, For Recipient). See **Section 4.4** for applicable labels and arrangement of assembly of forms.

   **Note:** ***Do not*** *include the words “Substitute for” or “In lieu of” on the form recipient statement.*
7. Layout and format of the form is at the discretion of the filer. However, the IRS encourages the use of boxes so that the statement has the appearance of a form and can be easily distinguished from other nontax statements.
8. Each recipient statement of **Forms 1099-DIV, 1099-INT, 1099-OID,** and **1099-PATR** *must* include the direct access telephone number of an individual who can answer questions about the statement. **Include that telephone number conspicuously anywhere on the recipient statement.**
9. Until new regulations are issued, the IRS will not assess penalties for use of a logo (e.g., the name of the payer in any typeface, font, or style, and/or a symbolic icon) or slogan on a recipient statement if the logo or slogan is used by the payer in the ordinary course of its trade or business. In addition, use of the logo or slogan must not make it less likely for a reasonable payee to recognize the importance of the statement for tax reporting purposes.
10. A mutual fund family may state separately on one document (e.g., one piece of paper) the dividend income earned by a recipient from each fund within the family of funds as required by **Form 1099-DIV.** However, each fund and its earnings must be stated separately. The form must contain an instruction to the recipient that each fund’s dividends and name, not the name of the mutual fund family, must be reported on the recipient’s tax return. **The form cannot contain an aggregate total of all funds.** In addition, a mutual fund family may furnish a single statement (as a single filer) for **Forms 1099-INT, 1099-DIV,** and **1099-OID** information. Each fund and its earnings must be stated separately. The form must contain an instruction to the recipient that each fund’s earnings and name, not the name of the mutual fund family, must be reported on the recipient’s tax return. **The form cannot contain an aggregate total of all funds**

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**4.1.3 Substitute Statements to Recipients for Certain Forms 1098, 1099, 5498, and W-2G**

Statements to form recipients for **Forms 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-G, 1099-LTC, 1099-MISC, 1099-MSA, 1099-R, 1099-S, 5498, 5498-MSA, W-2G, 1099-DIV** (only for section 404(k) dividends reportable under section 6047), and **1099-INT** (only for interest of $600 or more made in the course of a trade or business reportable under section 6041) can be copies of the official forms or an acceptable substitute. To be acceptable, a substitute form recipient statement must meet the following requirements.

1. The tax year, form number, and form name must be the same as the official form and must be displayed prominently together in one area on the statement. For example, they may be shown in the upper right part of the statement.
2. The filer’s and the form recipient’s identifying information required on the official IRS form must be included.
3. Each substitute recipient statement for **Forms W-2G, 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-DIV, 1099-G** (excluding state and local income tax refunds), **1099-INT, 1099-LTC, 1099-MISC** (excluding fishing boat proceeds), **1099-OID, 1099-PATR,** and **1099-S** *must* include the direct access telephone number of an individual who can answer questions about the statement. **You may include the telephone number conspicuously anywhere on the recipient statement.** Although not required, payers reporting on **Forms 1099-C, 1099-MSA, 1099-R, 5498,** and **5498-MSA** are encouraged to furnish telephone numbers.
4. All applicable money amounts and information, including box numbers, required to be reported to the form recipient must be titled on the form recipient statement in substantially the same manner as those on the official IRS form. The box caption **“Federal income tax withheld”** must be in boldface type on the form recipient statement.

   **Exception.** If you are reporting a payment as “Other income” in box 3 of **Form 1099-MISC,** you may substitute appropriate language for the box title. For example, for payments of accrued wages and leave to a beneficiary of a deceased employee, you might change the title of box 3 to “Beneficiary payments” or something similar.

**Note:** *You cannot make this change on **Copy A.***

5. You must provide appropriate instructions to the form recipient similar to those on the official IRS form, to aid in the proper reporting on the form recipient's income tax return. For payments reported on **Form 1099-B,** the requirement to include instructions substantially similar to those on the official IRS form may be satisfied by providing form recipients with a single set of instructions for all **Forms 1099-B** statements required to be furnished in a calendar year.
   **Note:** *If Federal income tax is withheld and shown on **Form 1099-R** or **W-2G, Copy B and Copy C** must be furnished to the recipient. If Federal income tax is not withheld, only **Copy C of Form 1099-R** and **W-2G** must be furnished. However, for **Form 1099-R,** instructions similar to those on the back of the official **Copy B and Copy C of Form 1099-R** must be furnished to the recipient. For convenience, you may choose to provide both **Copies B and C of Form 1099-R** to the recipient.*
6. If you use carbon to produce recipient statements, the quality of the carbon must meet the following standards:
   - All copies must be **clearly legible,**
   - All copies must be able to be photocopied, and
   - Fading must not diminish legibility and the ability to photocopy.

   In general, black chemical transfer inks are preferred, but other colors are permitted if the above standards are met. Hot wax and cold carbon spots are not permitted on any of the internal form plies. The back of a mailer top envelope ply may contain these spots.
7. A mutual fund family may state separately on one document (e.g., one piece of paper) the **Form 1099-B** information for a recipient from each fund as required by Form 1099-B. However, the gross proceeds, etc., from each transaction within a fund must be stated separately. The form must contain an instruction to the recipient that each fund's (not the mutual fund family's) name and amount must be reported on the recipient's tax return. The form cannot contain an aggregate total of all funds.
8. You may use a Uniform Settlement Statement (under the Real Estate Settlement Procedures Act of 1974 (RESPA)) for **Form 1099-S.** The Uniform Settlement Statement is acceptable as the written statement to the transferor if you include the legend for **Form 1099-S** in **Section 4.3.2** and indicate which information on the Uniform Settlement Statement is being reported to the IRS on Form 1099-S.
9. For reporting state income tax withholding and state payments, you may add an additional box(es) to recipient copies as appropriate.
   **Note:** *You cannot make this change on **Copy A.***
10. On **Copy C** of **Form 1099-LTC,** you may reverse the location of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.
11. Logos are permitted on substitute recipient statements for the forms listed in this section **(Section 4.1.3).**

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## Section 4.2 - Composite Statements

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**4.2.1 Composite Substitute Statements for Certain Forms 1099-INT, 1099-DIV, 1099-MISC, and 1099-S, and for Forms 1099-OID and 1099-PATR**

A composite form recipient statement is permitted for reportable payments of interest, dividends, original issue discount, patronage dividends, and royalties **(Forms 1099-INT** (except for interest reportable under section 6041), **1099-DIV** (except for section 404(k) dividends), **1099-MISC** or **1099-S** (for royalties only), **1099-OID,** or **1099-PATR)** when one payer is reporting more than one of these payments during a calendar year to the same form recipient. Generally, do not include any other **Form 1099** information (e.g., **1098** or **1099-A)** on a composite statement with the information required on the forms listed in the preceding sentence.

**Exception.** A filer may include **Form 1099-B** information on a composite form with the forms listed above.

Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the following requirements in addition to the requirements listed earlier in **Section 4.1.2.**

- All information pertaining to a particular type of payment must be located and blocked together on the form and separate from any information covering other types of payments included on the form. For example, if you are reporting interest and dividends, the Form **1099-INT** information must be presented separately from the Form **1099-DIV** information.
- The composite form recipient statement must prominently display the tax year, form number, and form name of the official IRS form together in one area at the beginning of each appropriate block of information.

- Any information required by the official IRS forms that would otherwise be repeated in each information block is required to be listed only once in the first information block on the composite form. For example, there is no requirement to report the name of the filer in each information block. This rule does not apply to any money amounts (e.g., Federal income tax withheld) or to any other information that applies to money amounts.
- A composite statement is an acceptable substitute only if the type of payment and the recipient's tax obligation with respect to the payment are as clear as if each required statement were furnished separately on an official form.

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

A composite form recipient statement for the forms specified in **Section 4.1.3** is permitted when one filer is reporting more than one type of payment during a calendar year to the same form recipient. A composite statement is not allowed for a combination of forms listed in **Section 4.1.3** and forms listed in **Section 4.1.2.**

**Exceptions. Form 1099-B** information may be reported on a composite form with the forms specified in **Section 4.1.2** as described in **Section 4.2.1.** In addition, royalties reported on **Form 1099-MISC** or **1099-S** may be reported on a composite form only with the forms specified in Section 4.1.2.

Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the requirements listed in **Section 4.2.1** as well as the requirements in **Section 4.1.3.** A composite statement of **Forms 1098** and **1099-INT** (for interest reportable under section 6049) is **not** allowed.

## Section 4.3 - Required Legends

**4.3.1 Required Legends for Forms 1098**

**Form 1098** recipient statements **(Copy B)** must contain the following legends:

- **Form 1098**
  1. "The information in boxes 1, 2, and 3 is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for this mortgage interest or for these points or because you did not report this refund of interest on your return."
  2. **"Caution:** *The amount shown may not be fully deductible by you. Limits based on the loan amount and the cost and value of the secured property may apply. Also, you may only deduct interest to the extent it was incurred by you, actually paid by you, and not reimbursed by another person."*
- **Form 1098-E –**"This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if the IRS determines that an underpayment of tax results because you overstated a deduction for student loan interest."
- **Form 1098-T –** "This is important tax information and is being furnished to the Internal Revenue Service."

**4.3.2 Required Legends for Forms 1099 and W-2G**

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

- **Forms 1099-A and 1099-C – Copy B**

"This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported."

- **Forms 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-MISC, 1099-OID, and 1099-PATR – Copy B**
  "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported."
- **Form 1099-LTC –**
  **Copy B –** "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported."

**Copy C –** "Copy C is provided to you for information only. Only the policyholder is required to report this information on a tax return."

- **Form 1099-MSA – Copy B**
  "This information is being furnished to the Internal Revenue Service."
- **Form 1099-R –**
  **Copy B –** "Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return. This information is being furnished to the Internal Revenue Service."
  **Copy C –** "This information is being furnished to the Internal Revenue Service."
- **Form 1099-S – Copy B**
  "This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported."
- **Form W-2G –**
  **Copy B –** "This information is being furnished to the Internal Revenue Service. Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 2, attach this copy to your return."
  **Copy C –**"This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported."

**4.3.3 Required Legends for Forms 5498**

**Form 5498** recipient statements **(Copy B)** must contain the following legends:

- **Form 5498 –** "This information is being furnished to the Internal Revenue Service."
  **Note:** *If you do not furnish another statement to the participant because no contributions were made for the year, the statement of the fair market value of the account must contain this legend and a designation of which information is being furnished to the IRS.*
- **Form 5498-MSA –** "The information in boxes 1 through 6 is being furnished to the Internal Revenue Service."

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

**4.4.1 Copies**

**Copies B, C,** and in some cases, **D, 1, and 2** are included in the official assembly for the convenience of the filer. You are not legally required to include all these copies with the privately printed substitute forms. Furnishing Copies B and, in some cases, C will satisfy the legal requirement to provide statements of information to form recipients.

**Note:** *If an amount of Federal income tax withheld is shown on **Form 1099-R** or **W-2G, Copy B** (to be attached to the tax return) and **Copy C** must be furnished to the recipient. **Copy D (Forms 1099-R and W-2G)** may be used for filer records. Only **Copy A** should be filed with the IRS.*

**4.4.2 Arrangement of Assembly**

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

- **Form 1098—**Copy B "For Payer"; Copy C "For Recipient."
- **Form 1098-E**—Copy B "For Borrower"; Copy C "For Recipient."
- **Form 1098-T**—Copy B "For Student"; Copy C "For Filer."
- **Form 1099-A**—Copy B "For Borrower"; Copy C "For Lender."
- **Forms 1099-B, 1099-DIV, 1099-G, 1099-INT, 1099-MSA, 1099-OID, and 1099-PATR**—Copy B "For Recipient"; Copy C "For Payer."
- **Form 1099-C**—Copy B "For Debtor"; Copy C "For Creditor."
- **Form 1099-LTC**—Copy B "For Policyholder"; Copy C "For Insured"; and Copy D "For Payer."
- **Form 1099-MISC**—Copy 1 "For State Tax Department"; Copy B "For Recipient"; Copy 2 "To be filed with recipient's state income tax return, when required"; and Copy C "For Payer."
- **Form 1099-R—**Copy 1 "For State, City, or Local Tax Department"; Copy B "Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return"; Copy C "For Recipient's Records"; Copy 2 "File this copy with your state, city, or local income tax return, when required"; Copy D "For Payer."

- **Form 1099-S**—Copy B "For Transferor"; Copy C "For Filer."
- **Form 5498**—Copy B "For Participant"; Copy C "For Trustee or Issuer."
- **Form 5498-MSA**—Copy B "For Participant"; Copy C "For Trustee."
- **Form W-2G**—Copy 1 "For State Tax Department"; Copy B "Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 2, attach this copy to your return"; Copy C "For Winner's Records"; Copy 2 "Attach this copy to your state income tax return, if required."; Copy D "For Payer."

**4.4.3 Perforations**

Perforations are required between forms on all copies except Copy A to make separating the forms easier. (Copy A of Form W-2G may be perforated.)

# Part 5
# Additional Instructions for Substitute Forms 1098, 1099, 5498, W-2G, and 1042-S

## Section 5.1 - Paper Substitutes for Form 1042-S

**5.1.1 Paper Substitutes**

Paper substitutes of Copy A for Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, that totally conform to the specifications contained in this procedure may be privately printed without prior approval from the Internal Revenue Service. Proposed substitutes not conforming to these specifications must be submitted for consideration.

**Note:** *Copies B, C, D, and E of Form 1042-S may contain multiple income entries for the same recipient, i.e. multiple rows of the top boxes 1-8 of the Form.*

**5.1.2 Time Frame For Submission of Form 1042-S**

The request should be submitted by November 15 of the year prior to the year the form is to be used. This is to allow the Service adequate time to respond and the submitter adequate time to make any corrections. These requests should contain a copy of the proposed form, the need for the specific deviation(s), and the number of information returns to be printed.

**5.1.3 Revisions**

Form 1042-S is subject to annual review and possible change. Withholding agents and form suppliers are cautioned against overstocking supplies of the privately printed substitutes.

**5.1.4 Obtaining Copies**

Copies of the official form for the reporting year may be obtained from most Service offices. The Service provides only cut sheets (no carbon interleaves) of these forms. Continuous fan-fold/pinned forms are not provided.

**5.1.5 Instructions For Withholding Agents**

Instructions for withholding agents:

- Only original copies may be filed with the Service. Carbon copies and reproductions are not acceptable.
- The term "Recipient's U.S. TIN" for an individual means the social security number (SSN) or IRS individual taxpayer identification number (ITIN), consisting of nine digits separated by hyphens as follows: 000–00–0000. For all other recipients, the term means employer identification number (EIN) or qualified intermediary employer identification number (QI-EIN). The EIN and QI-EIN consist of nine digits separated by a hyphen as follows: 00-0000000. The taxpayer identification number (TIN) must be in one of these formats.
- Withholding agents are requested to type or machine print whenever possible, provide quality data entries on the forms (that is, use black ribbon and insert data in the middle of blocks well separated from other printing and guidelines), and take other measures to guarantee a clear, sharp image. Withholding agents are not required, however, to acquire special equipment solely for the purpose of preparing these forms.
- The "VOID," "CORRECTED," and "PRO-RATA BASIS REPORTING" boxes must be printed at the top center of the form under the title and checked, if applicable.
- Substitute forms prepared in continuous or strip form must be burst and stripped to conform to the size specified for a single form before they are filed with the Service. The dimensions are found below. Computer cards are acceptable provided they meet all requirements regarding layout, content, and size.

#### 5.1.6 Substitute Form 1042-S Format Requirements

| Property | Substitute Form 1042-S Format Requirements |
|---|---|
| Printing | Privately printed substitute Forms 1042-S must be exact replicas of the official forms with respect to layout and content. Only the dimensions of the substitute form may differ. The Government Printing Office (GPO) symbol must be deleted. The exact dimensions are found below. |
| Box Entries | Only one item of income may be represented on the copy submitted to the Service (Copy A). Multiple income items may be used on copies provided to recipients only. All boxes appearing on the official form must be present on the substitute form, with appropriate captions. |
| Color and Quality of Ink | All printing must be in high quality non-gloss black ink. Bar codes should be free from picks and voids. |
| Typography | Type must be substantially identical in size and shape to corresponding type on the official form. All rules on the document are either 1 point (0.015″) or 3 point (0.045″). Vertical rules must be parallel to the left edge of the document; horizontal rules must be parallel to the top edge. |
| Carbons | Carbonized forms or "spot carbons" are not permissible. Interleaved carbons, if used, must be of good quality to preclude smudging and should be black. |
| Assembly | If all five parts are present, the parts of the assembly shall be arranged from top to bottom as follows: Copy A (Original) "For Internal Revenue Service," Copies B, C, and D "For Recipient," and Copy E "For Withholding Agent." |
| Color Quality of Paper | • Paper For Copy A must be white chemical wood bond, or equivalent, 20 pound (basis 17 x 22-500), plus or minus 5 percent; or offset book paper, 50 pound (basis 25 x 38-500). No optical brighteners may be added to the pulp or paper during manufacture. The paper must consist of principally bleach chemical wood pulp or recycled printed paper. It also must be suitably sized to accept ink without feathering.<br>• Copies B, C, D (for Recipient), and E (For Withholding Agent) are provided in the official assembly solely for the convenience of the withholding agent. Withholding agents may choose the format, design, color, and quality of the paper used for these copies. |
| Dimensions | • The official form is 8 inches wide x 5 1/2 inches deep, exclusive of a 1/2 snap stub on the left side of the form. The snap feature is not required on substitutes.<br>• The width of a substitute Copy A must be a minimum of 7 inches and a maximum of 8 inches, although adherence to the size of the official form is preferred. If the width of substitute Copy A is reduced from that of the official form, the width of each field on the substitute form must be reduced proportionately. The left margin must be 1/2 inch and free of all printing other than that shown on the official form.<br>• The depth of a substitute Copy A must be a minimum of 5 1/6 inches and a maximum of 5 1/2 inches. |
| Other Copies | Copies B, C, and D must be furnished for the convenience of payees who must send a copy of the form with other Federal and State returns they file. Copy E may be used as a withholding agent's record/copy. |

## Section 5.2 - OMB Requirements for All Forms in This Revenue Procedure

**5.2.1 OMB Requirements**

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

- The OMB approves all IRS tax forms that are subject to the Act.
- Each IRS form contains (in or near the upper right corner) the OMB approval number, if any. (The official OMB numbers may be found on the official IRS printed forms and are also shown on the forms in the exhibits in **Part 6.)**
- Each IRS form (or its instructions) states:
  1. Why the IRS needs the information,
  2. How it will be used, and
  3. Whether or not the information is required to be furnished to the IRS.

This information must be provided to any users of official or substitute IRS forms or instructions.

**5.2.2 Substitute Form Requirements**

The OMB requirements for substitute IRS forms are:

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.
- For Copy A, the OMB number must appear exactly as shown on the official IRS form.
- For any copy other than Copy A, the OMB number must use one of the following formats.
  1. OMB No. XXXX-XXXX (preferred) or
  2. OMB # XXXX-XXXX (acceptable).

**5.2.3 Required Explanation to Users**

All substitute forms **(Copy A only)** must state "For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G."** (or "For Privacy Act and Paperwork Reduction Act Notice, see separate instructions." for Copy A of Form 1042-S).

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

## Section 5.3 - Reproducible Copies of Forms

**5.3.1 Introduction**

You can order official IRS forms and information copies of Federal tax materials by calling the IRS Distribution Center at 1-800-829-3676. Other ways to get Federal tax material include:

- The Internet.
- CD-ROM.
- GPO Superintendent of Documents Bookstores.

**Note:** *Several IRS forms are provided electronically on the IRS home page and on the Federal Tax Forms CD-ROM, but Copy A of Forms **1096**, the **1098** series, **1099** series, and **5498** series cannot be used for filing with the IRS when printed from a conventional printer. These forms contain drop-out ink requirements as described in Part 2 of this publication.*

**5.3.2 Internet**

You can download tax materials from the Internet.

| You Can Access the Internet by... | Using... |
|---|---|
| File Transfer Protocol (FTP) | ftp.irs.gov |
| World Wide Web | www.irs.gov |

**5.3.3 IRS Federal Tax Forms CD-ROM**

The IRS also offers an alternative to downloading electronic files and provides current and prior-year access to tax forms and instructions through its Federal Tax Forms CD-ROM. The CD will be available for the upcoming filing season. Order **Pub. 1796,** IRS Federal Tax Products CD-ROM, by using the IRS's Internet Web Site at **www.irs.gov/cdorders** or by calling 1-877-CDFORMS (1-877-233-6767).

**5.3.4 GPO Supt. of Documents Bookstores**

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

## Section 5.4 - Effect on Other Revenue Procedures

**5.4.1 Other Revenue Procedures**

Revenue Procedure 2000-28, 2000-27 I.R.B. 60, which provides rules and specifications for private printing of 2000 substitute forms and statements to recipients, is superseded.

# Part 6
# Exhibits

## Section 6.1 - Exhibits of Forms in the Revenue Procedure

**6.1.1 Purpose**

Exhibits A through U illustrate some of the specifications that were discussed earlier in this revenue procedure. The dimensions apply to the actual size forms, but the exhibits have been reduced in size.

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

**6.1.2 Guidelines**

Keep in mind the following guidelines when printing substitute forms.

- Closely follow the specifications to avoid delays in processing the forms.
- Always use the specifications as outlined in this revenue procedure and illustrated in the exhibits.
- Do not add the text line “Do Not Cut or Separate Forms on This Page” to the bottom form. This will cause inconsistency with the specifications.

# Exhibit A

.50"

Do Not Staple 6969

Form **1096** Department of the Treasury Internal Revenue Service

**Annual Summary and Transmittal of U.S. Information Returns**

OMB No. 1545-0108

**2001**

FILER'S name

Street address (including room or suite number)

City, state, and ZIP code

1.33" 2.25" 7.30" 4.50"

| Name of person to contact | Telephone number ( ) |
|---|---|
| Fax number ( ) | E-mail address |

**For Official Use Only**

.35" .25"

| 1 Employer identification number | 2 Social security number | 3 Total number of forms | 4 Federal income tax withheld | 5 Total amount reported with this Form 1096 |
|---|---|---|---|---|
| 1.40" | 1.40" | 1.20 | $ 1.40" | $ 1.90" |

Enter an "X" in only one box below to indicate the type of form being filed. If this is your **final return**, enter an "X" here . . . ▶ ☐

| W-2G 32 | 1098 81 | 1098-E 84 | 1098-T 83 | 1099-A 80 | 1099-B 79 | 1099-C 85 | 1099-DIV 91 | 1099-G 86 | 1099-INT 92 | 1099-LTC 93 | 1099-MISC 95 | 1099-MSA 94 | 1099-OID 96 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ | ☐ |
| 1099-PATR 97 | 1099-R 98 | 1099-S 75 | 5498 28 | 5498-MSA 27 | | | | | | | | | |
| ☐ | ☐ | ☐ | ☐ | ☐ | | | | | | | | | |

**Please return this entire page to the Internal Revenue Service. Photocopies are not acceptable.**

Under penalties of perjury, I declare that I have examined this return and accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

8.00"

**Signature ▶** **Title ▶** **Date ▶**

11.00"

## Instructions

**Purpose of form.** Use this form to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. **Do not use Form 1096 to transmit magnetic media.** See **Form 4804,** Transmittal of Information Returns Reported Magnetically/Electronically.

**Who must file. The name, address, and TIN of the filer on this form must be the same as those you enter in the upper left area of Form 1099, 1098, 5498, or W-2G.** A filer includes a payer, a recipient of mortgage interest payments (including points) or student loan interest, an educational institution, a broker, a barter exchange, a creditor, a person reporting real estate transactions, a trustee or issuer of any individual retirement arrangement or a medical savings account (MSA) (including a Medicare+Choice MSA), and a lender who acquires an interest in secured property or who has reason to know that the property has been abandoned.

**Preaddressed Form 1096.** If you received a preaddressed Form 1096 from the IRS with Package 1099, use it to transmit paper Forms 1099, 1098, 5498, and W-2G to the Internal Revenue Service. If any of the imprinted information is incorrect, make corrections on the form.

**Note:** *You will no longer receive an IRS-prepared label with your Package 1099.*

If you are not using a preaddressed form, enter the filer's name, address (including room, suite, or other unit number), and TIN in the spaces provided on the form.

**When to file.** File Form 1096 with Forms 1099, 1098, or W-2G by February 28, 2002. File Form 1096 with Forms 5498 by May 31, 2002.

## Where To File

Send all information returns filed on paper with Form 1096 to the following:

| If your principal business, office or agency, or legal residence in the case of an individual, is located in | Use the following Internal Revenue Service Center address |
|---|---|
| Alabama, Arizona, Florida, Georgia, Louisiana, Mississippi, New Mexico, Texas | Austin, TX 73301 |
| Arkansas, Connecticut, Kentucky, Maine, Massachusetts, New Hampshire, New York, Ohio, Rhode Island, Vermont, West Virginia | Cincinnati, OH 45999 |
| Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Oklahoma, South Dakota, Wisconsin | Kansas City, MO 64999 |

**For more information and the Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** Cat. No. 14400O Form **1096** (2001)

# Exhibit B

.65" .33" .50" 4.70" 3.33" 1.70" 2.80" .25" 3.40" 2.83" 7.30" 8.00" .85" 11.00"

8181 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| RECIPIENT'S/LENDER'S name, address, and telephone number | | OMB No. 1545-0901<br>**2001**<br>Form **1098** | **Mortgage Interest Statement** |
| RECIPIENT'S Federal identification no. | PAYER'S social security number | 1 Mortgage interest received from payer(s)/borrower(s)<br>$ | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| PAYER'S/BORROWER'S name | | 2 Points paid on purchase of principal residence<br>$ | |
| Street address (including apt. no.) | | 3 Refund of overpaid interest<br>$ | |
| City, state, and ZIP code | | 4 | |
| Account number (optional) | | | |

Form **1098** Cat. No. 14402K Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**


8181 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| RECIPIENT'S/LENDER'S name, address, and telephone number | | OMB No. 1545-0901<br>**2001**<br>Form **1098** | **Mortgage Interest Statement** |
| RECIPIENT'S Federal identification no. | PAYER'S social security number | 1 Mortgage interest received from payer(s)/borrower(s)<br>$ | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| PAYER'S/BORROWER'S name | | 2 Points paid on purchase of principal residence<br>$ | |
| Street address (including apt. no.) | | 3 Refund of overpaid interest<br>$ | |
| City, state, and ZIP code | | 4 | |
| Account number (optional) | | | |

Form **1098** Cat. No. 14402K Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

8181 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| RECIPIENT'S/LENDER'S name, address, and telephone number | | OMB No. 1545-0901<br>**2001**<br>Form **1098** | **Mortgage Interest Statement** |
| RECIPIENT'S Federal identification no. | PAYER'S social security number | 1 Mortgage interest received from payer(s)/borrower(s)<br>$ | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| PAYER'S/BORROWER'S name | | 2 Points paid on purchase of principal residence<br>$ | |
| Street address (including apt. no.) | | 3 Refund of overpaid interest<br>$ | |
| City, state, and ZIP code | | 4 | |
| Account number (optional) | | | |

Form **1098** Cat. No. 14402K Department of the Treasury - Internal Revenue Service

# Exhibit C

8484 ☐ VOID ☐ CORRECTED

| RECIPIENT'S/LENDER'S name, address, and telephone number | | OMB No. 1545-1576<br>**2001**<br>Form **1098-E** | **Student Loan Interest Statement** |
|---|---|---|---|
| RECIPIENT'S Federal identification no. | BORROWER'S social security number | **1** Student loan interest received by lender<br>$ ← 2.80" → | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| BORROWER'S name<br>← 3.40" → | | 2.83" | |
| Street address (including apt. no.) | | | |
| City, state, and ZIP code | | | |
| Account number (optional) | | **2** Check if box 1 includes loan origination fees and/or capitalized interest . . . . . . ☐ | |

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**


8484 ☐ VOID ☐ CORRECTED

| RECIPIENT'S/LENDER'S name, address, and telephone number | | OMB No. 1545-1576<br>**2001**<br>Form **1098-E** | **Student Loan Interest Statement** |
|---|---|---|---|
| RECIPIENT'S Federal identification no. | BORROWER'S social security number | **1** Student loan interest received by lender<br>$ | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| BORROWER'S name | | | |
| Street address (including apt. no.) | | | |
| City, state, and ZIP code | | | |
| Account number (optional) | | **2** Check if box 1 includes loan origination fees and/or capitalized interest . . . . . . ☐ | |

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

8484 ☐ VOID ☐ CORRECTED

| RECIPIENT'S/LENDER'S name, address, and telephone number | | OMB No. 1545-1576<br>**2001**<br>Form **1098-E** | **Student Loan Interest Statement** |
|---|---|---|---|
| RECIPIENT'S Federal identification no. | BORROWER'S social security number | **1** Student loan interest received by lender<br>$ | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| BORROWER'S name | | | |
| Street address (including apt. no.) | | | |
| City, state, and ZIP code | | | |
| Account number (optional) | | **2** Check if box 1 includes loan origination fees and/or capitalized interest . . . . . . ☐ | |

Form **1098-E** Cat. No. 25088U Department of the Treasury - Internal Revenue Service

# Exhibit D

.33"

8383 ~~VOID~~ ~~CORRECTED~~ 6.30"

| FILER'S name, street address, city, state, ZIP code, and telephone number | 1 Qualified tuition and related expenses<br>$ | OMB No. 1545-1574<br>**2001**<br>Form **1098-T** | **Tuition Payments Statement** |
|---|---|---|---|
| | 2 Reimbursements or refunds<br>1.40"<br>$ | | |
| FILER'S Federal identification no. / STUDENT'S social security number | 3 Scholarships or grants<br>$ | | **Copy A For Internal Revenue Service Center** .25" |
| STUDENT'S name<br>3.40" | | | **File with Form 1096.** |
| Street address (including apt. no.) | | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | 2.80" | | |
| Account number (optional) | 4 Check if at least half-time student . ☐ | 5 Check if a graduate student . . . ☐ | |

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

8383 ☐ VOID ☐ CORRECTED

| FILER'S name, street address, city, state, ZIP code, and telephone number | 1 Qualified tuition and related expenses<br>$ | OMB No. 1545-1574<br>**2001**<br>Form **1098-T** | **Tuition Payments Statement** |
|---|---|---|---|
| | 2 Reimbursements or refunds<br>$ | | |
| FILER'S Federal identification no. / STUDENT'S social security number | 3 Scholarships or grants<br>$ | | **Copy A For Internal Revenue Service Center** |
| STUDENT'S name | | | **File with Form 1096.** |
| Street address (including apt. no.) | | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | | |
| Account number (optional) | 4 Check if at least half-time student . ☐ | 5 Check if a graduate student . . . ☐ | |

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

8383 ☐ VOID ☐ CORRECTED

| FILER'S name, street address, city, state, ZIP code, and telephone number | 1 Qualified tuition and related expenses<br>$ | OMB No. 1545-1574<br>**2001**<br>Form **1098-T** | **Tuition Payments Statement** |
|---|---|---|---|
| | 2 Reimbursements or refunds<br>$ | | |
| FILER'S Federal identification no. / STUDENT'S social security number | 3 Scholarships or grants<br>$ | | **Copy A For Internal Revenue Service Center** |
| STUDENT'S name | | | **File with Form 1096.** |
| Street address (including apt. no.) | | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | | |
| Account number (optional) | 4 Check if at least half-time student . ☐ | 5 Check if a graduate student . . . ☐ | |

Form **1098-T** Cat. No. 25087J Department of the Treasury - Internal Revenue Service

# Exhibit E

8080 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| LENDER'S name, street address, city, state, ZIP code, and telephone no. | | OMB No. 1545-0877 **2001** Form **1099-A** | **Acquisition or Abandonment of Secured Property** |
| LENDER'S Federal identification number / BORROWER'S identification number | 1 Date of lender's acquisition or knowledge of abandonment | 2 Balance of principal outstanding $ | **Copy A For Internal Revenue Service Center** |
| BORROWER'S name | 3 | 4 Fair market value of property 1.40" $ | **File with Form 1096.** |
| Street address (including apt. no.) | 5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No | | For Privacy Act and Paperwork 1.40" Reduction Act |
| City, state, and ZIP code | 6 Description of property | | Notice, see the 1.80" **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Account number (optional) | | | |

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**


8080 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| LENDER'S name, street address, city, state, ZIP code, and telephone no. | | OMB No. 1545-0877 **2001** Form **1099-A** | **Acquisition or Abandonment of Secured Property** |
| LENDER'S Federal identification number / BORROWER'S identification number | 1 Date of lender's acquisition or knowledge of abandonment | 2 Balance of principal outstanding $ | **Copy A For Internal Revenue Service Center** |
| BORROWER'S name | 3 | 4 Fair market value of property $ | **File with Form 1096.** |
| Street address (including apt. no.) | 5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No | | For Privacy Act and Paperwork Reduction Act |
| City, state, and ZIP code | 6 Description of property | | Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Account number (optional) | | | |

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

**Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page**

8080 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| LENDER'S name, street address, city, state, ZIP code, and telephone no. | | OMB No. 1545-0877 **2001** Form **1099-A** | **Acquisition or Abandonment of Secured Property** |
| LENDER'S Federal identification number / BORROWER'S identification number | 1 Date of lender's acquisition or knowledge of abandonment | 2 Balance of principal outstanding $ | **Copy A For Internal Revenue Service Center** |
| BORROWER'S name | 3 | 4 Fair market value of property $ | **File with Form 1096.** |
| Street address (including apt. no.) | 5 Was borrower personally liable for repayment of the debt? ☐ Yes ☐ No | | For Privacy Act and Paperwork Reduction Act |
| City, state, and ZIP code | 6 Description of property | | Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Account number (optional) | | | |

Form **1099-A** Cat. No. 14412G Department of the Treasury - Internal Revenue Service

# Exhibit F

7979 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1a Date of sale | OMB No. 1545-0715 **2001** Form **1099-B** | **Proceeds From Broker and Barter Exchange Transactions** |
| | | 1b CUSIP no. | | |
| | | 2 Stocks, bonds, etc. $ | Reported to IRS ☐ Gross proceeds ← 1.90" → ☐ Gross proceeds less commissions and option premiums | |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Bartering $ ← | 4 Federal income tax withheld $ 3.90" → | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 5 Description | | **File with Form 1096.** |
| | | **Regulated Futures Contracts** | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Street address (including apt. no.) | | 6 Profit or (loss) realized in 2001 | 7 Unrealized profit or (loss) on open contracts—12/31/2000 | |
| City, state, and ZIP code | | ← 1.40" → $ | ← 1.40" → $ | |
| Account number (optional) ← 2.80" → | 2nd TIN not. ☐ | 8 Unrealized profit or (loss) on open contracts—12/31/2001 $ | 9 Aggregate profit or (loss) $ 4.15" → | |

Form **1099-B** ← .60" → Cat. No. 14411V Department of the Treasury - Internal Revenue Service

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7979 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1a Date of sale | OMB No. 1545-0715 **2001** Form **1099-B** | **Proceeds From Broker and Barter Exchange Transactions** |
| | | 1b CUSIP no. | | |
| | | 2 Stocks, bonds, etc. $ | Reported to IRS ☐ Gross proceeds ☐ Gross proceeds less commissions and option premiums | |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Bartering $ | 4 Federal income tax withheld $ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 5 Description | | **File with Form 1096.** |
| | | **Regulated Futures Contracts** | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Street address (including apt. no.) | | 6 Profit or (loss) realized in 2001 | 7 Unrealized profit or (loss) on open contracts—12/31/2000 | |
| City, state, and ZIP code | | $ | $ | |
| Account number (optional) | 2nd TIN not. ☐ | 8 Unrealized profit or (loss) on open contracts—12/31/2001 $ | 9 Aggregate profit or (loss) $ | |

Form **1099-B** Cat. No. 14411V Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1a Date of sale | OMB No. 1545-0715 **2001** Form **1099-B** | **Proceeds From Broker and Barter Exchange Transactions** |
| | | 1b CUSIP no. | | |
| | | 2 Stocks, bonds, etc. $ | Reported to IRS ☐ Gross proceeds ☐ Gross proceeds less commissions and option premiums | |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Bartering $ | 4 Federal income tax withheld $ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 5 Description | | **File with Form 1096.** |
| | | **Regulated Futures Contracts** | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Street address (including apt. no.) | | 6 Profit or (loss) realized in 2001 | 7 Unrealized profit or (loss) on open contracts—12/31/2000 | |
| City, state, and ZIP code | | $ | $ | |
| Account number (optional) | 2nd TIN not. ☐ | 8 Unrealized profit or (loss) on open contracts—12/31/2001 $ | 9 Aggregate profit or (loss) $ | |

Form **1099-B** Cat. No. 14411V Department of the Treasury - Internal Revenue Service

# Exhibit G

8585 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| CREDITOR'S name, street address, city, state, and ZIP code | | | OMB No. 1545-1424<br>2001<br>Form 1099-C | Cancellation of Debt |
| CREDITOR'S Federal identification number | DEBTOR'S identification number | 1 Date canceled<br>← 1.40" → | 2 Amount of debt canceled<br>← 1.40" → | Copy A For Internal Revenue Service Center |
| DEBTOR'S name<br>← 3.40" → | | 3 Interest if included in box 2<br>$ | 4 | File with Form 1096. |
| Street address (including apt. no.) | | 5 Debt description | | For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G. |
| City, state, and ZIP code | | | | |
| Account number (optional) | | 6 Check for bankruptcy ☐ | 7 Fair market value of property<br>$ | ← 1.35" → |

Form 1099-C Cat. No. 26280W Department of the Treasury - Internal Revenue Service

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8585 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| CREDITOR'S name, street address, city, state, and ZIP code | | | OMB No. 1545-1424<br>2001<br>Form 1099-C | Cancellation of Debt |
| CREDITOR'S Federal identification number | DEBTOR'S identification number | 1 Date canceled | 2 Amount of debt canceled<br>$ | Copy A For Internal Revenue Service Center |
| DEBTOR'S name | | 3 Interest if included in box 2<br>$ | 4 | File with Form 1096. |
| Street address (including apt. no.) | | 5 Debt description | | For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G. |
| City, state, and ZIP code | | | | |
| Account number (optional) | | 6 Check for bankruptcy ☐ | 7 Fair market value of property<br>$ | |

Form 1099-C Cat. No. 26280W Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| CREDITOR'S name, street address, city, state, and ZIP code | | | OMB No. 1545-1424<br>2001<br>Form 1099-C | Cancellation of Debt |
| CREDITOR'S Federal identification number | DEBTOR'S identification number | 1 Date canceled | 2 Amount of debt canceled<br>$ | Copy A For Internal Revenue Service Center |
| DEBTOR'S name | | 3 Interest if included in box 2<br>$ | 4 | File with Form 1096. |
| Street address (including apt. no.) | | 5 Debt description | | For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G. |
| City, state, and ZIP code | | | | |
| Account number (optional) | | 6 Check for bankruptcy ☐ | 7 Fair market value of property<br>$ | |

Form 1099-C Cat. No. 26280W Department of the Treasury - Internal Revenue Service

# Exhibit H

9191 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Ordinary dividends<br>$<br>2a Total capital gain distr.<br>$ 1.40"<br>2b 28% rate gain<br>$ | OMB No. 1545-0110<br>**2001**<br>Form **1099-DIV** | **Dividends and Distributions** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 2c Qualified 5-year gain<br>$ | 2d Unrecap. sec. 1250 gain<br>$ | **Copy A For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| RECIPIENT'S name | | 2e Section 1202 gain<br>$ | 3 Nontaxable distributions<br>$ | |
| Street address (including apt. no.) | | 4 Federal income tax withheld<br>$ | 5 Investment expenses<br>$ | |
| City, state, and ZIP code | | 6 Foreign tax paid<br>$ | 7 Foreign country or U.S. possession | |
| Account number (optional)<br>2.80" | 2nd TIN not. ☐ | 8 Cash liquidation distr.<br>$ | 9 Noncash liquidation distr.<br>$ 4.50" | |

Form **1099-DIV** .60" Cat. No. 14415N Department of the Treasury - Internal Revenue Service

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9191 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Ordinary dividends<br>$<br>2a Total capital gain distr.<br>$<br>2b 28% rate gain<br>$ | OMB No. 1545-0110<br>**2001**<br>Form **1099-DIV** | **Dividends and Distributions** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 2c Qualified 5-year gain<br>$ | 2d Unrecap. sec. 1250 gain<br>$ | **Copy A For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| RECIPIENT'S name | | 2e Section 1202 gain<br>$ | 3 Nontaxable distributions<br>$ | |
| Street address (including apt. no.) | | 4 Federal income tax withheld<br>$ | 5 Investment expenses<br>$ | |
| City, state, and ZIP code | | 6 Foreign tax paid<br>$ | 7 Foreign country or U.S. possession | |
| Account number (optional) | 2nd TIN not. ☐ | 8 Cash liquidation distr.<br>$ | 9 Noncash liquidation distr.<br>$ | |

Form **1099-DIV** Cat. No. 14415N Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Ordinary dividends<br>$<br>2a Total capital gain distr.<br>$<br>2b 28% rate gain<br>$ | OMB No. 1545-0110<br>**2001**<br>Form **1099-DIV** | **Dividends and Distributions** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 2c Qualified 5-year gain<br>$ | 2d Unrecap. sec. 1250 gain<br>$ | **Copy A For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| RECIPIENT'S name | | 2e Section 1202 gain<br>$ | 3 Nontaxable distributions<br>$ | |
| Street address (including apt. no.) | | 4 Federal income tax withheld<br>$ | 5 Investment expenses<br>$ | |
| City, state, and ZIP code | | 6 Foreign tax paid<br>$ | 7 Foreign country or U.S. possession | |
| Account number (optional) | 2nd TIN not. ☐ | 8 Cash liquidation distr.<br>$ | 9 Noncash liquidation distr.<br>$ | |

Form **1099-DIV** Cat. No. 14415N Department of the Treasury - Internal Revenue Service

# Exhibit I

8686 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Unemployment compensation<br>1.40"<br>$<br>2 State or local income tax refunds, credits, or offsets<br>$ | OMB No. 1545-0120<br>2001<br>Form 1099-G | **Certain Government and Qualified State Tuition Program Payments** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Box 2 amount is for tax year | 4 Federal income tax withheld<br>$ | **Copy A** |
| RECIPIENT'S name | | 5 Qualified state tuition program earnings<br>$ | 6 Taxable grants<br>$ | **For Internal Revenue Service Center**<br>**File with Form 1096.** |
| Street address (including apt. no.) | | 7 Agriculture payments<br>$ | 8 The amount in box 2 applies to income from a trade or business ▶ ☐ | 1.15"<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

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8686 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Unemployment compensation<br>$<br>2 State or local income tax refunds, credits, or offsets<br>$ | OMB No. 1545-0120<br>2001<br>Form 1099-G | **Certain Government and Qualified State Tuition Program Payments** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Box 2 amount is for tax year | 4 Federal income tax withheld<br>$ | **Copy A** |
| RECIPIENT'S name | | 5 Qualified state tuition program earnings<br>$ | 6 Taxable grants<br>$ | **For Internal Revenue Service Center**<br>**File with Form 1096.** |
| Street address (including apt. no.) | | 7 Agriculture payments<br>$ | 8 The amount in box 2 applies to income from a trade or business ▶ ☐ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Unemployment compensation<br>$<br>2 State or local income tax refunds, credits, or offsets<br>$ | OMB No. 1545-0120<br>2001<br>Form 1099-G | **Certain Government and Qualified State Tuition Program Payments** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Box 2 amount is for tax year | 4 Federal income tax withheld<br>$ | **Copy A** |
| RECIPIENT'S name | | 5 Qualified state tuition program earnings<br>$ | 6 Taxable grants<br>$ | **For Internal Revenue Service Center**<br>**File with Form 1096.** |
| Street address (including apt. no.) | | 7 Agriculture payments<br>$ | 8 The amount in box 2 applies to income from a trade or business ▶ ☐ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **1099-G** Cat. No. 14438M Department of the Treasury - Internal Revenue Service

# Exhibit J

9292 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | Payer's RTN (optional) | OMB No. 1545-0112<br>**2001**<br>Form **1099-INT** | **Interest Income** |
| PAYER'S Federal identification number / RECIPIENT'S identification number | **1** Interest income not included in box 3<br>$ | | **Copy A** |
| RECIPIENT'S name | **2** Early withdrawal penalty<br>1.40"<br>$ | **3** Interest on U.S. Savings Bonds and Treas. obligations<br>$ | **For Internal Revenue Service Center**<br>**File with Form 1096.** |
| Street address (including apt. no.) | **4** Federal income tax withheld<br>$ | **5** Investment expenses<br>$ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | **6** Foreign tax paid | **7** Foreign country or U.S. possession | |
| Account number (optional) 2.80" / 2nd TIN not. ☐ .60" | $ | 4.15" | |

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

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9292 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | Payer's RTN (optional) | OMB No. 1545-0112<br>**2001**<br>Form **1099-INT** | **Interest Income** |
| PAYER'S Federal identification number / RECIPIENT'S identification number | **1** Interest income not included in box 3<br>$ | | **Copy A** |
| RECIPIENT'S name | **2** Early withdrawal penalty<br>$ | **3** Interest on U.S. Savings Bonds and Treas. obligations<br>$ | **For Internal Revenue Service Center**<br>**File with Form 1096.** |
| Street address (including apt. no.) | **4** Federal income tax withheld<br>$ | **5** Investment expenses<br>$ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | **6** Foreign tax paid | **7** Foreign country or U.S. possession | |
| Account number (optional) / 2nd TIN not. ☐ | $ | | |

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

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9292 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | Payer's RTN (optional) | OMB No. 1545-0112<br>**2001**<br>Form **1099-INT** | **Interest Income** |
| PAYER'S Federal identification number / RECIPIENT'S identification number | **1** Interest income not included in box 3<br>$ | | **Copy A** |
| RECIPIENT'S name | **2** Early withdrawal penalty<br>$ | **3** Interest on U.S. Savings Bonds and Treas. obligations<br>$ | **For Internal Revenue Service Center**<br>**File with Form 1096.** |
| Street address (including apt. no.) | **4** Federal income tax withheld<br>$ | **5** Investment expenses<br>$ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | **6** Foreign tax paid | **7** Foreign country or U.S. possession | |
| Account number (optional) / 2nd TIN not. ☐ | $ | | |

Form **1099-INT** Cat. No. 14410K Department of the Treasury - Internal Revenue Service

# Exhibit K

9393 ~~VOID~~ ~~CORRECTED~~ ← 4.50" →

<table>
<tr><td colspan="2" rowspan="2">PAYER'S name, street address, city, state, ZIP code, and telephone no.</td><td>1 Gross long-term care benefits paid<br>$</td><td rowspan="2">OMB No. 1545-1519<br>2001<br>Form 1099-LTC</td><td rowspan="2">Long-Term Care and Accelerated Death Benefits</td></tr>
<tr><td>2 Accelerated death benefits paid<br>$</td></tr>
<tr><td>PAYER'S Federal identification number</td><td>POLICYHOLDER'S identification number</td><td>3 Check one: ☐ Per diem ☐ Reimbursed amount</td><td>INSURED'S social security no.<br>← 1.40" →</td><td rowspan="5">Copy A<br>For<br>Internal Revenue Service Center<br>File with Form 1096.<br>For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.</td></tr>
<tr><td colspan="2">POLICYHOLDER'S name<br>← 3.40" →</td><td colspan="2">INSURED'S name</td></tr>
<tr><td colspan="2">Street address (including apt. no.)</td><td colspan="2">Street address (including apt. no.)<br>← 2.80" →</td></tr>
<tr><td colspan="2">City, state, and ZIP code</td><td colspan="2">City, state, and ZIP code</td></tr>
<tr><td>Account number (optional)</td><td>4 Qualified contract ☐ (optional)</td><td>5 Check, if applicable: (optional) ☐ Chronically ill ☐ Terminally ill</td><td>Date certified</td></tr>
</table>

Form **1099-LTC** Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

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9393 ☐ VOID ☐ CORRECTED

<table>
<tr><td colspan="2" rowspan="2">PAYER'S name, street address, city, state, ZIP code, and telephone no.</td><td>1 Gross long-term care benefits paid<br>$</td><td rowspan="2">OMB No. 1545-1519<br>2001<br>Form 1099-LTC</td><td rowspan="2">Long-Term Care and Accelerated Death Benefits</td></tr>
<tr><td>2 Accelerated death benefits paid<br>$</td></tr>
<tr><td>PAYER'S Federal identification number</td><td>POLICYHOLDER'S identification number</td><td>3 Check one: ☐ Per diem ☐ Reimbursed amount</td><td>INSURED'S social security no.</td><td rowspan="5">Copy A<br>For<br>Internal Revenue Service Center<br>File with Form 1096.<br>For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.</td></tr>
<tr><td colspan="2">POLICYHOLDER'S name</td><td colspan="2">INSURED'S name</td></tr>
<tr><td colspan="2">Street address (including apt. no.)</td><td colspan="2">Street address (including apt. no.)</td></tr>
<tr><td colspan="2">City, state, and ZIP code</td><td colspan="2">City, state, and ZIP code</td></tr>
<tr><td>Account number (optional)</td><td>4 Qualified contract ☐ (optional)</td><td>5 Check, if applicable: (optional) ☐ Chronically ill ☐ Terminally ill</td><td>Date certified</td></tr>
</table>

Form **1099-LTC** Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

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<table>
<tr><td colspan="2" rowspan="2">PAYER'S name, street address, city, state, ZIP code, and telephone no.</td><td>1 Gross long-term care benefits paid<br>$</td><td rowspan="2">OMB No. 1545-1519<br>2001<br>Form 1099-LTC</td><td rowspan="2">Long-Term Care and Accelerated Death Benefits</td></tr>
<tr><td>2 Accelerated death benefits paid<br>$</td></tr>
<tr><td>PAYER'S Federal identification number</td><td>POLICYHOLDER'S identification number</td><td>3 Check one: ☐ Per diem ☐ Reimbursed amount</td><td>INSURED'S social security no.</td><td rowspan="5">Copy A<br>For<br>Internal Revenue Service Center<br>File with Form 1096.<br>For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.</td></tr>
<tr><td colspan="2">POLICYHOLDER'S name</td><td colspan="2">INSURED'S name</td></tr>
<tr><td colspan="2">Street address (including apt. no.)</td><td colspan="2">Street address (including apt. no.)</td></tr>
<tr><td colspan="2">City, state, and ZIP code</td><td colspan="2">City, state, and ZIP code</td></tr>
<tr><td>Account number (optional)</td><td>4 Qualified contract ☐ (optional)</td><td>5 Check, if applicable: (optional) ☐ Chronically ill ☐ Terminally ill</td><td>Date certified</td></tr>
</table>

Form **1099-LTC** Cat. No. 23021Z Department of the Treasury - Internal Revenue Service

# Exhibit L

5.50"

9595 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, and ZIP code<br>4.50" | 1 Rents<br>1.40"<br>$ | OMB No. 1545-0115<br>**2001**<br>Form **1099-MISC** | **Miscellaneous Income** |
| | 2 Royalties<br>$ | | |
| | 3 Other income<br>$ | 4 Federal income tax withheld<br>$ | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.** |
| PAYER'S Federal identification number / RECIPIENT'S identification number | 5 Fishing boat proceeds<br>$ | 6 Medical and health care payments<br>$ | |
| RECIPIENT'S name | 7 Nonemployee compensation<br>$ | 8 Substitute payments in lieu of dividends or interest<br>$ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Street address (including apt. no.)<br>3.40" | 9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ▶ ☐ | 10 Crop insurance proceeds<br>$ | |
| City, state, and ZIP code | 11 | 12 | |
| Account number (optional) / 2nd TIN not. ☐ | 13 Excess golden parachute payments<br>$ | 14 Gross proceeds paid to an attorney<br>$ | |
| 15 | 16 State tax withheld<br>$<br>$ | 17 State/Payer's state no. | 18 State income<br>$<br>$ |

Form **1099-MISC** Cat. No. 14425J Department of the Treasury - Internal Revenue Service

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1.00"


9595 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, and ZIP code | 1 Rents<br>$ | OMB No. 1545-0115<br>**2001**<br>Form **1099-MISC** | **Miscellaneous Income** |
| | 2 Royalties<br>$ | | |
| | 3 Other income<br>$ | 4 Federal income tax withheld<br>$ | **Copy A**<br>**For Internal Revenue Service Center**<br>**File with Form 1096.** |
| PAYER'S Federal identification number / RECIPIENT'S identification number | 5 Fishing boat proceeds<br>$ | 6 Medical and health care payments<br>$ | |
| RECIPIENT'S name | 7 Nonemployee compensation<br>$ | 8 Substitute payments in lieu of dividends or interest<br>$ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Street address (including apt. no.) | 9 Payer made direct sales of $5,000 or more of consumer products to a buyer (recipient) for resale ▶ ☐ | 10 Crop insurance proceeds<br>$ | |
| City, state, and ZIP code | 11 | 12 | |
| Account number (optional) / 2nd TIN not. ☐ | 13 Excess golden parachute payments<br>$ | 14 Gross proceeds paid to an attorney<br>$ | |
| 15 | 16 State tax withheld<br>$<br>$ | 17 State/Payer's state no. | 18 State income<br>$<br>$ |

Form **1099-MISC** Cat. No. 14425J Department of the Treasury - Internal Revenue Service

# Exhibit M

9494 ☐ VOID ☐ CORRECTED

| PAYER'S name, street address, city, state, and ZIP code | | | OMB No. 1545-1517<br>**2001**<br>Form **1099-MSA** | **Distributions From an MSA or Medicare+Choice MSA** |
|---|---|---|---|---|
| PAYER'S Federal identification number | RECIPIENT'S identification number | 1 Gross distribution<br>1.40"<br>$ | 2 Earnings on excess contributions<br>1.40"<br>$ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name<br>3.40" | | 3 Distribution code | 4 FMV on date of death<br>$ | **File with Form 1096.** |
| Street address (including apt. no.) | | 5 Medicare+Choice MSA . . . . ☐ | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | 3.90" | | |
| Account number (optional) | | | | |

Form **1099-MSA** Cat. No. 23114L Department of the Treasury - Internal Revenue Service

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9494 ☐ VOID ☐ CORRECTED

| PAYER'S name, street address, city, state, and ZIP code | | | OMB No. 1545-1517<br>**2001**<br>Form **1099-MSA** | **Distributions From an MSA or Medicare+Choice MSA** |
|---|---|---|---|---|
| PAYER'S Federal identification number | RECIPIENT'S identification number | 1 Gross distribution<br>$ | 2 Earnings on excess contributions<br>$ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 3 Distribution code | 4 FMV on date of death<br>$ | **File with Form 1096.** |
| Street address (including apt. no.) | | 5 Medicare+Choice MSA . . . . ☐ | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **1099-MSA** Cat. No. 23114L Department of the Treasury - Internal Revenue Service

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9494 ☐ VOID ☐ CORRECTED

| PAYER'S name, street address, city, state, and ZIP code | | | OMB No. 1545-1517<br>**2001**<br>Form **1099-MSA** | **Distributions From an MSA or Medicare+Choice MSA** |
|---|---|---|---|---|
| PAYER'S Federal identification number | RECIPIENT'S identification number | 1 Gross distribution<br>$ | 2 Earnings on excess contributions<br>$ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 3 Distribution code | 4 FMV on date of death<br>$ | **File with Form 1096.** |
| Street address (including apt. no.) | | 5 Medicare+Choice MSA . . . . ☐ | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **1099-MSA** Cat. No. 23114L Department of the Treasury - Internal Revenue Service

# Exhibit N

9696 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Original issue discount for 2001<br>←1.40"→<br>$<br>2 Other periodic interest<br>$ | OMB No. 1545-0117<br>**2001**<br>Form **1099-OID** | **Original Issue Discount** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Early withdrawal penalty<br>$ | 4 Federal income tax withheld<br>$ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 5 Description | | **File with Form 1096.** |
| Street address (including apt. no.) | | 6 Original issue discount on U.S. Treasury obligations<br>$ | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | 7 Investment expenses<br>$ | | |
| Account number (optional)<br>←2.80"→ | 2nd TIN not. ☐ | ←4.15"→ | | |

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Original issue discount for 2001<br>$<br>2 Other periodic interest<br>$ | OMB No. 1545-0117<br>**2001**<br>Form **1099-OID** | **Original Issue Discount** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Early withdrawal penalty<br>$ | 4 Federal income tax withheld<br>$ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 5 Description | | **File with Form 1096.** |
| Street address (including apt. no.) | | 6 Original issue discount on U.S. Treasury obligations<br>$ | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | 7 Investment expenses<br>$ | | |
| Account number (optional) | 2nd TIN not. ☐ | | | |

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | | 1 Original issue discount for 2001<br>$<br>2 Other periodic interest<br>$ | OMB No. 1545-0117<br>**2001**<br>Form **1099-OID** | **Original Issue Discount** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Early withdrawal penalty<br>$ | 4 Federal income tax withheld<br>$ | **Copy A For Internal Revenue Service Center** |
| RECIPIENT'S name | | 5 Description | | **File with Form 1096.** |
| Street address (including apt. no.) | | 6 Original issue discount on U.S. Treasury obligations<br>$ | | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| City, state, and ZIP code | | 7 Investment expenses<br>$ | | |
| Account number (optional) | 2nd TIN not. ☐ | | | |

Form **1099-OID** Cat. No. 14421R Department of the Treasury - Internal Revenue Service

# Exhibit O

9797 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | 1 Patronage dividends $ ←1.40"→ | OMB No. 1545-0118 | **Taxable Distributions Received From Cooperatives** |
| | 2 Nonpatronage distributions $ | **2001** | |
| | 3 Per-unit retain allocations $ | Form **1099-PATR** | |
| PAYER'S Federal identification number / RECIPIENT'S identification number | 4 Federal income tax withheld $ | | **Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| RECIPIENT'S name | 5 Redemption of nonqualified notices and retain allocations $ | | |
| Street address (including apt. no.) | 6 $ | 7 Investment credit $ | |
| City, state, and ZIP code | 8 Work opportunity credit $ | 9 Patron's AMT adjustment $ | |
| Account number (optional) ←2.80"→ / 2nd TIN not. ☐ | ←4.15"→ | | |

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

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| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | 1 Patronage dividends $ | OMB No. 1545-0118 | **Taxable Distributions Received From Cooperatives** |
| | 2 Nonpatronage distributions $ | **2001** | |
| | 3 Per-unit retain allocations $ | Form **1099-PATR** | |
| PAYER'S Federal identification number / RECIPIENT'S identification number | 4 Federal income tax withheld $ | | **Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| RECIPIENT'S name | 5 Redemption of nonqualified notices and retain allocations $ | | |
| Street address (including apt. no.) | 6 $ | 7 Investment credit $ | |
| City, state, and ZIP code | 8 Work opportunity credit $ | 9 Patron's AMT adjustment $ | |
| Account number (optional) / 2nd TIN not. ☐ | | | |

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

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| | | | |
|---|---|---|---|
| PAYER'S name, street address, city, state, ZIP code, and telephone no. | 1 Patronage dividends $ | OMB No. 1545-0118 | **Taxable Distributions Received From Cooperatives** |
| | 2 Nonpatronage distributions $ | **2001** | |
| | 3 Per-unit retain allocations $ | Form **1099-PATR** | |
| PAYER'S Federal identification number / RECIPIENT'S identification number | 4 Federal income tax withheld $ | | **Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| RECIPIENT'S name | 5 Redemption of nonqualified notices and retain allocations $ | | |
| Street address (including apt. no.) | 6 $ | 7 Investment credit $ | |
| City, state, and ZIP code | 8 Work opportunity credit $ | 9 Patron's AMT adjustment $ | |
| Account number (optional) / 2nd TIN not. ☐ | | | |

Form **1099-PATR** Cat. No. 14435F Department of the Treasury - Internal Revenue Service

# Exhibit P

5.50"

9898 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, and ZIP code<br>4.50" | | 1 Gross distribution<br>1.40"<br>$<br>2a Taxable amount<br>$ | OMB No. 1545-0119<br>**2001**<br>Form **1099-R** | **Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.** |
| | | 2b Taxable amount not determined ☐ 2.65" | Total ~~distribution~~ ☐ | 1.25" ~~**Copy A For**~~ |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Capital gain (included in box 2a)<br>$ | 4 Federal income tax withheld<br>$ | **Internal Revenue Service Center**<br>**File with Form 1096.** |
| RECIPIENT'S name | | 5 Employee contributions or insurance premiums<br>$ .40" | 6 Net unrealized appreciation in employer's securities<br>$ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Street address (including apt. no.) | | 7 Distribution code 1.00" \| IRA/ SEP/ SIMPLE ☐ | 8 Other 1.00" .40"<br>$ 2.50" % | |
| City, state, and ZIP code | | 9a Your percentage of total distribution % | 9b Total employee contributions<br>$ | |
| Account number (optional) | | 10 State tax withheld<br>$<br>$ | 11 State/Payer's state no. | 12 State distribution<br>1.10"<br>$<br>$ |
| | | 13 Local tax withheld<br>$<br>$ | 14 Name of locality | 15 Local distribution<br>$<br>$ |

Form **1099-R** Cat. No. 14436Q Department of the Treasury - Internal Revenue Service

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1.00"

9898 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| PAYER'S name, street address, city, state, and ZIP code | | 1 Gross distribution<br>$<br>2a Taxable amount<br>$ | OMB No. 1545-0119<br>**2001**<br>Form **1099-R** | **Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.** |
| | | 2b Taxable amount not determined ☐ | Total distribution ☐ | **Copy A For** |
| PAYER'S Federal identification number | RECIPIENT'S identification number | 3 Capital gain (included in box 2a)<br>$ | 4 Federal income tax withheld<br>$ | **Internal Revenue Service Center**<br>**File with Form 1096.** |
| RECIPIENT'S name | | 5 Employee contributions or insurance premiums<br>$ | 6 Net unrealized appreciation in employer's securities<br>$ | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| Street address (including apt. no.) | | 7 Distribution code \| IRA/ SEP/ SIMPLE ☐ | 8 Other<br>$ % | |
| City, state, and ZIP code | | 9a Your percentage of total distribution % | 9b Total employee contributions<br>$ | |
| Account number (optional) | | 10 State tax withheld<br>$<br>$ | 11 State/Payer's state no. | 12 State distribution<br>$<br>$ |
| | | 13 Local tax withheld<br>$<br>$ | 14 Name of locality | 15 Local distribution<br>$<br>$ |

Form **1099-R** Cat. No. 14436Q Department of the Treasury - Internal Revenue Service

# Exhibit Q

7575 ☐ VOID ☐ CORRECTED

| | | | |
|---|---|---|---|
| FILER'S name, street address, city, state, ZIP code, and telephone no. | 1 Date of closing<br>1.40"<br>2 Gross proceeds<br>$ | OMB No. 1545-0997<br>2001<br>Form 1099-S | **Proceeds From Real Estate Transactions** |
| FILER'S Federal identification number 1.70" / TRANSFEROR'S identification number 1.70" | 3 Address or legal description (including city, state, and ZIP code)<br>2.80" | | **Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| TRANSFEROR'S name | | | |
| Street address (including apt. no.) | | | |
| City, state, and ZIP code | 4 Check here if the transferor received or will receive property or services as part of the consideration. ► ☐ 1.15" | | |
| Account number (optional) | 5 Buyer's part of real estate tax<br>$ | | |

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

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| | | | |
|---|---|---|---|
| FILER'S name, street address, city, state, ZIP code, and telephone no. | 1 Date of closing<br>2 Gross proceeds<br>$ | OMB No. 1545-0997<br>2001<br>Form 1099-S | **Proceeds From Real Estate Transactions** |
| FILER'S Federal identification number / TRANSFEROR'S identification number | 3 Address or legal description (including city, state, and ZIP code) | | **Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| TRANSFEROR'S name | | | |
| Street address (including apt. no.) | | | |
| City, state, and ZIP code | 4 Check here if the transferor received or will receive property or services as part of the consideration. ► ☐ | | |
| Account number (optional) | 5 Buyer's part of real estate tax<br>$ | | |

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

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| | | | |
|---|---|---|---|
| FILER'S name, street address, city, state, ZIP code, and telephone no. | 1 Date of closing<br>2 Gross proceeds<br>$ | OMB No. 1545-0997<br>2001<br>Form 1099-S | **Proceeds From Real Estate Transactions** |
| FILER'S Federal identification number / TRANSFEROR'S identification number | 3 Address or legal description (including city, state, and ZIP code) | | **Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| TRANSFEROR'S name | | | |
| Street address (including apt. no.) | | | |
| City, state, and ZIP code | 4 Check here if the transferor received or will receive property or services as part of the consideration. ► ☐ | | |
| Account number (optional) | 5 Buyer's part of real estate tax<br>$ | | |

Form **1099-S** Cat. No. 64292E Department of the Treasury - Internal Revenue Service

# Exhibit R

2828 ☐ VOID ☐ CORRECTED

| | | | | |
|---|---|---|---|---|
| TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code | | 1 IRA contributions (other than amounts in boxes 2, 3, 4, and 8–11)<br>$<br>2 Rollover contributions<br>◄—1.40"—►<br>$ | OMB No. 1545-0747<br>2001<br>Form 5498 | IRA Contribution Information |
| TRUSTEE'S or ISSUER'S Federal identification no. | PARTICIPANT'S social security number | 3 Roth conversion amount<br>$ | 4 Recharacterized contributions<br>$ | Copy A For Internal Revenue Service Center<br>File with Form 1096.<br>For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G. |
| PARTICIPANT'S name | | 5 Fair market value of account<br>$ | 6 Life insurance cost included in box 1<br>$ | |
| Street address (including apt. no.) | | 7 IRA ☐ SEP ☐ SIMPLE ☐ | Roth IRA ☐ Ed IRA ☐ | |
| City, state, and ZIP code | | 8 SEP contributions<br>◄—1.40"—► | 9 SIMPLE contributions<br>◄—1.40"—► | |
| Account number (optional) | | 10 Roth IRA contributions<br>$ | 11 Ed IRA contributions<br>$ | |

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code | | 1 IRA contributions (other than amounts in boxes 2, 3, 4, and 8–11)<br>$<br>2 Rollover contributions<br>$ | OMB No. 1545-0747<br>2001<br>Form 5498 | IRA Contribution Information |
| TRUSTEE'S or ISSUER'S Federal identification no. | PARTICIPANT'S social security number | 3 Roth conversion amount<br>$ | 4 Recharacterized contributions<br>$ | Copy A For Internal Revenue Service Center<br>File with Form 1096.<br>For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G. |
| PARTICIPANT'S name | | 5 Fair market value of account<br>$ | 6 Life insurance cost included in box 1<br>$ | |
| Street address (including apt. no.) | | 7 IRA ☐ SEP ☐ SIMPLE ☐ | Roth IRA ☐ Ed IRA ☐ | |
| City, state, and ZIP code | | 8 SEP contributions<br>$ | 9 SIMPLE contributions<br>$ | |
| Account number (optional) | | 10 Roth IRA contributions<br>$ | 11 Ed IRA contributions<br>$ | |

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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| | | | | |
|---|---|---|---|---|
| TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code | | 1 IRA contributions (other than amounts in boxes 2, 3, 4, and 8–11)<br>$<br>2 Rollover contributions<br>$ | OMB No. 1545-0747<br>2001<br>Form 5498 | IRA Contribution Information |
| TRUSTEE'S or ISSUER'S Federal identification no. | PARTICIPANT'S social security number | 3 Roth conversion amount<br>$ | 4 Recharacterized contributions<br>$ | Copy A For Internal Revenue Service Center<br>File with Form 1096.<br>For Privacy Act and Paperwork Reduction Act Notice, see the 2001 General Instructions for Forms 1099, 1098, 5498, and W-2G. |
| PARTICIPANT'S name | | 5 Fair market value of account<br>$ | 6 Life insurance cost included in box 1<br>$ | |
| Street address (including apt. no.) | | 7 IRA ☐ SEP ☐ SIMPLE ☐ | Roth IRA ☐ Ed IRA ☐ | |
| City, state, and ZIP code | | 8 SEP contributions<br>$ | 9 SIMPLE contributions<br>$ | |
| Account number (optional) | | 10 Roth IRA contributions<br>$ | 11 Ed IRA contributions<br>$ | |

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

# Exhibit S

2727 ☐ VOID ☐ CORRECTED

| TRUSTEE'S name, street address, city, state, and ZIP code | | 1 Employee or self-employed person's MSA contributions made in 2001 and 2002 for 2001<br>$ | OMB No. 1545-1518<br>2001<br>Form 5498-MSA | MSA or Medicare+Choice MSA Information |
|---|---|---|---|---|
| | | 2 Total contributions made in 2001<br>←1.40"→<br>$ | | |
| TRUSTEE'S Federal identification number | PARTICIPANT'S social security number | 3 Total MSA contributions made in 2002 for 2001<br>$ | | **Copy A For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| PARTICIPANT'S name<br>←3.40"→ | | 4 Rollover contributions<br>$ | 5 Fair market value of MSA or M+C MSA<br>$ | |
| Street address (including apt. no.) | | 6 Medicare+Choice MSA . . . . ☐ | | |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **5498-MSA** Cat. No. 23097L Department of the Treasury - Internal Revenue Service

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| TRUSTEE'S name, street address, city, state, and ZIP code | | 1 Employee or self-employed person's MSA contributions made in 2001 and 2002 for 2001<br>$ | OMB No. 1545-1518<br>2001<br>Form 5498-MSA | MSA or Medicare+Choice MSA Information |
|---|---|---|---|---|
| | | 2 Total contributions made in 2001<br>$ | | |
| TRUSTEE'S Federal identification number | PARTICIPANT'S social security number | 3 Total MSA contributions made in 2002 for 2001<br>$ | | **Copy A For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| PARTICIPANT'S name | | 4 Rollover contributions<br>$ | 5 Fair market value of MSA or M+C MSA<br>$ | |
| Street address (including apt. no.) | | 6 Medicare+Choice MSA . . . . ☐ | | |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **5498-MSA** Cat. No. 23097L Department of the Treasury - Internal Revenue Service

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| TRUSTEE'S name, street address, city, state, and ZIP code | | 1 Employee or self-employed person's MSA contributions made in 2001 and 2002 for 2001<br>$ | OMB No. 1545-1518<br>2001<br>Form 5498-MSA | MSA or Medicare+Choice MSA Information |
|---|---|---|---|---|
| | | 2 Total contributions made in 2001<br>$ | | |
| TRUSTEE'S Federal identification number | PARTICIPANT'S social security number | 3 Total MSA contributions made in 2002 for 2001<br>$ | | **Copy A For Internal Revenue Service Center**<br>**File with Form 1096.**<br>For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| PARTICIPANT'S name | | 4 Rollover contributions<br>$ | 5 Fair market value of MSA or M+C MSA<br>$ | |
| Street address (including apt. no.) | | 6 Medicare+Choice MSA . . . . ☐ | | |
| City, state, and ZIP code | | | | |
| Account number (optional) | | | | |

Form **5498-MSA** Cat. No. 23097L Department of the Treasury - Internal Revenue Service

# Exhibit T

3232 ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name<br>Street address<br>City, state, and ZIP code<br>Federal identification number  Telephone number | 1 Gross winnings<br>1.45" | 2 Federal income tax withheld<br>1.45" | OMB No. 1545-0238<br>**2001**<br>**Form W-2G**<br>**Certain Gambling Winnings** |
| 3.00" | 3 Type of wager | 4 Date won | |
| | 5 Transaction | 6 Race | |
| | 7 Winnings from identical wagers | 8 Cashier | 1.40" |
| WINNER'S name  2.85"<br>Street address (including apt. no.)<br>City, state, and ZIP code | 9 Winner's taxpayer identification no. | 10 Window | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| | 11 First I.D. | 12 Second I.D. | |
| | 13 State/Payer's state identification no. | 14 State income tax withheld | **File with Form 1096.** |
| Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments.<br>**Signature ►**  **Date ►** | | | **Copy A For Internal Revenue Service Center** |

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


3232 ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name<br>Street address<br>City, state, and ZIP code<br>Federal identification number  Telephone number | 1 Gross winnings | 2 Federal income tax withheld | OMB No. 1545-0238<br>**2001**<br>**Form W-2G**<br>**Certain Gambling Winnings** |
| | 3 Type of wager | 4 Date won | |
| | 5 Transaction | 6 Race | |
| | 7 Winnings from identical wagers | 8 Cashier | |
| WINNER'S name<br>Street address (including apt. no.)<br>City, state, and ZIP code | 9 Winner's taxpayer identification no. | 10 Window | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| | 11 First I.D. | 12 Second I.D. | |
| | 13 State/Payer's state identification no. | 14 State income tax withheld | **File with Form 1096.** |
| Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments.<br>**Signature ►**  **Date ►** | | | **Copy A For Internal Revenue Service Center** |

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

3232 ☐ CORRECTED

| | | | |
|---|---|---|---|
| PAYER'S name<br>Street address<br>City, state, and ZIP code<br>Federal identification number  Telephone number | 1 Gross winnings | 2 Federal income tax withheld | OMB No. 1545-0238<br>**2001**<br>**Form W-2G**<br>**Certain Gambling Winnings** |
| | 3 Type of wager | 4 Date won | |
| | 5 Transaction | 6 Race | |
| | 7 Winnings from identical wagers | 8 Cashier | |
| WINNER'S name<br>Street address (including apt. no.)<br>City, state, and ZIP code | 9 Winner's taxpayer identification no. | 10 Window | For Privacy Act and Paperwork Reduction Act Notice, see the **2001 General Instructions for Forms 1099, 1098, 5498, and W-2G.** |
| | 11 First I.D. | 12 Second I.D. | |
| | 13 State/Payer's state identification no. | 14 State income tax withheld | **File with Form 1096.** |
| Under penalties of perjury, I declare that, to the best of my knowledge and belief, the name, address, and taxpayer identification number that I have furnished correctly identify me as the recipient of this payment and any payments from identical wagers, and that no other person is entitled to any part of these payments.<br>**Signature ►**  **Date ►** | | | **Copy A For Internal Revenue Service Center** |

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

# Exhibit U

Form **1042-S** Department of the Treasury Internal Revenue Service

**Foreign Person's U.S. Source Income Subject to Withholding** **2001**

OMB No. 1545-0096 **Copy A** for Internal Revenue Service

☐ VOID ☐ CORRECTED ☐ PRO-RATA BASIS REPORTING

| 1 Income code | 2 Gross income | 3 Withholding allowances | 4 Net income | 5 Tax rate | 6 Exemption code | 7 U.S. Federal tax withheld | 8 Amount repaid to recipient |
|---|---|---|---|---|---|---|---|
| | | | | | | | |

| | |
|---|---|
| 9 Withholding agent's EIN ▶ ☐ EIN ☐ QI-EIN | 14 Recipient's U.S. TIN, if any ▶ ☐ SSN or ITIN ☐ EIN ☐ QI-EIN |
| 10 WITHHOLDING AGENT'S name and address (including ZIP code) | 15 Recipient's country of residence for tax purposes / 16 Country code |
| | 17 NONQUALIFIED INTERMEDIARY'S (NQI's)/ FLOW-THROUGH ENTITY'S name / 18 Country code |
| 11 Recipient's account number (optional) / 12 Recipient code | 19 NQI's/Flow-through entity's address |
| 13 RECIPIENT'S name (first name, initial, and last name), street address, city or town, province or state, and country (including postal code) | 20 NQI's/Flow-through entity's TIN, if any ▶ |
| | 21 |
| | 22 State income tax withheld / 23 Payer's state tax no. / 24 Name of state |

For Privacy Act and Paperwork Reduction Act Notice, see page 15 of the separate instructions. Cat. No. 11386R Form **1042-S** (2001)

5.50"

.50"

8.00"

Form **1042-S** Department of the Treasury Internal Revenue Service

**Foreign Person's U.S. Source Income Subject to Withholding** **2001**

OMB No. 1545-0096 **Copy A** for Internal Revenue Service

☐ VOID ☐ CORRECTED ☐ PRO-RATA BASIS REPORTING

| 1 Income code | 2 Gross income | 3 Withholding allowances | 4 Net income | 5 Tax rate | 6 Exemption code | 7 U.S. Federal tax withheld | 8 Amount repaid to recipient |
|---|---|---|---|---|---|---|---|
| | | | | | | | |

| | |
|---|---|
| 9 Withholding agent's EIN ▶ ☐ EIN ☐ QI-EIN | 14 Recipient's U.S. TIN, if any ▶ ☐ SSN or ITIN ☐ EIN ☐ QI-EIN |
| 10 WITHHOLDING AGENT'S name and address (including ZIP code) | 15 Recipient's country of residence for tax purposes / 16 Country code |
| | 17 NONQUALIFIED INTERMEDIARY'S (NQI's)/ FLOW-THROUGH ENTITY'S name / 18 Country code |
| 11 Recipient's account number (optional) / 12 Recipient code | 19 NQI's/Flow-through entity's address |
| 13 RECIPIENT'S name (first name, initial, and last name), street address, city or town, province or state, and country (including postal code) | 20 NQI's/Flow-through entity's TIN, if any ▶ |
| | 21 PAYER'S name and TIN (if different from withholding agent's) |
| | 22 State income tax withheld / 23 Payer's state tax no. / 24 Name of state |

For Privacy Act and Paperwork Reduction Act Notice, see page 15 of the separate instructions. Cat. No. 11386R Form **1042-S** (2001)

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking and Notice of Public Hearing

## Catch-Up Contributions for Individuals Age 50 or Over

## REG–142499–01

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that would provide guidance concerning the requirements for retirement plans providing catch-up contributions to individuals age 50 or older pursuant to the provisions of section 414(v). These proposed regulations would affect section 401(k) plans, section 408(p) SIMPLE IRA plans, section 408(k) simplified employee pensions, section 403(b) tax-sheltered annuity contracts, and section 457 eligible governmental plans, and would affect participants eligible to make elective deferrals under these plans or contracts. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written and electronic comments and requests to speak (with outlines of oral comments) at a public hearing scheduled for February 21, 2002, must be received by January 31, 2002.

ADDRESSES: Send submissions to: CC:IT&A:RU (REG–142499–01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:IT&A:RU (REG–142499–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/reglist.html*. The public hearing will be held in the IRS Auditorium (7th Floor), Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad or John T. Ricotta at (202) 622-6060 (not a toll-free number); concerning submissions and the hearing, and/or to be placed on the building access list to attend the hearing, Donna Poindexter (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains proposed regulations under section 414(v) of the Internal Revenue Code of 1986 (Code). Section 414(v) was added by section 631 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) (Public Law 107–16), enacted on June 7, 2001. Under section 414(v), an individual age 50 or over is permitted to make additional elective deferrals (up to a dollar limit provided in that section) under a plan that otherwise permits elective deferrals if certain requirements provided under that section are satisfied. Section 414(v) also provides that a plan will not violate any provision of the Code by permitting these additional elective deferrals to be made.

**Explanation of Provisions**

These proposed regulations would implement new section 414(v) by providing that an employer plan is not treated as violating any provision of the Code solely because the plan permits a catch-up eligible participant (as defined in these proposed regulations) to make catch-up contributions. Catch-up contributions generally are elective deferrals made by a catch-up eligible participant that exceed an otherwise applicable limit and that are treated as catch-up contributions under the plan, but only to the extent they do not exceed the maximum amount of catch-up contributions permitted for the taxable year. An employer is not required to provide for catch-up contributions in any of its plans, even if the plans provide for elective deferrals. If, however, any plan of an employer provides for catch-up contributions, all plans of the employer that provide elective deferrals must comply with the universal availability requirements described below.

A. *Eligibility for Catch-up Contributions*

Under these proposed regulations, a participant is a catch-up eligible participant, and thus is permitted to make catch-up contributions, if the participant is otherwise eligible to make elective deferrals under the plan and is age 50 or older. For purposes of this rule, a participant who is projected to attain age 50 before the end of a calendar year is deemed to be age 50 as of January 1 of that year. The effect of this rule is that all participants who will attain age 50 during a calendar year are treated the same beginning January 1 of that year, without regard to whether the participant survives to his or her 50$^{th}$ birthday or terminates employment during the year and without regard to the employer's choice of plan year.

A catch-up eligible participant can make catch-up contributions under a section 401(k) plan, a SIMPLE IRA plan as defined in section 408(p), a simplified employee pension as defined in section 408(k) (SEP), a plan or contract that satisfies the requirements of section 403(b), or a section 457 eligible governmental plan, as long as the participant can otherwise make elective deferrals under the plan or contract. For this purpose, elective deferrals include not only elective deferrals defined in section 402(g)(3), but also any contribution to a section 457 eligible governmental plan.

B. *Determination of Catch-up Contribution*

In describing section 631 of EGTRRA, the Conference report states that "the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP, or SIMPLE, or deferrals under a section 457 plan is increased for individuals who have attained age 50 by the end of the year." Conf. Rep. No. 107–84, at 236 (2001). The legislative history to section 631 of EGTRRA indicates that the intent of Congress in enacting section 414(v) was to allow a catch-up eligible participant to make additional elective deferrals over and above any otherwise applicable limit, up to the catch-up contribution limit for the taxable year. The proposed regulations would provide that elective deferrals made by a catch-up eligible participant are treated as catch-up contributions if they exceed any otherwise applicable limit, to the extent they do not exceed the maximum dollar amount of catch-up contributions permitted under section 414(v). However, the regulations would not require that a participant have made elective deferrals in excess of an otherwise applicable limit in order to be a catch-up eligible participant. A plan providing for $1,000 of catch-up contributions in 2002 could allow a participant who is over age 50 to make elective deferrals in an amount projected to exceed the otherwise applicable limit by $1,000 at any time during 2002.

Under the proposed regulations, catch-up contributions would be determined by reference to three types of limits: statutory limits, employer-provided limits, and the actual deferral percentage (ADP) limit. A statutory limit is a limit contained in the Code on elective deferrals or annual additions permitted to be made under the plan or contract (without regard to section 414(v)). Statutory limits include the requirement under section 401(a)(30) that the plan limit all elective deferrals within a calendar year under the plan and other plans (or contracts) maintained by members of a controlled group to the amount permitted under section 402(g).

An employer-provided limit is a limit on the elective deferrals an employee can make under the plan (without regard to section 414(v)) that is contained in the terms of the plan, but that is not a statutory limit. For example, a limit on elective deferrals of highly compensated employees to 10% of pay is an employer-provided limit. The condition that an employer-provided limit be contained in the terms of the plan is intended to correspond with the requirements of §1.401–1 that a qualified plan have a definite written program and provide for a definite predetermined formula for allocating contributions made to the plan.

For a section 401(k) plan that would fail the ADP test of section 401(k)(3) if it did not correct under section 401(k)(8), the ADP limit is the highest dollar amount of elective deferrals that may be retained in the plan by a highly compensated employee after the application of section 401(k)(8)(C) (without regard to section 414(v)). For example, if after ADP testing, elective deferrals by highly compensated employees in excess of $8,000 would be required to be distributed or recharacterized as employee contributions under the statutory correction set forth under section 401(k)(8)(C), then the ADP limit is $8,000. Similar rules apply in the case of a SEP.

The amount of elective deferrals in excess of an applicable limit is generally determined as of the end of a plan year by comparing the total elective deferrals for the plan year with the applicable limit for the plan year. For example, if a plan limits elective deferrals to 10% of compensation, then whether the participant has elective deferrals in excess of 10% of compensation is determined at the end of the plan year. Similarly, elective deferrals in excess of the ADP limit are determined as of the end of the plan year. For a limit that is determined on the basis of a year other than a plan year (such as the calendar year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

If a plan provides for separate employer-provided limits on separate portions of compensation during the plan year, the determination of the amount of elective deferrals in excess of the employer-provided limit is still made on an annual basis, with the applicable limit for the year equal to the sum of the dollar limits that apply to the separate portions of compensation. This situation may occur, for example, when the plan sets a deferral percentage limit for each payroll period.

If the plan limits elective deferrals for separate portions of the plan year, then, solely for purposes of determining the amount that is in excess of an employer-provided limit, the plan may provide, as an alternative rule, that the applicable limit for the plan year is the product of the employee's plan year compensation and the time-weighted average of the deferral percentage limits. For example, if a plan using this time-weighted average limits deferrals to 8 percent of compensation during the first half of the year and 10 percent of compensation for the second half of the year, the applicable limit will be 9 percent of each employee's plan year compensation.

Under the proposed regulations, elective deferrals in excess of an applicable limit would be treated as catch-up contributions only to the extent that such elective deferrals do not exceed the catch-up contribution limit for the taxable year reduced by elective deferrals previously treated as catch-up contributions for the taxable year. The catch-up contribution limit for a taxable year is generally the applicable dollar catch-up limit for such taxable year, except that an elective deferral will not be treated as a catch-up contribution to the extent that the elective deferral, when added to all other elective deferrals for the taxable year under all plans of the employer, exceeds the participant's compensation (determined in accordance with section 415(c)(3)).

These proposed regulations would include a timing rule for purposes of determining when elective deferrals in excess of an applicable limit are treated as catch-up contributions. This rule is necessary because the maximum amount of catch-up contributions is based on a participant's taxable year, but the determination of whether an elective deferral is in excess of an applicable limit is determined on the basis of a taxable year, plan year, or limitation year, depending on the underlying limit. Under the proposed regulations, whether these elective deferrals in excess of an applicable limit can be treated as catch-up contributions would be determined as of the last day of the relevant year, except that if the limit is determined on a taxable or calendar year basis, then whether elective deferrals in excess of the limit can be treated as catch-up contributions would be determined at the time they are deferred. This timing rule is most significant for a plan with a plan year that is not the calendar year. For example, in a plan with a plan year ending on June 30, 2005, elective deferrals in excess of the employer-provided limit or the ADP limit for the plan year ending June 30, 2005, would be treated as catch-up contributions as of the last day of the plan year, up to the catch-up contribution limit for 2005. Any amounts deferred after June 30, 2005, that are in excess of the section 401(a)(30) limit for the 2005 calendar year would also be treated as catch-up contributions at the time they are deferred, up to the catch-up contribution limit for 2005 reduced by elective deferrals treated as catch-up contributions as of June 30, 2005.

C. *Treatment of Catch-up Contributions*

If an elective deferral is treated as a catch-up contribution, it is not subject to otherwise applicable limits under the plan and the plan will not be treated as failing otherwise applicable nondiscrimination requirements because of the making of catch-up contributions. The proposed regulations would provide guidance on how catch-up contributions under the plan are taken into account for purposes of these various requirements under the Code. Under the proposed regulations, catch-up contributions would not be taken into account in applying the limits of section 401(a)(30), 401(k)(11), 402(h), 402A(c)(2), 403(b), 404(h), 408(k), 408(p), 415, or 457 to other contributions or benefits under the plan offering catch-up contributions or under any other plan of the employer.

For purposes of ADP testing, the proposed regulations would provide that any elective deferral for the plan year that is treated as a catch-up contribution because it is in excess of a statutory limit or an employer-provided limit is disregarded for purposes of calculating the participant's actual deferral ratio (*i.e.*, catch-up contributions are subtracted from the participant's elective deferrals for the plan year prior to determining the participant's actual deferral ratio). This subtraction applies without regard to whether the catch-up eligible participant is a highly compensated employee or a nonhighly compensated employee. If, after running the ADP test, a plan needs to take corrective action under section 401(k)(8), the plan must determine the amount of elective deferrals that are catch-up contributions because they are in excess of the ADP limit. The elective deferrals that are treated as catch-up contributions must be retained by the plan. The plan would not be treated as failing section 401(k)(8) by reason of this retention of catch-up contributions. Excess contributions treated as catch-up contributions would nevertheless be treated as excess contributions for purposes of section 411(a)(3)(G). Therefore, if the plan does not provide for matching contributions on catch-up contributions, any matching contributions related to excess contributions treated as catch-up contributions can be forfeited. The approach under the proposed regulations would exclude those catch-up contributions that can be identified before ADP testing, and allow the plan to treat elective deferrals as catch-up contributions for those participants who would be limited under the plan (because the plan otherwise would be required to distribute some of their elective deferrals), while minimizing changes to current plan administration.

Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 416 or 410(b). However, catch-up contributions made to the plan in prior years are taken into account in determining whether a plan is top-heavy under section 416, and for purposes of average benefit percentage testing to the extent prior years' contributions are taken into account (*i.e.*, if accrued to date calculations are used).

A plan does not fail the requirements of section 401(a)(4) merely because it permits only catch-up eligible participants to make catch-up contributions. Similarly, if a plan applies a single matching formula to elective deferrals whether or not they are catch-up contributions, the matching formula as applied to catch-up eligible participants is not treated as a separate benefit, right, or feature under §1.401(a)(4)–4 from the matching formula as applied to the other participants. However, the matching contributions under the matching formula must satisfy the actual contribution percentage test under section 401(m)(2) taking into account all matching contributions, including matching contributions on catch-up contributions.

D. *Universal Availability*

Under the proposed regulations, a plan that offers catch-up contributions would satisfy the requirements of section 401(a)(4) only if all catch-up eligible participants are provided with the effective opportunity to make the same dollar amount of catch-up contributions. Therefore, if an employer provides for catch-up contributions under a section 401(k) plan, all other employer plans in the controlled group that provide for elective deferrals, including plans not subject to section 401(a)(4), must provide catch-up eligible participants with the same effective opportunity to make catch-up contributions. This universal availability requirement applies solely with respect to catch-up eligible participants. Because the definition of catch-up eligible participants requires that the participant be eligible to make elective deferrals under a plan without regard to section 414(v), the universal availability requirement will not require plans that do not otherwise provide for elective deferrals to provide for catch-up contributions.

In order to provide catch-up eligible participants with an effective opportunity to make catch-up contributions, the plan would have to permit each catch-up eligible participant to make sufficient elective deferrals during the year so that the participant has the opportunity to make elective deferrals up to the otherwise applicable limit plus the catch-up contribution limit. An effective opportunity could be provided in several different ways. For example, a plan that limits elective deferrals on a payroll-by-payroll basis might also provide participants with an effective opportunity to make catch-up contributions that is administered on a payroll-by-payroll basis (*i.e.*, by allowing catch-up eligible participants to increase their deferrals above the otherwise applicable limit by a *pro-rata* portion of the catch-up limit for the year). However, as discussed above, whether these elective deferrals are treated as catch-up contributions would not be determined until the end of the year.

A plan would not fail the universal availability requirement solely because an employer-provided limit did not apply to all employees or different employer-provided limits apply to different groups of employees. As under current law, a plan could provide for different employer-provided limits for different groups of employees, as long as each limit satisfies the nondiscriminatory availability requirements of §1.401(a)(4)–4 for benefits, rights, and features. Thus, for example, a plan could provide for an employer-provided limit that applies to highly compensated employees, even though no employer-provided limit applies to nonhighly compensated employees.

However, a plan is not permitted to provide lower employer-provided limits for catch-up eligible participants.

The proposed regulations would provide several exceptions to this universal availability requirement. First, the proposed regulations would provide for coordination between catch-up contributions under section 414(v) and the provisions of section 457(b)(3) in accordance with section 414(v)(6)(C). The proposed regulations would also provide transition rules for collectively bargained employees and newly-acquired plans.

E. *Participants in Multiple Plans*

As discussed in Section B above, the intent of section 414(v) is to permit a catch-up eligible participant to make elective deferrals in an amount equal to the catch-up contribution limit for the year in addition to the amount of elective deferrals that the participant would otherwise have been allowed to defer under the plan or plans in which the catch-up eligible participant participated. Many of the statutory limits that would otherwise limit the participant's elective deferrals are applied on an aggregated basis, for example, across all plans within a controlled group. Accordingly, the proposed regulations would provide that, for purposes of determining whether elective deferrals are in excess of a statutory limit, all elective deferrals in excess of the statutory limit are aggregated in the same manner as the underlying limit and the aggregate amount of elective deferrals treated as catch-up contributions because they exceed the statutory limit must not exceed the applicable dollar catch-up limit.

For example, compliance with section 401(a)(30) is determined based on elective deferrals under all section 401(k) plans and all section 403(b) contracts sponsored by the employer. Therefore, all section 401(k) plans and section 403(b) contracts in the controlled group of the employer would be aggregated for purposes of determining the total amount of elective deferrals in excess of the section 401(a)(30) limit. The amount of elective deferrals treated as catch-up contributions by reason of exceeding the section 401(a)(30) limit under the aggregated plans or contracts must not exceed the dollar amount of the catch-up limit for the taxable year.

In calculating the actual deferral ratio (ADR) (as defined in §1.401(k)–1(g)) for a highly compensated employee who participates in more than one section 401(k) plan of the employer during the year, all section 401(k) plans are treated as one section 401(k) plan. Consistent with this approach, if a highly compensated employee participates in more than one section 401(k) plan of an employer, in determining the elective deferrals in excess of an employer-provided limit, the proposed regulations would take into account the elective deferrals and employer-provided limits under all section 401(k) plans in which the employee participates. In such a case, the proposed regulations would provide that in determining whether an employee's elective deferrals exceed an employer-provided limit, the applicable limit for the plan year is the sum of the dollar amounts of the limits under the separate plans and the employee's elective deferrals under all these plans are combined to determine if that aggregate employer-provided limit is exceeded.

When the elective deferrals in excess of a statutory or employer-provided limit would be determined based on more than one plan, the aggregate amount of elective deferrals in excess of that limit made under all section 401(k) plans of the employer in which a catch-up eligible participant who is a highly compensated employee participates would be treated as elective deferrals in excess of an applicable limit under each of those section 401(k) plans. In the case of a highly compensated employee, all elective deferrals that exceed a statutory or employer-provided limit and are treated as catch-up contributions under the section 401(k) plans of the employer in which the catch-up eligible participant participates are subtracted from the participant's elective deferrals for purposes of determining the participant's ADR. However, if any of the section 401(k) plans corrects through distribution of excess contributions under section 401(k)(8) in order to comply with section 401(k)(3), only the catch-up contributions made under that plan are permitted to be subtracted from elective deferrals for purposes of this correction.

When the elective deferrals in excess of a statutory or employer-provided limit are determined on an aggregated basis, it must be determined under which plan the elective deferrals in excess of the limit were made. The plan under which the elective deferrals in excess of the limit were made may be determined in any manner that is not inconsistent with the manner in which such amounts were actually deferred under the plans. For example, if a catch-up eligible participant participates in a section 401(k) plan only during the first 6 months of the year and during the second 6 months of the year, while participating in a section 403(b) contract, the participant's contributions reach and exceed the section 401(a)(30) limit for the year, then all elective deferrals in excess of the section 401(a)(30) limit for the year could be treated as made to the section 403(b) contract.

F. *Excludability of Catch–up Contributions*

Catch-up contributions are generally not treated as exceeding the applicable dollar amount of section 402(g)(1). The proposed regulations would also provide that a catch-up eligible participant who participates in multiple plans may treat an elective deferral as a catch-up contribution (up to the maximum amount of catch-up contributions permitted for the taxable year) because it exceeds the catch-up eligible participant's section 402(g) limit for the taxable year. This rule would allow a catch-up eligible participant who participates in plans of two or more employers an exclusion from gross income for elective deferrals that exceed the section 402(g) limit, even though the elective deferrals do not exceed an applicable limit for either employer's plan. The treatment by an individual of such elective deferrals as catch-up contributions will not have any impact on either employer's plan. This treatment is parallel to the treatment of excess deferrals for an individual under age 50 who exceeds the section 402(g) limit in the plans of two unrelated employers. Accordingly, the proposed regulations would not provide for the ADP test to be rerun to disregard elective deferrals that an individual treats as catch-up contributions because they exceed the section 402(g) limit. However, the total amount of elective deferrals in excess of the applicable dollar limit in section 402(g)(1)(B) that are not includible in income because they are treated as catch-up contributions cannot exceed that limit by more than the catch-up contribution limit for the taxable year.

### Proposed Effective Date

The regulations are proposed to apply to contributions in taxable years beginning on or after January 1, 2002. Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

### Special Analyses

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

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. In addition to the other requests for comments set forth in this document, the IRS and Treasury also request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 21, 2002, at 10 a.m. in the IRS Auditorium (7th Floor), Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by January 31, 2002.

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 R. Lisa Mojiri-Azad and John T. Ricotta of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.414(v)–1 is added to read as follows:

*§1.414(v)–1 Catch-up contributions.*

(a) *Catch-up contributions*—(1) *General rule*. An applicable employer plan shall not be treated as failing to meet any requirement of the Internal Revenue Code solely because the plan permits a catch-up eligible participant to make catch-up contributions in accordance with section 414(v) and this section. With respect to an applicable employer plan, catch-up contributions are elective deferrals made by a catch-up eligible participant that exceed any of the applicable limits set forth in paragraph (b) of this section and that are treated under the applicable employer plan as catch-up contributions, but only to the extent they do not exceed the catch-up contribution limit described in paragraph (c) of this section (determined in accordance with the special rules for employers that maintain multiple applicable employer plans in paragraph (f) of this section, if applicable). The definitions in paragraphs (a)(2) through (5) of this section apply for purposes of this section.

(2) *Applicable employer plan*. The term applicable employer plan means a section 401(k) plan, a SIMPLE IRA plan as defined in section 408(p), a simplified employee pension plan as defined in section 408(k) (SEP), a plan or contract that satisfies the requirements of section 403(b), or a section 457 eligible governmental plan.

(3) *Elective deferral*. The term elective deferral means an elective deferral within the meaning of section 402(g)(3) or any contribution to a section 457 eligible governmental plan.

(4) *Catch-up eligible participant*—(i) *General rule*. The term catch-up eligible participant means an employee who—

(A) Is eligible to make elective deferrals during the plan year under an applicable employer plan (without regard to section 414(v) or this section); and

(B) Is age 50 or older.

(ii) *Projection of age 50*. For purposes of paragraph (a)(4)(i)(B) of this section, a participant who is projected to attain age 50 before the end of a calendar year is deemed to be age 50 as of January 1 of such year.

(5) *Other definitions*. (i) The terms employer, employee, section 401(k) plan, and highly compensated employee have the meanings provided in §1.410(b)–9.

(ii) The term section 457 eligible governmental plan means an eligible deferred compensation plan described in section 457(b) that is established and maintained by an eligible employer described in section 457(e)(1)(A).

(b) *Elective deferrals that exceed an applicable limit*—(1) *Applicable limits*. An applicable limit for purposes of determining catch-up contributions for a catch-up eligible participant is any of the following:

(i) *Statutory limit.* A statutory limit is a limit on elective deferrals or annual additions permitted to be made (without regard to section 414(v) and this section) with respect to an employee for a year provided in section 401(a)(30), 402(h), 403(b)(1)(E), 404(h), 408(k), 408(p), 415, or 457, as applicable.

(ii) *Employer-provided limit*. An employer-provided limit is any limit on the elective deferrals an employee is permitted to make (without regard to section 414(v) and this section) that is contained in the terms of the plan, but which is not required under the Internal Revenue Code. Thus, for example, a plan provision that limits highly compensated employees to a deferral percentage of 10% of compensation is an employer-provided limit that is an applicable limit with respect to the highly compensated employees.

(iii) *Actual deferral percentage (ADP) limit.* In the case of a section 401(k) plan that would fail the ADP test of section 401(k)(3) if it did not correct under section 401(k)(8), the ADP limit is the highest amount of elective deferrals that can be retained in the plan by a highly compensated employee under the rules of section 401(k)(8)(C). In the case of a SEP with a salary reduction arrangement (within the meaning of section 408(k)(6)) that would fail the requirements of section 408(k)(6)(A)(iii) if it did not correct in accordance with section 408(k)(6)(C), the ADP limit is the highest amount of elective deferrals that can be made by a highly compensated employee under the rules of section 408(k)(6).

(2) *Contributions in excess of applicable limit*—(i) *Plan year limits*. Except as provided in paragraph (b)(2)(ii) of this section, the amount of elective deferrals in excess of an applicable limit is determined as of the end of the plan year by comparing the total elective deferrals for the plan year with the applicable limit for the plan year. In the case of a plan that provides for separate employer-provided limits on elective deferrals for separate portions of plan compensation within the plan year, the applicable limit for the plan year is the sum of the dollar amounts of the limits for the separate portions. This plan provision may occur, for example, when the plan sets a deferral percentage limit for each payroll period. If the plan limits elective deferrals for separate portions of the plan year, then, solely for purposes of determining the amount that is in excess of an employer-provided limit, the plan may provide, as an alternative rule, that the applicable limit for the plan year is the product of the employee's plan year compensation and the time-weighted average of the deferral percentage limits. Thus, for example, if a plan that provides for use of a time-weighted average limits deferrals to 8 percent of compensation during the first half of the plan year and 10 percent of compensation for the second half of the plan year, the applicable limit is 9 percent of each employee's plan year compensation.

(ii) *Other year limit.* In the case of an applicable limit which is applied on the basis of a year other than the plan year (*e.g.*, the calendar year limit on elective deferrals under section 401(a)(30)), the determination of whether elective deferrals are in excess of the applicable limit is made on the basis of such other year.

(c) *Catch-up contribution limit*—(1) *General rule*. Elective deferrals with respect to a catch-up eligible participant in excess of an applicable limit under paragraph (b) of this section are treated as catch-up contributions under this section as of a date within a taxable year only to the extent that such elective deferrals do not exceed the catch-up contribution limit described in this paragraph (c), reduced by elective deferrals previously treated as catch-up contributions for the taxable year, determined in accordance with paragraph (c)(3) of this section. The catch-up contribution limit for a taxable year is generally the applicable dollar catch-up limit for such taxable year, as set forth in paragraph (c)(2) of this section. However, an elective deferral is not treated as a catch-up contribution to the extent that the elective deferral, when added to all other elective deferrals for the taxable year under any applicable employer plan of the employer, exceeds the participant's compensation (determined in accordance with section 415(c)(3)) for the taxable year.

(2) *Applicable dollar catch-up limit*—(i) *In general*. The applicable dollar catch-up limit for an applicable employer plan, other than an applicable employer plan described in section 401(k)(11) or a SIMPLE IRA plan as defined in section 408(p), is determined under the following table:

| For Taxable Years Beginning in | Applicable Dollar Catch-up Limit |
|---|---|
| 2002 | $1,000 |
| 2003 | $2,000 |
| 2004 | $3,000 |
| 2005 | $4,000 |
| 2006 | $5,000 |

(ii) *SIMPLE plan*. The applicable dollar catch-up limit for an applicable employer plan described in section 401(k)(11) or a SIMPLE IRA plan as defined in section 408(p) is determined under the following table:

| For Taxable Years Beginning in | Applicable Dollar Catch-up Limit |
|---|---|
| 2002 | $ 500 |
| 2003 | $1,000 |
| 2004 | $1,500 |
| 2005 | $2,000 |
| 2006 | $2,500 |

(iii) *Cost of living adjustments*. For taxable years after 2006, the applicable dollar catch-up limit is the applicable dollar catch-up limit for 2006 described in paragraph (c)(2)(i) or (ii) of this section increased at the same time and in the same manner as adjustments under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase that is not a multiple of $500 shall be rounded to the next lower multiple of $500.

(3) *Timing rules*. For purposes of determining the maximum amount of permitted catch-up contributions for a catch-up eligible participant during a taxable year, the determination of whether an elective deferral is a catch-up contribution is made as of the last day of the plan year (or in the case of section 415, as of the last day of the limitation year), except that, with respect to elective deferrals in excess of an applicable limit that is tested on the basis of the taxable year or calen-

dar year (*e.g.*, the section 401(a)(30) limit on elective deferrals), the determination of whether such elective deferrals are treated as catch-up contributions is made at the time they are deferred.

(d) *Treatment of catch-up contributions*—(1) *Contributions not taken into account for certain limits*. Catch-up contributions shall not be taken into account in applying the limits of section 401(a)(30), 401(k)(11), 402(h), 402A(c)(2), 403(b), 404(h), 408(k), 408(p), 415, or 457 to other contributions or benefits under an applicable employer plan or any other plan of the employer.

(2) *Contributions not taken into account for certain nondiscrimination tests*—(i) *Application of ADP test*. Elective deferrals that are treated as catch-up contributions with respect to a section 401(k) plan because they exceed a statutory or employer-provided limit described in paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the actual deferral ratio (ADR) (as defined in §1.401(k)–1(g)) of a catch-up eligible participant. Similarly, elective deferrals that are treated as catch-up contributions with respect to a SEP because they exceed a statutory or employer-provided limit described in paragraph (b)(1)(i) or (ii) of this section, respectively, are subtracted from the catch-up eligible participant's elective deferrals for the plan year for purposes of determining the deferral percentage under section 408(k)(6)(D) of a catch-up eligible participant.

(ii) *Adjustment of elective deferrals for correction purposes*. For purposes of the correction of excess contributions in accordance with section 401(k)(8)(C), elective deferrals under the plan treated as catch-up contributions for the plan year are subtracted from the catch-up eligible participant's elective deferrals under the plan for the plan year.

(iii) *Excess contributions treated as catch-up contributions*. A section 401(k) plan that satisfies the ADP test of section 401(k)(3) through correction under section 401(k)(8) must retain any elective deferrals that are treated as catch-up contributions pursuant to paragraph (c) of this section because they exceed the ADP limit in paragraph (b)(1)(iii) of this section. In addition, a section 401(k) plan is not treated as failing to satisfy section 401(k)(8) merely because elective deferrals described in the preceding sentence are not distributed or recharacterized as employee contributions. Similarly, a SEP is not treated as failing to satisfy section 408(k)(6)(A)(iii) merely because catch-up contributions are not treated as excess contributions with respect to a catch-up eligible participant under the rules of section 408(k)(6)(C). Notwithstanding the fact that elective deferrals described in this paragraph (d)(2)(iii) are not distributed, such elective deferrals are still considered to be excess contributions under section 401(k)(8), and accordingly, matching contributions with respect to such elective deferrals may be forfeited under the rules of section 411(a)(3)(G).

(iv) *Application for top-heavy*. Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 416. Thus, if the only contributions made for a plan year for key employees are catch-up contributions, the applicable percentage under section 416(c)(2) is 0%, and no top-heavy minimum contribution under section 416 is required for the year. However, catch-up contributions for prior years are taken into account for purposes of section 416. Thus, catch-up contributions for prior years are included in the account balances that are used in determining whether the plan is top-heavy under section 416(g).

(v) *Application for section 410(b)*. Catch-up contributions with respect to the current plan year are not taken into account for purposes of section 410(b). Thus, catch-up contributions are not taken into account in determining the average benefit percentage under §1.410(b)–5 for the year if benefit percentages are determined based on current year contributions. However, catch-up contributions for prior years are taken into account for purposes of section 410(b). Thus, catch-up contributions for prior years would be included in the account balances that are used in determining the average benefit percentage if allocations for prior years are taken into account.

(3) *Availability of catch-up contributions*. An applicable employer plan does not violate §1.401(a)(4)–4 merely because the group of employees for whom catch-up contributions are currently available (*i.e.*, the catch-up eligible participants) is not a group of employees that would satisfy section 410(b) (without regard to §1.410(b)–5). In addition, a catch-up eligible participant is not treated as having a right to a different rate of allocation of matching contributions merely because an otherwise nondiscriminatory schedule of matching rates is applied to elective deferrals that include catch-up contributions. The rules in this paragraph (d)(3) also apply for purposes of satisfying the requirements of section 403(b)(12).

(e) *Universal availability requirement*—(1) *General rule*. An applicable employer plan that offers catch-up contributions and that is otherwise subject to section 401(a)(4) (including a plan that is subject to section 401(a)(4) pursuant to section 403(b)(12)) will not satisfy the requirements of section 401(a)(4) unless all catch-up eligible participants who participate under any applicable employer plan maintained by the employer are provided with the effective opportunity to make the same dollar amount of catch-up contributions. A plan does not fail to satisfy this effective opportunity requirement merely because the plan allows participants to defer an amount equal to a specified percentage of compensation for each payroll period and for each payroll period permits each catch-up eligible participant to defer a *pro-rata* share of the applicable dollar catch-up limit in addition to that amount. A plan does not fail the universal availability requirement of this paragraph (e) solely because an employer-provided limit does not apply to all employees or different limits apply to different groups of employees under paragraph (b)(2)(i) of this section. However, a plan may not provide lower employer-provided limits for catch-up eligible participants.

(2) *Exception for section 457 eligible governmental plans*. An applicable employer plan does not fail to comply with the universal availability requirement of this paragraph (e) merely because another applicable employer plan that is a section 457 eligible governmental plan does not provide for catch-up contributions to the extent set forth in section 414(v)(6)(C).

(3) *Exception for newly acquired plans*. An applicable employer plan does not fail to comply with the universal availability requirement of this paragraph (e) merely

because another applicable employer plan does not provide for catch-up contributions, if—

(i) The other applicable employer plan becomes maintained by the employer by reason of a merger, acquisition or similar transaction described in §1.410(b)–2(f); and

(ii) The other applicable employer plan is amended to provide for catch-up contributions as soon as practicable, but no later than by the end of the period described in section 410(b)(6)(C).

(f) *Special rules for an employer that sponsors multiple plans*—(1) *General rule*. If elective deferrals under more than one applicable employer plan of an employer are aggregated for purposes of applying a statutory limit under paragraph (b)(1)(i) of this section, then the aggregate elective deferrals treated as catch-up contributions by reason of exceeding that statutory limit under all such applicable employer plans must not exceed the applicable dollar catch-up limit for the taxable year. For example, since compliance with section 401(a)(30) is determined based on elective deferrals under section 401(k) plans and section 403(b) contracts sponsored by the employer, the total amount of elective deferrals under all section 401(k) plans and section 403(b) contracts of the employer treated as catch-up contributions by reason of exceeding the section 401(a)(30) limit for a calendar year under the aggregated plans must not exceed the applicable dollar catch-up limit for such taxable year.

(2) *Highly compensated employee in more that one section 401(k) plan*. If a highly compensated employee is a participant in more than one section 401(k) plan of an employer, in determining whether the employee's elective deferrals exceed an employer-provided limit under paragraph (b)(1)(ii) of this section, the employer-provided limit for the plan year is the sum of the dollar amounts of the limits under the separate plans for that employee and the employee's elective deferrals under all section 401(k) plans of the employer are combined to determine if the employer-provided limit is exceeded.

(3) *Allocation rules*. When the amount of elective deferrals in excess of an applicable limit under paragraph (b)(1) of this section is determined under the aggregation rules of paragraph (f)(1) or (f)(2) of this section, the aggregate amount of the elective deferrals in excess of that applicable limit made under all section 401(k) plans that are aggregated for purposes of determining a highly compensated employee's ADR are treated as elective deferrals in excess of an applicable limit for purposes of applying the catch-up contribution limit under paragraph (c)(1) of this section with respect to each of these section 401(k) plans. However, the catch-up contributions are subtracted from elective deferrals for purposes of paragraph (d)(2)(ii) of this section only under the applicable employer plan under which the catch-up contributions are made. The applicable employer plan under which the elective deferrals in excess of an applicable limit are made for purposes of this paragraph (f)(3) may be determined in any manner that is not inconsistent with the manner in which such amounts were actually deferred under the plans.

(g) *Application of section 402(g)*—(1) *Exclusion of catch-up contributions*. In determining the amount of elective deferrals that are includible in gross income under section 402(g), except as provided in paragraph (g)(2) of this section, catch-up contributions are not treated as exceeding the applicable dollar amount of section 402(g)(1). For purposes of this paragraph (g), a catch-up eligible participant who makes elective deferrals under applicable employer plans of two or more employers that exceed the applicable dollar amount under section 402(g)(1) may treat the elective deferrals in excess of that applicable dollar amount as a catch-up contribution to the extent permitted in paragraph (g)(2) of this section, even though the elective deferrals do not exceed an applicable limit under either plan. Therefore, for a catch-up eligible participant who makes elective deferrals under applicable employer plans of two or more employers that exceed the applicable dollar amount under section 402(g)(1), the elective deferrals in excess of that applicable dollar amount are excludable from gross income as catch-up contributions to the extent permitted in paragraph (g)(2) of this section. Whether an elective deferral is treated as a catch-up contribution by an applicable employer plan is determined under paragraph (c) of this section and without regard to whether the employee treats an elective deferral as a catch-up contribution under this paragraph (g).

(2) *Maximum excludable amount*. If a catch-up eligible participant participates in two or more applicable employer plans during a taxable year, the total amount of elective deferrals under all plans that are not includible in gross income under this paragraph (g) because they are catch-up contributions shall not exceed the applicable dollar catch-up limit under paragraph (c)(2)(i) of this section for the taxable year.

(h) *Coordination with other catch-up provisions*—(1) *Coordination with section 457(b)(3)*. In the case of an applicable employer plan that is a section 457 eligible governmental plan, the catch-up contributions permitted under this section shall not apply to a catch-up eligible participant for any taxable year for which the additional contributions permitted under section 457(b)(3) applies to such participant. For additional guidance, see regulations under section 457.

(2) *Coordination with section 402 (g)(7)*. [Reserved].

(i) *Examples*. The following examples illustrate the application of this section. For purposes of these examples, the limit under section 401(a)(30) is $15,000 and the applicable dollar catch-up limit is $5,000 and, except as specifically provided, the plan year is the calendar year. In addition, it is assumed that the participant's elective deferrals under all plans of the employer do not exceed the participant's section 415(c)(3) compensation and that any correction pursuant to section 401(k)(8) is made through distribution of excess contributions. The examples are as follows:

*Example 1*. (i) Participant A is eligible to make elective deferrals under a section 401(k) plan, Plan P. Plan P does not limit elective deferrals except as necessary to comply with sections 401(a)(30) and 415. In 2006, Participant A is 55 years old. Plan P also provides that a catch-up eligible participant is permitted to defer amounts in excess of the section 401(a)(30) limit up to the applicable dollar catch-up limit for the year. Participant A defers $18,000 during 2006.

(ii) Participant A's elective deferrals in excess of the section 401(a)(30) limit ($3,000) do not exceed the applicable dollar catch-up limit for 2006 ($5,000). Under paragraph (a)(1) of this section, the $3,000 is a catch-up contribution and, pursuant to paragraph (d)(2)(i) of this section, it is not taken into account in determining Participant A's ADR for purposes of section 401(k)(3).

*Example 2*. (i) Participants B and C, who are highly compensated employees earning $120,000, are eligible to make elective deferrals under a section 401(k) plan, Plan Q. Plan Q limits elective deferrals as necessary to comply with section 401(a)(30) and 415, and also provides that no highly compensated employee may make an elective deferral at a rate that exceeds 10% of compensation. However, Plan Q also provides that a catch-up eligible participant is permitted to defer amounts in excess of 10% during the plan year up to the applicable dollar catch-up limit for the year. In 2006, Participants B and C are both 55 years old and, pursuant to the catch-up provision in Plan Q, both elect to defer 10% of compensation plus a *pro-rata* portion of the $5,000 applicable dollar catch-up limit for 2006. Participant B continues this election in effect for the entire year, for a total elective contribution for the year of $17,000. However, in July 2006, after deferring $8,500, Participant C discontinues making elective deferrals.

(ii) Once Participant B's elective deferrals for the year exceed the section 401(a)(30) limit ($15,000), subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the catch-up contribution limit for the taxable year. Since the $2,000 in elective deferrals made after Participant B reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $2,000 is treated as a catch-up contribution.

(iii) As of the last day of the plan year, Participant B has exceeded the employer-provided limit of 10% (10% of $120,000 or $12,000 for Participant B) by an additional $3,000. Since the additional $3,000 in elective deferrals does not exceed the $5,000 applicable dollar catch-up limit for 2006, reduced by the $2,000 in elective deferrals previously treated as catch-up contributions, the entire $3,000 of elective deferrals is treated as a catch-up contribution.

(iv) In determining Participant B's ADR, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's ADR is 10% ($12,000 / $120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $12,000.

(v) Participant C's elective deferrals for the year do not exceed an applicable limit for the plan year. Accordingly, Participant C's $8,500 of elective deferrals must be taken into account in determining Participant C's ADR for purposes of section 401(k)(3).

*Example 3*. (i) The facts are the same as in *Example 2,* except that Plan Q is amended to change the maximum permitted deferral percentage for highly compensated employees to 7%, effective for deferrals after April 1, 2006. Participant B, who has earned $40,000 in the first 3 months of the year and has been deferring at a rate of 10% of compensation plus a *pro-rata* portion of the $5,000 applicable dollar catch-up limit for 2006, reduces the 10% of pay deferral rate to 7% for the remaining 9 months of the year (while continuing to defer a *pro-rata* portion of the $5,000 applicable dollar catch-up limit for 2006). During those 9 months, Participant B earns $80,000. Thus, Participant B's total elective deferrals for the year are $14,600 ($4,000 for the first 3 months of the year plus $5,600 for the last 9 months of the year plus an additional $5,000 throughout the year).

(ii) The employer-provided limit for Participant B for the plan year is $9,600 ($4,000 for the first 3 months of the year, plus $5,600 for the last 9 months of the year). Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,000 (the excess of $14,600 over $9,600), which does not exceed the applicable dollar catch-up limit of $5,000.

(iii) Alternatively, Plan Q may provide that the employer-provided limit is determined as the time-weighted average of the different deferral percentage limits over the course of the year. In this case, the time-weighted average limit is 7.75% for all participants, and the applicable limit for Participant B is 7.75% of $120,000, or $9,300. Accordingly, Participant B's elective deferrals for the year that are in excess of the employer-provided limit are $5,300 (the excess of $14,600 over $9,300). Since the amount of Participant B's elective deferrals in excess of the employer-provided limit ($5,300) exceeds the applicable dollar catch-up limit for the taxable year, only $5,000 of Participant B's elective deferrals may be treated as catch-up contributions. In determining Participant B's actual deferral ratio, the $5,000 of catch-up contributions are subtracted from Participant B's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant B's actual deferral ratio is 8% ($9,600 / $120,000). In addition, for purposes of applying the rules of section 401(k)(8), Participant B is treated as having elective deferrals of $9,600.

Example 4. (i) The facts are the same as in *Example 1*. In addition to Participant A, Participant D is a highly compensated employee who is eligible to make elective deferrals under Plan P. During 2006, Participant D, who is 60 years old, elects to defer $14,000.

(ii) The ADP test is run for Plan P (after excluding the $3,000 in catch-up contributions from Participant A's elective deferrals), but Plan P needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(B), the maximum deferrals which may be retained by any highly compensated employee in Plan P is $12,500.

(iii) Pursuant to paragraph (b)(1)(iii) of this section, the ADP limit under Plan P of $12,500 is an applicable limit. Accordingly, $1,500 of Participant D's elective deferrals exceed the applicable limit. Similarly, $2,500 of Participant A's elective deferrals (other than the $3,000 of elective deferrals treated as catch-up contributions because they exceed the section 401(a)(30) limit) exceed the applicable limit.

(iv) The $1,500 of Participant D's elective deferrals that exceed the applicable limit are less than the applicable dollar catch-up limit and are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant D's $1,500 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant D.

(v) The $2,500 of Participant A's elective deferrals that exceed the applicable limit are greater than the portion of the applicable dollar catch-up limit ($2,000) that remains after treating the $3,000 of elective deferrals in excess of the section 401(a)(30) limit as catch-up contributions. Accordingly, $2000 of Participant A's elective deferrals are treated as catch-up contributions. Pursuant to paragraph (d)(2)(iii) of this section, Plan P must retain Participant A's $2,000 in elective deferrals and Plan P is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant A. However, $500 of Participant A's elective deferrals can not be treated as catch-up contributions and must be distributed to Participant A in order to satisfy section 401(k)(8).

*Example 5*. (i) Participant E is a catch-up eligible employee under a section 401(k) plan, Plan R, with a plan year ending October 31, 2006. Plan R does not limit elective deferrals except as necessary to comply with section 401(a)(30) and section 415. Plan R permits all catch-up eligible participants to defer an additional amount equal to the applicable dollar catch-up limit for the year ($5,000) in excess of the section 401(a)(30) limit. Participant E did not exceed the section 401(a)(30) limit in 2005. Participant E made $3,200 of deferrals in the period November 1, 2005, through December 31, 2005, and an additional $16,000 of deferrals in the first 10 months of 2006, for a total of $19,200 in elective deferrals for the plan year.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions at the time they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for the calendar year does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's $19,200 in elective deferrals for the plan year ending October 31, 2006, in determining Participant E's ADR for that plan year.

(iii) The ADP test is run for Plan R (after excluding the $1,000 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R for the plan year ending October 31, 2006, (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $18,200 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $3,400 ($18,200 minus $14,800), which is less than the excess of the applicable dollar catch-up limit ($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $3,400 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for the calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last two months of the calendar year, since Participant E's catch-up contributions for the taxable year have not exceeded the applicable dollar catch-up limit for the taxable year. However, the maximum amount of elective deferrals Participant E may make for the balance of the calendar year is $600 (the $5,000 applicable dollar catch-up limit for 2006, reduced by the $4,400 ($1,000 plus $3,400) of elective deferrals previously treated as catch-up contributions during the taxable year).

*Example 6.* (i) The facts are the same as in *Example 5*, except that Participant E exceeded the section 401(a)(30) limit for 2005 by $1,300 prior to October 31, 2005, and made $600 of elective deferrals in the period November 1, 2005, through December 31, 2005 (which were catch-up contributions for 2005). Thus, Participant E made $16,600 of elective deferrals for the plan year ending October 31, 2006.

(ii) Once Participant E's elective deferrals for the calendar year 2006 exceed $15,000, subsequent elective deferrals are treated as catch-up contributions as they are deferred, provided that such elective deferrals do not exceed the applicable dollar catch-up limit for the taxable year. Since the $1,000 in elective deferrals made after Participant E reaches the section 402(g) limit for calendar year 2006 does not exceed the applicable dollar catch-up limit for 2006, the entire $1,000 is a catch-up contribution. Pursuant to paragraph (d)(2)(i) of this section, $1,000 is subtracted from Participant E's elective deferrals in determining Participant E's actual deferral ratio for the plan year ending October 31, 2006. In addition, the $600 of catch-up contributions from the period November 1, 2005, to December 31, 2005, are subtracted from Participant E's elective deferrals in determining Participant E's ADR. Thus, the total elective deferrals taken into account in determining Participant E's ADR for the plan year ending October 31, 2006, is $15,000 ($16,600 in elective deferrals for the current plan year, less $1,600 in catch-up contributions).

(iii) The ADP test is run for Plan R (after excluding the $1,600 in elective deferrals in excess of the section 401(a)(30) limit), but Plan R needs to take corrective action in order to pass the ADP test. After applying the rules of section 401(k)(8)(C) to allocate the total excess contributions determined under section 401(k)(8)(C), the maximum deferrals that may be retained by any highly compensated employee under Plan R (the ADP limit) is $14,800.

(iv) Under paragraph (d)(2)(ii) of this section, elective deferrals that exceed the section 401(a)(30) limit under Plan R are also subtracted from Participant E's elective deferrals under Plan R for purposes of applying the rules of 401(k)(8). Accordingly, for purposes of correcting the failed ADP test, Participant E is treated as having contributed $15,000 of elective deferrals in Plan R. The amount of elective deferrals that would have to be distributed to Participant E in order to satisfy section 401(k)(8)(C) is $200 ($15,000 minus $14,800), which is less than the excess of the applicable dollar catch-up limit ($5,000) over the elective deferrals previously treated as catch-up contributions under Plan R for the taxable year ($1,000). Under paragraph (d)(2)(iii) of this section, Plan R must retain Participant E's $200 in elective deferrals and is not treated as failing to satisfy section 401(k)(8) merely because the elective deferrals are not distributed to Participant E.

(v) Even though Participant E's elective deferrals for calendar year 2006 have exceeded the section 401(a)(30) limit, Participant E can continue to make elective deferrals during the last two months of the calendar year, since Participant E's catch-up contributions for the taxable year 2006 have not exceeded the applicable dollar catch-up limit for the taxable year. However, the maximum amount of elective deferrals Participant E may make for the balance of the calendar year is $3,800 (the $5,000 applicable dollar catch-up limit for 2006, reduced by $1,200 ($1,000 plus $200) in elective deferrals previously treated as catch-up contributions during taxable year 2006).

*Example 7.* (i) Participant F, who is 58 years old, is a highly compensated employee who earns $100,000. Participant F participates in a section 401(k) plan, Plan S, for the first six months of the year and then transfers to another section 401(k) plan, Plan T, sponsored by the same employer, for the second six months of the year. Plan S limits highly compensated employees' elective deferrals to 6% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 6% during the plan year, up to the applicable dollar catch-up limit for the year. Plan T limits highly compensated employee's elective deferrals to 8% of compensation for the period of participation, but permits catch-up eligible participants to defer amounts in excess of 8% during the plan year, up to the applicable dollar catch-up limit for the year. Participant F, who earned $50,000 in the first six months of the year, defers $5,000 under Plan S. Participant F also deferred $5,000 under Plan T.

(ii) Under paragraph (f)(2) of this section, the employer-provided limit for Participant F is $7,000, the sum of the employer-provided limit for Plan S ($3,000) and the employer-provided limit for Plan T ($4,000). Participant F's elective deferrals for the year are $10,000. Therefore, the amount of Participant F's elective deferrals in excess of the employer-provided limit is $3,000. Under paragraph (f)(3) of this section, the $3,000 in excess of the employer-provided limit is treated as an elective deferral in excess of that limit under both Plans S and T for purposes of applying the catch-up contribution limit under paragraph (c)(1) of this section.

(iii) Since the amount of Participant F's elective deferrals in excess of the employer-provided limit ($3,000) does not exceed the applicable dollar catch-up limit for the taxable year, the entire $3,000 of Participant F's elective deferrals are treated as catch-up contributions. In determining Participant F's actual deferral ratio, the entire $3,000 of catch-up contributions is subtracted from Participant F's elective deferrals for the plan year under paragraph (d)(2)(i) of this section. Accordingly, Participant F's actual deferral ratio is 7% ($7,000 / $100,000) for both Plans S and T.

(iv) In accordance with paragraph (f)(3) of this section, it is determined that $2,000 of the excess over the employer-provided limit was made under Plan S and $1,000 of the excess over the employer-provided limit was made under Plan T. This determination is not inconsistent with the manner in which the elective deferrals were actually made. Therefore, under paragraph (d)(2)(ii) of this section, for purposes of applying the rules of section 401(k)(8), Participant F is treated as having elective deferrals of $3,000 ($5,000–$2,000) in Plan S and $4,000 ($5,000–$1,000) in Plan T.

(v) If, after applying the ADP test of section 401(k)(3), Plan S or Plan T were to require correction under section 401(k)(8), the maximum amount of elective deferrals in excess of the ADP limit that could be treated as catch-up contributions for Participant F under the Plan could not exceed $2,000, the applicable dollar catch-up limit of $5,000, reduced by the $3,000 in excess of the employer-provided limit previously treated as catch-up contributions for the taxable year.

(j) *Effective date and transition rule*—(1) *Effective date.* Section 414(v) and this section apply to contributions in taxable years beginning on or after January 1, 2002.

(2) *Transition rule for collectively bargained employees*. An applicable employer plan will not fail to satisfy the requirements of paragraph (e) of this section merely because employees eligible to make elective deferrals who are included in a unit of employees covered by a collective bargaining agreement in effect on January 1, 2002, are not permitted to make catch-up contributions until the first plan year beginning after the termination of such agreement.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on October 22, 2001, 8:45 a.m., and published in the issue of the Federal Register for October 23, 2001, 66 F.R. 53555)

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## Availability of Revised Determination Letter Forms

## Announcement 2001–109

In Announcement 2001–77 (2001–30 I.R.B. 83), July 23, 2001, the Service described changes that were being made to simplify its application procedures for determination letters on the qualification of pension, profit-sharing, stock bonus and annuity plans under §§ 401(a) and 403(a) of the Internal Revenue Code. Part of the simplification of the application procedures described in Announcement 2001–77 involves the revision of the determination letter application forms.

The first four of those application forms used to request determination letters for ongoing qualified employee benefit plans and a related schedule as well as the instructions to these forms and schedule are now available. These revised application forms and instructions will be available in late November 2001, from IRS distribution centers at 1-800-TAX FORM. In addition, these forms are **currently** available on the IRS Web Site at *http://www.irs.gov/forms_pubs/forms.html*. These 2001 application forms may be submitted as downloaded from the Service's Web Site, *i.e.*, the requirement to provide a duplicate front page (or pink copy) has been eliminated for these revisions. The currently revised application forms are:

Form 5300, *Application for Determination for Employee Benefit Plan (including collectively bargained plans formerly filed on Form 5303)* (Rev. September 2001)

Schedule Q (Form 5300), *Elective Determination Requests* (Rev. August 2001)

Form 5307, *Application for Determination for Adopters of Master or Prototype or Volume Submitter Plans* (Rev. September 2001)

Form 5309, *Application for Determination of Employee Stock Ownership Plan* (Rev. August 2001)

Form 6406, *Short Form Application for Determination for Minor Amendment of Employee Benefit Plan* (Rev. September 2001)

In addition to changing the titles of certain forms to reflect simplified methods and the elimination of one form, *i.e.*, Form 5303, *Application for Determination for Collectively Bargained Plan*, these revisions contain many of the changes described in Announcement 2001–77. For example, the Schedule Q is now optional and two questions previously on the Schedule Q have been moved to the Form 5300 and the Form 5307 and made optional. Moreover, while **applicants are strongly encouraged to use the 2001 revisions to these forms**, applicants may continue to submit determination letter applications on the prior versions of the revised forms (or on Form 5303) through December 31, 2001, consistent with the procedures in section I.G of Announcement 2001–77.

The other forms referred to in Announcement 2001–77 (Forms 5310, 5310–A, 6088, and 8717) are currently undergoing revision. These forms are expected to be available on the IRS Web Site later this year. The Service will issue an announcement when these forms are available.

**Drafting Information**

The principal author of this announcement is Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this announcement, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 9:30 p.m. Eastern Time, Monday through Friday. Mr. Rubin may be reached at (202) 283-9888 (not a toll-free number).

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## Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

## Announcement 2001–110

The name of an organization that no longer qualifies as an organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) begins on November 5, 2001, and ends on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Northwest Childrens Institute
Seattle, WA

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## Gasoline Tax Claims Under Section 6416(a)(4)

## Announcement 2001–111

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: This document invites comments from the public on issues that the IRS may address in proposed regulations relating to claims for credits or refunds of the gasoline tax. All materials submitted will be available for public inspection and copying.

DATES: Written and electronic comments must be received by January 22, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–143219–01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–143219–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may send submissions electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html*.

FOR FURTHER INFORMATION CONTACT: Concerning submissions, the Regulations Unit (202) 622-7180; concerning the proposals, Frank Boland (202) 622-3130 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Under section 6416(b)(2), the person that paid the gasoline tax imposed by section 4081 to the government may receive a credit or refund of the amount of the tax if the gasoline is, by any person, exported, used or sold for use as supplies for vessels or aircraft, sold to a state or local government for its exclusive use, sold to a nonprofit educational organization for its exclusive use, or used or sold for use in the production of special fuels (exempt purposes).

Section 6102 of the Technical and Miscellaneous Revenue Act of 1988 (the 1988 Act) (Public Law 100–647, 102 Stat. 3342) added section 6416(a)(4) to the Internal Revenue Code. Under section 6416(a)(4)(A), a wholesale distributor (described in section 6416(a)(4)(B)) that buys gasoline on which the tax imposed by section 4081 has been paid and sells the gasoline to its ultimate purchaser for an exempt purpose is treated as the person (and the only person) that paid the tax to the government and thus is the person eligible to claim a credit or refund of that tax.

Section 6416(a)(4)(B), as added by the 1988 Act, provides that the term wholesale distributor includes any person that sells gasoline to producers, retailers, or to users that purchase in bulk quantities and accept delivery into bulk storage tanks. For this purpose, the term producer includes a refiner, blender, or wholesale distributor of gasoline, or a dealer selling gasoline exclusively to producers of gasoline. The term wholesale distributor does not include any person that is an importer, refiner, or blender of gasoline, or is a dealer selling gasoline exclusively to producers. Section 905 of the Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 788) amended section 6416(a)(4)(B) of the Code by providing that the term wholesale distributor also includes any person that makes retail sales of gasoline at 10 or more retail motor fuel outlets.

Notice 89–29 (1989–1 C.B. 669) provides rules for implementing section 6416(a)(4), as added by the 1988 Act. These include rules that allow claims by the person that actually paid the tax to the government instead of claims by the wholesale distributor if (1) tax is not included in the price of the gasoline bought by the wholesale distributor or (2) the sale by the wholesale distributor is charged on an oil company credit card issued to an exempt person.

In response to questions that have arisen concerning the application of the rules in Notice 89–29, the IRS is considering proposing regulations under section 6416(a)(4) that, when finalized, would replace the guidance provided by Notice 89–29. The IRS invites comments from the public on issues that should be addressed in the regulations, including issues relating to refund claims by persons other than the wholesale distributor.

Paul Kugler,
*Associate Chief Counsel*
*(Passthroughs and Special Industries).*

(Filed by the Office of the Federal Register on October 22, 2001, 8:45 a.m., and published in the issue of the Federal Register for October 23, 2001, 66 F.R. 53564)

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## Notice of Disposition of Declaratory Judgment Proceedings Under Section 7428

This announcement serves notice to donors that on June 15, 2001, the United States Court of Appeals for the Eleventh Circuit entered judgment finding that there was no actual case or controversy and affirming the United States Tax Court's determination that the organization listed below lacked capacity to bring suit from the retroactive revocation of its tax exempt status as a section 501(c)(3) organization. Therefore the organization listed below is not recognized as an organization described in section 501(c)(3) and is not exempt from tax under section 501(a) effective January 1, 1990.

Abraham Lincoln Opportunity
Foundation, Denver, CO

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## Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organization listed below has recently filed a timely declaratory judgment suit under section 7428 of the Code, challenging revocation of its status as an eligible donee under section 170(c)(2).

Protection under section 7428(c) of the Code begins on November 5, 2001, and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

Endowment for Paso Del Norte Schools,
Inc., El Paso, TX

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

## Section 1(h).—Maximum Capital Gains Rate

*(Also: § 121)*

**Gross income; sale of principal residence.** If an individual elects under section 311(e) of the Tax Reform Act of 1997 to treat the individual's principal residence as being both sold and reacquired on January 1, 2001, for an amount equal to its fair market value on that date, the individual cannot exclude from gross income under section 121 of the Code any of the gain from the deemed sale.

## Rev. Rul. 2001–57

ISSUE

If an individual elects under § 311(e) of the Taxpayer Relief Act of 1997 ("TRA 97"), 1997–4 (Vol. 1) C.B. 1, 49-50, to treat the individual's principal residence as being both sold and reacquired on January 1, 2001, for an amount equal to its fair market value on that date ("§ 311(e) election"), can the individual exclude from gross income under § 121 of the Internal Revenue Code any of the gain resulting from the deemed sale?

FACTS

*A* makes a § 311(e) election with respect to *A*'s principal residence on *A*'s federal income tax return for the year including January 1, 2001. On January 1, 2001, the residence had a fair market value that was $250,000 greater than *A*'s basis. If, on that date, *A* had actually sold the residence for its fair market value, § 121 would have entitled *A* to exclude from gross income the full $250,000 of gain realized on the sale.

LAW AND ANALYSIS

Under § 121, a taxpayer may exclude from gross income up to $250,000 ($500,000 in the case of certain jointly filed returns) of gain realized on the sale or exchange of property, if that property was owned and used as the taxpayer's principal residence for an aggregate period of two years or more during the 5-year period ending on the date of the sale or exchange. The full exclusion is available only once every two years.

Under § 1(h)(1), gain resulting from the sale or exchange of most capital assets is taxed at a capital gains rate of 20 percent (10 percent for gain otherwise taxed at an ordinary rate of 15 percent or less).

Section 1(h)(2) provides reduced capital gains rates for qualified 5-year gain, generally defined in § 1(h)(9) as "the aggregate long-term capital gain from property held for more than 5 years." Section 1(h)(2)(B) provides that the 20-percent capital gains rate is reduced to 18 percent for qualified 5-year gain resulting from the sale or exchange of property with a holding period beginning after December 31, 2000.

Section 311(e) of TRA 97 allows a noncorporate taxpayer holding a capital asset on January 1, 2001, to elect to treat that asset as having been both sold and reacquired on that date for an amount equal to its fair market value. Thus, if the election is made, the holding period for the asset begins after December 31, 2000, making the asset eligible for the 18-percent rate if it is later sold when the taxpayer has a holding period of more than five years in the asset. Section 311(e)(2)(A) of TRA 97 provides, "Any gain resulting from [a § 311(e) election] shall be treated as received or accrued on the date the asset is treated as sold . . . and shall be recognized notwithstanding any provision of the . . . Code."

Pursuant to *A*'s § 311(e) election, *A* is deemed to have both sold and reacquired *A*'s principal residence for an amount equal to its fair market value on January 1, 2001. As stated above, § 121 would entitle *A* to exclude from gross income gain from an actual sale. Thus, the question presented is how to reconcile the requirement that the gain from the deemed sale be "recognized notwithstanding any other provision" of the Code and the mandate in § 121 that "[g]ross income shall not include gain" from a qualifying sale or exchange of a principal residence.

In interpreting an internal revenue statute, it is necessary to infer legislative intent from all of the facts and circumstances. These factors include the role that the provision at issue plays in the structure of the internal revenue law, the statutory language, and all relevant legislative history. *See U.S. v. Amer. Trucking Ass'ns*, 310 U.S. 534, 542–45 (1940); *U.S. v. Dickerson*, 310 U.S. 554, 561–62 (1940).

A § 311(e) election confers tax benefits on the electing taxpayer (a holding period that begins after December 31, 2000, and a step-up in basis), but it imposes a tax cost as well (current recognition of gain resulting from any existing appreciation in the asset). Exclusion of the gain from the deemed sale would frustrate this balancing of benefits and burdens. For this reason, the statutory requirement that gain be recognized "notwithstanding any other provision" of the Code necessarily precludes application of the exclusion from gross income under § 121, or else the intended consequences of the mandated recognition (taxation of the gain) would be prevented. The legislative history of the § 311(e) election is consistent with this conclusion. "If the election is made, any gain is recognized (and any loss disallowed)." H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 383 (1997)

HOLDING

If an individual elects under § 311(e) of TRA 97 to treat the individual's principal residence as being both sold and reacquired on January 1, 2001, for an amount equal to its fair market value on that date, the individual cannot exclude from gross income under § 121 any of the gain resulting from the deemed sale.

DRAFTING INFORMATION

The principal author of this revenue ruling is Amy Pfalzgraf of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. Pfalzgraf at (202) 622-7900 (not a toll-free call).

## Section 42.—Low-Income Housing Credit

**Low-income housing credit; satisfactory bond; "bond factor" amounts for the period October through December 2001.** This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December

2001. This ruling also provides a summary of the bond factor amounts for dispositions occurring during the period January through September 2001.

## Rev. Rul. 2001–53

In Rev. Rul. 90–60 (1990–2 C.B. 4), the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

Rev. Proc. 99–11 (1999–1 C.B. 275) established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period October through December 2001. Table 1 also provides a summary of the bond factor amounts for dispositions occurring during the period January through September 2001.

Table 1
Rev. Rul. 2001–53
Monthly Bond Factor Amounts for Dispositions
Expressed As a Percentage of Total Credits

| | Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Month of Disposition | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 |
| Jan ’01 | 21.53 | 39.56 | 54.68 | 67.46 | 78.28 | 81.29 | 84.62 | 87.92 | 91.31 | 94.99 | 98.92 | 103.25 | 107.67 | 111.85 | 112.52 |
| Feb ’01 | 21.53 | 39.56 | 54.68 | 67.46 | 78.28 | 81.05 | 84.36 | 87.65 | 91.02 | 94.68 | 98.57 | 102.87 | 107.22 | 111.28 | 112.52 |
| Mar ’01 | 21.53 | 39.56 | 54.68 | 67.46 | 78.28 | 80.81 | 84.11 | 87.38 | 90.73 | 94.37 | 98.24 | 102.50 | 106.80 | 110.79 | 112.52 |
| Apr ’01 | 20.36 | 37.41 | 51.71 | 63.80 | 74.03 | 75.46 | 77.76 | 79.98 | 82.22 | 84.67 | 87.27 | 90.15 | 93.01 | 95.60 | 97.21 |
| May ’01 | 20.36 | 37.41 | 51.71 | 63.80 | 74.03 | 75.25 | 77.54 | 79.75 | 81.98 | 84.42 | 87.01 | 89.87 | 92.71 | 95.31 | 97.21 |
| Jun ’01 | 20.36 | 37.41 | 51.71 | 63.80 | 74.03 | 75.05 | 77.32 | 79.52 | 81.75 | 84.18 | 86.76 | 89.61 | 92.44 | 95.05 | 97.21 |
| Jul ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 70.27 | 71.68 | 72.99 | 74.30 | 75.75 | 77.30 | 79.07 | 80.80 | 82.36 | 83.98 |
| Aug ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 70.09 | 71.49 | 72.80 | 74.10 | 75.55 | 77.10 | 78.86 | 80.60 | 82.19 | 83.98 |
| Sep ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 69.91 | 71.31 | 72.61 | 73.91 | 75.36 | 76.91 | 78.67 | 80.41 | 82.05 | 83.98 |
| Oct ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 69.73 | 71.12 | 72.42 | 73.72 | 75.17 | 76.72 | 78.48 | 80.24 | 81.91 | 83.98 |
| Nov ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 69.55 | 70.94 | 72.24 | 73.54 | 74.99 | 76.54 | 78.31 | 80.07 | 81.79 | 83.98 |
| Dec ’01 | 19.30 | 35.47 | 49.02 | 60.48 | 70.18 | 69.38 | 70.77 | 72.06 | 73.36 | 74.81 | 76.37 | 78.14 | 79.92 | 81.68 | 83.98 |

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see: Rev. Rul. 98–3 (1998–1 C.B. 248), and Rev. Rul. 2001–2 (2001–2 I.R.B. 255).

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran at (202) 622-3040 (not a toll-free call).

## Section 162.—Trade or Business Expenses

*26 CFR 1.162–1: Business expenses.*

How do federal income and employment taxes apply to payments by employers under certain leave-based donation programs established in the aftermath of the September 11, 2001, terrorist attacks? See Notice 2001–69, page 491.

## Section 170.—Charitable, etc., Contributions and Gifts

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

Interim guidance is provided on the application of the rules on charitable deductions in connection with payments by employers under certain leave-based donation programs established in the aftermath of the September 11, 2001, terrorist attacks. See Notice 2001–69, page 491.

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

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

**LIFO; price indexes; department stores.** The September 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 2001.

## Rev. Rul. 2001–54

The following Department Store Inventory Price Indexes for September 2001 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46 (1986–2 C.B. 739), for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, September 30, 2001.

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

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

| Groups | Sep. 2000 | Sep. 2001 | Percent Change from Sep. 2000 to Sep. 2001[1] |
|---|---|---|---|
| 1. Piece Goods | 496.1 | 509.9 | 2.8 |
| 2. Domestics and Draperies | 609.3 | 589.1 | -3.3 |
| 3. Women's and Children's Shoes | 660.6 | 668.9 | 1.3 |
| 4. Men's Shoes | 913.6 | 854.7 | -6.4 |
| 5. Infants' Wear | 633.7 | 625.4 | -1.3 |
| 6. Women's Underwear | 584.9 | 571.0 | -2.4 |
| 7. Women's Hosiery | 342.9 | 356.7 | 4.0 |
| 8. Women's and Girls' Accessories | 540.0 | 557.9 | 3.3 |
| 9. Women's Outerwear and Girls' Wear | 400.2 | 392.0 | -2.0 |
| 10. Men's Clothing | 606.3 | 578.4 | -4.6 |
| 11. Men's Furnishings | 624.8 | 603.1 | -3.5 |
| 12. Boys' Clothing and Furnishings | 481.7 | 477.1 | -1.0 |
| 13. Jewelry | 933.7 | 899.0 | -3.7 |
| 14. Notions | 788.0 | 795.0 | 0.9 |
| 15. Toilet Articles and Drugs | 969.9 | 979.9 | 1.0 |
| 16. Furniture and Bedding | 707.2 | 632.8 | -10.5 |
| 17. Floor Coverings | 614.8 | 622.9 | 1.3 |
| 18. Housewares | 777.5 | 767.5 | -1.3 |
| 19. Major Appliances | 230.6 | 227.0 | -1.6 |
| 20. Radio and Television | 58.3 | 52.9 | -9.3 |
| 21. Recreation and Education[2] | 92.3 | 89.3 | -3.3 |
| 22. Home Improvements[2] | 128.3 | 125.6 | -2.1 |
| 23. Auto Accessories[2] | 106.5 | 110.1 | 3.4 |
| Groups 1 - 15: Soft Goods | 600.3 | 588.6 | -1.9 |
| Groups 16 - 20: Durable Goods | 438.9 | 421.2 | -4.0 |
| Groups 21 - 23: Misc. Goods[2] | 99.8 | 98.3 | -1.5 |
| Store Total[3] | 539.4 | 526.8 | -2.3 |

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

[2] Indexes on a January 1986=100 base.

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

DRAFTING INFORMATION

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

# Part III. Administrative, Procedural, and Miscellaneous

## Treatment of Certain Amounts Paid to Section 170(c) Organizations Under Employer Leave-Based Donation Programs

## Notice 2001–69

PURPOSE AND OVERVIEW

In the aftermath of the September 11, 2001, terrorist attacks, a number of employers have adopted or are considering adopting leave-based donation programs, under which employees forgo vacation, sick, or personal leave in exchange for employer contributions of amounts to organizations described in § 170(c) of the Internal Revenue Code. This notice provides interim guidance on the application of income and employment taxes to, and the proper reporting of, payments by employers under these programs. During the period covered by this interim guidance, the Internal Revenue Service and the Treasury Department intend to study whether it may be appropriate to modify the regulations under § 61 to address certain leave-based donation programs.

BACKGROUND

Under general assignment-of-income tax principles, where, pursuant to an agreement or understanding, services are rendered to a person for the benefit of an organization described in § 170(c) and an amount for such services is paid to such organization by the person to whom services are rendered, the amount so paid constitutes income to the person performing the services. Section 1.61–2(c) of the Income Tax Regulations. See also *Lucas v. Earl*, 281 U.S. 111 (1930); Rev. Rul. 58–495 (1958–2 C.B. 27). Under general constructive receipt principles, when income is made available so that the taxpayer may draw upon it at any time, the income is constructively received by the taxpayer unless the taxpayer's control of its receipt is subject to substantial limitations or restrictions. Section 1.451–2(a). However, application of assignment-of-income and constructive receipt principles depends on the facts and circumstances of each case. See, *e.g.*, *Commissioner v. Giannini*, 129 F.2d 638 (9th Cir. 1942).

INTERIM GUIDANCE

The Service will not assert that payments made by an employer to an organization described in § 170(c), in exchange for vacation, sick, or personal leave that the employee elects to forgo, constitute gross income or wages of an employee, *provided* that the payments are made to such organizations before January 1, 2003. Similarly, the Service will not assert that the opportunity to make such an election results in constructive receipt of gross income or wages for employees.

Amounts to which this interim guidance applies need not be included in Box 1, 3 (if applicable), or 5 of the Form W-2.

Participating employees may not claim a charitable contribution deduction under § 170 with respect to the value of forgone leave excluded from compensation and wages. In the case of an employer, the Service will not assert that payments made under such programs before January 1, 2003, are deductible under § 170, rather than under § 162.

REQUEST FOR COMMENTS

The Service and the Treasury Department invite comments on the taxation of leave-based donation programs, including comments on whether § 1.61–2(c) should be modified to except certain leave-based donation programs from the assignment-of-income doctrine, and on appropriate limitations to any such exception. Comments are also requested on the application of constructive receipt principles in connection with those programs. Finally, comments are requested on what types of leave-based donation programs employers currently offer.

Comments may be submitted on or before February 1, 2002, to Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20224, Attn: CC:ITA:RU (Notice 2001–69), Room 5226. Submissions may also be sent electronically via the Internet to the following e-mail address: *notice.comments@m1.irscounsel.treas.gov.* All materials submitted will be available for public inspection and copying.

FURTHER INFORMATION

For further information, please contact Mr. Sheldon A. Iskow at (202) 622-4920 (not a toll-free call).

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*26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, § 6662.)*

## Rev. Proc. 2001–52

SECTION 1. PURPOSE

.01 This revenue procedure updates Rev. Proc. 2001–11 (2001–2 I.R.B. 275), and identifies circumstances under which the disclosure on a taxpayer's return of a position with respect to an item is adequate for the purpose of reducing the understatement of income tax under § 6662(d) of the Internal Revenue Code (relating to the substantial understatement aspect of the accuracy-related penalty), and for the purpose of avoiding the preparer penalty under § 6694(a) (relating to understatements due to unrealistic positions). This revenue procedure does not apply with respect to any other penalty provision (including the negligence or disregard provisions of the § 6662 accuracy-related penalty).

.02 This revenue procedure applies to any return filed on 2001 tax forms for a taxable year beginning in 2001, and to any return filed on 2001 tax forms in 2002 for short taxable years beginning in 2002.

SEC. 2. CHANGES FROM REV. PROC. 2001–11

Editorial changes only have been made in updating Rev. Proc. 2001–11.

SEC. 3. BACKGROUND

.01 If § 6662 applies to any portion of an underpayment of tax required to be shown on a return, an amount equal to 20 percent of the portion of the underpayment to which the section applies is added to the tax. (The penalty rate is 40 percent in the case of certain gross valuation misstatements.) Under § 6662(b)(2), § 6662 applies to the portion of an underpayment that is attributable to a substantial understatement of income tax.

.02 Section 6662(d)(1) provides that there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of 10 percent of the amount of tax required to be shown on the return for the taxable year or $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Section 6662(d)(2) defines an understatement as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of the tax that is shown on the return reduced by any rebate (within the meaning of § 6211(b)(2)).

.03 In the case of an item not attributable to a tax shelter, § 6662(d)(2)(B)(ii) provides that the amount of the understatement is reduced by the portion of the understatement attributable to any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed on the return or on a statement attached to the return, and there is a reasonable basis for the tax treatment of such item by the taxpayer.

.04 In general, this revenue procedure provides guidance in determining when disclosure is adequate for purposes of § 6662(d). For purposes of this revenue procedure, the taxpayer must furnish all required information in accordance with the applicable forms and instructions, and the money amounts entered on these forms must be verifiable. Guidance under § 6662(d) for returns filed for 2000, 1999, and 1998 is provided in Rev. Proc. 2001–11; Rev. Proc. 99–41 (1999–2 C.B. 566); and Rev. Proc. 98–62 (1998–2 C.B. 816), respectively.

SEC. 4. PROCEDURE

.01 Additional disclosure of facts relevant to, or positions taken with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of income tax under § 6662(d), provided that the forms and attachments are completed in a clear manner and in accordance with their instructions. The money amounts entered on the forms must be verifiable, and the information on the return must be disclosed in the manner described below. For purposes of this revenue procedure, a number is verifiable if, on audit, the taxpayer can demonstrate the origin of the number (even if that number is not ultimately accepted by the Internal Revenue Service) and the taxpayer can show good faith in entering that number on the applicable form.

(1) Form 1040, Schedule A, Itemized Deductions:

(a) Medical and Dental Expenses: Complete lines 1 through 4, supplying all required information.

(b) Taxes: Complete lines 5 through 9, supplying all required information. Line 8 must list each type of tax and the amount paid.

(c) Interest Expense: Complete lines 10 through 14, supplying all required information. This section 4.01(1)(c) does not apply to (i) amounts disallowed under § 163(d) unless Form 4952, *Investment Interest Expense Deduction*, is completed, or (ii) amounts disallowed under § 265.

(d) Contributions: Complete lines 15 through 18, supplying all required information. Merely entering the amount of the donation on Schedule A, however, will not constitute adequate disclosure if the taxpayer receives a substantial benefit from the donation shown. If a contribution of property other than cash is made and the amount claimed as a deduction exceeds $500, a properly completed Form 8283, *Noncash Charitable Contributions*, must be attached to the return. This section 4.01(1)(d) will not apply to any contribution of $250 or more unless the contemporaneous written acknowledgment requirement of § 170(f)(8) is satisfied.

(e) Casualty and Theft Losses: Complete Form 4684, *Casualties and Thefts*, and attach to the return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(2) Certain Trade or Business Expenses (including, for purposes of this section 4.01(2), the following six expenses as they relate to the rental of property):

(a) Casualty and Theft Losses: The procedure outlined in section 4.01(1)(e) above must be followed.

(b) Legal Expenses: The amount claimed must be stated. This section 4.01(2)(b) does not apply, however, to amounts properly characterized as capital expenditures, personal expenses, or nondeductible lobbying or political expenditures, including amounts that are required to be (or that are) amortized over a period of years.

(c) Specific Bad Debt Charge-off: The amount written off must be stated.

(d) Reasonableness of Officers' Compensation: Form 1120, Schedule E, Compensation of Officers, must be completed when required by its instructions. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed." This section 4.01(2)(d) does not apply to "golden parachute" payments, as defined under § 280G. This section 4.01(2)(d) will not apply to the extent that remuneration paid or incurred exceeds the $1 million-employee-remuneration limitation, if applicable.

(e) Repair Expenses: The amount claimed must be stated. This section 4.01(2)(e) does not apply, however, to any repair expenses properly characterized as capital expenditures or personal expenses.

(f) Taxes (other than foreign taxes): The amount claimed must be stated.

(3) Form 1120, Schedule M-1, Reconciliation of Income (Loss) per Books With Income per Return, provided:

(a) The amount of the deviation from the financial books and records is not the result of a computation that includes the netting of items; and

(b) The information provided reasonably may be expected to apprise the Internal Revenue Service of the nature of the potential controversy concerning the tax treatment of the item.

(4) Foreign Tax Items:

(a) International Boycott Transactions: Transactions disclosed on Form 5713, International Boycott Report.

(b) Treaty-Based Return Position: Transactions and amounts under § 6114 or § 7701(b) as disclosed on Form 8833, *Treaty-Based Return Position Disclosure.*

(5) Other:

(a) Moving Expenses: Complete Form 3903, *Moving Expenses*, and attach to the return.

(b) Employee Business Expenses: Complete Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed Employee Business Expenses*, and attach to the return. This section 4.01(5)(b) does not apply to club dues, or to travel expenses for any non-employee accompanying the taxpayer on the trip.

(c) Fuels Credit: Complete Form 4136, *Credit for Federal Tax Paid on Fuels*, and attach to the return.

(d) Investment Credit: Complete Form 3468, *Investment Credit*, and attach to the return.

SEC. 5. EFFECTIVE DATE

This revenue procedure applies to any return filed on 2001 tax forms for a taxable year beginning in 2001, and to any return filed on 2001 tax forms in 2002 for short taxable years beginning in 2002.

SEC. 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Willie Armstrong, Jr. of the Office of Associate Chief Counsel, Procedure & Administration (Administrative Provisions & Judicial Practice Division). For further information regarding this revenue procedure, contact Branch 2 of the Administrative Provisions & Judicial Practice Division at (202) 622-4940 (not a toll-free call).

# Part IV. Items of General Interest

## Redesignation of Estimated Income Tax Payments

## Announcement 2001–112

Many taxpayers have informed the Internal Revenue Service (IRS) that their income for the current year will be substantially less than previously expected because of economic disruptions resulting from the September 11, 2001, terrorist attacks. Some taxpayers who made estimated income tax payments now believe their tax liability for their current taxable year will be lower than the sum of the estimated tax payments they have already made. Several of these taxpayers have asked whether the IRS will permit them to redesignate their estimated income tax payments, in whole or in part, as deposits to satisfy their obligations to deposit employment and withheld income taxes.

This announcement clarifies that the IRS will permit the redesignation of estimated income tax payments as tax deposits to satisfy obligations to deposit employment taxes imposed by chapters 21, 22, and 23 of the Internal Revenue Code, and income taxes withheld under chapter 24. To make this redesignation, a taxpayer should contact the IRS through its Disaster Relief toll-free telephone number 1-866-562-5227.

Taxpayers who wish to redesignate their estimated tax payments should keep in mind their estimated income tax obligations. If, as a result of the redesignation, the amount of estimated tax payments is reduced below the amount required to satisfy the taxpayer's estimated income tax obligation, the taxpayer may be liable for additions to tax under section 6654 or 6655.

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## Foundations Status of Certain Organizations

## Announcement 2001–113

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

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

Aaron Kritz Music Foundation, Chicago, IL
Abundant Grace, Inc., Longmont, CO
Aid for the Homeless and Children, Inc., Littleton, CO
Alice G Reynolds Memorial Fund, Denver, CO
Alliance for Donor Insemination Families, Inc., Englewood, CO
American Coordination Center of the Sovereign Military Order of Malta, Inc., Coral Gables, FL
American Institute of Technology, Littleton, CO
Antonia and Vladimer Kulaev Cultural Heritage Fund, Inc., Los Angeles, CA
Appropriate Technology, Incorporated, Ogallala, NE
Area 76 Alcoholics Anonymous, Casper, WY
Arklight Ministries, Woodland Hills, CA
Arrowhead Housing Development Fund Company, Inc., Dunkirk, NY
Arvada Youth Foundation, Inc., Arvada, CO
Bainbridge-Guilford PTO, Inc., Bainbridge, NY
Balanced Transportation Education, Denver, CO
Blue Angels Cheerleaders, Denver, CO
Bolder Options, Boulder, CO
Branyon Workshop, Ltd, Amagansett, NY
Buffalo Girls Productions, Inc., Moscow, ID
Cain Family Day Care, Inc., South Bay, FL
Camden County Education Foundation, Inc., Camden SC
Casper World War II Commemorative Association, Casper, WY
Catskill Mountain Wolf Center, Athens, NY
Centennial Rural Development Project, Alpine, TX
Changeology Learning Centre, Colorado Springs, CO
Cheyenne Gospel Mission, Cheyenne, WY
Children's Rights Project, Inc., Baltimore, MD
Childrens Village Management, Inc., An Idaho Non Profit Corporation, Coeur Dalene, ID
Christian Outreach for Pastors, Anaheim Hills, CA
Club Zion Ministries, Hanford, CA
Colorado Capitol Preservation Fund, Golden, CO
Colorado Herpetological Society, Denver, CO
Colorado Knights Templar Foundation, Denver, CO
Colorado Longball Youth Softball, Inc., Englewood, CO
Colorado Meeting Place, Denver, CO
Colorado Solar Racers, Inc., Denver, CO
Commercial Fisherman Memorial, Inc., Port Washington, WI
Conejos Parks Education & Heritage Foundation, Romeo, CO
Conifer Basketball Association, Conifer, CO
Consumer Advisory Services, Snoqualmie, WA
Crawford Creative Alliance, Crawford, CO
Creek Court Club, Englewood, CO
Crosslink International Ministries, Silver Creek, CO
Crossroads Lodestar, Corporation, Falcon, CO
Crusades for Kids, Inc., Boise, ID
Currier International Foundation, Inc., Pasadena, CA
Dear Old Cu Fund, Inc., Littleton, CO
Denver Metro Association of Evangelicals, Thornton, CO
Denver Million Man March Coalition, Denver, CO
Designing Brighter Tomorrows, Inc., Denver, CO
Diannes Day Care & Christian Schools, Gardena, CA
DML & Associates Foundation A Housing Corporation, Tarzana, CA

Dolphin Human Research, Inc., Miami, FL
Drug Free Events, Inc., Colorado Springs, CO
Ebenezer Enhancement, Corp., Augusta, GA
Education Project of Maya Children in Guatemala, Denver, CO
Erie Senior Citizens Fund, Erie, CO
Esa Indah, Redlands, CA
Essence of Enhancement, Inc., Denver, CO
Everybody Wins, Federal Way, WA
Facing our Childrens Urban Situation Foundation, Inc., Franklin Lakes, NJ
Family Empowerment Center, Inc., Grand Junction, CO
Family Learning Tree, Inc., Decatur, GA
Family Life Foundation, Englewood, CO
Feyda, Inc., Aurora, CO
Film the Bible Ministries, Inc., Tamarac, FL
Finding Hope, Incorporated, Colorado Springs, CO
Fire Safety Educators of Colorado, Inc., Denver, CO
Firebrand Ministries, Inc., Ft. Worth, TX
Foresight Affordable Housing, Inc., Rockville, MD
Foresight Affordable Housing-Ridgewood Park, Inc., Rockville, MD
Foundation for Justice and Democracy in Latin America, Washington, DC
Foundation of the Florida Chapter of the American College of Cardiology, Tampa, FL
Foxview Preservation Corporation, Chicago, IL
Friends of Hospice Fremont County, Canon City, CO
Friends of the South Routt Library District, Yampa, CO
Front Range Dolphins Swim Club, Thornton, CO
Frontier Mission Foundation, Mount Lake Terrace, WA
Frontier Pathways Scenic Byway, Inc., Westcliffe, CO
Gods Way Ministry, Houston, TX
Good Samaritan Childrens Mission, Inc., Sugarland, TX
Grant Street Development Corporation, Homestead, PA
Greater Erie County Marketing Group Community Urban Redevelopment Corp., Sandusky, OH
Greater Reading Development Corporation, Reading, PA
Hands on Childrens Museum, Inc., Ridgewood, NJ
Haymarket Historical Foundation, Haymarket, VA
Healing Images Artfest Association, Colorado Springs, CO
Heritage Lacrosse Club, Inc., Littleton, CO
Higgins Diggins Lions Trust, Auburn, CA
Home for the Future Hope, Washington, DC
House of Joy, Inc., Indian Springs, AL
Hudsons River Project Corp, New York, NY
Hugh A Martin Memorial Scholarship Fund, Colorado Springs, CO
Human Rights Interactive Network, Antelope, CA
Idaho Dance Classic, Meridian, ID
Imagination Station, Marina Del Rey, CA
Imani House, Inc., Houston, TX
Inkatha Foundation for the Arts, Las Vegas, NV
Institute for Trauma of Colorado, Inc., Colorado Springs, CO
Integral Health Foundation, Inc., Rockville, MD
Irish Arts Foundation of Kentucky, Inc., Louisville, KY
Jairus, Inc., Hilo, HI
Jami Breedlove Ministries, Loveland, CO
Janrus, Incorporated, Harvey, LA
J H Machina, Inc., Boulder, CO
Jim McQueen Ministries, Inc., Ridgway, CO
J Morris Center for Children with Special Needs LTD, St Louis, MO
Jobscomp Educational Services Corporation, Columbia, MD
K & A Sports Alliance, Inc., W Jordan, UT
Kids One, Inc., Larkspur, CA
Kuumba Project, Inc., Milwaukee, WI
La Comunidad, Westminster, CO
La Puente Enterprises, Inc., Alamosa, CO
Larry G. Huss Scholarship Memorial, Inc., Appleton, WI
Legacy for Learning, Denver, CO
Lida Project, Denver, CO
Life Light Drug Free International, Inc., Lumberton, NC
Lillian Leppe & Augusto Mauro Memorial Foundation, Inc., New York, NY
Lytton Research and Analysis, Sandpoint, ID
Mainstreet Roswell, Inc., Roswell, NM
Max Dream, Springfield, VT
Medicine Wheel Story Tellers Institute of the Arts, Douglas, WY
Mel Berg Ministries, Inc., Westminster, CO
Metropolitan Community Resource Center, Pasadena, CA
Mezzo Consortium, Inc., Boise, ID
Ministry Resources International, Englewood, CO
Morey Organization Scholarship Trust Fund, Wildwood, NJ
Moscow Parents Womens Fastpitch Softball Association, Moscow, ID
Mountain International Exchange, Inc., Denver, CO
Musicmedicine Institute, Chicago, IL
National Association of Shooting Sports Athletes, Colorado Springs, CO
Native American Prisoners Support Group, Inc., Buena Vista, CO
NBC-USA Housing, Inc., Thirty, Newark, OH
North Metro Gang Task Force, Inc., Westminster, CO
Nourishment Education Foundation, Boulder, CO
Oasis World Mission, West Monroe, LA
Oklahoma Investment Forum Educational Foundation, Tulsa, OK
Open Arms International, Arlington, VA
Orenda, Santa Fe, NM
Panini Foundation, Westerville, OH
Peers, Denver, CO
Pentecostal Assembly Commitment to Empowerment, Restoration and Service, Inc., Jackson, TN
Pets are Wonderful Support for People with Aids-Arc, Denver, CO
Plattee County Science Education & Research Foundation, Wheatland, WY
Policemen-Firemen Killed in Action, Inc., Carmen, ID
Promised Land Ministries, Denver, CO
Promised Land's Development and Redevelopment Corporation, Cincinnati, OH
Pueblo Flyers, Inc., Pueblo, CO
PWA Center, Corp., Honolulu, HI
Reclaiming Easter International USA, Inc., Andover, MA
Righteousness & Praise Ministries, Inc., Peyton, CO
Rita Leahy Manning Charitable Trust, Southwick, MA
Robert Victor Sager & Beatrice Mintz Sager Charitable Foundation, Rolla, MO

Safe Haven Animal Sanctuary, Inc., Boca Raton, FL
San Pedro Charity Foundation, Houston, TX
Save a Child, Incorporated, Denver, CO
Senior Resource Council, Inc., Colorado Springs, CO
Shakespeare Marionette Company, Chicago, IL
Shekhina House, Boulder, CO
Shining Mountains Center for Cooperation, Durango, CO
Shoshone County Substance Abuse Council, Inc., Wallace, ID
Sillca Syndrome Reach Corporation, Idaho Falls, ID
Simone Institute for Women, Denver, CO
Sisters Organizational Services, Gardena, CA
Soli Deo Gloria, Ltd., Eau Claire, WI
Southeast Colorado Crime Stoppers, Lamar, CO
Southside Nondenominational Fellowship, Inc., Fort Wayne, IN
Story Gleaner, Evergreen, CO
Street Project, Inc., New York, NY
Strykers Field Charitable Foundation, Wichita, KS
Students Hope, Inc., Denver, CO
Superior Image Economic Development Corporation, Rialto, CA
Survivors of Violence, Westminster, CO
Tanner Daily Memorial Scholarship Fund, Aspen, CO
Technology Transfer Solutions, Greenwood Village, CO
Thirteenth-Irving Development Corporation, Washington, DC
Thomas Foundation, Inc., Albany, GA
Tibetan Childrens Education Foundation, Morgantown, WV
Tolo Mammoth Replica Group, Inc., Grangeville, ID
Tony Gaines Memorial Fund, Denver, CO
Touch International Missions, Inc., Denteon, TX
Trinidad Access to Informational Resources, Trinidad, CO
United Ethiopian Services, Inc., Cambridge, MA
United Karate Federation of America, Inc., Seattle, WA
United States Council on Veterans Affairs, Inc., Las Vegas, NV
Usoc Employee Hardship and Relief Foundation, Colorado Springs, CO
Valley Voices, Inc., Modesto, CA
Warriors of Light, Boulder, CO
Weiser Soccer Association, Inc., Weiser, ID
Wendell P Carnefix Memorial Scholarship Trust, Fruitland, ID
Wiconi Waste, Lakewood, CO
Windows to the Future, Brighton, CO
Wings of Light Foundation, Lakewood, CO
Win-Win Resource Network, Evergreen, CO
Womens Home Improvement, Incorporated, Aurora, CO
World Baseball Card, Corp., Neenah, WI
Wyoming Buffalo Soldiers Association, Fe Warren AFB, WY
Your Life Can Change, Gary, IN
Youth Pops America Foundation, Denver, CO
Youth Social Development Center, Denver, CO

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

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

## Section 401. —Qualified Pension, Profit–Sharing, and Stock Bonus Plans

*26 CFR 1.401(l)–1: Permitted disparity in employer–provided contributions or benefits.*

**Covered compensation tables; 2002**. The covered compensation tables for the year 2002 under section 401 of the Code are provided for use in determining contributions to defined benefit plans and permitted disparity.

## Rev. Rul. 2001–55

This revenue ruling provides tables of covered compensation under § 401(I)(5)(E) of the Internal Revenue Code (the "Code") and the Income Tax Regulations, thereunder, for the 2002 plan year.

Section 401(I)(5)(E)(i) defines covered compensation with respect to an employee, as the average of the contribution and benefit bases in effect under section 230 of the Social Security Act (the "Act") for each year in the 35–year period ending with the year in which the employee attains social security retirement age.

Section 401(I)(5)(E)(ii) of the Code states that the determination for any year preceding the year in which the employee attains social security retirement age shall be made by assuming that there is no increase in covered compensation after the determination year and before the employee attains social security retirement age.

Section 1.401(I)-1(c)(34) of the regulations defines the taxable wage base as the contribution and benefit base under section 230 of the Act.

Section 1.401(I)-1(c)(7)(i) defines covered compensation for an employee as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35–year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35–year period is used for all individuals regardless of the year of birth of the individual. In determining an employee's covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year. An employee's covered compensation for a plan year beginning after the 35–year period applicable under § 1.401(I)-1(c)(7)(i) is the employee's covered compensation for a plan year during which the 35–year period ends. An employee's covered compensation for a plan year beginning before the 35–year period applicable under § 1.401(I)-1(c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

Section 1.401(I)-1(c)(7)(ii) provides that, for purposes of determining the amount of an employee's covered compensation under § 1.401(I)-1(c)(7)(i), a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

For purposes of determining covered compensation for the 2002 year the taxable wage base is $84,900.

The following tables provide covered compensation for 2002:

2002 COVERED COMPENSATION TABLE

| CALENDAR YEAR OF BIRTH | CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE | 2002 COVERED COMPENSATION TABLE |
|---|---|---|
| 1907 | 1972 | $4,488 |
| 1908 | 1973 | 4,704 |
| 1909 | 1974 | 5,004 |
| 1910 | 1975 | 5,316 |
| 1911 | 1976 | 5,664 |
| 1912 | 1977 | 6,060 |
| 1913 | 1978 | 6,480 |
| 1914 | 1979 | 7,044 |
| 1915 | 1980 | 7,692 |
| 1916 | 1981 | 8,460 |
| 1917 | 1982 | 9,300 |
| 1918 | 1983 | 10,236 |
| 1919 | 1984 | 11,232 |

2002 COVERED COMPENSATION TABLE

| CALENDAR YEAR OF BIRTH | CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE | 2002 COVERED COMPENSATION TABLE |
|---|---|---|
| 1920 | 1985 | 12,276 |
| 1921 | 1986 | 13,368 |
| 1922 | 1987 | 14,520 |
| 1923 | 1988 | 15,708 |
| 1924 | 1989 | 16,968 |
| 1925 | 1990 | 18,312 |
| 1926 | 1991 | 19,728 |
| 1927 | 1992 | 21,192 |
| 1928 | 1993 | 22,716 |
| 1929 | 1994 | 24,312 |
| 1930 | 1995 | 25,920 |
| 1931 | 1996 | 27,576 |
| 1932 | 1997 | 29,304 |
| 1933 | 1998 | 31,128 |
| 1934 | 1999 | 33,060 |
| 1935 | 2000 | 35,100 |
| 1936 | 2001 | 37,212 |
| 1937 | 2002 | 39,444 |
| 1938 | 2004 | 43,848 |
| 1939 | 2005 | 46,056 |
| 1940 | 2006 | 48,252 |
| 1941 | 2007 | 50,424 |
| 1942 | 2008 | 52,548 |
| 1943 | 2009 | 54,588 |
| 1944 | 2010 | 56,616 |
| 1945 | 2011 | 58,608 |
| 1946 | 2012 | 60,552 |
| 1947 | 2013 | 62,472 |
| 1948 | 2014 | 64,248 |
| 1949 | 2015 | 65,940 |
| 1950 | 2016 | 67,512 |
| 1951 | 2017 | 69,012 |
| 1952 | 2018 | 70,416 |
| 1953 | 2019 | 71,760 |
| 1954 | 2020 | 73,056 |
| 1955 | 2022 | 75,456 |
| 1956 | 2023 | 76,596 |
| 1957 | 2024 | 77,652 |
| 1958 | 2025 | 78,612 |
| 1959 | 2026 | 79,512 |
| 1960 | 2027 | 80,352 |
| 1961 | 2028 | 81,132 |
| 1962 | 2029 | 81,828 |

2002 COVERED COMPENSATION TABLE

| CALENDAR YEAR OF BIRTH | CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE | 2002 COVERED COMPENSATION TABLE |
|---|---|---|
| 1963 | 2030 | 82,500 |
| 1964 | 2031 | 83,136 |
| 1965 | 2032 | 83,700 |
| 1966 | 2033 | 84,168 |
| 1967 | 2034 | 84,516 |
| 1968 | 2035 | 84,768 |
| 1969 or later | 2036 | 84,900 |

2002 ROUNDED COVERED
COMPENSATION TABLE

| YEAR OF BIRTH | COVERED COMPENSATION |
|---|---|
| 1935–1936 | $36,000 |
| 1937 | 39,000 |
| 1938 – 1939 | 45,000 |
| 1940 | 48,000 |
| 1941 | 51,000 |
| 1942 – 1943 | 54,000 |
| 1944 | 57,000 |
| 1945 – 1946 | 60,000 |
| 1947 – 1948 | 63,000 |
| 1949 | 66,000 |
| 1950 – 1952 | 69,000 |
| 1953 – 1954 | 72,000 |
| 1955 | 75,000 |
| 1956 – 1958 | 78,000 |
| 1959 – 1962 | 81,000 |
| 1963 – 1966 | 84,000 |
| 1967 and later | 84,900 |

DRAFTING INFORMATION

The principal author of this revenue ruling is Todd Newman of Employee Plans Actuarial Group 1 of the Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500, between the hours of 8:00 a.m. and 9:30 p.m. Eastern time, Monday through Friday (a toll–free number). Mr. Newman's number is (202) 283-9888 (not a toll free number).

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## Section 995.—Taxation of DISC Income to Shareholders

**2001 base period T-bill rate**. The "base period T-bill rate" for the period ending September 30, 2001, is published as required by section 995(f) of the Code.

## Rev. Rul. 2001–56

Section 995(f)(1) of the Internal Revenue Code provides that a shareholder of a DISC shall pay interest each taxable year in an amount equal to the product of the shareholder's DISC-related deferred tax liability for the year and the "base period T-bill rate." Under section 995(f)(4), the base period T-bill rate is the annual rate of interest determined by the Secretary to be equivalent to the average of the 1-year constant maturity Treasury yields, as published by the Board of Governors of the Federal Reserve System, for the 1-year period ending on September 30 of the calendar year ending with (or of the most recent calendar year ending before) the close of the taxable year of the shareholder. The base period T-bill rate for the period ending September 30, 2001, is 4.41 percent.

Pursuant to section 6222 of the Code, interest must be compounded daily. The table below provides factors for compounding the base period T-bill rate daily for any number of days in the shareholder's taxable year (including a 52-53 week accounting period) for the 2001 base period T-bill rate. To compute the amount of the interest charge for the shareholder's taxable year, multiply the amount of the shareholder's DISC-related deferred tax liability (as defined in section 995(f)(2)) for that year by the base period T-bill rate factor corresponding to the number of days in the shareholder's taxable year for which the interest charge is being computed. Generally, one would use the factor for 365 days. One would use a different factor only if the shareholder's taxable year for which the interest charge being determined is a short taxable year, if the shareholder uses the 52–53 week taxable year, or if the shareholder's taxable year is a leap year.

For the base period T-bill rates for the periods ending in prior years, see Rev. Rul. 2000–52 (2000-48 I.R.B. 516).

DRAFTING INFORMATION

The principal author of this revenue ruling is David Bergkuist of the Office of the Associate Chief Counsel (International). For further information about this revenue ruling, contact Mr. Bergkuist at (202) 622-3850 (not a toll–free call).

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2001 ANNUAL RATE
COMPOUNDED DAILY

4.410 PERCENT

| DAYS | FACTOR |
|---|---|
| 1 | .000120822 |
| 2 | .000241658 |
| 3 | .000362510 |
| 4 | .000483375 |
| 5 | .000604256 |
| 6 | .000725151 |
| 7 | .000846060 |
| 8 | .000966984 |
| 9 | .001087923 |
| 10 | .001208876 |
| 11 | .001329844 |
| 12 | .001450827 |
| 13 | .001571824 |
| 14 | .001692836 |
| 15 | .001813862 |

4.410 PERCENT

| DAYS | FACTOR |
|---|---|
| 16 | .001934903 |
| 17 | .002055959 |
| 18 | .002177029 |
| 19 | .002298114 |
| 20 | .002419214 |
| 21 | .002540328 |
| 22 | .002661457 |
| 23 | .002782601 |
| 24 | .002903759 |
| 25 | .003024931 |
| 26 | .003146119 |
| 27 | .003267321 |
| 28 | .003388538 |
| 29 | .003509769 |
| 30 | .003631015 |
| 31 | .003752275 |
| 32 | .003873551 |
| 33 | .003994841 |
| 34 | .004116145 |
| 35 | .004237464 |
| 36 | .004358798 |
| 37 | .004480147 |
| 38 | .004601510 |
| 39 | .004722888 |
| 40 | .004844281 |
| 41 | .004965688 |
| 42 | .005087110 |
| 43 | .005208546 |
| 44 | .005329997 |
| 45 | .005451463 |
| 46 | .005572944 |
| 47 | .005694439 |
| 48 | .005815949 |
| 49 | .005937474 |
| 50 | .006059013 |
| 51 | .006180567 |
| 52 | .006302136 |
| 53 | .006423719 |
| 54 | .006545317 |
| 55 | .006666930 |
| 56 | .006788557 |
| 57 | .006910199 |
| 58 | .007031856 |
| 59 | .007153528 |
| 60 | .007275214 |

2001 ANNUAL RATE
COMPOUNDED DAILY—CONTINUED

| 4.410 PERCENT | | 4.410 PERCENT | | 4.410 PERCENT | |
|---|---|---|---|---|---|
| DAYS | FACTOR | DAYS | FACTOR | DAYS | FACTOR |
| 61 | .007396915 | 101 | .012277028 | 141 | .017180782 |
| 62 | .007518630 | 102 | .012399333 | 142 | .017303680 |
| 63 | .007640361 | 103 | .012521653 | 143 | .017426592 |
| 64 | .007762106 | 104 | .012643988 | 144 | .017549520 |
| 65 | .007883866 | 105 | .012766338 | 145 | .017672462 |
| 66 | .008005640 | 106 | .012888702 | 146 | .017795419 |
| 67 | .008127429 | 107 | .013011081 | 147 | .017918391 |
| 68 | .008249233 | 108 | .013133475 | 148 | .018041378 |
| 69 | .008371052 | 109 | .013255884 | 149 | .018164380 |
| 70 | .008492885 | 110 | .013378307 | 150 | .018287396 |
| 71 | .008614733 | 111 | .013500746 | 151 | .018410428 |
| 72 | .008736596 | 112 | .013623199 | 152 | .018533474 |
| 73 | .008858473 | 113 | .013745667 | 153 | .018656535 |
| 74 | .008980366 | 114 | .013868149 | 154 | .018779611 |
| 75 | .009102272 | 115 | .013990647 | 155 | .018902702 |
| 76 | .009224194 | 116 | .014113159 | 156 | .019025808 |
| 77 | .009346131 | 117 | .014235686 | 157 | .019148929 |
| 78 | .009468082 | 118 | .014358228 | 158 | .019272064 |
| 79 | .009590048 | 119 | .014480785 | 159 | .019395215 |
| 80 | .009712028 | 120 | .014603356 | 160 | .019518380 |
| 81 | .009834023 | 121 | .014725943 | 161 | .019641560 |
| 82 | .009956034 | 122 | .014848544 | 162 | .019764755 |
| 83 | .010078058 | 123 | .014971160 | 163 | .019887965 |
| 84 | .010200098 | 124 | .015093791 | 164 | .020011190 |
| 85 | .010322152 | 125 | .015216436 | 165 | .020134429 |
| 86 | .010444221 | 126 | .015339097 | 166 | .020257684 |
| 87 | .010566305 | 127 | .015461772 | 167 | .020380954 |
| 88 | .010688404 | 128 | .015584462 | 168 | .020504238 |
| 89 | .010810517 | 129 | .015707167 | 169 | .020627537 |
| 90 | .010932645 | 130 | .015829886 | 170 | .020750851 |
| 91 | .011054788 | 131 | .015952621 | 171 | .020874180 |
| 92 | .011176945 | 132 | .016075370 | 172 | .020997524 |
| 93 | .011299118 | 133 | .016198134 | 173 | .021120883 |
| 94 | .011421305 | 134 | .016320913 | 174 | .021244257 |
| 95 | .011543507 | 135 | .016443707 | 175 | .021367646 |
| 96 | .011665723 | 136 | .016566516 | 176 | .021491049 |
| 97 | .011787955 | 137 | .016689340 | 177 | .021614468 |
| 98 | .011910201 | 138 | .016812178 | 178 | .021737901 |
| 99 | .012032462 | 139 | .016935031 | 179 | .021861350 |
| 100 | .012154738 | 140 | .017057899 | 180 | .021984813 |

2001 ANNUAL RATE
COMPOUNDED DAILY—CONTINUED

| 4.410 PERCENT DAYS | FACTOR | 4.410 PERCENT DAYS | FACTOR | 4.410 PERCENT DAYS | FACTOR |
|---|---|---|---|---|---|
| 181 | .022108291 | 221 | .027059670 | 261 | .032035036 |
| 182 | .022231784 | 222 | .027183762 | 262 | .032159728 |
| 183 | .022355292 | 223 | .027307868 | 263 | .032284436 |
| 184 | .022478815 | 224 | .027431989 | 264 | .032409158 |
| 185 | .022602353 | 225 | .027556126 | 265 | .032533896 |
| 186 | .022725906 | 226 | .027680277 | 266 | .032658648 |
| 187 | .022849473 | 227 | .027804443 | 267 | .032783416 |
| 188 | .022973056 | 228 | .027928625 | 268 | .032908199 |
| 189 | .023096654 | 229 | .028052821 | 269 | .033032997 |
| 190 | .023220266 | 230 | .028177032 | 270 | .033157810 |
| 191 | .023343894 | 231 | .028301258 | 271 | .033282638 |
| 192 | .023467536 | 232 | .028425500 | 272 | .033407481 |
| 193 | .023591193 | 233 | .028549756 | 273 | .033532340 |
| 194 | .023714865 | 234 | .028674027 | 274 | .033657213 |
| 195 | .023838553 | 235 | .028798314 | 275 | .033782102 |
| 196 | .023962255 | 236 | .028922615 | 276 | .033907005 |
| 197 | .024085972 | 237 | .029046932 | 277 | .034031924 |
| 198 | .024209704 | 238 | .029171263 | 278 | .034156857 |
| 199 | .024333451 | 239 | .029295610 | 279 | .034281806 |
| 200 | .024457213 | 240 | .029419971 | 280 | .034406770 |
| 201 | .024580990 | 241 | .029544347 | 281 | .034531749 |
| 202 | .024704782 | 242 | .029668739 | 282 | .034656743 |
| 203 | .024828588 | 243 | .029793146 | 283 | .034781752 |
| 204 | .024952410 | 244 | .029917567 | 284 | .034906777 |
| 205 | .025076247 | 245 | .030042004 | 285 | .035031816 |
| 206 | .025200099 | 246 | .030166455 | 286 | .035156871 |
| 207 | .025323965 | 247 | .030290922 | 287 | .035281940 |
| 208 | .025447847 | 248 | .030415404 | 288 | .035407025 |
| 209 | .025571743 | 249 | .030539901 | 289 | .035532125 |
| 210 | .025695655 | 250 | .030664412 | 290 | .035657240 |
| 211 | .025819581 | 251 | .030788939 | 291 | .035782370 |
| 212 | .025943523 | 252 | .030913481 | 292 | .035907515 |
| 213 | .026067479 | 253 | .031038038 | 293 | .036032676 |
| 214 | .026191451 | 254 | .031162610 | 294 | .036157851 |
| 215 | .026315437 | 255 | .031287197 | 295 | .036283042 |
| 216 | .026439439 | 256 | .031411799 | 296 | .036408247 |
| 217 | .026563455 | 257 | .031536416 | 297 | .036533468 |
| 218 | .026687486 | 258 | .031661049 | 298 | .036658704 |
| 219 | .026811533 | 259 | .031785696 | 299 | .036783955 |
| 220 | .026935594 | 260 | .031910358 | 300 | .036909221 |

2001 ANNUAL RATE
COMPOUNDED DAILY—CONTINUED

| 4.410 PERCENT | | 4.410 PERCENT | | 4.410 PERCENT | |
|---|---|---|---|---|---|
| DAYS | FACTOR | DAYS | FACTOR | DAYS | FACTOR |
| 301 | .037034503 | 326 | .040171461 | 351 | .043317908 |
| 302 | .037159799 | 327 | .040297137 | 352 | .043443964 |
| 303 | .037285111 | 328 | .040422827 | 353 | .043570035 |
| 304 | .037410438 | 329 | .040548533 | 354 | .043696121 |
| 305 | .037535780 | 330 | .040674254 | 355 | .043822222 |
| 306 | .037661137 | 331 | .040799990 | 356 | .043948339 |
| 307 | .037786509 | 332 | .040925742 | 357 | .044074471 |
| 308 | .037911896 | 333 | .041051509 | 358 | .044200618 |
| 309 | .038037299 | 334 | .041177290 | 359 | .044326780 |
| 310 | .038162716 | 335 | .041303087 | 360 | .044452958 |
| 311 | .038288149 | 336 | .041428900 | 361 | .044579151 |
| 312 | .038413597 | 337 | .041554727 | 362 | .044705359 |
| 313 | .038539060 | 338 | .041680570 | 363 | .044831582 |
| 314 | .038664539 | 339 | .041806428 | 364 | .044957821 |
| 315 | .038790032 | 340 | .041932301 | 365 | .045084074 |
| 316 | .038915541 | 341 | .042058189 | 366 | .045210343 |
| 317 | .039041064 | 342 | .042184092 | 367 | .045336628 |
| 318 | .039166603 | 343 | .042310011 | 368 | .045462927 |
| 319 | .039292157 | 344 | .042435945 | 369 | .045589242 |
| 320 | .039417727 | 345 | .042561894 | 370 | .045715572 |
| 321 | .039543311 | 346 | .042687858 | 371 | .045841918 |
| 322 | .039668911 | 347 | .042813838 | | |
| 323 | .039794526 | 348 | .042939833 | | |
| 324 | .039920156 | 349 | .043065843 | | |
| 325 | .040045801 | 350 | .043191868 | | |

# Part III – Administrative, Procedural, and Miscellaneous

## Disaster Relief for Taxpayers Affected by the September 11, 2001 Terrorist Attack

## Notice 2001–68

PURPOSE

This notice supplements the tax relief granted in Notice 2001–61, 2001–40 I.R.B. 305 (October 1, 2001), for taxpayers affected by the September 11, 2001 Terrorist Attack (the "Terrorist Attack") by clarifying and expanding the definition of affected taxpayer, listing additional acts for which a postponement is granted, and providing other relief. The relief provided to taxpayers in this notice will apply retroactively to September 11, 2001.

This notice also postpones the deadlines for certain acts performed by the Internal Revenue Service (IRS). The postponement of these deadlines is not retroactive to September 11, 2001. Thus, the IRS deadlines are postponed only if the last day for performing the act (*e.g.*, making a tax assessment) would otherwise be on or after November 2, 2001.

Taxpayers who believe they are entitled to relief under this notice should mark "September 11, 2001 Terrorist Attack" in red ink on the top of their returns and other documents submitted to the IRS and petitions submitted to the United States Tax Court. ***Taxpayers should not put this notation on envelopes***. Doing so may result in a delay in the delivery or processing of the return or document.

Taxpayers that do not qualify for relief under Notice 2001–61 or this notice may still qualify for extensions and relief from penalties for reasonable cause. Reasonable cause relief may also be available to taxpayers who did receive relief under Notice 2001–61 or this notice but who nevertheless could not meet their tax obligations within the relief period. A request for relief from penalties for reasonable cause should beattached to the return with an explanation of the reasons supporting relief. If penalties are assessed, Form 843, *Claim for Refund and Request for Abatement*, may be completed as a request for reasonable cause relief from penalties.

A. MISSING TAXPAYERS

Individuals missing as a result of the Terrorist Attack are affected taxpayers as defined in Notice 2001–61 under the term "victims of the crash." Thus, the relief granted by Notice 2001–61 and this notice applies to individuals missing as a result of the Terrorist Attack.

B. POSTPONEMENT OF DEADLINES FOR SECTION 1031 EXCHANGES

As explained below, a 120–day postponement of time is granted to affected taxpayers for the acts listed in Rev. Proc. 2001–53, 2001–47 I.R.B 506 (November 19, 2001), if the last day to perform the act would otherwise fall within the period beginning on September 11, 2001, and ending on November 30, 2001. One of the acts listed in Rev. Proc. 2001–53 is an exchange of property under section 1031. This notice provides three types of postponements relating to section 1031 exchanges.

(1) If the taxpayer (transferor) is an ***affected taxpayer*** under Notice 2001–61, then the last day of the identification period or the exchange period set forth in section 1.1031(k)–1(b)(2) of the regulations, relating to deferred like-kind exchanges, or the last day of any period set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, 2000–40 I.R.B. 308 (October 2, 2000), relating to a qualified exchange accommodation arrangement, is postponed by 120 days if the following requirements are met:

(a) The relinquished property was transferred on or before September 11, 2001, or, in a transaction governed by Rev. Proc. 2000–37, property was transferred to the exchange accommodation titleholder on or before September 11, 2001; and

(b) Absent application of this notice, the identification period or the exchange period, or any time period set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, would end on or after September 11, 2001, and on or before November 30, 2001.

(2) If a taxpayer (transferor) is ***not*** an affected taxpayer under Notice 2001–61, then the last day of the identification period or the exchange period set forth in section 1.1031(k)–1(b)(2), or the last day of any period set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, is postponed by 120 days if the following requirements are met:

(a) The relinquished property was transferred on or before September 11, 2001, or, in a transaction governed by Rev. Proc. 2000–37, property was transferred to the exchange accommodation titleholder on or before September 11, 2001; and

(b) Absent application of this notice, the identification period or the exchange period, or any time period set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, would end on or after September 11, 2001, and on or before November 30, 2001, and

(c) It is difficult to meet a deadline set forth in section 1.1031(k)–1(b), or a deadline in section 4.02(3) through (6) of Rev. Proc. 2000–37, due to the Terrorist Attack for the following or similar reasons:

(I) The relinquished property or the replacement property is or was located in a covered disaster area (as defined in Notice 2001–61); or

(II) The principal place of business of any party to the transaction other than the transferor (*e.g.*, a qualified intermediary, exchange accommodation titleholder, transferee, settlement attorney, lender, financial institution or a title insurance company) is located in a covered disaster area (as defined in Notice 2001–61); or

(III) Any party to the transaction other than the transferor (or an employee of such a party who is or was involved in the section 1031 transaction) was killed, injured, or is missing as a result of the Terrorist Attack; or

(IV) A document prepared in connection with the exchange (*e.g.*, the agreement between the transferor and the qualified intermediary or the deed to the relinquished property or replacement property) or land records were destroyed, damaged, or lost as a result of the Terrorist Attack; or

(V) A lender decided not to fund a real estate closing due to the Terrorist Attack or refused to fund a loan to the taxpayer because terrorism insurance was not available; or

(VI) A title insurance company was not able to provide the required title insurance policy necessary to settle or close a real estate transaction due to the Terrorist Attack.

(3) If a postponement is not otherwise granted under paragraphs (1) and (2), a postponement to September 24, 2001, similar to the postponement provided in Notice 2001–63, 2001–40 I.R.B. 308 (October 1, 2001), is granted if the following requirements are met:

(a) The relinquished property was transferred on or before September 11, 2001, or, in a transaction governed by Rev. Proc. 2000–37, property was transferred to the exchange accommodation titleholder on or before September 11, 2001; and

(b) Absent application of this notice, the identification period or the exchange period, or any time period set forth in section 4.02(3) through (6) of Rev. Proc. 2000–37, would end on or after September 11, 2001, and on or before September 17, 2001.

C. ADDITIONAL GRANT OF RELIEF

(1) This notice expands the relief provided by paragraph (2) of the Grant of Relief section of Notice 2001–61. The additional relief is for tax returns on an extension (not on a postponement under section 7508A) that expires on or after December 1, 2001, and on or before January 31, 2002. For these returns, the last date for filing the return is postponed until February 15, 2002, under section 7508A. This additional relief is available only to taxpayers that have difficulty in meeting their federal tax obligations because their records, computers, or other essential supporting services were lost or damaged, or essential personnel were injured or killed, or are missing as a result of the Terrorist Attack.

(2) Under paragraph (4) of the Grant of Relief section of Notice 2001–61, the IRS granted to all affected taxpayers a 120–day postponement of time to perform the acts described in section 301.7508A–1(c)(1), if the last day to perform the act fell within the period beginning on September 11, 2001, and ending on November 30, 2001. One of these acts is the filing of any Tax Court petition. Under this notice, the relief provided by paragraph (4) is expanded as follows. If the last date for filing any Tax Court petition would otherwise be on or after December 1, 2001, and on or before December 31, 2001, the last date for filing the petition is postponed by 60 days under section 7508A.

(3) In addition to the acts specifically identified in section 301.7508A–1(c)(1), a 120–day postponement is granted for each act listed in Rev. Proc. 2001–53, for affected taxpayers if the last day to perform the act would otherwise fall within the period beginning on September 11, 2001, and ending on November 30, 2001. This postponement does not, however, apply to the acts required by section 148(f)(3) and section 1.148–3(g), section 1.148–5(c), section 148(f)(4)(C)(xvi) and section 1.148–7(k)(1), or section 149(e). Postponements of these acts for issuers of tax exempt bonds were provided in Announcement 2001–101, 2001–43 I.R.B. 374 (October 22, 2001). For purposes of tax–exempt bonds, the term "affected taxpayer" shall include any affected issuer as described in Announcement 2001–101. This postponement also does not apply to the deadline for Form 5500 and Form 5500–EZ filings. The Department of Labor's Pension and Welfare Benefits Administration Press Release No. 01–36 (released September 14, 2001) grants relief extending the deadline for filing Form 5500 and Form 5500-EZ.

D. PARTNERS, S CORPORATION SHAREHOLDERS, AND BENEFICIARIES OF TRUSTS AND ESTATES

Partners, S corporation shareholders, and beneficiaries of trusts and estates use the information reported to them on Schedule K-1 by their partnerships, corporations, trusts, or estates to prepare their own income tax returns. If the income tax return of the partnership, S corporation, trust or estate was postponed or extended under this notice or Notice 2001–61, the partner, S corporation shareholder, or beneficiary of a trust or estate may not receive the Schedule K-1 prior to the due date or extended due date of the partner's, shareholder's, or beneficiary's income tax return. The income tax return of the partner, shareholder, or beneficiary is ***not*** postponed or extended by Notice 2001–61 or this notice solely because the entity (the partnership, S corporation, trust, or estate) is an affected taxpayer.

Partners, shareholders, and beneficiaries of trusts and estates may request extensions of time to file their income tax returns. *See* I.R.C. § 6081. If the Schedule K-1 is not received by the extended due date, the partner, shareholder, or beneficiary should prepare and file the income tax return on a timely basis by making a reasonable estimate in good faith of items of income, gain, loss, deduction, and credit attributable to the taxpayer's interest in the entity. Later, when the Schedule K-1 is received, the taxpayer should prepare an amended return reflecting the items reported on the Schedule K-1. If the taxpayer's original return underestimated items of income or gain, or overstated items of deduction, loss, or credit, and a late payment penalty attributable to these items is assessed, the taxpayer should request an abatement of the penalty for reasonable cause. If the original return was prepared in good faith based on reasonable estimates of the tax items attributable to the entity, the IRS will waive or abate penalties for late payment.

E. RELIEF FROM PENALTY FOR FAILING TO FILE PARTNERSHIP RETURN BY MAGNETIC MEDIA

Any partnership that is an affected taxpayer, as defined in Notice 2001–61 and this notice, and that is required to file a partnership return by magnetic media (electronically) under section 6011(e) will not be assessed a penalty under section 6721 for failing to file the partnership return electronically if the partnership elects to file a paper return. This relief is for partnership returns that have an original due date or extended due date (not a postponed due date under section 7508A) on or after September 11, 2001, and on or before November 30, 2001. Taxpayers who qualify should write "September 11, 2001 Terrorist Attack" in red ink on the top of their paper Form 1065. The IRS will abate any penalty that is improperly assessed.

F. ACTS PERFORMED BY THE GOVERNMENT

(1) If the last date otherwise prescribed by law for making a tax assessment is on or after November 2, 2001, and the taxpayer received a 120-day postponement of time to file a Tax Court petition under paragraph (4) of the Grant of Relief section of Notice 2001–61, then the last date otherwise prescribed by law for making an assessment is correspondingly postponed by 120 days. This additional time for making an assessment is needed for the following reason. Under section 6503, the period of limitations on assessment is suspended when a statutory notice of deficiency is mailed. The section 6503 suspension period (generally 150 days) includes the period (generally 90 days) after the issuance of a statutory notice of deficiency during which the taxpayer is permitted to file a Tax Court petition and the IRS is prohibited from making an assessment. *See* I.R.C. §§ 6213(a) and 6213(c). Under Notice 2001–61, affected taxpayers are entitled to an additional 120 days to file a Tax Court petition in response to the notice of deficiency. In some cases, the period of limitations on assessment could expire prior to the expiration of the expanded period during which an affected taxpayer may file a Tax Court petition.

(2) Similar to paragraph (1), if the last date otherwise prescribed by law for making a tax assessment is on or after November 2, 2001, and the taxpayer receives a 60–day postponement of time to file a Tax Court petition under paragraph (2) of the Additional Grant of Relief section of this notice, the last date otherwise prescribed by law for making a tax assessment is correspondingly postponed by 60 days.

(3) Documents maintained by the IRS (including the Office of Chief Counsel) in New York City were destroyed or lost in the Terrorist Attack, or remain in buildings that are inaccessible. The destruction or loss of these documents (or the IRS's lack of access to them) will materially interfere with the IRS's ability to timely administer the Internal Revenue Code with respect to certain taxpayers. The taxpayers to whom these records relate are "affected taxpayers" for the limited purpose of this paragraph. In these cases, a 120–day postponement is granted for the following government acts if the last date for performance of the act is on or after November 2, 2001, and on or before November 30, 2001: making an assessment of any tax; issuing a statutory notice of deficiency; allowing a credit or refund of any tax; collecting by the Secretary, by levy or otherwise, the amount of any liability in respect of any tax; bringing suit by the United States, or any office on its behalf, in respect of any tax liability; returning property under section 6343; and the discharge of an executor from personal liability for a decedent's taxes under section 6905. The IRS will notify, as soon as practicable, any affected taxpayers, as defined under this paragraph, of the government act or acts that will be postponed.

G. TAXPAYER INQUIRIES

If you wish to recommend that other acts qualify for postponement under this notice, Notice 2001–61, or Rev. Proc. 2001–53, please write to the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division), CC:PA:APJP:Br2, 1111 Constitution Avenue, NW, Washington, DC 20224, or send an e-mail message to *Notice.Comments@irscounsel.treas.gov*. Please write "7508A List" on the envelope or in the subject matter area of the e-mail.

H. DRAFTING INFORMATION

This notice was drafted by the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice you may call the toll–free disaster hotline at (866) 562-5227 or (202) 622-4940 (not a toll–free call).

*26 CFR 301.7508-1: Time for performing certain acts postponed by reason of service in a combat zone or a Presidentially declared disaster. (Also Part I, 7508A; 301.7508A–1.)*

## Rev. Proc. 2001–53

SECTION 1. PURPOSE

.01 This revenue procedure provides a list of time-sensitive acts, the performance of which may be postponed under sections 7508 and 7508A of the Internal Revenue Code (Code). Section 7508 of the Code postpones specified acts for individuals serving in the Armed Forces of the United States or serving in support of such Armed Forces in a combat zone. Section 7508A of the Code permits a postponement of specified acts for taxpayers affected by a Presidentially declared disaster. The list of acts in this revenue procedure supplements the list of postponed acts in section 7508(a)(1) of the Code and § 301.7508A-1(b) of the Regulations on Procedure and Administration.

.02 This revenue procedure does not, by itself, provide any postponements under sections 7508 or 7508A. In order for taxpayers to be entitled to a postponement of any act listed in this revenue procedure, the IRS generally will publish a Notice or other guidance providing relief with respect to a specific combat zone or Presidentially declared disaster.

.03 This revenue procedure will be updated as needed when the IRS determines that additional acts should be included in the list of postponed acts or that certain acts should be removed from the list. Also, taxpayers may recommend that additional acts be considered for postponement under sections 7508 and 7508A. See section 17 of this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 7508(a)(1) of the Internal Revenue Code permits a postponement of certain time-sensitive acts for individuals serving in the Armed Forces or in support of such Armed Forces in an area designated by the President as a combat zone under section 112. Among these acts are the filing of returns, the payment of tax, the filing of a Tax Court petition, and the filing of a refund claim. In the event of service in a combat zone, the acts specified in section 7508(a)(1) of the Code are *automatically postponed*. In addition, if the Service publishes a Notice or other guidance providing additional relief under section 7508, some or all of the acts listed in this revenue procedure may be postponed. Likewise, acts not listed in this revenue procedure may be included in published guidance.

.02 Section 7508A of the Code provides that certain acts performed by taxpayers and the government may be postponed if the taxpayer is affected by a Presidentially declared disaster. A "Presidentially declared disaster" is defined in section 1033(h)(3) of the Code. Section 301.7508A-1(d)(1) of the Regulations on Procedure and Administration defines seven types of affected taxpayers, including any individual whose principal residence (for purposes of 1033(h)(4)) is located in a "covered disaster area" and any business entity or sole proprietor whose principal place of business is located in a "covered disaster area." Postponements under section 7508A are not available simply because a disaster has occurred. Generally, the IRS will publish a Notice or other guidance authorizing the postponement. Such guidance will describe the acts postponed, the duration of the postponement, and the location of the covered disaster area. See, for example, Notice 2001–30, 2001–14 I.R.B. 989 and Notice 97–62, 1997–2 C.B. 320, 1997–49 I.R.B. 8. When a notice or other guidance for a particular disaster is published, the guidance generally will refer to this revenue procedure and may provide for a postponement of all the acts listed in the regulations and this revenue procedure. Alternatively, the guidance may provide that only certain acts listed in this revenue procedure are postponed based on the time when the disaster occurred, its severity, and other factors.

SECTION 3. SCOPE

This revenue procedure applies to individuals serving in the Armed Forces in a combat zone, or in support of such Armed Forces, and to affected taxpayers within the meaning of § 301.7508A-1(d)(1) of the Regulations on Procedure and Administration.

SECTION 4. APPLICATION

.01 The tables below list sections of the Internal Revenue Code and Treasury Regulations requiring the timely performance of specified acts that may be postponed under sections 7508 and 7508A.

.02 In order to avoid unnecessary duplication, the following tables do not include acts specified in sections 7508 or 7508A or the regulations thereunder. Thus, for example, no mention is made in the following tables of the filing of tax returns or the payment of taxes (or an installment thereof) because these acts are already covered by sections 7508 and 7508A and the regulations thereunder. Also, the following tables do not refer to the making of accounting method elections or any other elections required to be made on tax returns or attachments thereto. Reference to these elections is not necessary because postponement of the filing of a tax return automatically postpones the making of any election required to be made on the return or an attachment thereto.

.03 The following tables refer only to postponement of acts performed by taxpayers. Additional guidance will be published in the Internal Revenue Bulletin if a decision is made that acts performed by the government may be postponed under section 7508 or section 7508A.

SECTION 5. ACCOUNTING METHODS AND PERIODS

| | Statute or Regulation | Act Postponed |
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| 1. | Chapter 1, Subchapter E of the Code | Any act relating to the adoption, election, retention, or change of any accounting method or accounting period, or to the use of an accounting method or accounting period, that is required to be performed on or before the due date of a tax return (including extensions). Examples of such acts are (a) the requirement in Rev. Proc. 2000–11, section 6.02, that Form 1128 must be filed with the Director, Internal Revenue Service Center, on or before the due date of the tax return for the short period required to effect the change in accounting period; and (b) the requirement in Rev. Proc. 99–49, section 6.02, that a copy of Form 3115 must be filed with the national office no later than when the original Form 3115 is filed with the timely filed tax return for the year of the accounting method change. |
| 2. | Treas. Reg. § 1.381(c)(4)-1 (d)(2) | If the acquiring corporation is not permitted to use the method of accounting used by the acquiring corporation, the method of accounting used by the distributor/transferor corporation, or the principal method of accounting; or if the corporation wishes to use a new method of accounting, then the acquiring corporation must apply to the Commissioner to use another method. Treas. Reg. § 1.381(c)(4)–1(d)(2) requires applications to be filed not later than 90 days after the date of distribution or transfer. Rev. Proc. 83–77, 1983-2 C.B. 594, provides an automatic 90–day extension. |
| 3. | Treas. Reg. § 1.381(c)(5)-1 (d)(2) | If the acquiring corporation is not permitted to use the inventory method used by the acquiring corporation, the inventory method used by the distributor/transferor corporation, or the principal method of accounting, or wishes to use a new method of accounting, then the acquiring corporation must apply to the Commissioner to use another method. Treas. Reg. § 1.381(c)(5)–1(d)(2) requires applications to be filed not later than 90 days after the date of distribution or transfer. Rev. Proc. 83–77 provides an automatic 90-day extension. |
| 4. | Treas. Reg. § 1.442-1(b)(1) | In order to secure prior approval of an adoption, change or retention of a taxpayer's annual accounting period, the taxpayer generally must file an application on Form 1128, Application to Adopt, Change, or Retain a Tax Year, with the Commissioner. The application must be filed on or before the 15th day of the second calendar month following the close of the short period. (But see Rev. Proc. 2001–11, 2000-3 I.R.B. 309, for automatic changes in annual accounting period that can be made with the return.) |
| 5. | Treas. Reg. § 1.444-3T(b)(1) | A section 444 election must be made by filing Form 8716, Election to Have a Tax Year Other Than a Required Tax Year, with the Service Center. Generally, Form 8716 must be filed by the earlier of (a) the 15th day of the fifth month following the month that includes the first day of the taxable year for which the election will first be effective, or (b) the due date (without regard to extensions) of the income tax return resulting from the section 444 election. |
| 6. | Treas. Reg. § 1.446-1(e)(3)(i) | To secure the Commissioner's consent to a change in method of accounting, the taxpayer must file an application on Form 3115, Application for Change in Accounting Method, with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting (*i.e.*, must be filed by the last day of such taxable year). This filing requirement is also in Rev. Proc. 97–27, 1997-1 C.B. 680. (But see Rev. Proc. 99–49, 1999-2 C.B. 725, for automatic changes in method of accounting that can be made with the return.) |

| | Statute or Regulation | Act Postponed |
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| 7. | Treas. Reg. § 1.461-1(c)(3)(ii) | A taxpayer may elect, with the consent of the Commissioner, to accrue real property taxes ratably in accordance with section 461(c). A written request for permission to make such an election must be submitted within 90 days after the beginning of the taxable year to which the election is first applicable. Rev. Proc. 83–77 provides an automatic 90-day extension. |
| 8. | Sec. 461(h)(3) | A taxpayer may elect the recurring item exception method of accounting under which certain items that are recurring in nature (for example, rebates, prizes, and provision of services under warranty contracts) are treated as incurred during a taxable year if, (among other requirements) for each such item, economic performance occurs within 8½-months after the close of the taxable year. |
| 9. | Treas. Reg. § 1.7519-2T(a)(2),(3) and (4) | A partnership or S corporation must file the Form 8752, Required Payment or Refund Under Section 7519, if the taxpayer has made an election under section 444 to use a taxable year other than its required taxable year and the election is still in effect. The Form 8752 must be filed and any required payment must be made by the date stated in the instructions to Form 8752. |
| 10. | Rev. Proc. 87-32, 1987-2 C.B. 396 | Certain partnerships, S corporations, corporations electing to be S corporations, or personal service corporations that desire to change or retain a tax year that is its natural business year, as defined in section 4.01(1) of Rev. Proc. 87–32, and S corporations or corporations electing to be S corporations that desire to change to a tax year that meets the “ownership tax year test” set forth in section 4.02, must file Form 1128, Application to Adopt, Change, or Retain a Tax Year, with the Service Center on or before the 15th day of the second calendar month following the close of the short period for which a return is required.<br><br>If a partnership, S corporation or a personal service corporation desires to retain a tax year not described in Rev. Proc. 87–32, then the taxpayer should request permission to retain its tax year by filing Form 1128 on or before the 75th day of the tax year for which the retention is to apply.<br><br>An electing S corporation that desires to adopt, change to, or retain a tax year not described in Rev. Proc. 87–32 must request permission by filing Form 2553, Election by a Small Business Corporation, when the election to be an S corporation is filed. |
| 11. | Rev. Proc. 92-29, section 6.02 | A developer of real estate requesting the Commissioner’s consent to use the alternative cost method must file a private letter ruling request within 30 days after the close of the taxable year in which the first benefitted property in the project is sold.<br><br>The request must include a consent extending the period of limitation on the assessment of income tax with respect to the use of the alternative cost method. |

SECTION 6. BUSINESS AND INDIVIDUAL TAX ISSUES

| | Statute or Regulation | Act Postponed |
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| 1. | Treas. Reg. § 1.71-1T(b), Q&A-7 | A payer spouse may send cash to a third party on behalf of a spouse that qualifies for alimony or separate maintenance payments if the payments are made to the third party at the written request or consent of the payee spouse. The request or consent must state that the parties intend the payment to be treated as an alimony payment to the payee spouse subject to the rules of section 71. The payer spouse must receive the request or consent prior to the date of filing of the payer spouse's first return of tax for the taxable year in which the payment was made. |
| 2. | Treas. Reg. § 1.77-1 | A taxpayer who receives a loan from the Commodity Credit Corporation may elect to include the amount of the loan in his gross income for the taxable year in which the loan is received. The taxpayer in subsequent taxable years must include in his gross income all amounts received during those years as loans from the Commodity Credit Corporation, unless he secures the permission of the Commissioner to change to a different method of accounting. Treas. Reg. § 1.77-1 requires such requests to be filed within 90 days after the beginning of the taxable year of change. Rev. Proc. 83-77 provides an automatic 90-day extension. |
| 3. | Treas. Reg. § 1.110-1(b)(4)(ii)(A) | The lessee must expend its construction allowance on the qualified long-term real property within eight and one-half months after the close of the taxable year in which the construction allowance was received. |
| 4. | Sec. 118(c)(2) | A contribution in aid of construction received by a regulated public utility that provides water or sewerage disposal services must be expended by the utility on qualifying property before the end of the second taxable year after the year in which it was received by the utility. |
| 5. | Treas. Reg. § 1.170A-5(a)(2) | A contribution of an undivided present interest in tangible personal property shall be treated as made upon receipt by the donee of a formally executed and acknowledged deed of gift. However, the period of initial possession by the donee may not be deferred for more than one year. |
| 6. | Sec. 468A(g) | A taxpayer that makes payments to a nuclear decommissioning fund with respect to a taxable year must make the payments within 2½ months after the close of such taxable year (the deemed payment date). |
| 7. | Sec. 530(h) | A trustee of a Coverdell education savings account must provide certain information concerning the account to the beneficiary by January 31 following the calendar year to which the information relates. In addition, Form 5498 must be filed with the IRS by May 31 following the calendar year to which the information relates. |
| 8. | Sec. 563(a) | In the determination of the dividends paid deduction for purposes of the accumulated earnings tax imposed by section 531, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended. |
| 9. | Sec. 563(b) | In the determination of the dividends paid deduction for purposes of the personal holding company tax imposed by section 541, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall, to the extent the taxpayer elects on its return for the taxable year, be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½ -month period within which the dividend is paid is the period extended. |
| 10. | Sec. 563(c) | In the determination of the dividends paid deduction for purposes of part III, a dividend paid after the close of any taxable year and on or before the 15th day of the third month following the close of such taxable year shall, to the extent the company designates such dividend as being taken into account, be considered as paid during such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended. |

| | Statute or Regulation | Act Postponed |
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| 11. | Treas. Reg. § 1.468A-3(h)(1)(v) | A taxpayer must file a request for a schedule of ruling amounts for a nuclear decommissioning fund by the deemed payment date (2½-months after the close of the taxable year for which the schedule of ruling amounts is sought). |
| 12. | Treas. Reg. § 1.468A-3(h)(1)(vii) | A taxpayer has 30 days to provide additional requested information with respect to a request for a schedule of ruling amounts. If the information is not provided within the 30 days, the request will not be considered filed until the date the information is provided. |
| 13. | Sec. 529 (c)(3)(C)(i) | A rollover contribution to another qualified tuition program must be made no later than the 60th day after the date of a distribution from a qualified tuition program. |
| 14. | Sec. 530(d)(4)(C)(i) | Excess contributions to a Coverdell education savings account must be distributed before a specified time in the taxable year following the taxable year in which the contribution is made. |
| 15. | Sec. 530(d)(5) | A rollover contribution to another Coverdell education savings account must be made no later than the 60th day after the date of a payment or distribution from a Coverdell education savings account. |
| 16. | Sec. 563(d) | For the purpose of applying section 562(a), with respect to distributions under subsection (a), (b), or (c) of section 562, a distribution made after the close of the taxable year and on or before the 15th day of the third month following the close of the taxable year shall be considered as made on the last day of such taxable year. The close of the taxable year is not affected by this revenue procedure; the 3½-month period within which the dividend is paid is the period extended. |
| 17. | Sec. 1031(a) | Any property received by the taxpayer shall be treated as property which is not like-kind property if - (A) such property is not identified as property to be received in the exchange on or before the day which is 45 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (B) such property is received after the earlier of (i) the day which is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange, or (ii) the due date (determined with regard to extension) for the transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs. |
| 18. | Sec. 1043(a) | If an eligible person (as defined under section 1043(b)) sells any property pursuant to a certificate of divestiture, then at the election of the taxpayer, gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds the cost of any permitted property purchased by the taxpayer during the 60-day period beginning on the date of such sale. |
| 19. | Sec. 1045(a) | A taxpayer other than a corporation may elect to roll over gain from the sale of qualified small business stock held for more than six months if other qualified small business stock is purchased by the taxpayer during the 60-day period beginning on the date of sale. |
| 20. | Sec. 1382(d) | An organization, to which section 1382(d) applies, is required to pay a patronage dividend within 8½ months after the close of the year. |
| 21. | Sec. 1388(j)(3)(A) | Any cooperative organization that exercises its option to net patronage gains and losses, is required to give notice to its patrons of the netting by the 15th day of the 9th month following the close of the taxable year. |
| 22. | Treas. Reg. § 301.7701-3(c) | The effective date of an entity classification election (Form 8832) cannot be more than 75 days prior to the date on which the election is filed. |

| | Statute or Regulation | Act Postponed |
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| 23. | Treas. Reg. §§ 301.9100-2(b)–(d) | An automatic extension of 6 months from the due date of a return, excluding extensions, is granted to make the regulatory of statutory elections whose due dates are the due date of the return or the due date of the return including extensions (for example, an application to change a method of accounting under Rev. Proc. 99–49), provided the taxpayer (a) timely filed its return for the year of election, (b) within that 6-month extension period, takes the required corrective action to file the election in accordance with the statute, regulations, revenue procedure, revenue ruling, notice or announcement permitting the election, and (c) writes at the top of the return, statement of election or other form "FILED PURSUANT TO § 301.9100-2." |
| 24. | Treas. Reg. § 301.9100-2(a)(1) | An automatic extension of 12 months from the due date for making a regulatory election is granted to make certain elections, including the election to use other than the required taxable year under section 444, and the election to use LIFO under section 472. |

SECTION 7. CORPORATE ISSUES

| | Statute or Regulation | Act Postponed |
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| 1. | Sec. 302(e)(1) | A corporation must complete a distribution in pursuance of a plan of partial liquidation of a corporation within the specified period. |
| 2. | Sec. 303 and Treas. Reg. § 1.303-2 | A corporation must complete the distribution of property to a shareholder in redemption of all or part of the stock of the corporation which (for Federal estate tax purposes) is included in determining the estate of a decedent. Section 303 and Treas. Reg. § 1.303-2 require, among other things, that the distribution occur within the specified period. |
| 3. | Sec. 304(b)(3)(C) | If certain requirements are met, section 304(a) does not apply to a transaction involving the formation of a bank holding company. One requirement is that within a specified period (generally 2 years) after control of a bank is acquired, stock constituting control of the bank is transferred to a bank holding company in connection with the bank holding company's formation. |
| 4. | Sec. 332(b) and Treas. Reg. §§ 1.332-3 and 1.332-4 | A corporation must completely liquidate a corporate subsidiary within the specified period. |
| 5. | Sec. 338(d)(3) and (h), and Treas. Reg. § 1.338–2 | An acquiring corporation must complete a "qualified stock purchase" of a target corporation's stock within the specified acquisition period. |
| 6. | Sec. 338(g) and Treas. Reg. § 1.338-2 | An acquiring corporation may elect to treat certain stock purchases as asset acquisitions. The election must be made within the specified period. |
| 7. | Sec. 338(h)(10) and Treas. Reg. § 338(h)(10)-1(c) | An acquiring corporation and selling group of corporations may elect to treat certain stock purchases as asset purchases, and to avoid gain or loss upon the stock sale. The election must be made within the specified period. |
| 8. | Sec. 341 and Treas. Reg. § 1.341-7 | A shareholder of a collapsible corporation must sell its stock in the corporation within the specified period. |

SECTION 7. CORPORATE ISSUES—CONTINUED

| | Statute or Regulation | Act Postponed |
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| 9. | Treas. Reg. § 1.381(c)(17)-1(c) | An acquiring corporation files a Form 976, Claim for Deficiency Dividends Deduction by a Personal Holding Company, Regulated Investment Company, or Real Estate Investment Trust, within 120 days after the date of the determination under section 547(c) to claim a deduction of a deficiency dividend. |
| 10. | Sec. 562(b)(1)(B) | In the case of a complete liquidation (except in the case of a complete liquidation of a personal holding company or foreign personal holding company) occurring within 24 months after the adoption of a plan of liquidation, any distribution within such period pursuant to such plan shall, to the extent of the earnings and profits (computed without regard to capital losses) of the corporation for the taxable year in which such distribution is made, be treated as a dividend for purposes of computing the dividends paid deduction. |
| 11. | Sec. 562(b)(2) | In the case of a complete liquidation of a personal holding company occurring within 24 months after the adoption of a plan of liquidation, the amount of any distribution within such period pursuant to such plan shall be treated as a dividend for purposes of computing the dividends paid deduction to the extent that such is distributed to corporate distributees and represents such corporate distributees' allocable share of the undistributed personal holding company income for the taxable year of such distribution. |
| 12. | Sec. 1502 and Treas. Reg. § 1.1502-75(c)(1)(i) | A common parent must apply for permission to discontinue filing consolidated returns within a specified period after the date of enactment of a law affecting the computation of tax liability. |
| 13. | Sec. 6425 and Treas. Reg. § 1.6425-1 | Corporations applying for an adjustment of an overpayment of estimated income tax must file Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax, on or before the 15th day of the third month after the taxable year, or before the date the corporation first files its income tax return for such year, whichever is earlier. |

SECTION 8. EMPLOYEE BENEFIT ISSUES

| | Statute or Regulation | Act Postponed |
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| 1. | Sec. 72(p)(2)(B) and (C), and Treas. Reg. § 1.72(p)–1, Q&A–10 | A loan from a qualified employer plan to a participant in, or a beneficiary of, such plan must be repaid according to certain time schedules specified in section 72(p)(2)(B) and (C) (including, if applicable, any grace period granted pursuant to Treas. Reg. § 1.72(p)-1, Q&A-10). |
| 2. | Sec. 72(t)(2)(A)(iv) | Under section 72(t)(2)(A)(iv), to avoid the imposition of a 10-percent additional tax on a distribution from a qualified retirement plan, the distribution must be part of a series of substantially equal periodic payments, made at least annually. |
| 3. | Sec. 72(t)(2)(F) | To avoid the imposition of a 10-percent additional tax on a distribution from an individual retirement arrangement (IRA) for a first-time home purchase, such distribution must be used within 120 days of the distribution to pay qualified acquisition costs or rolled into an IRA. |
| 4. | Sec. 83(b) and Treas. Reg. § 1.83-2(a) | Any person who performs services in connection with which property is transferred to any person may elect not later than 30 days after the date of the transfer of the property to include in his gross income, for the taxable year in which such property is transferred, the excess of the fair market value of the property over the amount (if any) paid for the property. |
| 5. | Proposed Treas. Reg. § 1.125-1, Q&A-15 | Cafeteria plan participants will avoid constructive receipt of the taxable amounts if they elect the benefits they will receive before the beginning of the period during which the benefits will be provided. |

| | Statute or Regulation | Act Postponed |
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| 6. | Proposed Treas. Reg. § 1.125-1, Q&A-14 and Proposed Treas. Reg. § 1.125-2, Q&A-7 | Cafeteria plan participants will not be in constructive receipt if, at the end of the plan year, they forfeit amounts elected but not used during the plan year. |
| 7. | Proposed Treas. Reg. § 1.125-2, Q&A-5 | Cafeteria plan participants may receive in cash the value of unused vacation days on or before the earlier of the last day of the cafeteria plan year or the last day of the employee's taxable year to which the unused days relate. |
| 8. | Treas. Reg. § 1.162-27(e)(2) | A performance goal is considered pre-established if it is established in writing by the corporation's compensation committee not later than 90 days after the commencement of the period of service to which the performance goal relates if the outcome is substantially uncertain at the time the compensation committee actually establishes the goal. In no event, however, will the performance goal be considered pre-established if it is established after 25 percent of the period of service has elapsed. |
| 9. | Sec. 220(f)(5) | A rollover contribution to an Archer MSA must be made no later than the 60th day after the day on which the holder receives a payment or distribution from an Archer MSA. |
| 10. | Sec. 220(h) | A trustee or custodian of an MSA (Archer MSA or Medicare+Choice MSA) must provide certain information concerning the MSA to the account holder by January 31 following the calendar year to which the information relates. In addition, MSA contribution information must be furnished to the account holder, and Form 5498, IRA Contribution Information, filed with the IRS, by May 31 following the calendar year to which the information relates. |
| 11. | Secs. 401(a)(9), 403(a)(1), 403(b)(10), 408(a)(6), 408(b)(3) and 457(d)(2) | The first required minimum distribution from plans subject to the rules in section 401(a)(9) must be made no later than the required beginning date. Subsequent required minimum distributions must be made by the end of each distribution calendar year. |
| 12. | Sec. 401(a)(28)(B)(i) | A qualified participant in an ESOP (as defined in section 401(a)(28)(B)(iii)) may elect within 90 days after the close of each plan year in the qualified election period (as defined in section 401(a)(28)(B)(iv)) to direct the plan as to the investment of at least 25 percent of the participant's account in the plan (50 percent in the case of the last election). |
| 13. | Sec. 401(a)(28)(B)(ii) | A plan must distribute the portion of the participant's account covered by an election under section 401(a)(28)(B)(i) within 90 days after the period during which an election can be made; or the plan must offer at least 3 investment options (not inconsistent with regulations prescribed by the Secretary) to each participant making the election under section 401(a)(28)(B)(i) and within 90 days after the period during which the election may be made, the plan must invest the portion of the participant's account in accordance with the participant's election. |
| 14. | Sec. 401(a)(30) and Treas. Reg. § 1.401(a)-30 and § 1.402(g)-1 | Excess deferrals for a calendar year, plus income attributable to the excess, must be distributed no later than the first April 15 following the calendar year. |

| | Statute or Regulation | Act Postponed |
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| 15. | Sec. 401(b) and Treas. Reg. § 1.401(b)-1 | A retirement plan that fails to satisfy the requirements of section 401(a) or section 403(a) on any day because of a disqualifying provision will be treated as satisfying such requirements on such day if, prior to the expiration of the applicable remedial amendment period, all plan provisions necessary to satisfy the requirements of section 401(a) or 403(a) are in effect and have been made effective for the whole of such period. |
| 16. | Sec. 401(k)(8) | A cash or deferred arrangement must distribute excess contributions for a plan year, plus income attributable to the excess, pursuant to the terms of the arrangement no later than the close of the following plan year. |
| 17. | Sec. 401(m)(6) | A plan subject to section 401(m) must distribute excess aggregate contributions for a plan year, plus income attributable to the excess, pursuant to the terms of the plan no later than the close of the following plan year. |
| 18. | Sec. 402(g)(2)(A) and Treas. Reg. § 1.402(g)-1 | An individual with excess deferrals for a taxable year must notify a plan, not later than a specified date following the taxable year, that excess deferrals have been contributed to that plan for the taxable year. A distribution of excess deferrals identified by the individual, plus income attributable to the excess, must be accomplished no later than the first April 15 following the taxable year of the excess. |
| 19. | Sec. 404(k)(2)(A)(ii) | An ESOP receiving dividends on stock of the C corporation maintaining the plan must distribute the dividend in cash to participants or beneficiaries not later than 90 days after the close of the plan year in which the dividend was paid. |
| 20. | Secs. 408(i) and 6047(c) | A trustee or issuer of an individual retirement arrangement (IRA) must provide certain information concerning the IRA to the IRA owner by January 31 following the calendar year to which the information relates. In addition, IRA contribution information must be furnished to the owner, and Form 5498, Individual Retirement Arrangement Information, filed with the IRS, by May 31 following the calendar year to which the information relates. |
| 21. | Sec. 409(h)(4) | An employer required to repurchase employer securities under section 409(h)(1)(B) must provide a put option for a period of at least 60 days following the date of distribution of employer securities to a participant, and if the put option is not exercised, for an additional 60-day period in the following plan year. A participant who receives a distribution of employer securities under section 409(h)(1)(B) must exercise the put option provided by that section within a period of at least 60 days following the date of distribution, or if the put option is not exercised within that period, for an additional 60-day period in the following plan year. |
| 22. | Sec. 409(h)(5) | An employer required to repurchase employer securities distributed as part of a total distribution must pay for the securities in substantially equal periodic payments (at least annually) over a period beginning not later than 30 days after the exercise of the put option and not exceeding 5 years. |
| 23. | Sec. 409(h)(6) | An employer required to repurchase employer securities distributed as part of an installment distribution must pay for the securities not later than 30 days after the exercise of the put option under section 409(h)(4). |
| 24. | Sec. 409(o) | An ESOP must commence the distribution of a participant's account balance, if the participant elects, not later than 1 year after the close of the plan year — i) in which the participant separates from service by reason of attaining normal retirement age under the plan, death or disability; or ii) which is the 5th plan year following the plan year in which the participant otherwise separates from service (except if the participant is reemployed before distribution is required to begin). |
| 25. | Sec. 1042(a)(2) | A taxpayer must purchase qualified replacement property (defined in section 1042(c)(4)) within the replacement period, defined in section 1042(c)(3) as the period which begins 3 months before the date of the sale of qualified securities to an ESOP and ends 12 months after the date of such sale. |
| 26. | Treas. Reg. § 1.1042-1T, Q&A-3 | A taxpayer must notarize any statement of purchase with respect to qualified replacement property required under Treas. Reg. § 1.1042-1T, Q&A-3 no later than 30 days after a purchase of qualified replacement property. |

| | Statute or Regulation | Act Postponed |
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| 27. | Sec. 4972(c)(3) | Nondeductible plan contributions must be distributed prior to a certain date to avoid a 10 percent tax. |
| 28. | Sec. 4979 and Treas. Reg. § 54.4979-1 | A 10 percent tax on the amount of excess contributions and excess aggregate contributions under a plan for a plan year will be imposed unless the excess, plus income attributable to the excess is distributed (or, if forfeitable, forfeited) no later than 2½-months after the close of the plan year. In the case of an employer maintaining a SARSEP, employees must be notified of the excess by the employer within the 2½-month period to avoid the tax. |
| 29. | Secs. 6033, 6039D, 6047, 6057, 6058, and 6059 | Form 5500 and Form 5500-EZ, which are used to report annual information concerning employee benefit plans and fringe benefit plans, must be filed by a specified time.<br><br>*General Advice*<br><br>Affected filers are advised to follow the instructions accompanying the Form 5500 series (or other guidance published on the postponement) regarding how to file the forms when postponements are granted pursuant to section 7508 or section 7508A.<br><br>*Combat Zone Postponements under Section 7508*<br><br>In the case of taxpayers who are individuals, the IRS may permit a postponement of the filing of the Form 5500 or Form 5500-EZ under section 7508. Whatever postponement of the Form 5500 series filing due date is permitted by the IRS under section 7508 will also be permitted by the Department of Labor and the Pension Benefit Guaranty Corporation (PBGC) for similarly situated individuals who are plan administrators.<br><br>*Postponements for Presidentially Declared Disasters under Section 7508A*<br><br>In the case of "affected taxpayers," as defined in Treas. Reg. § 301.7508A-1(d), the IRS may permit a postponement of the filing of the Form 5500 or Form 5500-EZ. Taxpayers who are unable to obtain on a timely basis information necessary for completing the forms from a bank, insurance company, or any other service provider because such service providers' operations are located in a covered disaster area will be treated as "affected taxpayers." Whatever postponement of the Form 5500 series filing due date is permitted by the IRS under section 7508A will also be permitted by the Department of Labor and PBGC for similarly situated plan administrators and direct filing entities. |
| 30. | Rev. Proc. 2001-17, Sections 9.02(1), (2) and (3) | The correction period for self-correction of operational failures is the last day of the second plan year following the plan year for which the failure occurred. The correction period for self-correction of operational failures for transferred assets does not end until the last day of the first plan year that begins after the corporate merger, acquisition, or other similar employer transaction. |
| 31. | Rev. Proc. 2001-17, Section 12.08 | If the submission involves a plan with transferred assets and the IRS determines that none of the failures in the submission occurred after the end of the second plan year that begins after the corporate merger, acquisition or other similar employer transaction, the plan sponsor may calculate the amount of plan assets and number of plan participants based on the Form 5500 information that would have been filed by the plan sponsor for the plan year that includes the employer transaction if the transferred assets were maintained as a separate plan. |
| 32. | Rev. Proc. 2001-17, Section 14.03 | If an examination involves a plan with transferred assets and the IRS determines that the failures did not occur after the end of the second plan year that begins after the corporate merger, acquisition, or other similar employer transaction occurred, the sanction under Audit CAP will not exceed the sanction that would apply if the transferred assets were maintained as a separate plan. |

SECTION 9. ESTATE, GIFT AND TRUST ISSUES

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Sec. 643(g) | The trustee may elect to treat certain payments of estimated tax as paid by the beneficiary. The election shall be made on or before the 65th day after the close of the taxable year of the trust. |
| 2. | Sec. 2011(c) | The executor of a decedent's estate must file a claim for a credit for state estate, inheritance, legacy or succession taxes by filing a claim within 4 years of filing Form 706, United States Estate (and Generation Skipping Transfer) Tax Return. |
| 3. | Sec. 2014(e) | The executor of a decedent's estate must file a claim for foreign death taxes within 4 years of filing Form 706, United States Estate (and Generation Skipping Transfer) Tax Return. |
| 4. | Sec. 2016 and Treas. Reg. § 20.2016-1 | If an executor of a decedent's estate (or any other person) receives a refund of any state or foreign death taxes claimed as a credit on Form 706, the IRS must be notified within 30 days of receipt. |
| 5. | Sec. 2031(c) | If an executor of a decedent's estate elects on Form 706 to exclude a portion of the value of land that is subject to a qualified conservation easement, agreements relating to development rights must be implemented within 2 years after the date of the decedent's death. |
| 6. | Sec. 2032(d) | The executor of a decedent's estate may elect an alternate valuation on a late filed Form 706 if the Form 706 is not filed later than 1 year after the due date. |
| 7. | Sec. 2032A(c)(7) | A qualified heir, with respect to specially valued property, is provided a two-year grace period immediately following the date of the decedent's death in which the failure by the qualified heir to begin using the property in a qualified use will not be considered a cessation of qualified use and therefore will not trigger additional estate tax. |
| 8. | Sec. 2032A(d)(3) | The executor of a decedent's estate has 90 days after notification of incomplete information/signatures to provide the information/signatures to the IRS regarding an election on Form 706 with respect to specially valued property. |
| 9. | Sec. 2046 | A taxpayer may make a qualified disclaimer no later than 9 months after the date on which the transfer creating the interest is made, or the date the person attains age 21. |
| 10. | Sec. 2053(d) and Treas. Reg. §§ 20.2053-9(c) and 10(c) | If the executor of a decedent's estate elects to take a deduction for state and foreign death tax imposed upon a transfer for charitable or other uses, the executor must file a written notification to that effect with the IRS before expiration of the period of limitations on assessments (generally 3 years). |
| 11. | Sec. 2055(e)(3) | A party in interest must commence a judicial proceeding to change an interest into a qualified interest no later than the 90th day after the estate tax return (Form 706) is required to be filed or, if no return is required, the last date for filing the income tax return for the first taxable year of the trust. |
| 12. | Sec. 2056(d) | A qualified domestic trust (QDOT) election must be made on Form 706, Schedule M, and the property must be transferred to the trust before the date on which the return is made. Any reformation to determine if a trust is a QDOT requires that the judicial proceeding be commenced on or before the due date for filing the return. |
| 13. | Sec. 2056A(b)(2) | The trustee of a QDOT must file a claim for refund of excess tax no later than 1 year after the date of final determination of the decedent's estate tax liability. |
| 14. | Sec. 2057(i)(3)(G) | A qualified heir, with respect to qualified family owned business, has a two-year grace period immediately following the date of the decedent's death in which the failure by the qualified heir to begin using the property in a qualified use will not be considered a cessation of qualified use and therefore will not trigger additional estate tax. |

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 15. | Sec. 2057(i)(3)(H) | The executor of a decedent's estate has 90 days after notification of incomplete information/signatures to provide the information/signatures to the IRS regarding an election on Form 706 with respect to specially valued property. |
| 16. | Sec. 2516 | The IRS will treat certain transfers as made for full and adequate consideration in money or money's worth where husband and wife enter into a written agreement relative to their marital and property rights and divorce actually occurs within the 3-year period beginning on the date 1 year before such agreement is entered into. |
| 17. | Sec. 2518(b) | A taxpayer may make a qualified disclaimer no later than 9 months after the date on which the transfer creating the interest is made, or the date the person attains age 21. |
| 18. | Sec. 26.2654-1(b) | The IRS recognizes the division of a trust for generation-skipping transfer tax purposes if the severance occurs (or a reformation proceeding, if required, is commenced) prior to the date prescribed for filing the estate tax return, Form 706. |

SECTION 10. EXEMPT ORGANIZATION ISSUES

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Sec. 505(c)(1) | An organization must give notice by filing Form 1024, Application for Recognition of Exemption Under Section 501(a), to be recognized as an organization exempt under section 501(c)(9) or section 501(c)(17). Generally, if the exemption is to apply for any period before the giving of the notice, Treas. Reg. § 505(c)-1T, Q&A-6, of the regulations requires that Form 1024 be filed within 15 months from the end of the month in which the organization was organized. |
| 2. | Sec. 508 and Treas. Reg. § 1.508-1 | A purported section 501(c)(3) organization must generally file Form 1023, Application for Recognition of Exemption, to qualify for exemption. Generally, if the exemption is to apply for any period before the giving of the notice, the Form 1023 must be filed within 15 months from the end of the month in which the organization was organized. |
| 3. | Sec. 6072(e) and Treas. Reg. § 1. 6033-2(e) | Annual returns of organizations exempt under section 501(a) must be filed on or before the 15th day of the 5th month following the close of the taxable year. |

SECTION 11. EXCISE TAX ISSUES

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Treas. Reg. § 48.4101-1(h)(v) | A registrant must notify the IRS of any change in the information a registrant has submitted within 10 days. |
| 2. | Sec. 4221(b) and Treas. Reg. § 48.4221-2(c) | A manufacturer is allowed to make a tax-free sale of articles for resale to a second purchaser for use in further manufacture. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof. |
| 3. | Sec. 4221(b) and Treas. Reg. § 48.4221-3(c) | A manufacturer is allowed to make a tax-free sale of articles for export. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof. |

SECTION 11. EXCISE TAX ISSUES—CONTINUED

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 4. | Sec. 4221(e)(2)(A) and Treas. Reg. § 48.4221-7(c) | A manufacturer is allowed to make a tax-free sale of tires for use by the purchaser in connection with the sale of another article manufactured or produced by the purchaser. This rule ceases to apply six months after the earlier of the sale or shipment date unless the manufacturer receives certain proof. |

SECTION 12. INTERNATIONAL ISSUES

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Sec. 482 and Treas. Reg. § 1.482-1(g)(4)(ii)(C) | A claim for a setoff of a section 482 allocation by the IRS must be filed within 30 days of either the date of the IRS's letter transmitting an examination report with notice of the proposed adjustment or the date of a notice of deficiency. |
| 2. | Sec. 482 and Treas. Reg. § 1.482-1(j)(2) | A claim for retroactive application of the final section 482 regulations, otherwise effective only for taxable years beginning after October 6, 1994, must be filed prior to the expiration of the statute of limitations for the year for which retroactive application is sought. |
| 3. | Sec. 482 and Treas. Reg. § 1.482-7(j)(2) | A participant in a cost-sharing arrangement must provide documentation regarding the arrangement, as well as documentation specified in Treas. Reg. §§ 1.482-7(b)(4) and 1.482-7(c)(1), within 30 days of a request by the IRS. |
| 4. | Treas. Reg. § 1.882-5(d)(2)(ii)(A)(2) | Liabilities of a foreign corporation that is not a bank must be entered on a set of books at a time reasonably contemporaneous with the time the liabilities are incurred. |
| 5. | Treas. Reg. § 1.882-5(d)(2)(iii)(A)(1) | Liabilities of foreign corporations that are engaged in a banking business must be entered on a set of books relating to an activity that produces ECI before the close of the day on which the liability is incurred. |
| 6. | Treas. Reg. § 1.884-2T(b)(3)(i) | Requirement that marketable securities be identified on the books of a U.S. trade or business within 30 days of the date an equivalent amount of U.S. assets ceases to be U.S. assets. This requirement applies when a taxpayer has elected to be treated as remaining engaged in a U.S. trade or business for branch profits tax purposes. |
| 7. | Treas. Reg. § 1.884-4(b)(3)(ii)(B) | Requirement that a foreign corporation which identifies liabilities as giving rise to U.S. branch interest, send a statement to the recipients of such interest within two months of the end of the calendar year in which the interest was paid, stating that such interest was U.S. source income (if the corporation did not make a return pursuant to section 6049 with respect to the interest payment). |
| 8. | Sec. 922(a)(1)(E) and Treas. Reg. § 1.922-1(j) (Q&A-19) | The FSC must appoint a new non-U.S. resident director within 30 days of the date of death, resignation, or removal of the former director, in the event that the sole non-U.S. resident director of a FSC dies, resigns, or is removed. |
| 9. | Sec. 924(b)(2)(B) and Treas. Reg. § 1.924(a)-1T(j)(2)(i) | A taxpayer must execute an agreement regarding unequal apportionment at a time when at least 12 months remain in the period of limitations (including extensions) for assessment of tax with respect to each shareholder of the small FSC in order to apportion unequally among shareholders of a small FSC the $5 million foreign trading gross receipts used to determine exempt foreign trade income. |

| | Statute or Regulation | Act Postponed |
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| 10. | Sec. 924(c)(2) and Treas. Reg. § 1.924(c)-1(c)(4) | The FSC must open a new qualifying foreign bank account within 30 days of the date of termination of the original bank account, if a FSC's qualifying foreign bank account terminates during the taxable year due to circumstances beyond the control of the FSC. |
| 11. | Sec. 924(c)(3) and Treas. Reg. § 1.924(c)-1(d)(1) | The FSC must transfer funds from its foreign bank account to its U.S. bank account, equal to the dividends, salaries or fees disbursed, and such transfer must take place within 12 months of the date of the original disbursement from the U.S. bank account, if dividends, salaries, or fees are disbursed from a FSC's U.S. bank account. |
| 12. | Sec. 924(c)(3) and Treas. Reg. § 1.924(c)-1(d)(2) | The FSC must reimburse from its own bank account any dividends or other expenses that are paid by a related person, on or before the due date (including extensions) of the FSC's tax return for the taxable year to which the reimbursement relates. |
| 13. | Sec. 924(c)(3) and Treas. Reg. § 1.924(c)-1(d)(3) | If the Commissioner determines that the taxpayer acted in good faith, the taxpayer may comply with the reimbursement requirement by reimbursing the funds within 90 days of the date of the Commissioner's determination, notwithstanding a taxpayer's failure to meet the return-filing-date reimbursement deadline in Treas. Reg. § 1.924(c)-1(d)(2). |
| 14. | Sec. 924(e)(4) and Treas. Reg. § 1.924(e)-1(d)(2)(iii) | If a payment with respect to a transaction is made directly to the FSC or the related supplier in the United States, the funds must be transferred to and received by the FSC bank account outside the United States no later than 35 days after the receipt of good funds (*i.e.*, date of check clearance) on the transaction. |
| 15. | Temp. Treas. Reg. § 1.925(a)-1T(e)(4) | A FSC and its related supplier may redetermine a transfer pricing method, the amount of foreign trading gross receipts, and costs and expenses, provided such redetermination occurs before the expiration of the statute of limitations for claims for refund for both the FSC and related supplier, and provided such redetermination shall affect both the FSC and the related supplier. See Treas. Reg. § 1.925(a)-1(c)(8)(i) for time limitations with respect to FSC administrative pricing grouping redeterminations and for a cross-reference to Temp. Treas. Reg. § 1.925(a)-1T(e)(4). |
| 16. | Sec. 927(f)(3)(A) and Treas. Reg. § 1.927(f)-1(b) (Q&A-12) | A corporation may terminate its election to be treated as a FSC or a small FSC by revoking the election during the first 90 days of the FSC taxable year (other than the first year in which the election is effective) in which the election was to take effect. |
| 17. | Sec. 927 and Temp. Treas. Reg. § 1.927(a)-1T (d)(2)(i)(B) | A taxpayer may satisfy the destination test with respect to property sold or leased by a seller or lessor if such property is delivered by the seller or lessor (or an agent of the seller or lessor) within the United States to a purchaser or lessee, if the property is ultimately delivered outside the United States (including delivery to a carrier or freight forwarder for delivery outside the United States) by the purchaser or lessee (or a subsequent purchaser or sublessee) within one year after the sale or lease. |
| 18. | Sec. 927 and Temp. Treas. Reg. § 1.927(b)-1T(e)(2)(i) | A taxpayer that claims FSC commission deductions must designate the sales, leases, or rentals subject to the FSC commission agreement no later than the due date (as extended) of the tax return of the FSC for the taxable year in which the transaction(s) occurred. |

| | Statute or Regulation | Act Postponed |
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| 19. | Sec. 927 and Treas. Reg. § 1.927(f)-1(a) (Q&A 4) | A transferee or other recipient of shares in the corporation (other than a shareholder that previously consented to the election) must consent to be bound by the prior election within 90 days of the first day of the FSC's taxable year to preserve the status of a corporation that previously qualified as a FSC or as a small FSC. |
| 20. | Sec. 936 and Treas. Reg. § 1.936-10(c) | If a "qualified investment" in a Caribbean Basin country ceases to meet the qualification requirements, the taxpayer may correct any disqualifying events within a reasonable period of time, which is defined as not more than 60 days from the date that such events came to the attention of the taxpayer (or should have come to its attention by the exercise of reasonable diligence). |
| 21. | Sec. 936 and Treas. Reg. § 1.936-11 | A taxpayer that elects retroactive application of the temporary regulation regarding separate lines of business for taxable years beginning after December 31, 1995, must elect to do so prior to the expiration of the statute of limitations for the year in question. |
| 22. | Treas. Reg. §§ 1.964 -1(c)(3)(ii) and -1T(g)(2). | An election of, or an adoption of or change in a method of accounting of a CFC (controlled foreign corporation) requires the filing of a written statement jointly executed by the controlling U.S. shareholders of the CFC within 180 days after the close of the taxable year of the CFC. |
| 23. | Sec. 982(c)(2)(A) | Any person to whom a formal document request is mailed shall have the right to bring a proceeding to quash such request not later than the 90th day after the day such request was mailed. |
| 24. | Treas. Reg. § 1.988-1(a)(7)(ii). | An election to have Treas. Reg. § 1.988-1(a)(2)(iii) apply to regulated futures contracts and nonequity options must be made on or before the first day of the taxable year, or if later, on or before the first day during such taxable year on which the taxpayer holds a contract described in section 988(c)(1)(D)(ii) and Treas. Reg. § 1.988-1(a)(7)(ii). A late election may be made within 30 days after the time prescribed for the election. |
| 25. | Sec. 988(c)(1)(E)(iii)(V) (qualified fund) and Treas. Reg. § 1.988-1(a)(8)(i)(E). | A qualified fund election must be made on or before the first day of the taxable year, or if later, on or before the first day during such taxable year on which the partnership holds an instrument described in section 988(c)(1)(E)(i). |
| 26. | Treas. Reg. § 1.988-3(b) | An election to treat (under certain circumstances) any gain or loss recognized on a contract described in Treas. Reg. § 1.988-2(d)(1) as capital gain or loss must be made by clearly identifying such transaction on taxpayer's books and records on the date the transaction is entered into. |
| 27. | Treas. Reg. § 1.988-5(a)(8)(i) | Taxpayer must establish a record, and before the close of the date the hedge is entered into, the taxpayer must enter into the record for each qualified hedging transaction the information contained in Treas. Reg. §§ 1.988-5(a)(8)(i)(A) through (E). |
| 28. | Treas. Reg. § 1.988-5(b)(3)(i) | Taxpayer must establish a record and before the close of the date the hedge is entered into, the taxpayer must enter into the record a clear description of the executory contract and the hedge. |
| 29. | Treas. Reg. § 1.988-5(c)(2) | Taxpayer must identify a hedge and underlying stock or security under the rules of Treas. Reg. § 1.988-5(b)(3). |
| 30. | Sec. 991 | A corporation that elects IC-DISC treatment (other than in the corporation's first taxable year) must file Form 4876-A, Election To Be Treated as an Interest Charge DISC, with the regional service center during the 90-day period prior to the beginning of the tax year in which the election is to take effect. |

| | Statute or Regulation | Act Postponed |
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| 31. | Sec. 991 and Treas. Reg. § 1.991-1(g)(2) | A corporation that filed a tax return as a DISC, but subsequently determines that it does not wish to be treated as a DISC, must notify the [district director] more than 30 days before the expiration of period of limitations on assessment applicable to the tax year. |
| 32. | Sec. 992 and Treas. Reg. § 1.992-2(a)(1)(i) | A qualifying corporation must file Form 4876-A, or attachments thereto, containing the consent of every shareholder of the corporation to be treated as a DISC as of the beginning of the corporation's first taxable year. |
| 33. | Sec. 992 and Treas. Reg. § 1.992-2(b)(2) | A qualifying corporation must file consents of the shareholders of the corporation to be treated as a DISC with the service center with which the DISC election was first filed, within 90 days after the first day of the taxable year, or within the time granted for an extension to file such consents. |
| 34. | Sec. 992 and Treas. Reg. § 1.992-2(e)(2)(ii) | A corporation seeking to revoke a prior election to be treated as a DISC, must file a statement within the first 90 days of the taxable year in which the election is to take effect with the service center with which it filed the election or, if the corporation filed an annual information return, by filing the statement at the service center with which it filed its most recent annual information return. |
| 35. | Sec. 992 and Treas. Reg. § 1.992-3(c)(3) | A DISC that receives notification that it failed to satisfy the 95 percent of gross receipts test or the 95 percent assets test, or both tests, for a particular taxable year, must make a corrective deficiency distribution within 90 days of the date of the first written notification from the IRS. |
| 36. | Sec. 993 and Treas. Reg. § 1.993-3(d)(2)(i)(b) | A taxpayer must deliver export property outside the U.S. within one year of the date of sale or lease in order to generate DISC benefits from a qualifying export transaction. |
| 37. | Sec. 1445 Treas. Reg. § 1.1445-1 | Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests, must be filed by a buyer or other transferee of a U.S. real property interest, and a corporation, partnership, or fiduciary that is required to withhold tax. The amount withheld is to be transmitted with Form 8288, which is generally to be filed by the 20th day after the date of transfer. |
| 38. | Sec. 1446 | All partnerships with effectively connected gross income allocable to a foreign partner in any tax year must file forms 8804, Annual Return for Partnership Withholding Tax, and 8805, Foreign Partner's Information Statement of Section 1446 Withholding Tax, on or before the 15th day of the 4th month following the close of the partnership's taxable year. |
| 39. | Sec. 1446 | Form 8813, Partnership Withholding Tax Payment Voucher, is used to pay the withholding tax under section 1446 for all partnerships with effectively connected gross income allocable to a foreign partner in any tax year. Form 8813 must accompany each payment of section 1446 tax made during the partnership’s taxable year. Form 8813 is to be filed on or before the 15th day of the 4th, 6th, 9th, and 12th months of the partnership's taxable year for U.S. income tax purposes. |
| 40. | Sec. 6038A(d)(2) and Treas. Reg. § 1.6038A-4(d)(1) | A reporting corporation must cure any failure to furnish information or failure to maintain records within 90 days after the IRS gives notice of the failure to avoid the continuation penalty. |

| | Statute or Regulation | Act Postponed |
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| 41. | Sec. 6038A(d)(2) and Treas. Reg. § 1.6038A-4(d)(1) | A reporting corporation must cure any failure to furnish information or failure to maintain records before the beginning of each 30-day period after expiration of the initial 90-day period to avoid additional continuation penalties. |
| 42. | Sec. 6038A(e)(1) and Treas. Reg. § 1.6038A-5(b) | A reporting corporation must furnish an authorization of agent within 30 days of a request by the IRS to avoid a penalty. |
| 43. | Sec. 6038A(e)(4)(A) | A reporting corporation must commence any proceeding to quash a summons filed by the IRS in connection with an information request within 90 days of the date the summons is issued. |
| 44. | Sec. 6038A(e)(4)(B) | A reporting corporation must commence any proceeding to review the IRS's determination of noncompliance with a summons within 90 days of the IRS's notice of noncompliance. |
| 45. | Sec. 6038A and Treas. Reg. § 1.6038A-3(b)(3) | A reporting corporation must supply an English translation of records provided pursuant to a request for production within 30 days of a request by the IRS for a translation to avoid a penalty. |
| 46. | Sec. 6038A and Treas. Reg. § 1.6038A-3(f)(2) | A reporting corporation must, within 60 days of a request by the IRS for records maintained outside the United States, either provide the records to the IRS, or move them to the United States and provide the IRS with an index to the records to avoid a penalty. |
| 47. | Sec. 6038A and Treas. Reg. § 1.6038A-3(f)(2)(i) | A reporting corporation must supply English translations of documents maintained outside the United States within 30 days of a request by the IRS for translation to avoid a penalty. |
| 48. | Sec. 6038A and Treas. Reg. § 1.6038A-3(f)(4) | A reporting corporation must request an extension of time to produce or translate documents maintained outside the United States beyond the period specified in the regulations within 30 days of a request by the IRS to avoid a penalty. |
| 49. | Sec. 6662(e) and Treas. Reg. § 1.6662-6(d)(2)(iii)(A) | A taxpayer must provide, within 30 days of a request by the IRS, specified "principal documents" regarding the taxpayer's selection and application of transfer pricing method to avoid potential penalties in the event of a final transfer pricing adjustment by the IRS. *See also* Treas. Reg. § 1.6666-6(d)(2)(iii)(C) (similar requirement re: background documents). |
| 50. | Secs. 6038, 6038B, and 6046A | The filing of Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, for those taxpayers who do not have to file an income tax return. The form is due at the time that an income tax return would have been due had the taxpayer been required to file an income tax return. |

SECTION 13. PARTNERSHIP AND S CORPORATION ISSUES

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Treas. Reg. § 1.706-1(b)(4)(i) | A partnership may apply for approval to change a partnership taxable year by filing Form 1128, Application to Adopt, Change, or Retain a Tax Year, on or before the 15th day of the second calendar month following the close of the short period involved. |
| 2. | Treas. Reg. § 1.706-1(b)(4)(ii) | A partnership may apply for approval to adopt a partnership taxable year by filing Form 1128, Application to Adopt, Change, or Retain a Tax Year, on or before the last day of the month following the close of the taxable year to be adopted. |
| 3. | Treas. Reg. § 1.743-1(k)(2) | A transferee that acquires, by sale or exchange, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within 30 days of the sale or exchange. A transferee that acquires, on the death of a partner, an interest in a partnership with an election under section 754 in effect for the taxable year of the transfer, must notify the partnership, in writing, within one year of the death of the deceased partner. |
| 4. | Treas. Reg. § 1.754-1(c)(1) | Generally, a partnership may revoke a section 754 election by filing the revocation no later than 30 days after the close of the partnership taxable year with respect to which the revocation is intended to take effect. |
| 5. | Treas. Reg. § 1.761-2(b)(3) | A partnership may generally elect to be excluded from subchapter K. The election will be effective unless within 90 days after the formation of the organization any member of the organization notifies the Commissioner that the member desires subchapter K to apply to such organization and also advises the Commissioner that he has so notified all other members of the organization. In addition, an application to revoke an election to be excluded from subchapter K must be submitted no later than 30 days after the beginning of the first taxable year to which the revocation is to apply. |
| 6. | Treas. Reg. § 1.761-2(c) | A partnership requesting permission to be excluded from certain provisions of subchapter K must submit the request to the Commissioner no later than 90 days after the beginning of the first taxable year for which partial exclusion is desired. |
| 7. | Sec. 1361(e) | In general, the trustee of the electing small business trust (ESBT) must file the ESBT election within the 2-month and 16-day period beginning on the day the stock is transferred to the trust. *See* Notice 97-12, 1997-1 C.B. 385. |
| 8. | Treas. Reg. § 1.1361-1(j)(6) | The current income beneficiary of a qualified subchapter S trust (QSST) must make a QSST election within the 2-month and 16-day period from one of the dates prescribed in Treas. Reg. § 1.1361-1(j)(6)(iii). |
| 9. | Treas. Reg. § 1.1361-1(j)(10) | The successive income beneficiary of a QSST may affirmatively refuse to consent to the QSST election. The beneficiary must sign the statement and file the statement with the IRS within 15 days and 2 months after the date on which the successive income beneficiary becomes the income beneficiary. |
| 10. | Treas. Reg. § 1.1361-3(a)(4) | If an S corporation elects to treat an eligible subsidiary as a qualified subchapter S subsidiary (QSUB), the election cannot be effective more than 2 months and 15 days prior to the date of filing the election. |
| 11. | Treas. Reg. § 1.1361-3(b)(2) | An S corporation may revoke a QSUB election by filing a statement with the service center. The effective date of a revocation of a QSUB election cannot be more than 2 months and 15 days prior to the filing date of the revocation. |
| 12. | Treas. Reg. § 1.1362-2(a)(2), (4) | If a corporation revokes its subchapter S election after the first 2½-months of its taxable year, the revocation will not be effective until the following taxable year. An S corporation may rescind a revocation of an S election at any time before the revocation becomes effective. |
| 13. | Sec. 1362(b)(3) | If a corporation files a subchapter S election after the first 2½-months of a corporation's taxable year, that corporation will not be treated as an S corporation until the taxable year after the year in which the S election is made. |

SECTION 14. PROCEDURE & ADMINISTRATION ISSUES

.01 Bankruptcy and Collection

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Sec. 6320(a)(3)(B), 6230(c) and Treas. Reg. §§ 301.6320-1T(b), (c) and (f) | A taxpayer has 30 days after receiving a notice of a lien to request a Collection Due Process (CDP) administrative hearing. After a determination at the CDP hearing, the taxpayer may appeal this determination within 30 days to the United States Tax Court or a United States district court. |
| 2. | Sec. 6330(a)(3)(B) and (d)(1) and Treas. Reg. §§ 301.6330-1T(b), (c) and (f) | The taxpayer must request a Collections Due Process (CDP) administrative hearing within 30 days after the IRS sends notice of a proposed levy. After a determination at the CDP hearing, the taxpayer may appeal this determination within 30 days to the United States Tax Court or a United States district court. |
| 3. | Treas. Reg. §§ 301.6036-1(a)(2) and (3) | A court-appointed receiver or fiduciary in a non-bankruptcy receivership, a fiduciary in aid of foreclosure who takes possession of substantially all of the debtor's assets, or an assignee for benefit of creditors, must give written notice within ten days of his appointment to the IRS as to where the debtor will file his tax return. |

.02 Information Returns

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Sec. 6050I | Any person engaged in a trade or business receiving more than $10,000 cash in one transaction (or 2 or more related transactions) must file an information return, Form 8300, Report of Cash Payments over $10,000 Received in a Trade or Business, by the 15th day after the date the cash was received. Additionally, a statement must be provided to the person with respect to whom the information is required to be furnished by Jan. 31st of the year following. |
| 2. | Sec. 6050L | Returns relating to certain dispositions of donated property, Forms 8282, Donee Information Return, must be filed within 125 days of the disposition. |

.03 Miscellaneous

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Sec. 1314(b) | A taxpayer may file a claim for refund or credit of tax based upon the mitigation provisions of sections 1311 through 1314 if, as of the date a determination (as defined in section 1313(a)) is made, one year remains on the period for filing a claim for refund. |
| 2. | Sec. 6015 | A requesting spouse must request relief under section 6015 within 2 years of the first collection activity against the requesting spouse. |
| 3. | Sec. 6411 | Taxpayers applying for a tentative carry back adjustment of the tax for the prior taxable year must file Form 1139 (for corporations) or Form 1045 (for entities other than corporations) within 12 months after the end of such taxable year that generates such net operating loss, net capital loss, or unused business credit from which the carryback results |
| 4. | Sec. 6656(e)(2) | A taxpayer who is required to deposit taxes and fails to do so is subject to a penalty under section 6656. Under section 6656(e)(2), the taxpayer may, within 90 days of the date of the penalty notice, designate to which deposit period within a specified tax period the deposits should be applied. |

SECTION 15. TAX CREDIT ISSUES

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Treas. Reg. § 1.42-8(a)(3)(v) | The taxpayer and an Agency may elect to use an appropriate percentage under section 42(b)(2)(A)(ii)(I) by notarizing a binding agreement by the 5th day following the end of the month in which the binding agreement was made. |
| 2. | Treas. Reg. § 1.42-8(b)(1)(vii) | The taxpayer and an Agency may elect an appropriate percentage under section 42(b)(2)(A)(ii)(II) by notarizing a binding agreement by the 5th day following the end of the month in which the tax-exempt bonds are issued. |
| 3. | Sec. 42(d)(2)(D)(ii)(IV) | In order to claim section 42 credits on an existing building, section 42(d)(2)(B)(ii)(I) requires that the building must have been placed in service at least ten years before the date the building was acquired by the taxpayer. A building is not considered placed in service for purposes of section 42(d)(2)(B)(ii) if the building is resold within a 12-month period after acquisition by foreclosure of any purchase-money security interest. |
| 4. | Sec. 42(g)(3)(A) | A building shall be treated as a qualified low-income building only if the project meets the minimum set aside requirement by the close of the first year of the credit period of the building. |
| 5. | Sec. 42(h)(6)(J) | A low-income housing agreement commitment must be in effect as of the beginning of the year for a building to receive credit. If such a commitment was not in effect, the taxpayer has a one-year period for correcting the failure. |
| 6. | Sec. 42(h)(1)(E) and (F) | The taxpayer's basis in the building project, as of the later of the date which is 6 months after the date the allocation was made or the close of the calendar year in which the allocation is made, must be more than 10 percent of the taxpayer's reasonably expected basis in the project. |
| 7. | Sec. 47(c)(1)(C) and Treas. Reg. § 1.48-12(b)(2) | A taxpayer has a 24- or 60-month measuring period in which the requisite amount of rehabilitation expenditures have to be incurred in order to satisfy the "substantial rehabilitation" test. |
| 8. | Treas. Reg. § 1.48-12(d)(7) | In the historic rehabilitation context, if the taxpayer fails to receive final certification of completed work prior to the date that is 30 months after the date that the taxpayer filed the return on which the credit is claimed, the taxpayer must, prior to the last day of the 30th month, consent to extending the statute of limitations by submitting a written statement to the District Director. |
| 9. | Sec. 51(d)(12)(A)(ii)(II) and 51A(d)(1) | An employer seeking the Work Opportunity Credit or the Welfare-to-Work Credit with respect to an individual must submit Form 8850, Pre-Screening Notice and Certification Request for the Work Opportunity and Welfare-to-Work Credits, to the State Employment Security Agency not later than the 21st day after the individual begins work for the employer. |

SECTION 16. TAX-EXEMPT BOND ISSUES

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 1. | Treas. Reg. §§ 1.141-12(d)(3) and 1.142-2(c)(2) | An issuer must provide notice to the Commissioner of the establishment of a defeasance escrow within 90 days of the date such defeasance escrow is established in accordance with Treas. Reg. § 1.141-12(d)(1) or 1.142-2(c)(1). |
| 2. | Sec. 142(d)(7) | An operator of a multi-family housing project for which an election was made under section 142(d) must submit to the Secretary an annual certification as to whether such project continues to meet the requirements of section 142(d). |

| | Statute or Regulation | Act Postponed |
|---|---|---|
| 3. | Sec. 142(f)(4) and Treas. Reg. § 1.142(f)(4)–1 | A person engaged in the local furnishing of electric energy or gas (a local furnisher) that uses facilities financed with exempt facility bonds under section 142(a)(8) and expands its service area in a manner inconsistent with the requirements of sections 142(a)(8) and 142(f), may make an election to ensure that those bonds will continue to be treated as exempt facility bonds. The election must be filed with the IRS on or before 90 days after the date of the service area expansion that causes the bonds to cease to meet the applicable requirements. |
| 4. | Sec. 146(f) and Notice 89–12 | If an issuing authority's volume cap for any calendar year exceeds the aggregate amount of tax–exempt private activity bonds issued during such calendar year by such authority, such authority may elect to treat all (or any portion) of such excess as a carryforward for 1 or more carryforward purposes. Such election must be filed by the earlier of (1) February 15 of the calendar year following the year in which the excess amount arises, or (2) the date of issue of bonds issued pursuant to the carryforward election. |
| 5. | Sec. 148(f)(3) and Treas. Reg. § 1.148-3(g) | An issuer of a tax-exempt municipal obligation must make any required rebate payment no later than 60 days after the computation date to which the payment relates. A rebate payment is paid when it is filed with the IRS at the place or places designated by the Commissioner. A payment must be accompanied by the form provided by the Commissioner for this purpose. |
| 6. | Treas. Reg. § 1.148-5(c) | An issuer of a tax-exempt municipal obligation must make a yield reduction payment on or before the date of required rebate installment payments as described in Treas. Reg. § 1.148-3(f), (g) and (h). |
| 7. | Sec. 148(f)(4)(C)(xvi) and Treas. Reg. § 1.148-7(k)(1) | As issuer of a tax-exempt municipal obligation that elects to pay certain penalties in lieu of rebate must make any required penalty payments not later than 90 days after the period to which the penalty relates. |
| 8. | Sec. 149(e) | An issuer of a tax-exempt municipal obligation must submit to the Secretary a statement providing certain information regarding the municipal obligation not later than the 15th day of the 2nd calendar month after the close of the calendar quarter in which the municipal obligation is issued. |

SECTION 17. INQUIRIES

If you wish to recommend that other acts qualify for postponement, please write to the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division), CC:PA:APJP:B2, 1111 Constitution Avenue, NW, Washington, DC 20224. Please mark "7508A List" on the envelope. In the alternative, e-mail your comments to: *Notice.Comments@m1.irscounsel.treas.gov.*

SECTION 18. EFFECTIVE DATE

This revenue procedure is effective for acts which may be performed on or after September 11, 2001.

SECTION 19. DRAFTING INFORMATION

The principal author of this revenue procedure is Marcy W. Mendelsohn of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this revenue procedure, contact Ms. Mendelsohn at (202) 622-4940 (not a toll free call).

# Part IV. Items of General Interest

## New Form 1042-T, *Annual Summary and Transmittal of Forms 1042–S*

## Announcement 2001–114

New Form 1042–T is now available at the IRS Web Site for immediate use.

The new form is to be used to transmit paper Forms 1042–S, *Foreign Person's U.S. Source Income Subject to Withholding*, to the Internal Revenue Service.

You can obtain Form 1042–T by visiting the IRS Web Site at **www.irs.gov**. The printed version of Form 1042–T will be available soon. You will be able to order it by phone at **1–800–TAX–FORM** (1–800–829–3676).

# 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 under which a reimbursement or other expense allowance arrangement for the cost of operating an automobile for business purposes will satisfy the requirements of section 62(c) of the Code as to business connection, substantiation, and returning amounts in excess of expenses are provided. See Rev. Proc. 2001–54, page 530.

## 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 for an expense for business use of an automobile that most nearly represents current costs. See Rev. Proc. 2001–54, page 530.

## Section 170.—Charitable, etc., Contributions and Gifts

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

Rules are set forth for substantiating the amount of a deduction for an expense for charitable use of an automobile. See Rev. Proc. 2001–54, page 530.

## Section 213.—Medical, Dental, etc., Expenses

*26 CFR 1.213–1: Medical, dental, etc., expenses.*

Rules are set forth for substantiating the amount of a deduction for an expense for use of an automobile to obtain medical services. See Rev. Proc. 2001–54, page 530.

## Section 217.—Moving Expenses

*26 CFR 1.217–2: Moving expenses.*

Rules are set forth for substantiating the amount of a deduction for an expense for use of an automobile as part of a move. See Rev. Proc. 2001–54, page 530.

## Section 274.—Disallowance of Certain Entertainment, etc., Expenses

*26 CFR 1.274–5: Substantiation requirements.*

Rules are set forth for an optional method for substantiating the amount of ordinary and necessary business expenses of an employee for automobile expenses when a payor provides a mileage allowance for such expenses. Rules are also set forth for an optional method for employees and self-employed individuals to use in substantiating a trade or business deduction for automobile expenses. See Rev. Proc. 2001–54, page 530.

## Section 1016.—Adjustments to Basis

*26 CFR 1.1016–3: Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.*

Rules are set forth for substantiation of expenses relating to the business use of an automobile using a standard mileage rate, one component of which is depreciation, which will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016. See Rev. Proc. 2001–54, page 530.

# Part III. Administrative, Procedural, and Miscellaneous

## Weighted Average Interest Rate Update

## Notice 2001–71

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30–year Treasury Constant Maturities for October 2001 is 5.32 percent.

The following rates were determined for the plan years beginning in the month shown below.

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---|---|---|---|---|
| November | 2001 | 5.74 | 5.17 to 6.03 | 5.17 to 6.32 |

DRAFTING INFORMATION

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283–9888 (not a toll-free number).

*26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, Sections 62, 162, 170, 213, 217, 274, 1016; 1.62–2, 1.162–17, 1.170A–1, 1.213–1, 1.217–2, 1.274–5, 1.1016–3.)*

## Rev. Proc. 2001–54

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2000–48 (2000–49 I.R.B. 570) by providing optional standard mileage rates for employees, self-employed individuals, or other taxpayers to use in computing the deductible costs of operating an automobile for business, charitable, medical, or moving expense purposes. This revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under § 1.274–5 of the Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation.

SECTION 2. SUMMARY OF STANDARD MILEAGE RATES

.01 *Standard mileage rates.*

(1) Business (section 5 below)
36.5 cents per mile

(2) Charitable (section 7 below)
14 cents per mile

(3) Medical and Moving (section 7 below)
13 cents per mile

.02 *Determination of standard mileage rates.* The business, medical, and moving standard mileage rates reflected in this revenue procedure are based on an annual study of the fixed and variable costs of operating an automobile conducted on behalf of the Internal Revenue Service by an independent contractor, and the charitable standard mileage rate is provided in § 170(i) of the Internal Revenue Code.

SECTION 3. BACKGROUND

.01 Section 162(a) allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct the cost of operating an automobile to the extent that it is used in a trade or business. However, under § 262, no portion of the cost of operating an automobile that is attributable to personal use is deductible.

.02 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 with respect to any listed property (as defined in § 280F(d)(4) to include passenger automobiles and any other property used as a means of transportation) unless the taxpayer complies with certain substantiation requirements. The section further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by such regulations.

.03 Section 1.274–5(j), in part, grants the Commissioner of Internal Revenue the authority to establish a method under which a taxpayer may use mileage rates to substantiate, for purposes of § 274(d), the amount of the ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home.

.04 Section 1.274–5(g), in part, grants the Commissioner the authority to prescribe rules relating to mileage allowances for ordinary and necessary expenses of using a vehicle for local transportation and transportation to, from, and at the destination while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such allowances, if in accordance with reasonable business practice, will be regarded as (1) equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel and transportation expenses for purposes of § 1.274–5(c), and (2) satisfying the requirements of an adequate accounting to the employer of the amount of such expenses for purposes of § 1.274–5(f).

.05 Section 62(a)(2)(A) allows an employee, in determining adjusted gross income, a deduction for the expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement. Section 62(c) further provides that the substantiation requirements described therein shall not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for such expense.

.07 Under § 1.62–2(c)(1), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274–5(g) will be treated as substantiation of the amount of such expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an arrangement providing mileage allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of such an allowance that relates to miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance that relates to miles of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a mileage allowance under an arrangement that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to miles of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under § 274(d) and § 1.274–5(g), and that the employee is not required to return, is subject to withholding and payment of employment taxes. See §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this excess portion.

.09 Under § 1.62–2(h)(2)(i)(B)(4), the Commissioner may, in his or her discretion, prescribe special rules regarding the timing of withholding and payment of employment taxes on mileage allowances.

## SECTION 4. DEFINITIONS

.01 *Standard mileage rate.* The term "standard mileage rate" means the applicable amount provided by the Service for optional use by employees or self-employed individuals in computing the deductible costs of operating automobiles (including vans, pickups, or panel trucks) owned or leased for business purposes, or by taxpayers in computing the deductible costs of operating automobiles for charitable, medical, or moving expense purposes.

.02 *Transportation expenses.* The term "transportation expenses" means the expenses of operating an automobile for local travel or transportation away from home.

.03 *Mileage allowance.* The term "mileage allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62–2(c)(1) and that is

(1) paid with respect to the ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for transportation expenses in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at the applicable standard mileage rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.04 *Flat rate or stated schedule.* A mileage allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 4.03 of this revenue procedure. Such allowance may be paid periodically at a fixed rate, at a cents-per-mile rate, at a variable rate based on a stated schedule, at a rate that combines any of these rates, or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, a periodic payment at a fixed rate to cover the fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving an automobile in connection with the performance of services as an employee of the employer, coupled with a periodic payment at a cents-per-mile rate to cover the operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of using an automobile for such purposes, is an allowance paid at a flat rate or stated schedule. Likewise, a periodic payment at a variable rate based on a stated schedule for different locales to cover the costs of driving an automobile in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

## SECTION 5. BUSINESS STANDARD MILEAGE RATE

.01 *In general.* The standard mileage rate for transportation expenses is 36.5 cents per mile for all miles of use for business purposes. This business standard mileage rate will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.02 *Use of the business standard mileage rate.* A taxpayer may use the business standard mileage rate with respect to an automobile that is either owned or leased by the taxpayer. A taxpayer generally may deduct an amount equal to either the business standard mileage rate times the number of business miles traveled or the actual costs (both operating and fixed) paid or incurred by the taxpayer that are allocable to traveling those business miles.

.03 *Business standard mileage rate in lieu of operating and fixed costs.* A deduction using the standard mileage rate for business miles is computed on a yearly basis and is in lieu of all operating and fixed costs of the automobile allocable to business purposes (except as provided in section 9.06 of this revenue procedure). Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, and license and registration fees are included in operating and fixed costs for this purpose.

.04 *Parking fees, tolls, interest, and taxes.* Parking fees and tolls attributable to use of the automobile for business purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local personal property taxes may be deducted as separate items, but only to the extent allowable under § 163 or 164, respectively. If the automobile is operated less than 100 percent for business purposes, an allocation is required to determine the business and nonbusiness portion of the taxes and interest deduction allowable. However, §163(h)(2)(A) expressly provides that interest is nondeductible personal interest when it is paid or accrued on indebtedness properly allocable to the trade or business of performing services as an employee. Section 164 also expressly provides that state and local taxes that are paid or accrued by a taxpayer in connection with an acquisition or disposition of property will be treated as part of the cost of the acquired property or as a reduction in the amount realized on the disposition of such property.

.05 *Depreciation.* For owned automobiles placed in service for business purposes, and for which the business standard mileage rate has been used for any year, depreciation will be considered to have been allowed at the rate of 12 cents per mile for 1997, 1998, and 1999; 14 cents per mile for 2000; and 15 cents per mile for 2001 and 2002, for those years in which the business standard mileage rate was used. If actual costs were used for one or more of those years, the rates above will not apply to any year in which such costs were used. The depreciation described above will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016.

.06 *Limitations.*

(1) The business standard mileage rate may not be used to compute the deductible expenses of (a) automobiles used for hire, such as taxicabs, or (b) two or more automobiles used simultaneously (such as in fleet operations).

(2) The business standard mileage rate may not be used to compute the deductible business expenses of an automobile leased by a taxpayer unless the taxpayer uses either the business standard mileage rate or a "FAVR" allowance (as provided in section 8 of this revenue procedure) to compute the deductible business expenses of the automobile for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(3) The business standard mileage rate may not be used to compute the deductible expenses of an automobile for which the taxpayer has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. By using the business standard mileage rate, the taxpayer has elected to exclude the automobile (if owned) from MACRS pursuant to § 168(f)(1). If, after using the business standard mileage rate, the taxpayer uses actual costs, the taxpayer must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(4) The business standard mileage rate and this revenue procedure may not be used to compute the amount of the deductible automobile expenses of an employee of the United States Postal Service incurred in performing services involving the collection and delivery of mail on a rural route if the employee receives qualified reimbursements (as defined in § 162(o)) for such expenses. See § 162(o) for the rules that apply to these qualified reimbursements.

## SECTION 6. RESERVED

## SECTION 7. CHARITABLE, MEDICAL, AND MOVING STANDARD MILEAGE RATE

.01 *Charitable.* Section 170(i) provides a standard mileage rate of 14 cents per mile for purposes of computing the charitable deduction for use of an automobile in connection with rendering gratuitous services to a charitable organization under § 170.

.02 *Medical and moving.* The standard mileage rate is 13 cents per mile for use of an automobile (a) to obtain medical care described in § 213, or (b) as part of a move for which the expenses are deductible under § 217. The standard mileage rates for medical and moving transportation expenses will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.03 *Charitable, medical, or moving expense standard mileage rate in lieu of operating expenses.* A deduction computed using the applicable standard mileage rate for charitable, medical, or moving expense miles is in lieu of all operating expenses (including gasoline and oil) of the automobile allocable to such purposes. Costs for such items as depreciation (or lease payments), insurance, and license and registration fees are not deductible, and are not included in such standard mileage rates.

.04 *Parking fees, tolls, interest, and taxes.* Parking fees and tolls attributable to the use of the automobile for charitable, medical, or moving expense purposes may be deducted as separate items.

Interest relating to the purchase of the automobile and state and local personal property taxes are not deductible as charitable, medical, or moving expenses, but they may be deducted as separate items to the extent allowable under § 163 or 164, respectively.

## SECTION 8. FIXED AND VARIABLE RATE ALLOWANCE

.01 *In general.*

(1) The ordinary and necessary expenses paid or incurred by an employee in driving an automobile owned or leased by the employee in connection with the performance of services as an employee of the employer will be deemed substantiated (in an amount determined under section 9 of this revenue procedure) when a payor reimburses such expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable rate payments that meet all the requirements of section 8 of this revenue procedure (a FAVR allowance).

(2) The amount of a FAVR allowance must be based on data that (a) is derived from the base locality, (b) reflects retail prices paid by consumers, and (c) is reasonable and statistically defensible in approximating the actual expenses employees receiving the allowance would incur as owners of the standard automobile.

.02 *Definitions.*

(1) *FAVR allowance.* A FAVR allowance includes periodic fixed payments and periodic variable payments. A payor may maintain more than one FAVR allowance. A FAVR allowance that uses the same payor, standard automobile (or an automobile of the same make and model that is comparably equipped), retention period, and business use percentage is considered one FAVR allowance, even though other features of the allowance may vary. A FAVR allowance also includes any optional high mileage payments; however, such optional high mileage payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes when paid. See section 9.05 of this revenue procedure. An optional high mileage payment covers the additional depreciation for a standard automobile attributable to business miles driven and substantiated by the employee for a calendar year in excess of the annual business mileage for that year. If an employee is covered by the FAVR allowance for less than the entire calendar year, the annual business mileage may be prorated on a monthly basis for purposes of the preceding sentence.

(2) *Periodic fixed payment.* A periodic fixed payment covers the projected fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving the standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. A periodic fixed payment may be computed by (a) dividing the total projected fixed costs of the standard automobile for all years of the retention period, determined at the beginning of the retention period, by the number of periodic fixed payments in the retention period, and (b) multiplying the resulting amount by the business use percentage.

(3) *Periodic variable payment.* A periodic variable payment covers the projected operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. The rate of a periodic variable payment for a computation period may be computed by dividing the total projected operating costs for the standard automobile for the computation period, determined at the beginning of the computation period, by the computation period mileage. A computation period can be any period of a year or less. Computation period mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a computation period and equals the retention mileage divided by the number of computation periods in the retention period. For each business mile substantiated by the employee for the computation period, the periodic variable payment must be paid at a rate that does not exceed the rate for that computation period.

(4) *Base locality.* A base locality is the particular geographic locality or region of the United States in which the costs of driving an automobile in connection with the performance of services as an employee of the employer are generally paid or incurred by the employee. Thus, for purposes of determining the amount of fixed costs, the base locality is generally the geographic locality or region in which the employee resides. For purposes of determining the amount of operating costs, the base locality is generally the geographic locality or region in which the employee drives the automobile in connection with the performance of services as an employee of the employer.

(5) *Standard automobile.* A standard automobile is the automobile selected by the payor on which a specific FAVR allowance is based.

(6) *Standard automobile cost.* The standard automobile cost for a calendar year may not exceed 95 percent of the sum of (a) the retail dealer invoice cost of the standard automobile in the base locality, and (b) state and local sales or use taxes applicable on the purchase of such an automobile. Further, the standard automobile cost may not exceed $27,100.

(7) *Annual mileage.* Annual mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a calendar year. Annual mileage equals the annual business mileage divided by the business use percentage.

(8) *Annual business mileage.* Annual business mileage is the mileage a payor reasonably projects a standard automobile will be driven by an employee in connection with the performance of services as an employee of the employer during the calendar year, but may not be less than 6,250 miles for a calendar year. Annual business mileage equals the annual mileage multiplied by the business use percentage.

(9) *Business use percentage.* A business use percentage is determined by dividing the annual business mileage by the annual mileage. The business use percentage may not exceed 75 percent. In lieu of demonstrating the reasonableness

of the business use percentage based on records of total mileage and business mileage driven by the employees annually, a payor may use a business use percentage that is less than or equal to the following percentages for a FAVR allowance that is paid for the following annual business mileage:

| *Annual business mileage* | *Business use percentage* |
|---|---|
| 6,250 or more but less than 10,000 | 45 percent |
| 10,000 or more but less than 15,000 | 55 percent |
| 15,000 or more but less than 20,000 | 65 percent |
| 20,000 or more | 75 percent |

(10) *Retention period.* A retention period is the period in calendar years selected by the payor during which the payor expects an employee to drive a standard automobile in connection with the performance of services as an employee of the employer before the automobile is replaced. Such period may not be less than two calendar years.

(11) *Retention mileage.* Retention mileage is the annual mileage multiplied by the number of calendar years in the retention period.

(12) *Residual value.* The residual value of a standard automobile is the projected amount for which it could be sold at the end of the retention period after being driven the retention mileage. The Service will accept the following safe harbor residual values for a standard automobile computed as a percentage of the standard automobile cost:

| *Retention period* | *Residual value* |
|---|---|
| 2-year | 70 percent |
| 3-year | 60 percent |
| 4-year | 50 percent |

.03 *FAVR allowance in lieu of operating and fixed costs.*

(1) A reimbursement computed using a FAVR allowance is in lieu of the employee's deduction of all the operating and fixed costs paid or incurred by an employee in driving the automobile in connection with the performance of services as an employee of the employer, except as provided in section 9.06 of this revenue procedure. Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, license and registration fees, and personal property taxes are included in operating and fixed costs for this purpose.

(2) Parking fees and tolls attributable to an employee driving the standard automobile in connection with the performance of services as an employee of the employer are not included in fixed and operating costs and may be deducted as separate items. Similarly, interest relating to the purchase of the standard automobile may be deducted as a separate item, but only to the extent that the interest is an allowable deduction under § 163.

.04 *Depreciation.*

(1) A FAVR allowance may not be paid with respect to an automobile for which the employee has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. If an employee uses actual costs for an owned automobile that has been covered by a FAVR allowance, the employee must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(2) Except as provided in section 8.04(3) of this revenue procedure, the total amount of the depreciation component for the retention period taken into account in computing the periodic fixed payments for that retention period may not exceed the excess of the standard automobile cost over the residual value of the standard automobile. In addition, the total amount of such depreciation component may not exceed the sum of the annual § 280F limitations on depreciation (in effect at the beginning of the retention period) that apply to the standard automobile during the retention period.

(3) If the depreciation component of periodic fixed payments exceeds the limitations in section 8.04(2) of this revenue procedure, that section will be treated as satisfied in any year during which the total annual amount of the periodic fixed payments and the periodic variable payments made to an employee driving 80 percent of the annual business mileage of the standard automobile does not exceed the amount obtained by multiplying 80 percent of the annual business mileage of the standard automobile by the applicable business standard mileage rate for that year (see, for example, section 5.01 of this revenue procedure).

(4) The depreciation included in each periodic fixed payment portion of a FAVR allowance paid with respect to an automobile will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016. See section 8.07(2) of this revenue procedure for the requirement that the employer report the depreciation component of a periodic fixed payment to the employee.

.05 *FAVR allowance limitations.*

(1) A FAVR allowance may be paid only to an employee who substantiates to the payor for a calendar year at least 5,000 miles driven in connection with the performance of services as an employee of the employer or, if greater, 80 percent of the annual business mileage of that FAVR allowance. If the employee is covered by the FAVR allowance for less than the entire calendar year, these limits may be prorated on a monthly basis.

(2) A FAVR allowance may not be paid to a control employee (as defined in § 1.61–21(f)(5) and (6), excluding the $100,000 limitation in paragraph (f)(5)(iii)).

(3) At no time during a calendar year may a majority of the employees covered by a FAVR allowance be management employees.

(4) At all times during a calendar year at least five employees of an employer must be covered by one or more FAVR allowances.

(5) A FAVR allowance may be paid only with respect to an automobile (a) owned or leased by the employee receiving the payment, (b) the cost of which, when new, is at least 90 percent of the standard automobile cost taken into account for purposes of determining the FAVR allowance for the first calendar year the employee receives the allowance with respect to that automobile, and (c) the model year of which does not differ from the current calendar year by more than the number of years in the retention period.

(6) A FAVR allowance may not be paid with respect to an automobile leased by an employee for which the employee has used actual expenses to compute the deductible business expenses of the automobile for any year during the entire lease period. For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(7) The insurance cost component of a FAVR allowance must be based on the rates charged in the base locality for insurance coverage on the standard automobile during the current calendar year without taking into account such rate-increasing factors as poor driving records or young drivers.

(8) A FAVR allowance may be paid only to an employee whose insurance coverage limits on the automobile with respect to which the FAVR allowance is paid are at least equal to the insurance coverage limits used to compute the periodic fixed payment under that FAVR allowance.

.06 *Employee reporting.* Within 30 days after an employee's automobile is initially covered by a FAVR allowance, or is again covered by a FAVR allowance if such coverage has lapsed, the employee by written declaration must provide the payor with the following information: (a) the make, model, and year of the employee's automobile, (b) written proof of the insurance coverage limits on the automobile, (c) the odometer reading of the automobile, (d) if owned, the purchase price of the automobile or, if leased, the price at which the automobile is ordinarily sold by retailers (the gross capitalized cost of the automobile), and (e) if owned, whether the employee has claimed depreciation with respect to the automobile using any of the depreciation methods prohibited by section 8.04(1) of this revenue procedure or, if leased, whether the employee has computed deductible business expenses with respect to the automobile using actual expenses. The information described in (a), (b), and (c) of the preceding sentence also must be supplied by the employee to the payor within 30 days after the beginning of each calendar year that the employee's automobile is covered by a FAVR allowance.

.07 *Payor recordkeeping and reporting.*

(1) The payor or its agent must maintain written records setting forth (a) the statistical data and projections on which the FAVR allowance payments are based, and (b) the information provided by the employees pursuant to section 8.06 of this revenue procedure.

(2) Within 30 days of the end of each calendar year, the employer must provide each employee covered by a FAVR allowance during that year with a statement that, for automobile owners, lists the amount of depreciation included in each periodic fixed payment portion of the FAVR allowance paid during that calendar year and explains that by receiving a FAVR allowance the employee has elected to exclude the automobile from MACRS pursuant to § 168(f)(1). For automobile lessees, the statement must explain that by receiving the FAVR allowance the employee may not compute the deductible business expenses of the automobile using actual expenses for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

.08 *Failure to meet section 8 requirements.* If an employee receives a mileage allowance that fails to meet one or more of the requirements of section 8 of this revenue procedure, the employee may not be treated as covered by any FAVR allowance of the payor during the period of such failure. Nevertheless, the expenses to which that mileage allowance relates may be deemed substantiated using the method described in sections 5, 9.01(1), and 9.02 of this revenue procedure to the extent the requirements of those sections are met.

SECTION 9. APPLICATION

.01 If a payor pays a mileage allowance in lieu of reimbursing actual transportation expenses incurred or to be incurred by an employee, the amount of the expenses that is deemed substantiated to the payor is either:

(1) for any mileage allowance other than a FAVR allowance, the lesser of the amount paid under the mileage allowance or the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee; or

(2) for a FAVR allowance, the amount paid under the FAVR allowance less the sum of (a) any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return to the payor although required to do so, (b) any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return to the payor although required to do so, and (c) any optional high mileage payments.

.02 If the amount of transportation expenses is deemed substantiated under the rules provided in section 9.01 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place (or use), and business purpose of the transportation expenses in accordance with paragraphs (b)(2) (travel away from home), (b)(6) (listed property, which includes passenger automobiles and any other property used as a means of transportation), and (c) of § 1.274–5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5(f), as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5(c). **See** § 1.62–2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.03 An arrangement providing mileage allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses as follows:

(1) For a mileage allowance other than a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of such an allowance that relates to miles of travel not substantiated by the employee, even though the arrangement does not require the employee to return the portion of such an allowance that relates to the miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance mileage allowance of $80 based on an anticipated 200 business miles at 40 cents per mile (at a time when the applicable business standard mileage rate is 36.5 cents per mile), and the employee substantiates 120 business miles. The requirement to return excess amounts will be treated as satisfied if the employee is required to return the portion of the allowance that relates to the 80 unsubstantiated business miles ($32) even though the employee is not required to return the portion of the allowance ($4.20) that exceeds the amount of the employee's expenses deemed substantiated under section 9.01 of this revenue procedure ($43.80) for the 120 substantiated business miles. However, the $4.20 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 9.05.

(2) For a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)), (a) the portion (if any) of the periodic variable payment received that relates to miles in excess of the business miles substantiated by the employee, and (b) the portion (if any) of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance.

.04 An employee is not required to include in gross income the portion of a mileage allowance received from a payor that is less than or equal to the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02. *See* § 1.274-5(f)(2)(i). In addition, such portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W–2, and is exempt from the withholding and payment of employment taxes. *See* §§ 1.62–2(c)(2) and (c)(4).

.05 An employee is required to include in gross income only the portion of a mileage allowance received from a payor that exceeds the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02 of this revenue procedure. *See* § 1.274–5(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W–2, and is subject to withholding and payment of employment taxes. *See* §§ 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.06

(1) Except as otherwise provided in section 9.06(2) of this revenue procedure with respect to leased automobiles, if the amount of the expenses deemed substantiated under the rules provided in section 9.01 of this revenue procedure is less than the amount of the employee's business transportation expenses, the employee may claim an itemized deduction for the amount by which the business transportation expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business transportation expenses, includes on Form 2106, *Employee Business Expenses*, the deemed substantiated portion of the mileage allowance received from the payor, and includes in gross income the portion (if any) of the mileage allowance received from the payor that exceeds the amount deemed substantiated. *See* § 1.274–5(f)(2)(iii). However, for purposes of claiming this itemized deduction, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the applicable standard mileage rate multiplied by the number of business miles substantiated by the employee minus the amount deemed substantiated under section 9.01 of this revenue procedure. The itemized deduction is subject to the 2–percent floor on miscellaneous itemized deductions provided in § 67.

(2) An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(1) of this revenue procedure (relating to an allowance other than a FAVR allowance) may not claim a deduction based on actual expenses unless the employee does so consistently beginning with the first business use of the automobile after December 31, 1997. However, an employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(2) of this revenue procedure (relating to a FAVR allowance) may not claim a deduction based on actual expenses.

.07 An employee may deduct an amount computed pursuant to section 5.01 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2–percent floor on miscellaneous itemized deductions provided in § 67.

.08 A self-employed individual may deduct an amount computed pursuant to section 5.01 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.09 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. Thus, such payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes. *See* §§ 1.62–2(c)(3), (c)(5), and (h)(2).

SECTION 10. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a mileage allowance (other than a FAVR allowance), if any, that relates to the miles of business travel substantiated and that exceeds the amount deemed substantiated for those miles under section 9.01(1) of this revenue procedure is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) In the case of a mileage allowance paid as a reimbursement, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the business miles substantiated. *See* § 1.62–2(h)(2)(i)(B)(2).

(2) In the case of a mileage allowance paid as an advance, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the business miles with respect to which the advance was paid are substantiated. *See* § 1.62–2(h)(2)(i)(B)(3). If some or all of the business miles with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those miles within a reasonable period of time, the portion of the allowance that relates to those miles is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(3) In the case of a mileage allowance that is not computed on the basis of a fixed amount per mile of travel (for example, a mileage allowance that combines periodic fixed and variable rate payments, but that does not satisfy the requirements of section 8 of this revenue procedure), the payor must compute periodically (no less frequently than quarterly) the amount, if any, that exceeds the amount deemed substantiated under section 9.01(1) of this revenue procedure by comparing the total mileage allowance paid for the period to the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee for the period. Any excess is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. *See* § 1.62–2(h)(2)(i)(B)(4).

(4) For example, assume an employer pays its employees a mileage allowance at a rate of 40 cents per mile (when the business standard mileage rate is 36.5 cents per mile). The employer does not require the return of the portion of the allowance that exceeds the business standard mileage rate for the business miles substantiated (3.5 cents). In June, the employer advances an employee $200 for 500 miles to be traveled during the month. In July, the employee substantiates to the employer 400 business miles traveled in June and returns $40 to the employer for the 100 business miles not traveled. The amount deemed substantiated for the 400 miles traveled is $146 and the employee is not required to return the remaining $14. No later than the first payroll period following the payroll period in which the 400 business miles traveled are substantiated, the employer must withhold and pay employment taxes on $14.

.02 The portion of a FAVR allowance, if any, that exceeds the amount deemed substantiated for those miles under section 9.01(2) of this revenue procedure is subject to withholding and payment of employment taxes. *See* § 1.62–2(h)(2)(i)(B).

(1) Any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return within a reasonable period, or any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return within a reasonable period, is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. *See* § 1.62–2(h)(2)(i)(A).

(2) Any optional high mileage payment is subject to withholding and payment of employment taxes when paid.

## SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2000–48 (2000–49 I.R.B. 5702) is hereby superseded for mileage allowances that are paid both (1) to an employee on or after January 1, 2002, and (2) with respect to transportation expenses paid or incurred by the employee on or after January 1, 2002. Rev. Proc. 2000–48 is also hereby superseded for purposes of computing the amount allowable as a deduction for transportation expenses paid or incurred on or after January 1, 2002.

## DRAFTING INFORMATION

The principal author of this revenue procedure is John Trevey of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Trevey at (202) 622–4970 (not a toll-free call).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking

## Conforming Amendments to Section 446

## REG–125161–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: On July 18, 1995, the Treasury and the IRS published final regulations governing the intercompany transaction system of the consolidated return regulations. Those regulations state that the timing rules of the intercompany transaction system are a method of accounting. At the time of the publication of those regulations, no amendment was made to the regulations promulgated under section 446 to coordinate with that statement. This document contains proposed regulations confirming that the timing rules of the intercompany transaction regulations are a method of accounting.

DATES: Written or electronic comments and requests for a public hearing must be received by January 7, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU, room 5226 (REG–125161–01), Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU, room 5226 (REG–125161–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet directly to the IRS internet site at *http://www.irs.gov/tax_/regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulation, Marie C. Milnes-Vasquez or Frances Kelly (202) 622–7770, or Jeffery G. Mitchell (202) 622–4930; concerning submissions and/or requests for a public hearing, Guy Traynor (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background and Explanation**

On July 18, 1995, the Treasury and the IRS published in the **Federal Register** (60 FR 36671 [1995–2 C.B. 147]) final regulations under §1.1502–13 governing the intercompany transaction system of the consolidated return regulations. Included in such regulations was an express statement that "[t]he timing rules of [the intercompany transaction regulations] are a method of accounting for intercompany transactions, to be applied by each member in addition to the member's other methods of accounting." § 1.1502–13(a)(3)(i). At the time of the publication of those final regulations, no amendment was made to the regulations promulgated under section 446 to coordinate with the statement in § 1.1502–13(a)(3)(i) that the timing rules of § 1.1502–13 are a method of accounting.

In *General Motors v. Commissioner*, 112 T.C. 270 (1999), the Tax Court determined that the timing rule of former § 1.1502–13(b)(2) was not a method of accounting for purposes of section 446(e). The proposed regulations included in this document amend § 1.446–1 to confirm the IRS's position that the timing rules of current §1.1502–13 are a method of accounting.

**Proposed Effective Date**

The regulations in this section are proposed to apply to consolidated return years beginning on or after November 7, 2001.

**Special Analyses**

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

**Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are timely submitted to the IRS. All comments will be made available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

**Drafting Information**

The principal author of these proposed regulations is Marie C. Milnes-Vasquez, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

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

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

Par. 2. Section 1.446–1 is amended by adding paragraph (c)(2)(iii) to read as follows:

*§ 1.446-1 General rule for methods of accounting.*

*****

(c) ***

(2) ***

(iii) The timing rules of §1.1502–13 are a method of accounting for intercompany transactions (as defined in § 1.1502–13(b)(1)(i)), to be applied by each member of a consolidated group in addition to the member's other methods of accounting. See §1.1502–13(a)(3)(i). This paragraph is applicable to consolidated return years beginning on or after November 7, 2001.

* * * * *

Par. 3. In §1.1502-13, the second sentence of paragraph (a)(3)(i) is revised to read as follows:

*§1.1502–13 Intercompany transactions.*

(a) * * *

(3) * * *

(i) * * * See §1.1502-17 and, with regard to consolidated return years beginning on or after November 7, 2001, §1.446-1(c)(2)(iii). * * *

* * * * *

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on November 6, 2001, 8:45 a.m., and published in the issue of the Federal Register for November 7, 2001, 66 F.R. 56262)

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## New Form 8038–R, Request for Recovery of Overpayments Under Arbitrage Rebate Provisions

## Announcement 2001–115

The IRS has released new Form 8038–R, *Request for Recovery of Overpayments Under Arbitrage Rebate Provisions*. Form 8038–R replaces the procedures of Revenue Procedure 92–83 (1992–2 C.B. 487) the purpose of which was to provide guidance to issuers of tax-exempt bonds who seek to recover overpayments of amounts required to be paid under section 148.

You can obtain Form 8038–R by telephone or by using IRS electronic information services.

| Request by | Number or address |
|---|---|
| Telephone | **1-800-TAX-FORM (1-800-829-3676)** |
| Personal Computer: | |
| IRS Web Site | www.irs.gov |
| File transfer protocol | **ftp.irs.gov** |

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## IRS and The George Washington University To Sponsor Institute on International Tax Issues

## Announcement 2001–116

Director, International, LMSB, Carol Dunahoo, has announced the Fourteenth Annual Institute on Current Issues in International Taxation, jointly sponsored by the Internal Revenue Service and The George Washington University, to be held on December 13 and 14, 2001, at the J.W. Marriott Hotel in Washington, DC. Registration is currently underway for the Institute, which is intended for professionals in international tax law.

The program will present a unique opportunity for top IRS and Treasury officials and tax experts, as well as leading private sector specialists, to address breaking issues and present key perspectives on new developments. The Institute will open with an address by B. John Williams, Jr., IRS Chief Counsel nominee. The first day will also feature sessions on the following:

- Moving from CFCs to CFPs: Credit and Deferral Issues in the Partnership Setting;
- Le Partnership: Coordinating Foreign and U.S. Taxation of Partnerships;
- Evolution of Business Form: Hybrids, Contractual Ventures, Etc.; and
- Updates on Outbound Issues.

Competent Authority officials from France, Canada, Japan, and the United States will discuss current issues. R. Glenn Hubbard, Chairman of the White House's Council of Economic Advisors, will deliver the luncheon address.

The second day will focus on such topics as:

- Updates on Inbound Issues,
- Selected Transfer Pricing Issues and
- Managing Multinationals' International Tax Controversies.

Mark A. Weinberger, Assistant Treasury Secretary for Tax Policy, is scheduled to deliver the luncheon address. The second day will also include an "Ask the IRS" panel.

Those interested in attending or obtaining more information should contact The George Washington University, Conference Management Services, by visiting their web site at *www.gwu.edu/~cms/iti14* or by telephone at 202-973-1110.

## Foundations Status of Certain Organizations

## Announcement 2001–118

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

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

1st Class, Ridgefield, WA
12 Steps on the Way Home, Arlington, WA
Aaron A. Hofmann Foundation, Inc., Salt Lake City, UT
A B A Foundation, Inc., Phoenix, AZ
Ace Foundation, Pleasant Grove, UT
AC-Tec, Everett, WA
Adelante Housing Corporation, Surprise, AZ
All Related Extended Care Services, Inc., Phoenix, AZ
Allied Services for Aids Prevention, Las Vegas, NV
Ammpec, Inc., Albuquerque, NM
Arizona Archival Institute, Inc., Glendale, AZ
Arizona Citizens Project, Scottsdale, AZ
Arizona Jazz Rhythm & Blues Festival, Inc., Flaggstaff, AZ
Arizona Junior Ski Racing Association, Phoenix, AZ
Arizona Lawyers Committee on Violence, Oro Valley, AZ
Arizona Minority Counsel Program, Inc., Chandler, AZ
Arizona Rising Suns Track Club, Inc., Glendale, AZ
Arizona Youth Theater, Inc., Tucson, AZ
Back-on-Track, Inc., Phoenix, AZ
Begin Again Foundation, Phoenix, AZ
Belagana Research Institute, Tucson, AZ
Bells Palsy Research Foundation, Tucson, AZ
Beneficial Care, Incorporated, Murray, UT
Beyond X Harambee Museum and Cultural Center, Murray, UT
Blue Mountain Demonstration Forest, Port Angeles, WA
Border K-9 Search and Rescue, Inc., Las Cruces, NM
Brianne Kiner Foundation for Exceptional Parents & Children, Edmonds, WA
Brolly Arts, Salt Lake City, UT
Camano Ranch, Camano Island, WA
Camwood Players, Stanwood, WA
Caribou Trail Housing Association, Okanogan, WA
Caughlin Ranch School Foundation, Reno, NV
Center for Entrpreneurship and Economic Development, Inc., Albuquerque, NM
Central Area Coaches Association, Seattle, WA
Children and Adults Affected by Pesticides, Santa Fe, NM
Children’s Dignity Project Foundation, Inc., Santa Fe, NM
Childrens Recording Corporation, Inc., Park City, UT
Christian Outreach Assembly for Children, Monroe, WA
Cinema Concepts Foundation, Scottsdale, AZ
Citizens 911 Guide to Democracy, Seattle, WA
Clark County Housing Affordability Consortium, Las Vegas, NV
Coalition for Community Development, Seattle, WA
Comhaltas Ceoltoiri Eireann, Albuquerque, NM
Community Advocates Aligned to Unite Ethnic Social Services, Kent, WA
Community Built Association, Inc., Alamogordo, NM
Companion Care, Inc., Provo, UT
Computer Outreach, Phoenix, AZ
Copeland-Freeman Foundation, Mesa, AZ
Cops Racing Against Violence Through Education, Las Vegas, NV
Cornerstone Christian Counseling, Tucson, AZ
County Line Riders of Catalina, Inc., Tucson, AZ
Crossroads Treatment Center, Sparks, NV
Dead Printers Society, Phoenix, AZ
Decker Lake Wetlands Preserve Foundation, Salt Lake City, UT
Deer Valley Spiritline Booster Club, Glendale, AZ
Diamond Magic, Spokane, WA
Directions in Education Training and Consultation, Gig Harbor, WA
Disease Prevention Program, Roy, UT
Divine Mercy Foundation, Tacoma, WA
Dolphin Institute, Seattle, WA
Door of Hope Ministries, Bellingham, WA
Double Camp Ministries, Glendale, AZ
Earth Spirit Wholeness Center, Tahotchi, NM
Earth Views Center for Ecosystem Mapping and Monitoring, Santa Fe, NM
Eclectic Cross Foundation, Las Vegas, NV
Ed Rimer Ministries, Inc., Albuquerque, NM
Edison Foundation, Seattle, WA
Edmonds Floral and Arts Foundation, Edmonds, WA
El Pesebre, Inc., Green Valley, AZ
Empathology Research Foundation, Bellevue, WA
Entiat Valley Service Club, Entiat, WA
Evergreen Clown Care, Orting, WA
Familia of Seattle, Mercer Island, WA
Family Mental Health Clinic, Las Cruces, NM
Fast Forward Media Lab, Seattle, WA
Fillmore Housing Corporation, Phoenix, AZ
Flag Children Services, Inc., Glendale, AZ
Fork in the Road, Inc., Tucson, AZ
Foundation for Colorectal Surgical Education, Seattle, WA
Foundation for Law Enforcement Education and Training, Inc., Phoenix, AZ
Friends of Garfield Foundation, Seattle, WA
Friends of the Adelson Drug Clinic, Inc., Las Vegas, NV
Gamblers at Their End Society, Graham, WA
Gateway Estates, Inc., Silver City, NM
Get High on Life-Be Dear to Yourself, Inc., Las Vegas, NV
Gods Little Creatures Foundation, Seattle, WA

Golden Hills Neighborhood Association, Salt Lake City, UT
Golden League Association, Kent, WA
Goldendale Education Fund, Goldendale, WA
Granny-Nanny Caregivers, Inc., Reno, NV
Gratitude Fellowship, Salt Lake City, UT
Great Basin National Feline Found, Fallon, NV
Grey Hound Friends Northwest, Issaquah, WA
Harp, Inc., Glendale, AZ
Healthy Start Infants Home, Deer Park, WA
Heartpraise Music Association, Vancouver, WA
Help Ministries, Inc., Scottsdale, AZ
Herdas Bicycle Club, Las Vegas, NV
Hispanic Historical Society, Inc., Albuquerque, NM
Hope for Coap, Spokane, WA
Hosanna Ministries International, Henderson, NV
Howard Memorial Mission, Inc., Glendale, AZ
Impact Foundation, Salt Lake City, UT
Independent Technicians Education Coalition, Tukwila, WA
Institute for International Economic Education, Mercer Island, WA
International Society for Integrated Human Development and Universal Peace, West Valley City, UT
Inventors Association of Arizona, Tucson, AZ
Irish Pipers Club, Seattle, WA
Jackson High Booster Club, Everett, WA
JASNET, Seattle, WA
Jewish Council For HIV-AIDS, Inc., Phoenix, AZ
Jimi Hendrix Family Foundation, Tukwila, WA
Jonathon Turner Trauma Foundation, Incline Village, NV
Kandy Productions Company, Inc., Scottsdale, AZ
King County Samoan Organizing Project, Seattle, WA
Kingdom Giving Foundation, Bellingham, WA
Kings Kids Day Care, Inc., Roswell, NM
Kylies Project, Bellingham, WA
La Jicarita Enterprise Communities, Penasco, NM
Laughing Horse Productions, Seattle, WA
Lead International Ministry Network, Vancouver, WA
Legacy Foundation, Inc., Phoenix, AZ
Leonard Bolar Foundation, Tacoma, WA
Lewis & Clark Bicentennial Seaplane Rendezvous Committee, Vashon, WA
Light Foundation, Inc., Salt Lake City, UT
Light to the Nations, Wasilla, AK
Malcom Harris Memorial Educational Enrichment Trust, Phoenix, AZ
Mannings Child Care Learning Center, Seattle, WA
Marine View Homes Association, Federal Way, WA
Marshall-David Library, Tucson, AZ
Mesa American Youth Football, Inc., Mesa, AZ
Mighty River Evangelistic Association, Inc., Albuquerque, NM
Mobile Caterer for the Homeless, Seattle, WA
Mobile Community Council for Progress, Inc., Maricopa, AZ
Mother of Mercy Chapel, Coulee City, WA
My Brothers Resource Center, Casa Grande, AZ
National American Indian Diabetes Association, Sacramento, CA
Native American Fish & Wildlife Society, Broomfield, CO
Native Americas International Film Exposition, Santa Fe, NM
NDN Productions, Inc., Albuquerque, NM
Neighborhood Ice and Recreation Development Fund, Inc., Salt Lake City, UT
New Exodus Ministries, Inc., Mesa, AZ
New Mexico Vietnam Veterans Foundation, Inc., Albuquerque, NM
New Shiprock Campus Committee, Inc., Shiprock, NM
Nibbana Foundation, Corrales, NM
Nicholas Group, Seattle, WA
Nighthawk, Santa Fe, NM
Noah 2 Northern Navajo Organization for the Advancement of Animal Health & Humanity, Shiprock, NM
Noahs Ark Animal Refuge, Inc., Carlsbad, NM
North High School Alumni Association, Phoenix, AZ
North Snohomish County Boxing Club, Arlington, WA
Northwest Tasar Association, Bow, WA
Nurses for Christ, Kingman, AZ
NW River Ecology, Spokane, WA
Open Gates Ministries , Yuma, AZ
Options for Youth Families and Communities, Inc., Logan, UT
Organization Latins Unidos, Albuquerque, NM
Organization of Positive Thought and Action, Mesa, AZ
Pathway to Freedom Counseling Center, Inc., Tucson, AZ
Peak at Santa Teresa, Santa Teresa, NM
Percussion for Kids Association, Seattle, WA
Personal Credit Assistance, Inc., Carson City, NV
Pierce Housing Corporation, Phoenix, AZ
Post-Recovery Aid Foundation, Federal Way, WA
Power to Cope-Missionary Health Restoration Work, Spokane, WA
Pro Homo Arts, Seattle, WA
Professionals Helping Amputees Train, Inc., Tucson, AZ
Recycling Insight, Everett, WA
Resources United for Supportive Services, Blaine, WA
Rialto Foundation, Tucson, AZ
Rising Star Communications of the Pacific Northwest, Inc., Kennewick, WA
Robbins Housing Corp , Santaquin, UT
Rocky Mountain Band of Cherokee Descendants, Sandy, UT
Safe Passage, Sedro Wooley, WA
San Jose Community Center, San Jose, NM
San Juan Resident Committee, San Juan Pueblo, NM
Sanctuary for Enlightened Action, Inc., Montpelier, VA
Santa Fe High School Football Booster Association, Inc., Sante Fe, NM
Santa Fe Institute for Medicine & Prayer, Sante Fe, NM
Scottsdale Childrens Nature Center for Science & Education, Scottsdale, AZ
Sedro-Woolley Playfield Association, Sedro Woolley, WA
Shield Ministries, Kennewick, WA
Shiprock Community Development Corporation, Shiprock, NM
Sierra Vista Ballet Company, Sierra Vista, AZ
Sigma Tau Sigma, Las Vegas, NV
Sonja L Harrison Foundation for Seniors, Bothell, WA

Sons of Haiti Manor Housing Association, Seattle, WA
Sons of Haiti Senior Housing Association, Seattle, WA
South Asia Cultural Association, Spokane, WA
South Pacific County Cliff Rescue, Seaview, WA
Southern Oregon Hockey Association, Inc., Medford, OR
Stephen Christopher Foundation, Inc., Scottsdale, AZ
Super Kids of America, Springville, UT
Tacoma Empowerment Consortium, Tacoma, WA
Theatre Southwest, Inc., Albuquerque, NM
Therapeutic Living Concept-Message Therapy for People With AIDS, Everett, WA
Threshold House, Mesa, AZ
Tohatchi Youth Center, Tohatchi, NM
Tseikiin Community Development Corporation, Ramah, NM
Tucson Marriage Encounter, Inc., Tucson, AZ
Tucson Mormon Battalion Monument Foundation, Tucson, AZ
United States Freestyle Ski Team, Inc., Salt Lake City, UT
Utah Hispanic Womens Association, Inc., Mountain Green, UT
Valdez Swim Club, Inc., Valdez, AK
Valley Crossroads, Inc., Salt Lake City, UT
Venturi Foundation, Sun City, AZ
Visions World Productions, Inc., Phoenix, AZ
Walla Walla Blues Associations, Walla Walla, WA
Wardley Foundation, Inc., Salt Lake City, UT
Warren and Jolene Young Ministries, Sun City West, AZ
Washington Higher Education Policy Center, Olympia, WA
Washington State Council of Firefighters Benevolent Fund, Olympia, WA
Washington Waterfowl Association, Edmonds, WA
Wellspring Womens Center, Sacramento, CA
West Bountiful Little League Baseball, West Bountiful, UT
West Jordan Municipal Soccer Authority Incorporated, West Jordan, UT
Wings Foundation, Tucson, AZ
Wings of Love Ministries, Tukwila, WA
Womens Resource Center, Carson City, NV
Worldwide Cultural Exchange, Inc., Sedona, AZ
Y.A.F.D.A. Youth Away From Drugs and Alcohol, Moses Lake, WA
Young at Heart Ministries, Albuquerque, NM
Zion Temple Ashram Community, Inc., Tucson, AZ
Zolo Foundation, Gold Canyon, AZ

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

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

## Section 401. — Qualified Pension, Profit-Sharing, and Stock Bonus Plans

*26 CFR 1.401(b)–1: Certain retroactive changes in plan.*

The GUST remedial amendment period is extended to February 28, 2002, where the period would otherwise end before then. In addition, as a result of the incidents of September 11, 2001, for plans directly affected, the period is extended to June 30, 2002. See Rev. Proc. 2001–55, page 552.

# Part III. Administrative, Procedural, and Miscellaneous

## Notice 2001–67

1. ANNOUNCEMENT OF THE LMSB FAST TRACK DISPUTE RESOLUTION PILOT PROGRAM

This Notice announces the LMSB Fast Track Dispute Resolution Pilot Program (LMSB Fast Track) which establishes new opportunities for large and mid-size business taxpayers, with the assistance of the IRS Office of Appeals (Appeals), to expedite case resolution at the lowest level within the IRS's Large and Mid-Size Business organization (LMSB). The purpose of the LMSB Fast Track program is to enable taxpayers and the IRS to work together in a concentrated and expedited fashion to resolve outstanding issues while the case is still in LMSB jurisdiction. The purpose of the pilot phase of the program is to test, measure, and explore whether the process described in this Notice, in fact, reduces cost and time to the parties.

The program is jointly administered by LMSB and Appeals. In the pilot phase, the program is available to large and mid-size businesses under LMSB jurisdiction that currently have unagreed issues in at least one open year under examination. LMSB Fast Track is a collaborative process among the taxpayer, LMSB, and Appeals. LMSB Fast Track is one process with two options for dispute resolution: Fast Track Mediation and Fast Track Settlement. Under Fast Track Mediation, an Appeals Officer or an Appeals Team Case Leader will act in the role of mediator to help the parties resolve factual issues. Under Fast Track Settlement, an Appeals Team Case Leader will facilitate communications to help the taxpayer and LMSB resolve factual and legal issues. During the pilot phase of the program, the program managers for LMSB and Appeals plan to select, from cases for which the taxpayer and the LMSB Team Manager agree that LMSB Fast Track might be beneficial, a minimum of one case from each of the five LMSB industry groups for Fast Track Mediation and a minimum of one case from each of the five LMSB industry groups for Fast Track Settlement.

The IRS believes that LMSB Fast Track has the potential to offer significant benefits for taxpayers as well as the IRS, and invites large and mid–size business taxpayers to participate.

2. DESCRIPTION OF THE LMSB FAST TRACK DISPUTE RESOLUTION PILOT PROGRAM

LMSB Fast Track establishes new opportunities designed to expedite case resolution at the lowest level within the LMSB organization. LMSB Fast Track offers two options using Alternative Dispute Resolution (ADR) techniques. The first option, Fast Track Mediation, involves an Appeals Officer or an Appeals Team Case Leader who has been trained in mediation techniques acting as a mediator between the taxpayer and the LMSB audit team.

The second option, Fast Track Settlement, involves an Appeals Team Case Leader who assists the parties to reach a resolution of the disputed issues.

Although the two options have many similarities, Fast Track Settlement is different from Fast Track Mediation because Fast Track Settlement allows the parties to consider both factual and legal issues and to take Appeals' assessment of the hazards of litigation into account in resolving disputes. Both options, Fast Track Settlement and Fast Track Mediation, take place prior to the issuance of the 30–day letter to the taxpayer, and each is designed to be completed in approximately 120 days.

3. SUBJECT MATTER FOR THE LMSB FAST TRACK DISPUTE RESOLUTION PILOT PROGRAM

The LMSB Fast Track process will assist taxpayers and Compliance to resolve factual and/or legal issues and is generally available to all LMSB taxpayers. Fast Track Mediation or Fast Track Settlement may be initiated at any time after an issue has been fully developed, the Form 5701 (*Notice of Proposed Adjustment*) has been issued, and a written response has been provided by the taxpayer, but before the issuance of the 30–day letter.

LMSB Fast Track is generally available for all LMSB cases within Compliance's jurisdiction. LMSB Fast Track is appropriate for cases where:

- Issues are fully developed;
- The taxpayer has stated its position in writing; and
- There are a limited number of unagreed issues.

LMSB Fast Track will not be available for:

- Issues designated for litigation by Chief Counsel;
- An issue that is the subject of a request for competent authority assistance;
- An issue for which the taxpayer has requested the simultaneous Appeal/ Competent Authority procedure described in section 8 of Rev. Proc. 96–13 (1996–1 C.B. 616);
- Issues outside LMSB's jurisdiction; or
- Issues outside Appeals' settlement authority (*e.g.*, application of certain international penalty provisions under Chapter 61 of the Internal Revenue Code (Code)).

LMSB Fast Track may not be the appropriate dispute resolution process for all cases. The LMSB Team Manager and the taxpayer will evaluate their individual circumstances to determine if this process meets their needs.

4. PROCEDURES FOR REQUESTING PARTICIPATION IN THE LMSB FAST TRACK DISPUTE RESOLUTION PILOT PROGRAM

A taxpayer that is interested in participating in LMSB Fast Track, or that has questions about the program and its suitability for the taxpayer's case, may contact the LMSB Team Manager for the year currently under examination. Taxpayers may also contact Jim Fike, LMSB Fast Track Program Manager, at (202) 283–8353 (not a toll-free number), or

J.W. Wyatt, Appeals Fast Track Acting Program Manager, at (314) 612–4639 (not a toll-free number), for further information about the pilot program.

*Initiating the Request for Participation in the Pilot Program*

Either the taxpayer or the LMSB Team Manager can suggest the use of LMSB Fast Track procedures. A request to participate in the LMSB Fast Track pilot program must be initiated before a 30–day letter is issued, and both parties must enter into an agreement to participate in the process by executing an LMSB Fast Track Agreement.

*Contents of the Request*

The LMSB Fast Track Agreement form used to request either Fast Track Mediation or Fast Track Settlement is attached to this Notice. The LMSB Team Manager and the taxpayer together indicate which LMSB Fast Track option, Fast Track Mediation or Fast Track Settlement, they believe is best suited for the case.

The goal is to complete the entire LMSB Fast Track process in approximately 120 days. A projected process ending date is agreed to and documented on the LMSB Fast Track Agreement form. The LMSB Team Manager and the taxpayer will identify a preferred conference site. The Notices of Proposed Adjustment (Forms 5701) and a written response from the taxpayer should be included with the LMSB Fast Track Agreement to complete the package. A formal protest is not required.

If the case is not accepted for inclusion in the LMSB Fast Track pilot program, the LMSB Team Manager will discuss other dispute resolution opportunities with the taxpayer. A taxpayer is not entitled to a conference to appeal a decision not to accept a case into the LMSB Fast Track pilot program.

## 5. SELECTION OF TAXPAYERS FOR THE LMSB FAST TRACK DISPUTE RESOLUTION PILOT PROGRAM

In general, LMSB Fast Track requests will be evaluated and selected for inclusion in the pilot program by applying criteria that include the following:

- LMSB Team Manager and taxpayer: Ensure that the issues identified for the process qualify for inclusion in the program.
- Appeals Officer or Appeals Team Case Leader and the Appeals Fast Track Program Manager: Concur with the taxpayer and LMSB Team Manager that the issues are appropriate for LMSB Fast Track under the option selected, and confirm that a different Appeals Officer will be able to handle any unagreed issues following the LMSB Fast Track process.
- LMSB Fast Track Program Manager and Appeals Fast Track Program Manager: Ensure that a cross-section of taxpayers of varying sizes and representing different industry lines, a geographical dispersion of cases and a variety of issues are included in the program.

## 6. CONDUCTING THE LMSB FAST TRACK PROCESS

LMSB Fast Track is one process with two options for dispute resolution: Fast Track Mediation and Fast Track Settlement.

Fast Track Mediation is designed to expedite case resolution using mediation techniques. An Appeals Officer or an Appeals Team Case Leader trained in mediation techniques acts as a mediator between the taxpayer and LMSB. The purpose is to facilitate communication and to help the parties resolve factual issues. The mediator will not have settlement authority and will not render a decision regarding any issue subject to the Fast Track Mediation process.

Fast Track Settlement involves an Appeals Team Case Leader who will use various dispute resolution techniques to propose solutions. The Appeals Team Case Leader will first attempt to facilitate an agreement between LMSB and the taxpayer regarding the Fast Track Settlement issues, and may ultimately make a recommendation regarding the settlement of any or all issues (both factual and legal). If the recommendation is acceptable to LMSB and the taxpayer, the settlement proposal may be adopted. The Appeals Team Case Leader will have settlement authority and may exercise that authority to write up the settlement of Fast Track Settlement issues agreed to by the parties.

*Participants*

During the LMSB Fast Track process, taxpayer and LMSB representatives, including a representative with decision-making authority from both the taxpayer and LMSB, will meet with the Appeals representative. The taxpayer and LMSB representatives should include persons with the information and expertise that will aid the decision-makers for the taxpayer and LMSB as well as the Appeals representative. In some cases, the Appeals representative may ask that the number of participants be limited.

*Time Frames*

Stringent time frames have been established in order to provide taxpayers an expedited resolution of tax disputes. The LMSB Fast Track process is designed to be completed within an average of 90 to 120 days.

*Site, Date and Agenda*

The LMSB Fast Track session will be held at a date and location agreeable to the parties. The representatives with decision-making authority for the taxpayer and LMSB must be present during the LMSB Fast Track session. Prior to or during the LMSB Fast Track session, the Appeals representative will advise the participants of the procedures and establish ground rules.

*Confidentiality*

The LMSB Fast Track process is confidential. IRS employees involved in any way with the LMSB Fast Track process are subject to the confidentiality and disclosure provisions of the Code. By signing the Fast Track Agreement, the taxpayer consents, pursuant to § 6103(c) of the Code, to the disclosure of the taxpayer's returns and return information pertaining to the issues being considered in the LMSB Fast Track process to those persons named on the agreement as participants in the process. If any person will be engaging in practice before the IRS, as defined in Publication 216, *Conferences and Practice Requirements*, a power of attorney, such as IRS Form 2848 (*Power* *of Attorney and Declaration of Representative*) will be required in addition to the Fast Track Agreement, unless such person has already been designated as the taxpayer's representative under a valid power of attorney.

IRS employees, the taxpayer and persons invited to participate by the IRS or the taxpayer shall not voluntarily disclose information regarding any communication made during the LMSB Fast Track session, except as provided by statute, such as in § 6103 of the Code and 5 U.S.C. § 574.

*Ex Parte*

Generally, the prohibition of *ex parte* communications between Appeals Officers and other IRS employees provided by § 1001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998 does not apply to the communications arising in the LMSB Fast Track process because the Appeals personnel are facilitating an agreement between the taxpayer and LMSB and are not acting in their traditional Appeals' settlement role. In some circumstances, the role the parties are asking Appeals to play may begin to resemble Appeals' traditional settlement role. In that case, Appeals may request that the taxpayer waive the *ex parte* rules if Appeals determines such a waiver is necessary in order for Appeals to fulfill its role in the LMSB Fast Track process. Regardless of whether a waiver is obtained, the LMSB Fast Track process may still continue if the taxpayer is present at any discussion that the Appeals representative has with LMSB.

*Closing Procedures*

If the parties reach an agreement on all or some issues through the Fast Track Mediation or the Fast Track Settlement process, LMSB or Appeals, as appropriate, will use established issue or case closing procedures, including preparation of a specific matters closing agreement.

7. WITHDRAWAL FROM THE LMSB FAST TRACK DISPUTE RESOLUTION PILOT PROGRAM

The taxpayer may withdraw from the LMSB Fast Track process at any time by notifying the LMSB Team Manager and the Appeals representative in writing. The Appeals representative or the LMSB Team Manager also may terminate the LMSB Fast Track process if it becomes apparent that meaningful progress toward resolution of the issues has stopped.

8. MISCELLANEOUS

*Precedent*

A resolution reached by the parties through the LMSB Fast Track process will not be binding on the parties for taxable years not covered by the LMSB Fast Track Agreement. Except as provided in the LMSB Fast Track Agreement, Delegation Order 236 (relating to the authority delegated to an Examination Team Manager in a CIC case to settle issues where a settlement has been effected by Appeals in a prior, subsequent or the same tax period on the same issue) and Delegation Order 247 (relating to the authority delegated to an Examination Team Manager for coordinated issues in the Office of Pre-Filing and Technical Guidance for which Appeals has approved settlement guidelines or positions), any such resolution shall not be used as precedent.

*Appeals Rights*

If any issues remain unresolved after the LMSB Fast Track process, the taxpayer will retain all the usual rights to request Appeals consideration of such unagreed issues. Appeals will assign a different Appeals Officer to handle the unagreed issues unless the taxpayer agrees otherwise.

*Term of Pilot Program*

The LMSB Fast Track Dispute Resolution Pilot Program will accept applications through November 14, 2002.

9. EFFECTIVE DATE

The LMSB Fast Track Dispute Resolution Pilot Program is effective beginning November 14, 2001.

10. COMMENTS

The IRS invites interested persons to comment on this program. Send submissions to:

Internal Revenue Service
Attn: Jim Fike
Large and Mid-Size Business Division LM:Q
Mint Building, 3rd Floor, M–3–148
1111 Constitution Avenue, NW
Washington, D.C. 20224

11. FURTHER INFORMATION

For further information regarding this notice, contact either: Jim Fike, LMSB Fast Track Program Manager, at (202) 283–8353 (not a toll-free number); or J.W. Wyatt, Appeals Fast Track Acting Program Manager, at (314) 612–4639 (not a toll-free number).

# LMSB Fast Track Agreement

**To:** Local Appeals Office ______________________________ Date ____________

The undersigned request Appeals assistance in the LMSB Fast Track process as described in Notice 2001-67. The issues for which this assistance is requested are described in the Form(s) 5701 and Taxpayer written response thereto attached to this agreement. The following is the option selected for this process:

☐ Fast Track Mediation ☐ Fast Track Settlement

This case is an ☐ Industry, or a ☐ Coordinated Industry case. (check one)

Estimated Fast Track Process End Date ____________ Preferred Conference Site ____________

LMSB Team Manager Name ______________________________

Telephone (____)____________ FAX (____)____________ Industry ____________

Taxpayer Name ______________________________

Taxpayer EIN ______________________________ Year(s) ____________

Address ______________________________

______________________________

Corporate Officer ______________________________ Title ____________

Telephone ( ____ ) ____________ FAX ( ____ ) ____________

Taxpayer Representative ______________________________

Name of Firm ______________________________

Address ______________________________

______________________________

Telephone ( ____ ) ____________ FAX ( ____ ) ____________

s/ ______________________________ s/ ______________________________

Taxpayer Date LMSB Team Manager Date

s/ ______________________________

Representative Date

***Comments and Other Expected Participants (attach additional sheets as necessary)***

| Name | Position or Affiliation | Phone |
|---|---|---|
| | | |
| | | |
| | | |
| | | |

**Accepted by Appeals** ☐ Yes ☐ No Appeals Team Manager ____________ Date ____________

# Notice of Proposed Rules Regarding Income Tax Withholding and Reporting Obligations Upon the Sale or Disposition of Stock Acquired Pursuant to the Exercise of a Statutory Stock Option

## Notice 2001–72

I. Overview and Purpose

This notice provides proposed rules regarding an employer's income tax withholding and reporting obligations upon sale or disposition of stock acquired by an individual pursuant to the exercise of a statutory stock option, *i.e.*, an incentive stock option (ISO) under section 422 or an option granted under an employee stock purchase plan (ESPP) under section 423. This notice is being published at the time of publication of related proposed regulations (REG–142686–01 on page 561) clarifying the application of employment taxes to statutory stock options. This notice solicits comments regarding the proposed rules. Treasury and the Service anticipate issuing a notice with final rules when the final regulations addressing the application of FICA tax, FUTA tax, and income tax withholding with respect to statutory stock options are issued.

II. Comments Received Pursuant to Notice 2001–14

On February 6, 2001, Treasury and the Service issued Notice 2001–14 (2001–6 I.R.B. 416). Notice 2001–14 addresses the application of employment taxes to statutory stock options. Notice 2001–14 announced the intent to issue administrative guidance that would clarify, among other issues, the application of income tax withholding to statutory stock options, and requested comments regarding the anticipated administrative guidance.

In response to Notice 2001–14, commentators stated that determining the occurrence of a disqualifying disposition (*i.e.*, a disposition of stock acquired pursuant to the exercise of a statutory stock option that results in loss of the special income tax treatment provided in section 421) to fulfill the income tax withholding deposit requirements on a timely basis would be burdensome, especially as to former employees.

Commentators also stated that fulfilling the income tax withholding obligations would be difficult as to certain employees, because those employees would not have sufficient other cash compensation from which to fund the withholding. Specifically, the commentators referred to former employees who are no longer receiving other cash compensation, as well as employees with disqualifying dispositions resulting in large income tax withholding obligations whose current other cash compensation would not be sufficient to fund these amounts.

Commentators also pointed out that the current reporting requirements mandate that the amounts be reported to the employees, so that the compensation will not escape Federal income tax. They also noted that employers have an incentive to report these amounts under section 1.83–6(a)(2) of the Income Tax Regulations.

III. Proposed Rule — Income Tax Withholding

In response to these comments, Treasury and the IRS propose the following rule:

An employer would have no income tax withholding obligation when an employee sells or disposes of stock acquired by the employee pursuant to the exercise of an ISO under section 422 or an option granted under an ESPP under section 423.

Example of proposed rule:

(a) Individual X is granted an option under a plan that satisfies the requirements of section 423(b). The option allows X to acquire 50 shares of the stock of X's employer, Y, at an exercise price equal to 85% of the fair market value of the stock at the time the option is granted. The fair market value of the Y stock at the time the option is granted is $100 per share. X exercises the option later when the fair market value of the Y stock is $120 per share. Thus, at the time of exercise, X acquires 50 shares of Y stock having a fair market value of $120 per share for $85 per share. X pays cash to acquire the shares of Y stock. Four months later, X sells the shares of Y stock for $160 a share.

(b) In this example, when X sells the shares of Y stock, X recognizes ordinary income under section 421(b) equal to the excess of the fair market value of the Y stock at the time of exercise ($120 per share) over the amount paid for the stock ($85 per share) which equals $35 per share, for a total of $1,750. Under the proposed rule, this $1,750 is remuneration that would not be subject to income tax withholding. X also has capital gain of $40 per share equal to the appreciation in value of the stock from the time of exercise to the time of sale. The capital gain of $40 per share is not remuneration and is not subject to income tax withholding.

IV. Proposed Rules — Reporting

Treasury and the Service propose the following rules:

Section 1.6041–2(a)(1) requires that, under certain circumstances, a payment made by an employer to an employee be reported on Form W–2 even if the payment is not subject to income tax withholding. Specifically, section 1.6041–2(a)(1) generally requires reporting if the total amount of the payment and other payments of remuneration, if any, made to the employee that are required to be reported on Form W–2, aggregate at least $600 in a calendar year. An employer must make reasonable efforts to ascertain whether it must provide a Form W–2 to an employee who has received remuneration not subject to income tax withholding upon a sale or disposition of stock acquired pursuant to the exercise of an ISO or option granted under an ESPP. An employer has not made reasonable efforts in any case in which it claims a deduction under section 83 for payment of the remuneration to an employee but fails to provide a Form W–2 reporting that remuneration to the employee, if the total amount of that payment, along with any other payments of remuneration made to the employee that are required to be reported on Form W–2, aggregate at least $600 in that calendar year. The employer is not required to provide a Form W–2 if the employer has made reasonable efforts and cannot determine whether a payment of remuneration has been made.

V. Former Employees

For purposes of this notice, the term "employee" includes any former employee.

VI. Request for Comments

Comments are requested regarding the proposed rules regarding income tax withholding and reporting obligations upon the sale or disposition of stock acquired pursuant to the exercise of a statutory stock option. All comments will be available for public inspection and copying. Comments must be submitted by February 14, 2002. Comments should reference Notice 2001–72, and be addressed to:

Associate Chief Counsel
(Tax Exempt and Government Entities)
CC:TEGE
ATTN: Statutory Stock Options and Income Tax Withholding
Room 5214
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

VII. Effective Date

The proposed rules set forth in this notice are not effective until a subsequent notice is issued with final rules. Treasury and the Service anticipate issuing such a notice to accompany the issuance of final regulations addressing the application of FICA tax, FUTA tax, and income tax withholding to statutory stock options.

VIII. Drafting Information

The principal author of this notice is Stephen Tackney of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from Treasury and the Service participated in its development. For further information regarding this notice, contact Stephen Tackney at (202) 622–6040 (not a toll-free call).

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## Notice of Proposed Rules of Administrative Convenience Regarding Application of the Federal Insurance Contributions Act and Federal Unemployment Tax Act to Statutory Stock Options

## Notice 2001–73

I. Overview and Purpose

This notice provides proposed rules of administrative convenience relating to the application of the Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) to statutory stock options, *i.e.*, incentive stock options under section 422 (ISOs) and options granted pursuant to an employee stock purchase plan under section 423 (ESPP options). The rules are proposed under the authority to be granted to the Commissioner under the regulations that are currently being proposed (as § 31.3121(a)–1(k) and § 31.3306(b)–1(l)) addressing the application of FICA tax, FUTA tax, and income tax withholding with respect to statutory stock options. This notice solicits comments regarding the proposed rules of administrative convenience. Treasury and the Service anticipate issuing a notice with final rules when the final regulations addressing the application of FICA tax, FUTA tax, and income tax withholding with respect to statutory stock options are issued.

On February 6, 2001, Treasury and the Service issued Notice 2001–14 (2001–6 I.R.B. 561). The notice states that Treasury and the Service anticipate issuing guidance clarifying the application of employment taxes to statutory stock options, and requests comments regarding the guidance. Proposed regulations are now being issued that generally provide that, at the time of the exercise of a statutory stock option, the individual who was granted the statutory stock option receives wages for FICA and FUTA purposes when the stock is transferred to the individual pursuant to the exercise.

To address the concerns raised by certain comments to Notice 2001–14, the proposed regulations would grant the Service authority to prescribe rules of administrative convenience to assist employers and employees in meeting the employment tax obligations that arise upon the exercise of a statutory stock option. To notify taxpayers of the potential rules, this notice describes the proposed rules of administrative convenience.

II. Proposed Rules of Administrative Convenience

Treasury and the Service propose the following rules of administrative convenience:

A. Payment Periods

Under the proposed rules, an employer would be permitted to treat FICA and FUTA wages resulting from the exercise of a statutory stock option as paid on a pay period, quarterly, semi-annual, annual, or other basis. An employer also could choose to treat FICA and FUTA wages resulting from the exercise of a statutory stock option as paid over more than one period. The deemed payment or payments could not commence before the exercise occurred and all payments would be required to be treated as paid on or before December 31 of the year of the exercise (except as provided under Section B below). The employer could change the method used at any time. A formal election would not be required, and the employer would not need to notify the Service of the use of any method or change in method used.

Examples

(i) Employer A sponsors an employee stock purchase plan under section 423 that permits the purchase of stock on a quarterly basis (January 1, April 1, July 1, and October 1). Employer A elects to treat the wages resulting from the exercises of ESPP options (*i.e.*, the stock purchases) as paid ratably over the calendar quarter in which the exercises occur, with an automatic acceleration upon the employee’s termination of employment.

(ii) Employer B sponsors an incentive stock option plan under section 422. Employer B elects to treat all wages resulting from the exercises of incentive stock options in a calendar year as paid on December 31 of that year.

(iii) Employer C sponsors an incentive stock option plan under section 422 that permits employees to exercise stock options during employment and within the 90–day period following a termination of employment. Employer C chooses to treat the FICA and FUTA wages resulting from an exercise in a calendar year as paid on December 31 of the calendar year, except that if the employee terminates employment before December 31, Employer C treats the wages as paid on the later of the date of termination of employment or the date of exercise of the statutory stock option.

B. Special Accounting Rule

Under the proposed rules, the employer would be permitted to choose to treat the wages resulting from the exercise of a statutory stock option occurring in the last month of the calendar year (December), or any shorter period ending on December 31, as paid in the first calendar quarter of the next following calendar year. However, an employer who treats any or all wages resulting from the exercise of a statutory stock option during the first 11 months of the calendar year as paid, in whole or in part, during the month of December would not then be permitted to treat those wages as paid in the first calendar quarter of the following calendar year. Rather, only the wages resulting from an actual exercise of a statutory stock option during the month of December could be treated as paid in the next following calendar quarter. Employers that choose to use the special accounting rule would not need to make a formal election, and employers would not need to notify the Service of the use of the rule or any change in the use of the rule.

Examples

(i) Employer A sponsors an employee stock purchase plan under which ESPP options are exercised on a semi-annual basis (June 30 and December 31). Employer A chooses to treat the FICA and FUTA wages resulting from each December 31 exercise as paid on the earlier of March 31 of the subsequent year or the employee's termination of employment.

(ii) Employer B sponsors an incentive stock option plan. Employer B chooses to treat the FICA and FUTA wages resulting from an exercise that occurs during the final seven days of December of any calendar year as paid on the earlier of January 31 of the subsequent year or the employee's termination of employment.

The special accounting rule would only apply for purposes of determining the date on which the FICA and FUTA wages result from the exercise of a statutory stock option. Therefore, the choice would apply for purposes of both the employer portion of FICA tax and the employee portion of FICA tax. If the employer used the special accounting rule, the employee would be required to use the special accounting rule and to use it for the same period as the employer. In addition, the employee would be required to use the special accounting rule and the same period for all purposes. For example, the special accounting rule would apply in determining the calendar year in which the wages were paid for purposes of the credit or refund under section 6413(c) relating to FICA tax and wage payments from multiple employers in the same calendar year.

An employer's choice to use the special accounting rule would be required to apply to all participants in the relevant employee stock purchase plan or incentive stock option plan. An employer that chose to use the special accounting rule would be required to notify the affected employees that the special accounting rule had been used and of the period for which it had been used. The employer would be required to provide the notice directly to each employee at or near the time the employer provided the employee with the Form W–2 for the calendar year in which the exercise occurred; the notice could not be provided earlier than with the employee's last paycheck of that calendar year.

C. Employee Pre-Funding of the Employee Portion of FICA Tax

Under current law, an employer and an employee may contractually arrange for the employee to pre-fund the amount of the employee portion of FICA tax that will arise upon the exercise of a statutory stock option.

Example

(i) Employer A sponsors an employee stock purchase plan under section 423 under which ESPP options are exercised on a quarterly basis (March 31, June 30, September 30, December 31). Employees fund the ESPP option exercise through payroll deductions. The payroll deductions include an additional amount equal to one percent of the payroll deduction deducted each payroll period and the one percent amount is used to fund the employee portion of FICA tax due at the time of the exercise. Any shortfall in funds to pay the employee portion of FICA tax is settled through withholding from the employee's current compensation at the time of the exercise, or such other method as may be available. Any excess over the amount necessary to pay the employee portion of FICA tax is returned to the employee.

Withholding to pre-fund the payment of the employee portion of FICA tax does not affect the taxation of, or the timing of taxation of, compensation. Therefore, the withheld amounts are included as gross income for income tax purposes, as well as wages paid to the employee for FICA tax, FUTA tax, and Federal income tax withholding purposes, as appropriate. In addition, for purposes of sections 3101 and 3102(a), this separate contractual arrangement does not satisfy either the employer's collection obligation or the employee's FICA tax liability until the funds are remitted to the Service. If the employer withholds funds from the employee and does not deposit the funds with the Service in satisfaction of the employee portion of FICA tax, the employee and the employer each remain liable for the tax, and any right of the employee to the pre-funded amounts held by the employer is not enforceable under the Internal Revenue Code.

D. Employer Advance of Employee Portion of FICA Tax

Under current law, an employer may arrange to advance the funds necessary to pay the employee portion of FICA tax and obtain reimbursement of those funds from the employee.

Examples

(i) Employer A sponsors an employee stock purchase plan under section 423 that permits the exercise of ESPP options on a quarterly basis (March 31, June 30, September 30, and December 31). Employees fund the ESPP option exercise price through payroll deductions. When an option is exercised, Employer A advances the funds to pay the employee portion of FICA tax arising from the exercise, and is repaid the advance from the employee's payroll deductions over the following quarter. Any repayment due to Employer A is accelerated upon the employee's termination of employment or termination of participation in the employee stock purchase plan.

(ii) Employer B sponsors an incentive stock option plan under section 422. When an incentive stock option granted under the plan is exercised, Employer B advances the funds to satisfy the employee portion of FICA tax arising from the exercise of the incentive stock option. Employer B is repaid the advance from the employee's future payroll. Any repayment due to Employer B is accelerated upon the employee's termination of employment.

E. Consistency Rule

For purposes of the rules of administrative convenience outlined in Sections A and B, the employer would be required to apply the chosen rule consistently to all employees eligible to participate under the relevant employee stock purchase plan under section 423 or incentive stock option plan under section 422. In addition, the requirements of section 423(b)(5) are applicable to an employee stock purchase plan under section 423. Section 423(b)(5) provides, with certain exceptions, that the terms of an employee stock purchase plan under section 423 must provide the same rights and privileges to all employees granted options under the plan.

Employers could impose conditions under which a chosen method would or would not apply to employees, provided that those conditions and the resulting method were applied consistently to all employees. For example, the employer could accelerate the deemed wage payment if an employee terminated employment, provided that the acceleration rule applied to all employees who terminated of employment. All of the examples provided in Sections A through E above would meet the consistency requirement of this notice as well as the requirements of section 423(b)(5).

III. Effective Date

The proposed rules are not effective until a subsequent notice is issued with final rules. Treasury and the Service anticipate issuing such a notice to accompany the issuance of final regulations addressing the application of FICA tax, FUTA tax, and income tax withholding to statutory stock options.

IV. Request for Comments

Comments are requested regarding the proposed rules of administrative convenience described in this notice. All comments will be available for public inspection and copying. Comments must be submitted by February 14, 2002. Comments should reference Notice 2001–73, and be addressed to:

Associate Chief Counsel
(Tax Exempt and Government Entities)
CC:TEGE
ATTN: Employment Taxes, Statutory Stock Options and Proposed Rules of Administrative Convenience
Room 5214
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

V. Paperwork Reduction Act

Before final rules of administrative convenience are published, the collection of information contained in the proposed rules of administrative convenience described in this notice will be submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)).

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 the proposed rules of administrative convenience is in section B, requiring employers who choose the special accounting rule to notify employees of the application of the rule. This information is required to inform employees that for purposes of FICA and FUTA, certain wage payments made in December of a calendar year will be deemed paid during some specified period in the first quarter of the following calendar year. This information will be used to explain the wage reporting on the Forms W–2 that the employee receives. The collection of information is required if the employer chooses to use the special accounting rule. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 17,010 hours.

The estimated annual burden per respondent/recordkeeper varies from 1 to 10 hours, depending on individual circumstances, with an estimated average of 3 hours. The estimated number of respondents and/or recordkeepers is 5,670.

The estimated annual frequency of responses (used for reporting requirements only) is once per calendar year.

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.

VI. Drafting Information

The principal author of this notice is Stephen Tackney of the Office of Chief Counsel. However, other personnel from Treasury and the Service participated in their development. For further information regarding this notice, contact Stephen Tackney at (202) 622–6040 (not a toll-free call).

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## Expansion of Notice 2001–70 — Additional Disaster Relief for Taxpayers Following the September 11, 2001, Terrorist Attack — Mid-Quarter Convention Relief

## Notice 2001–74

This notice supplements the tax relief granted in Notice 2001–70 (2001–45 I.R.B. 437) published November 5, 2001, by expanding the class of taxpayers entitled to the relief and clarifying the instructions for making the election provided under Notice 2001–70.

In Notice 2001–70, the Treasury Department and the Internal Revenue Service announced their intention to issue regulations permitting taxpayers to elect not to apply the mid-quarter convention rules contained in § 168(d)(3) of the Internal Revenue Code to certain property placed in service in the taxable year that includes September 11, 2001, if the third quarter of the taxpayer's 2001 taxable year includes September 11, 2001. Notice 2001–70 also provided that an eligible taxpayer that wishes to make the election must write "Election Pursuant to Notice 2001–70" across the top of the taxpayer's Form 4562, *Depreciation and Amortization*, for the taxpayer's taxable year that includes September 11, 2001.

Section 168(d)(3) generally provides that, except as provided in regulations, if the aggregate basis of property placed in service during the last three months of the taxable year exceeds 40 percent of the aggregate basis of property (other than property described in § 168(d)(3)(B)) placed in service during the taxable year, the applicable depreciation convention for all property (other than property described in § 168(d)(2)) to which § 168 applies placed in service during the taxable year is the mid-quarter convention.

Treasury and the Service have been made aware that certain taxpayers that are not entitled to relief under Notice 2001–70 because the third quarter of their 2001 taxable year does not include September 11, 2001, are purchasing property to replace property destroyed in the September 11, 2001, terrorist attack. As a result of these purchases, some of these taxpayers would be required to apply the mid-quarter convention. Such a result may place these taxpayers at a competitive disadvantage because other similarly situated taxpayers have received relief under Notice 2001–70.

Accordingly, Notice 2001–70 is expanded to provide that if the fourth quarter of a taxpayer's taxable year includes September 11, 2001, then the taxpayer may elect, for purposes of § 168(d), to apply the half-year convention to all property (other than property described in § 168(d)(2)) placed in service during the taxpayer's taxable year that includes September 11, 2001. The election is made in the same manner provided in Notice 2001–70.

In addition, certain taxpayers are required to file Form 2106, *Employee Business Expenses*, rather than Form 4562, *Depreciation and Amortization*, to report certain depreciation expenses. Accordingly, these taxpayers may make the election provided under Notice 2001–70, as supplemented by this notice, by writing "Election Pursuant to Notice 2001–70" across the top of the taxpayer's Form 2106. Taxpayers filing their returns electronically may make the election provided under Notice 2001–70, as supplemented by this notice, by typing "Election Pursuant to Notice 2001–70" in the Election Explanation (ELC) record when filing the Form 4562 or Form 2106.

Treasury and the Service intend to amend the regulations under § 168 to incorporate the guidance set forth in this notice. Until the regulations are amended, taxpayers may rely on the guidance set forth in this notice.

The principal author of this notice is Bernard P. Harvey of the Office of Associate Chief Counsel, Passthroughs and Special Industries. For further information regarding this notice, contact Mr. Harvey at (202) 622–3110 (not a toll-free call).

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*26 CFR 601.201: Rulings and determination letters (Also, Part I, §§ 401; 1.401(b)–1.)*

## Rev. Proc. 2001–55

SECTION 1. PURPOSE

This revenue procedure extends the GUST[1] remedial amendment period under § 401(b) of the Code for qualified retirement plans. First, the revenue procedure extends the GUST remedial amendment period for all plans to February 28, 2002, if the period would otherwise end before then. Second, the revenue procedure provides an additional extension to June 30, 2002, for plans that were directly affected by the September 11, 2001, terrorist attack on the United States (the "Terrorist Attack"). Finally, the revenue procedure provides that in cases of substantial hardship resulting from the Terrorist Attack the Service may, in its discretion, grant additional extensions of the GUST remedial amendment period to particular plans up to December 31, 2002.

SECTION 2. BACKGROUND

.01 Under § 401(b), plan sponsors have a remedial amendment period in which to adopt plan amendments for GUST. The end of the GUST remedial amendment period is the deadline for making all GUST plan amendments and other plan amendments specifically enumerated in Rev. Proc. 99–23 (1999–1 C.B. 920). The GUST remedial amendment period also applies with respect to all disqualifying provisions of new plans adopted or effective after December 7, 1994, and with respect to all plan amendments adopted after December 7, 1994, that would cause an existing plan to fail to be qualified.

.02 Rev. Proc. 2000–27 (2000–26 I.R.B. 1272) provides that the GUST remedial amendment period for nongovernmental plans ends on the last day of the first plan year beginning on or after January 1, 2001. This is also the end of the remedial amendment period for the Tax Reform Act of 1986 (TRA '86) for nonelecting church plans. The GUST remedial amendment period for governmental plans, as defined in § 414(d), ends on the later of (i) the last day of the first plan year beginning on or after January 1, 2001, or (ii) the last day of the first plan year beginning on or after the "2000 legislative date" (that is, the 90th day after the opening of the first legislative session beginning after December 31, 1999, of the governing body with authority to amend the plan, if that body does not meet continuously). This is also the end of the TRA '86 remedial amendment period for governmental plans.

.03 Rev. Proc. 2000–20 (2000–6 I.R.B. 553), as modified by Rev. Proc. 2000–27 and Notice 2001–42 (2001–30 I.R.B. 70), provides an extension of the GUST remedial amendment period for employers who, by the end of the GUST remedial amendment period (determined without regard to the extension), have adopted a pre-approved plan (that is, a master or prototype or volume submitter plan) or certified their intent to adopt such a plan. If the requirements for the extension are satisfied, the GUST remedial amendment period for the employer's plan will not end before the later of December 31, 2002, or the end of the 12th month beginning after the date on which the Service issues a GUST opinion or advisory letter for the pre-approved plan.

.04 Rev. Proc. 2001–6 (2001–1 I.R.B. 194) contains the Service's procedures for issuing determination letters on the qualified status of employee plans under §§ 401(a), 403(a), 409, and 4975(e)(7) of the Code and the exempt status of related trusts or custodial accounts under § 501(a).

.05 Section 1.401(b)–1(f) of the Income Tax Regulations provides that, at his discretion, the Commissioner may extend the remedial amendment period or may allow a particular plan to be amended after the expiration of its remedial amendment period and any applicable extension of such period. In determining whether such an extension will be granted, the Commissioner shall consider, among other factors, whether substantial hardship to the employer would result if such an extension were not granted, whether such an extension is in the best interest of plan participants, and whether the granting of the extension is adverse to the interests of the government.

SECTION 3. GENERAL EXTENSION OF REMEDIAL AMENDMENT PERIOD TO FEBRUARY 28, 2002

.01 The GUST remedial amendment period is extended to February 28, 2002, if the period would otherwise end before then. This extension applies to all GUST plan amendments, including all those plan

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[1] "GUST" refers to the following:

- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

amendments specifically enumerated in Rev. Proc. 99–23. In addition, this extension applies with respect to all disqualifying provisions of new plans adopted or effective after December 7, 1994, and with respect to all plan amendments adopted after December 7, 1994, that would cause an existing plan to fail to be qualified.

.02 The TRA '86 remedial amendment period for governmental plans and nonelecting church plans is also extended to February 28, 2002, if the period would otherwise end before then.

.03 This extension also applies to the time by which an employer must either adopt a pre-approved plan or certify its intent to adopt such a plan in order to be eligible for the extension of the GUST remedial amendment period under Rev. Proc. 2000–20, as modified.

SECTION 4. EXTENSION OF REMEDIAL AMENDMENT PERIOD TO JUNE 30, 2002, FOR PLANS DIRECTLY AFFECTED BY THE TERRORIST ATTACK

.01 The extension of the remedial amendment period provided by this section applies only to plans directly affected by the Terrorist Attack, as defined in sections 4.02 and 4.03 of this revenue procedure.

.02 For purposes of the revenue procedure, a plan will be considered to be directly affected by the Terrorist Attack if any of the following were located at the time of the attack in the area of the New York City borough of Manhattan bounded on the north by 14th Street: the principal place of business of any employer that maintains the plan; the office of the plan or the plan administrator; the office of the primary recordkeeper serving the plan; or the office of an attorney, enrolled actuary, certified public accountant, or other advisor retained by the plan (or by the employer with respect to issues involving the plan). A plan will also be considered to be directly affected by the Terrorist Attack if any individual required under the terms of the plan or corporate rules to approve plan amendments, the plan administrator, or an attorney, enrolled actuary, certified public accountant, or other advisor retained by the plan (or by the employer with respect to issues involving the plan) was injured or killed or is missing as a result of the Terrorist Attack.

.03 A plan sponsor of a plan that is not described in section 4.02 may ask the Service to designate the plan as directly affected by the Terrorist Attack if the plan sponsor's ability to amend the plan and file a determination letter application has been severely impaired as a direct result of the Terrorist Attack. Upon a showing of such directly related, severe impairment, as determined by the Service in its discretion, the Service will designate the plan as directly affected by the Terrorist Attack. The plan sponsor's request should be sent to the following address:

Manager, EP Determinations
Attention: RAP Extension Coordinator
550 Main Street
Room 5106
Cincinnati, Ohio 45202

The request must be made by the later of December 31, 2001, or the 60th day preceding the end of the plan's GUST remedial amendment period (determined without regard to the extensions under this revenue procedure). The request must explain how the Terrorist Attack has directly and severely impaired the ability to amend the plan and file a determination letter application. The Service will not designate a plan as directly affected by the Terrorist Attack on account of delays experienced by a significant segment of the nation, such as disruptions in transportation or mail delivery and delays associated with diversion of resources to other activities as a result of the Terrorist Attack. If the request is denied, the GUST remedial amendment period for the plan will end on the later of the date it would otherwise end or the date that is one month after the date of the letter denying the request.

.04 The GUST remedial amendment period for directly affected plans is extended to June 30, 2002, if the period would otherwise end before then.

.05 This extension of the GUST remedial amendment period applies to all GUST plan amendments of directly affected plans, including all those plan amendments specifically enumerated in Rev. Proc. 99–23. In addition, this extension applies with respect to all disqualifying provisions of directly affected new plans adopted or effective after December 7, 1994, and with respect to all plan amendments adopted after December 7, 1994, that would cause a directly affected existing plan to fail to be qualified.

.06 The TRA '86 remedial amendment period for directly affected governmental plans and nonelecting church plans is also extended to June 30, 2002, if the period would otherwise end before then.

.07 Plan sponsors who file determination letter applications utilizing the extension provided by this section must include with their application an attachment, labeled "September 11, 2001 Terrorist Attack," which describes how the plan meets the criteria in section 4.02 (for example, that at the time of the Terrorist Attack the office of the plan administrator was located in the area of Manhattan bounded on the north by 14th Street). This label must be on the attachment and not on the envelope. If the Service has designated the plan as directly affected in response to a request submitted under section 4.03, a copy of the Service's letter so designating the plan should be attached to the determination letter application in place of the attachment.

.08 A plan sponsor of a directly affected plan described in section 4.02 or 4.03 who can show that it will not be able to amend the plan for GUST or file a determination letter application within the plan's GUST remedial amendment period (including the extension under section 4.04) without incurring substantial hardship directly related to the Terrorist Attack may request a further extension under § 1.401(b)–1(f). The request should be addressed to the Manager, EP Determinations, at the address in section 4.03 and must be made by the later of April 30, 2002, or the 60th day preceding the end of the plan's GUST remedial amendment period. A request made under this section 4.08 may be combined with a request made under section 4.03, provided, however, that the combined request is made by the later of December 31, 2001, or the 60th day preceding the end of the plan's GUST remedial amendment period (determined without regard to the extensions under this revenue procedure). A request under this section 4.08 must clearly demonstrate the hardship that will be incurred without a further extension.

For example, if the extension is needed because of delays in obtaining documents and information needed to amend the plan, the request must include a description of such documents and information, an explanation of how these delays are directly related to the Terrorist Attack, an explanation of steps taken to date to amend the plan, and the requested extension date, including specific justification for the extension date. In no event will an extension beyond December 31, 2002, be granted. If the request for a further extension is denied, the GUST remedial amendment period for the plan will end on the later of the date on which it would otherwise end (including the extension under section 4.04) or the date that is one month after the date of the letter denying the request.

.09 This extension does not apply to the time by which an employer must either adopt a pre-approved plan or certify its intent to adopt such a plan in order to be eligible for the extension of the GUST remedial amendment period under Rev. Proc. 2000–20, as modified.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective December 3, 2001.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Rev. Procs. 2000–20, 2000–27 and 2001–6 are modified.

DRAFTING INFORMATION

The principal author of this revenue procedure is James Flannery of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue procedure, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 9:30 p.m. Eastern Time, Monday through Friday. Mr. Flannery may be reached at 1–202–283–9888 (not a toll-free number).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking and Notice of Public Hearing

## Statutory Mergers and Consolidations

## REG–126485–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of Proposed Rulemaking and Notice of Public Hearing.

SUMMARY: This document contains proposed regulations that define the term statutory merger or consolidation as that term is used in section 368(a)(1)(A). The proposed regulations permit certain transactions involving entities that are disregarded as entities separate from their corporate owners for Federal tax purposes to qualify as a statutory merger or consolidation. These proposed regulations affect corporations engaging in statutory mergers and consolidations, and their shareholders. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments and requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for March 13, 2002, must be received by February 20, 2002.

ADDRESSES: Send submissions to CC:ITA:RU (REG–126485–01), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–126485–01), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the Tax Regs option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs.reglist.html*.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Reginald Mombrun (202) 622–7750 or Marlene P. Oppenheim (202) 622–7770; 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**

A. *Section 368(a) Generally*

The Internal Revenue Code of 1986 (the Code) provides general nonrecognition treatment for reorganizations specifically described in section 368(a). Section 368(a)(1)(A) provides that the term reorganization includes "a statutory merger or consolidation." Section 1.368–2(b)(1) currently provides that a statutory merger or consolidation must be "effected pursuant to the corporation laws of the United States or a State or Territory or the District of Columbia." A transaction will only qualify as a reorganization under section 368(a)(1)(A), however, if it satisfies certain nonstatutory requirements, including the business purpose requirement of §1.368–1(b), the continuity of business enterprise requirement of §1.368–1(d), and the continuity of interest requirement of §1.368–1(e).

B. *Disregarded Entities Generally*

A business entity (as defined in §301.7701–2(a)) that has only one owner may be disregarded as an entity separate from its owner for Federal tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal tax purposes, a corporation (as defined in §301.7701–2(b)) that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

Because qualified REIT subsidiaries and qualified subchapter S subsidiaries are corporations under state law, state merger laws generally permit them to merge with other corporations. In addition, many state merger laws permit a limited liability company to merge with another limited liability company or with a corporation.

C. *Previous Proposal of Regulations*

On May 16, 2000, the IRS and Treasury issued a notice of proposed rulemaking (REG–106186–98, 65 FR 31115) providing guidance under section 368(a)(1)(A), including guidance regarding whether certain mergers involving disregarded entities may qualify as statutory mergers under section 368(a)(1)(A) (hereinafter referred to as the 2000 proposed regulations). The 2000 proposed regulations provided that neither the merger of a disregarded entity into a corporation nor the merger of a target corporation into a disregarded entity was a statutory merger or consolidation qualifying as a reorganization under section 368(a)(1)(A).

A public hearing on the 2000 proposed regulations was held on August 8, 2000. In addition, written comments were received. While commentators generally agreed that the merger of a disregarded entity into a corporation should not qualify as a statutory merger under section 368(a)(1)(A), commentators asserted that the merger of a target corporation into a disregarded entity with a corporate owner should be able to qualify as a statutory merger under section 368(a)(1)(A). Commentators argued that not permitting the merger of a target corporation into a disregarded entity to qualify as a statutory merger under section 368(a)(1)(A) is inconsistent with the general treatment of the disregarded entity as a division of its owner for Federal tax purposes.

**Explanation of Provisions**

A. *Definitions*

After consideration of the comments received, the IRS and Treasury have decided to withdraw the 2000 proposed regulations and issue new proposed regulations (hereinafter referred to as the 2001 proposed regulations) to provide guidance concerning the definition of the terms *statutory merger* and *consolidation* as those terms are used in section 368(a)(1)(A), including as those terms relate to transactions involving disregarded entities.

The 2001 proposed regulations introduce a number of terms that are employed in the definition of statutory merger or consolidation. The term disregarded entity is defined as a business entity (as defined in §301.7701–2(a)) that is disregarded as an entity separate from its owner for Federal tax purposes. The term combining entity is defined as a business entity that is a corporation (as defined in §301.7701–2(b)) that is not a disregarded entity. The term combining unit is defined as a combining entity and all disregarded entities, if any, the assets of which are treated as owned by such combining entity for Federal tax purposes.

The 2001 proposed regulations provide that, for purposes of section 368(a)(1)(A), a statutory merger or consolidation must be effected pursuant to the laws of the United States or a State or the District of Columbia. Pursuant to such laws, the following events must occur simultaneously at the effective time of the transaction: (1) all of the assets (other than those distributed in the transaction) and liabilities (except to the extent satisfied or discharged in the transaction) of each member of one or more combining units (each a transferor unit) become the assets and liabilities of one or more members of one other combining unit (the transferee unit); and (2) the combining entity of each transferor unit ceases its separate legal existence for all purposes.

The IRS and Treasury believe that these definitions of statutory merger and consolidation are consistent with the principles of current law. See *Cortland Specialty Co. v. Commissioner,* 60 F.2d 937 (2d Cir. 1932), cert. denied, 288 U.S. 599 (1933); Rev. Rul. 2000–5 (2000–1 C.B. 436). In particular, the IRS and Treasury do not intend for the requirement that all of the assets of one or more transferor units be transferred in the statutory merger or consolidation to be interpreted in the same manner as the "substantially all" requirement of 368(a)(1)(C), 368(a)(1)(D), 368(a)(2)(D), and 368(a)(2)(E). However, the IRS and Treasury do intend this requirement to ensure that divisive transactions do not qualify as statutory mergers or consolidations under section 368(a)(1)(A). See Rev. Rul. 2000–5.

In addition, the 2001 proposed regulations, like the 2000 proposed regulations, remove the word corporation from the requirement that, in order to qualify as a reorganization under section 368(a)(1)(A), a merger or consolidation must be "effected pursuant to the corporation laws." This change conforms the regulations to the IRS's long-standing position that a transaction may qualify as a reorganization under section 368(a)(1)(A) even if it is undertaken pursuant to laws other than the corporation law of the relevant jurisdiction. See Rev. Rul. 84–104 (1984–2 C.B. 94) (treating a consolidation pursuant to the National Banking Act, 12 U.S.C. 215, as a merger for Federal tax purposes).

Finally, the 2001 proposed regulations remove the word "Territory" from the types of jurisdictions pursuant to the laws of which a transaction that qualifies as a reorganization under section 368(a)(1)(A) may be effected to be consistent with the definition of domestic under section 7701(a)(4), which was amended by section 1906(c) of Tax Reform Act of 1976, Public Law 94–455, 90 Stat. 1525.

In this guidance project, the IRS and Treasury are not addressing the treatment under section 368(a)(1)(A) of transactions that involve one or more foreign corporations. As discussed below, the IRS and Treasury are considering issuing guidance regarding such transactions as part of a separate regulations project.

B. *Mergers Involving Disregarded Entities*

The 2001 proposed regulations' definition of a statutory merger or consolidation, unlike the approach of the 2000 proposed regulations, permits certain statutory mergers and consolidations involving disregarded entities to qualify as statutory mergers and consolidations under section 368(a)(1)(A). However, the 2001 proposed regulations provide that such a transaction in which any of the assets and liabilities of a combining entity of a transferor unit become assets and liabilities of one or more disregarded entities of the transferee unit is not a statutory merger or consolidation within the meaning of section 368(a)(1)(A) unless such combining entity, the combining entity of the transferee unit, such disregarded entities, and each business entity through which the combining entity of the transferee unit holds its interests in such disregarded entities is organized under the laws of the United States or a State or the District of Columbia.

Permitting certain transactions involving disregarded entities that have a single corporate owner to qualify as statutory mergers and consolidations for purposes of section 368(a)(1)(A) is appropriate because it is consistent with the general treatment of a disregarded entity as a division of its owner. Therefore, under the 2001 proposed regulations, the merger of a target corporation into a disregarded entity may qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A). Consistent with the 2000 proposed regulations, however, the 2001 proposed regulations do not permit the merger of a disregarded entity into a member of a transferee unit, where the owner of the disregarded entity does not also merge into a member of the transferee unit, to qualify as a statutory merger or consolidation under section 368(a)(1)(A). In such a transaction, all of the transferor unit's assets may not be transferred to the transferee unit, with the result that the transferor unit's assets may be divided between the transferor unit and the transferee unit. Moreover, the separate legal existence of the combining entity of the transferor unit does not terminate as a matter of law. Although such a transaction cannot qualify as a statutory merger or consolidation under section 368(a)(1)(A), it may qualify for nonrecognition treatment under other provisions of the Code.

C. *Request for Comments*

Treasury and the IRS are considering further revisions to the regulations under section 368(a)(1)(A) to address statutory mergers and consolidations that involve one or more foreign corporations, including transactions involving a disregarded entity. Comments are requested regarding the appropriate scope for any such revision. Comments also are specifically requested concerning what related changes would be necessary to the regulations under sections 358 (concerning the determination of stock basis in certain triangular reorganizations), 367, and 897, as well as other international provisions of the Code. Because a revision of the regulations may include revisions related to transactions under foreign merger or consolidation laws, comments are requested on what changes, if any, may be appropriate to the definition of a statutory merger or consolidation to facilitate the application of the definition in the context of the laws of a foreign jurisdiction. Finally, comments are requested regarding what additional reporting requirements may be appropriate to facilitate administration of the rules regarding statutory mergers or consolidations involving foreign entities.

## Effective Date

These regulations are proposed to apply to transactions occurring on or after the date these regulations are published as final regulations in the **Federal Register.**

## Special Analyses

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

## Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight copies) that are submitted timely to the IRS. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the Tax Regs option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/reglist.html*. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 13, 2002, beginning at 10 am in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by February 20, 2002. 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 reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

## Drafting Information

The principal authors of these proposed regulations are Reginald Mombrun and Marlene P. Oppenheim of the office of the Associate Chief Counsel (Corporate), IRS. However, other personnel from the Treasury and the IRS participated in their development.

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## Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

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

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

Par. 2. In §1.368–2, paragraph (b)(1) is revised to read as follows:

*§1.368–2 Definition of terms.*

* * * * *

(b)(1)(i) *Definitions.* For purposes of this paragraph (b)(1), the following terms shall have the following meanings:

(A) *Disregarded entity.* A disregarded entity is a business entity (as defined in §301.7701–2(a) of this chapter) that is disregarded as an entity separate from its owner for Federal tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal tax purposes, a corporation (as defined in §301.7701–2(b) of this chapter) that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

(B) *Combining entity.* A combining entity is a business entity that is a corporation that is not a disregarded entity.

(C) *Combining unit.* A combining unit is comprised solely of a combining entity and all disregarded entities, if any, the assets of which are treated as owned by such combining entity for Federal tax purposes.

(ii) *Statutory merger or consolidation generally.* For purposes of section 368(a)(1)(A), a statutory merger or consolidation is a transaction effected pursuant to the laws of the United States or a State or the District of Columbia, in which, as a result of the operation of such laws, the following events occur simultaneously at the effective time of the transaction —

(A) All of the assets (other than those distributed in the transaction) and liabilities (except to the extent satisfied or discharged in the transaction) of each member of one or more combining units (each a transferor unit) become the assets and liabilities of one or more members of one other combining unit (the transferee unit); and

(B) The combining entity of each transferor unit ceases its separate legal existence for all purposes.

(iii) *Statutory merger or consolidation involving disregarded entities.* A transaction effected pursuant to the laws of the United States or a State or the District of Columbia in which any of the assets and liabilities of a combining entity of a transferor unit become assets and liabilities of one or more disregarded entities of the transferee unit is not a statutory merger or consolidation within the meaning of section 368(a)(1)(A) and paragraph (b)(1)(ii) of this section unless such combining entity, the combining entity of the transferee unit, such disregarded entities, and each business entity through which the combining entity of the transferee unit holds its interests in such disregarded entities is organized under the laws of the United States or a State or the District of Columbia.

(iv) *Examples.* The following examples illustrate the rules of paragraph (b)(1) of this section. In each of the examples, except as otherwise provided, each of V, Y, and Z is a domestic corporation. X is a domestic limited liability company. Except as otherwise provided, X is wholly owned by Y and is disregarded as an entity separate from Y for Federal tax purposes. The examples are as follows:

*Example 1. Divisive transaction pursuant to a merger statute.* (i) Under State W law, Z transfers some of its assets and liabilities to Y, retains the remainder of its assets and liabilities, and remains in existence following the transaction. The transaction qualifies as a merger under state W corporate law. Prior to the transaction, Y is not treated as owning any assets of an entity that is disregarded as an entity separate from its owner for Federal tax purposes.

(ii) The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because all of the assets and liabilities of Z, the combining entity of the transferor unit, do not become the assets and liabilities of Y, the combining entity and sole member of the transferee unit. In addition, the transaction does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because the separate legal existence of Z does not cease. Accordingly, the transaction does not qualify as a statutory merger or consolidation under section 368(a)(1)(A).

*Example 2. Merger of a target corporation into a disregarded entity in exchange for stock of the owner.* (i) Under State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger, the Z shareholders exchange their stock of Z for stock of Y. Prior to the transaction, Z is not treated as owning any assets of an entity that is disregarded as an entity separate from its owner for Federal tax purposes.

(ii) The transaction meets the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, a disregarded entity the assets of which Y is treated as owning for Federal tax purposes, and Z ceases its separate legal existence for all purposes. Paragraph (b)(1)(iii) does not apply to prevent the transaction from qualifying as a statutory merger or consolidation for purposes of section 368(a)(1)(A) because each of Z, Y, and X is a domestic entity. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 3. Triangular merger of a target corporation into a disregarded entity.* (i) The facts are the same as in *Example 2*, except that V owns 100 percent of the outstanding stock of Y and, in the merger of Z into X, the Z shareholders exchange their stock of Z for stock of V. In the transaction, Z transfers substantially all of its properties to X.

(ii) The transaction is not prevented from qualifying as a statutory merger or consolidation under section 368(a)(1)(A), provided the requirements of section 368(a)(2)(D) are satisfied. Because the assets of X are treated for Federal tax purposes as the assets of Y, Y will be treated as acquiring substantially all of the properties of Z in the merger for purposes of determining whether the merger satisfies the requirements of section 368(a)(2)(D). As a result, the Z shareholders that receive stock of V will be treated as receiving stock of a corporation that is in control of Y, the combining entity of the transferee unit that is the acquiring corporation for purposes of section 368(a)(2)(D). Accordingly, the merger will satisfy the requirements of section 368(a)(2)(D) such that the Z shareholders' receipt of stock of V in the merger will not cause the transaction to fail to qualify as a reorganization under section 368(a)(1)(A).

*Example 4. Merger of a target corporation into a disregarded entity owned by a partnership.* (i) The facts are the same as in *Example 2*, except that Y is organized as a partnership under the laws of State W and is classified as a partnership for Federal tax purposes.

(ii) The transaction does not meet the requirements of paragraph (b)(1)(ii)(A) of this section. All of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit because neither X nor Y qualifies as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 5. Merger of a disregarded entity into a corporation.* (i) Under State W law, X merges into Z. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of X (but not the assets and liabilities of Y other than those of X) become the assets and liabilities of Z and X's separate legal existence ceases for all purposes.

(ii) The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because all of the assets and liabilities of a transferor unit do not become the assets and liabilities of one or more members of the transferee unit. The transaction also does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because X does not qualify as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

*Example 6. Merger of a corporation into a disregarded entity in exchange for interests in the disregarded entity.* (i) Under State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger of Z into X, the Z shareholders exchange their stock of Z for interests in X so that, immediately after the merger, X is not disregarded as an entity separate from Y for Federal tax purposes. Following the merger, pursuant to §301.7701–2(b)(1)(i) of this chapter, X is classified as a partnership for Federal tax purposes.

(ii) The transaction does not meet the requirements of paragraph (b)(1)(ii)(A) of this section because immediately after the merger X is not disregarded as an entity separate from Y and, consequently, all of the assets and liabilities of Z, the combining entity of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

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(v) *Effective date.* This paragraph (b)(1) applies to transactions occurring on or after the date these regulations are published as final regulations in the **Federal Register**.

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on November 14, 2001, 8:45 a.m., and published in the issue of the Federal Register for November 15, 2001, 66 F.R. 57400)

## Notice of Proposed Rulemaking and Notice of Public Hearing

## Consolidated Returns; Applicability of Other Provisions of Law; Non-Applicability of Section 357(c)

## REG–137519–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rule-making and notice of public hearing.

SUMMARY: This document proposes amendments relating to the consolidated return regulations dealing with the non-applicability of section 357(c) in a consolidated group. The proposed amendments clarify that, in certain transfers described in section 351 between members of a consolidated group, a transferee's assumption of certain liabilities described in section 357(c)(3) will not reduce the transferor's basis in the transferee's stock received in the transfer. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments and requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for March 21, 2002, must be submitted by February 28, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–137519–01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–137519–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at *http:www.irs.ustreas.gov/tax_regs/reglist.html*. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, T. Ian Russell of the Office of Associate Chief Counsel (Corporate), (202) 622–7930; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Donna M. Poindexter (202–622–7180) (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

Section 357(c)(1) generally provides that, in the case of certain exchanges described in section 351, if the sum of the amount of the liabilities assumed by the transferee corporation exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as gain from the sale or exchange of a capital asset or of property that is not a capital asset. Section 357(c)(3), however, excludes from the computation of liabilities assumed liabilities the payment of which would give rise to a deduction, provided that the incurrence of such liabilities did not result in the creation of, or an increase in, the basis of any property.

Section 358(a) generally provides that, in the case of an exchange to which section 351 applies, the basis of the property permitted to be received without the recognition of gain or loss is decreased by the amount of any money received by the transferor. For this purpose, under section 358(d)(1), the transferee's assumption of a liability of the transferor is treated as money received by the transferor on the exchange. Section 358(d)(2), however, provides an exception for liabilities excluded under section 357(c)(3).

On August 15, 1994, final regulations (T.D. 8560) adding paragraph (d) to §1.1502–80 were published in the **Federal Register** (59 FR 41666). A correcting amendment adding a sentence to the end of paragraph (d) of §1.1502–80 was published in the **Federal Register** for March 14, 1997 (62 FR 12096). As currently in effect, §1.1502–80(d) provides that "[s]ection 357(c) does not apply to any transaction to which §1.1502–13, §1.1502–13T, §1.1502–14, or §1.1502–14T applies, if it occurs in a consolidated return year beginning on or after January 1, 1995." The example in that regulation contemplates that, to the extent that the transferor does not recognize gain under section 357(c) by reason of the rule of §1.1502–80(d), the transferor's basis in the stock of the transferee that it receives in the exchange is reduced, with the result that an excess loss account may arise.

A concern has been raised that, as currently drafted, §1.1502–80(d) may produce an unintended basis result in certain intragroup transfers described in section 351. In particular, it is possible that one might conclude that, because §1.1502–80(d) provides that section 357(c) does not apply to certain intragroup section 351 exchanges, no liabilities can technically be excluded under section 357(c)(3). If that analysis were correct, in the case of a transfer described in section 351 between members of a consolidated group, the transferor's basis in the stock of the transferee received in the transfer would be reduced by liabilities assumed by the transferee, including those liabilities described in section 357(c)(3) that would not have reduced basis had section 357(c) applied. Assuming the transferor and the transferee are members of the consolidated group at the time the liability does in fact give rise to a deduction on the part of the transferee and is taken into account on the consolidated return, the transferor's basis in the stock of the transferee would be reduced a second time under the principles of §1.1502–32. This duplicated basis reduction, *i.e.*, once at the time of the transfer described in section 351 and again at the time the liability is taken into account by the consolidated group, may ultimately cause the transferor to recognize an amount of gain on the sale of the stock of the transferee that does not clearly reflect income.

**Explanation of Provisions**

These proposed regulations clarify that, in certain transfers described in section 351 between members of a consolidated group, a transferee's assumption of liabilities described in section 357(c)(3)(A), other than those also described in section 357(c)(3)(B), will not reduce the transferor's basis in the transferee's stock received in the exchange.

### Proposed Effective Date

These regulations are proposed to apply to transactions occurring in consolidated return years beginning on or after the date these regulations are published as final regulations in the **Federal Register.**

### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed 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 March 21, 2002, beginning at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit timely written comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by February 28, 2002.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

The principal author of these regulations is T. Ian Russell, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1 — INCOME TAXES

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

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

Par. 2. In §1.1502–80, paragraph (d) is revised to read as follows:

*§1.1502–80 Applicability of other provisions of law.*

* * * * *

(d) *Non-applicability of section 357(c)*–(1) *In general.* Section 357(c) does not apply to cause the transferor to recognize gain in any transaction to which §1.1502–13 applies, if such transaction occurs in a consolidated return year beginning on or after the date these regulations are published as final regulations in the **Federal Register.** Notwithstanding the foregoing, for purposes of determining the transferor's basis in property under section 358(a) received in a transfer described in section 351, section 358(d)(2) shall operate to exclude liabilities described in section 357(c)(3)(A), other than those also described in section 357(c)(3)(B), from the computation of the amount of liabilities assumed that is treated as money received under section 358(d)(1), if such transfer occurs in a consolidated return year beginning on or after the date these regulations are published as final regulations in the **Federal Register.** This paragraph (d)(1) does not apply to a transaction if the transferor or transferee becomes a nonmember as part of the same plan or arrangement. The transferor (or transferee) is treated as becoming a nonmember once it is no longer a member of a consolidated group that includes the transferee (or transferor). For purposes of this paragraph (d)(1), any reference to a transferor or transferee includes, as the context may require, a reference to a successor or predecessor. For rules regarding the application of section 357(c) to transactions occurring in consolidated return years beginning on or after January 1, 1995, but before the date these regulations are published as final regulations in the **Federal Register**, see §1.1502–80(d) in effect prior to the date these regulations are published as final regulations in the **Federal Register** (see 26 CFR part 1 revised April 1, 2001).

(2) *Examples.* The principles of paragraph (d)(1) of this section are illustrated by the following examples:

*Example 1.* P, S, and T are members of a consolidated group. P owns all of the stock of S and T with bases of $30 and $20, respectively. S has assets with a total fair market value equal to $100 and an aggregate basis of $30 and liabilities of $40. S merges into T in a transaction described in section 368(a)(1)(A) (and in section 368(a)(1)(D)). Section 357(c) does not apply to cause S to recognize gain in the merger. P's basis in T's stock increases to $50 ($30 plus $20), and T succeeds to S's $30 basis in the assets transferred and the $40 of liabilities.

*Example 2.* P owns all the stock of S1. S1 has assets with a total fair market value equal to $100 and an aggregate basis of $30. S1 has $40 of liabilities, $5 of which are described in section 357(c)(3)(A), but not section 357(c)(3)(B), and $35 of which are not described in section 357(c)(3)(A). S1 transfers its assets to a newly formed subsidiary, S2, in exchange for stock of S2 and S2's assumption of the liabilities of $40 in a transaction to which section 351 applies. Section 357(c) does not apply to cause S1 to recognize gain in connection with the transfer. For purposes of determining S1's basis in the S2 stock it received in the exchange, section 358(d)(2) operates to exclude $5 of the liabilities from the computation of the amount of liabilities assumed that are treated as money received under section 358(d)(1). S1's basis in the S2 stock received in the exchange is a $5 excess loss account (reflecting its $30 basis in the assets transferred reduced by $35, the amount of liabilities assumed that are not described in section 357(c)(3)(A)).

* * * * *

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on November 13, 2001, 8:45 a.m., and published in the issue of the Federal Register for November 14, 2001, 66 F.R. 57021)

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# Notice of Proposed Rulemaking and Notice of Public Hearing

## Application of the Federal Insurance Contributions Act, Federal Unemployment Tax Act, and Collection of Income Tax at Source to Statutory Stock Options

## REG–142686–01

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to incentive stock options and options granted under employee stock purchase plans. These proposed regulations would provide guidance concerning the application of the Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), and Collection of Income Tax at Source to these options. These proposed regulations would affect employers that grant these options and employees who exercise these options. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments and outlines of topics to be discussed at the public hearing scheduled for March 7, 2002, must be received by February 14, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–142686–01), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–142686–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/reglist.html*. The public hearing will be held in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622–6040; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

This document contains proposed amendments to the Employment Tax Regulations (26 CFR part 31) under sections 3121(a), 3306(b), and 3401(a) of the Internal Revenue Code of 1986 (Code), and to the Income Tax Regulations (26 CFR part 1) under section 424 of the Code. These regulations would clarify current law regarding FICA tax, FUTA tax, and income tax withholding consequences upon the exercise of statutory stock options, *i.e.*, incentive stock options described in section 422(b) and options granted under an employee stock purchase plan described in section 423(b). FICA tax consequences are determined by sections 3101 through 3128, FUTA tax consequences by sections 3301 through 3311, and income tax withholding consequences by sections 3401 through 3406.

A. *Statutory Stock Options*

Section 422(b) sets forth the requirements for treatment of options as incentive stock options. If certain conditions are met, special tax treatment is provided in section 421(a) for the transfer of stock to an individual pursuant to the exercise of an incentive stock option. These conditions include a requirement that the individual not dispose of the stock within two years from the date of the grant of the option, and a requirement that the individual not dispose of the stock within one year after the transfer of the stock to the individual.

Section 423(b) sets forth the requirements for establishment of an employee stock purchase plan. If certain conditions are met, special tax treatment is provided under section 421(a) for the transfer of stock to an individual pursuant to the exercise of an option granted under an employee stock purchase plan. These conditions include a requirement that the individual not dispose of the stock within two years from the date of the grant of the option, and a requirement that the individual not dispose of the stock within one year after the transfer of the stock to the individual.

Section 421(a) provides that at the time stock is transferred to an individual pursuant to the exercise of an option, if the conditions of section 422(a) or 423(a) are met, then no income to the individual results upon the exercise. Section 421(b) provides that at the time stock is transferred to an individual pursuant to the exercise of an option, if the stock is sold or disposed of by the individual and the holding period requirements of section 422(a)(1) or 423(a)(1) are not met, then any income to the individual which results for the taxable year, in which the option was exercised, attributable to the sale or disposition of the stock is income to the individual in the taxable year, of the individual, in which the sale or disposition occurred.

Section 423(c) provides guidance when the option price of a share of stock acquired by an individual pursuant to the exercise of an option granted under an employee stock purchase plan is less than 100 percent of the fair market value of the share at the time the option was granted. Section 423(c) provides that in the event of either the disposition of the share of stock by the individual which meets the holding period requirements of section 423(a) or in the event of the individual's death while owning the share of stock, that any resulting compensation is attributable to the individual in the taxable year in which the disposition or death occurred. The compensation attributable to the individual is the amount equal to the lesser of (1) the excess of the fair market value of the share at the time of the disposition or death over the amount paid for the share under the option or (2) the excess of the fair market value of the share at the time the option was granted over the option price.

B. *FICA, FUTA, and Income Tax Withholding*

1. *FICA*

FICA tax is generally imposed on each employer and employee. Under section 3111, FICA tax is imposed on the employer in an amount equal to a percentage of the wages paid by that employer. Under section 3101, FICA tax is also imposed on the employee in an amount equal to a percentage of the wages received by the employee with respect to employment.

FICA tax is composed of a tax for Old-Age, Survivors, and Disability Insurance (OASDI) and a tax for Hospital Insurance (HI). The OASDI portion of FICA tax is imposed separately on the employer and on the employee in an amount equal to 6.2 percent of wages. Under section 3121(a)(1), the wages subject to the OASDI portion of FICA tax are limited to the contribution and benefit base for OASDI for that year ($80,400 for calendar year 2001). The HI portion of FICA tax is separately imposed on the employer and the employee in an amount equal to 1.45 percent of wages. There is no dollar limit on the wages subject to the HI portion of FICA tax.

Under section 3102, the employer is required to collect the employee portion of FICA tax by deducting the amount of the tax from wages, as and when paid, and is liable for payment of the tax required to be collected. Under §31.3102–1(a) of the Employment Tax Regulations, the employer is required to collect the employee portion of FICA tax, notwithstanding that the wages are paid in something other than money, and to pay over the tax in money.

2. *FUTA*

FUTA tax is generally imposed under section 3301 on each employer in an amount equal to a percentage of wages paid by the employer with respect to employment. FUTA tax is imposed on the employer in an amount equal to 6.2 percent of wages. Under section 3306(b), wages of an employee subject to the FUTA tax are limited to $7,000 per calendar year.

3. *Income Tax Withholding*

Income tax withholding is imposed under section 3402(a), which requires employers paying wages to deduct and withhold income tax on those wages. The amount deducted and withheld is determined in accordance with tables or computational procedures prescribed by the Secretary of the Treasury.

C. *Wages*

1. *FICA*

For FICA purposes, section 3121(a) provides that the term *wages*, with certain exceptions, means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Similarly, under §31.3121(a)–1(b), the term *wages* means all remuneration for employment unless specifically excepted under section 3121(a) or §31.3121(a)–1(j). Neither the Code nor the regulations contain an exclusion from wages for the value of stock transferred pursuant to the exercise of an option.

Under §31.3121(a)–1(e), in general, the medium in which the remuneration is paid is immaterial. It may be paid in cash or in kind. The amount of non-cash remuneration is based on the fair market value of the non-cash remuneration at the time of payment.

Under §31.3121(a)–2(a), in general, wages are received by an employee at the time that they are paid by the employer to the employee. Wages are generally paid by an employer at the time that they are actually or constructively paid.

Under §31.3121(a)–1(i), remuneration for employment, unless specifically excepted under section 3121(a) or §31.3121(a)–1(j), constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

2. *FUTA*

For FUTA purposes, section 3306(b) provides that the term *wages*, with certain exceptions, means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Similarly, under §31.3306(b)–1(b), the term *wages* means all remuneration for employment unless specifically excepted under section 3306(b) or §31.3306(b)–1(j). Neither the Code nor the regulations contain an exclusion from wages for the value of stock transferred pursuant to the exercise of an option.

Under §31.3306(b)–1(e), in general, the medium in which the remuneration is paid is immaterial. It may be paid in cash or in kind. The amount of non-cash remuneration is based on the fair market value of the non-cash remuneration at the time of payment.

Under §31.3301–4, wages are considered paid when actually or constructively paid.

Under §31.3306(b)–1(i), remuneration for employment paid by an employer to an individual for employment, unless specifically excepted under section 3306(b), constitutes wages even though at the time paid the individual is no longer an employee.

3. *Income tax withholding*

For income tax withholding purposes, section 3401(a) provides that the term *wages*, with certain exceptions, means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Similarly, under §31.3401(a)–1(a), the term *wages* in general means all remuneration for employment for services performed by an employee for his employer unless specifically excepted under section 3401(a) or 3402(e).

Under §31.3401(a)–1(a)(4), in general, the medium in which the remuneration is paid is immaterial. It may be paid in cash or in kind. The amount of non-cash remuneration is based on the fair market value of the non-cash remuneration at the time of payment.

Under §31.3402(a)–1(b), the employer is required to collect the tax by deducting and withholding the amount from the employee's wages as and when paid, either actually or constructively.

Under §31.3401(a)–1(a)(5), remuneration for services, unless specifically excepted by statute, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

The legislative history of sections 3401 through 3404 indicates that a purpose of income tax withholding is to enable individuals to pay income tax in the year in which the income is earned. H.R. Conf. Rep. No. 78–510 at 1 (1943); H.R. Rep. No. 78–401 at 1 (1943); Rep. No. 78–221 at 1 (1943); and Senate Rep. No. 78–221 at 1 (1943). Therefore, income tax withholding is generally imposed only upon remuneration paid by an employer to the extent that an employee recognizes income. Section 421(a) provides that if a share of stock is transferred to an individual in a transfer which meets the requirements of section 422(a) or 423(a), no income is recognized at the time of the transfer.

As part of the Social Security Amendments of 1983, Public Law 98–21, 97 Stat. 65 (1983), Congress amended sections 3121(a) and 3306(b)[1] to provide specifically that regulations providing an exclusion from wages for income tax withholding purposes are not to be construed to require a similar exclusion from wages for FICA and FUTA purposes. The legislative history to the Social Security Amendments of 1983 at S. Rep. No. 98–23, 42, 98th Cong., 1st Sess. explains as to FICA and income tax withholding that "[S]ince, [however], the [social] security system has objectives which are significantly different from the objective underlying the income tax withholding rules, the committee believes that amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion." The legislative history further explains that Congress intended to reverse the holding in *Rowan Companies v. U.S.*, 452 U.S. 247 (1981), that the definitions of *wages* for FICA and income tax withholding purposes were the same. Thus, wages for income tax withholding purposes are not always the same as wages for FICA and FUTA purposes.

D. *Application of Law to Statutory Stock Options*

Revenue Ruling 71–52 (1971–1 C.B. 278) which was published before the statutory changes to sections 3121(a) and 3306(b) mentioned immediately above, addressed the FICA, FUTA, and income tax withholding consequences applicable to the exercise of qualified stock options under former section 422[2]. The ruling holds that a taxpayer does not make a payment of *wages* for purposes of FICA, FUTA, and income tax withholding at the time of the exercise of a qualified stock option under former section 422.

Notice 87–49 (1987–2 C.B. 355) addressed potential inconsistencies among and coordination of the proposed regulations under former section 422A (current section 422), section 83, and Rev. Rul. 71–52. Notice 87–49 provided that Rev. Rul. 71–52 was being reconsidered, but, until the results of such reconsideration were announced, the principles of Rev. Rul. 71–52 apply to the disposition of stock, acquired by an individual pursuant to the exercise of an incentive stock option, which does not meet the requirements of former section 422A(a) (current section 422(a)).

Notice 2001–14 (2001–6 I.R.B. 416) addresses the FICA, FUTA, and income tax withholding consequences applicable to the exercise of statutory stock options. Notice 2001–14 provides that in the case of any statutory stock option exercised before January 1, 2003, the IRS will not assess FICA or FUTA tax upon the exercise of the option and will not treat the disposition of stock acquired by an employee pursuant to the exercise of the option as subject to income tax withholding. Notice 2001–14 also provides that Revenue Ruling 71–52 is obsolete and that the holding of Revenue Ruling 71–52 does not apply to the exercise of a statutory stock option or to the disposition of stock acquired pursuant to the exercise of a statutory stock option. Consistent with that conclusion, Notice 2001–14 also provides that the provisions of Notice 87–49 described above no longer apply.

It has long been recognized that the transfer of stock to an employee pursuant to the exercise of a nonstatutory stock option granted in connection with employment constitutes a payment of compensation to the extent that the fair market value of the stock received by the employee pursuant to the exercise of the nonstatutory option exceeds the option exercise price. *Commissioner v. LoBue*, 351 U.S. 243 (1956); *Commissioner v. Smith*, 324 U.S. 177 (1945). The exclusion from gross income for income tax purposes that is provided by section 421(a)(1) for the transfer of stock upon the exercise of a statutory stock option, does not alter the compensatory character of such stock transfers or serve to distinguish statutory stock options from nonstatutory stock options for purposes of sections 3121(a) and 3306(b).

**Comments Received Pursuant to Notice 2001–14**

Notice 2001–14 announced the intent to issue further administrative guidance clarifying current law with respect to the application of employment taxes to statutory stock options and solicited public

[1] Sections 3121(a) and 3306(b) were amended by section 327(b)(1) and (c)(4), respectively, of the Social Security Amendments of 1983, Public Law 98–21, 97 Stat. 65 (1983).

[2] Section 603 of the Tax Reform Act of 1976, Public Law 94–355, 90 Stat. 1520 (1976), amended former section 422 to provide, generally, that qualified stock options could not be granted after May 20, 1976. Current section 422 (Incentive Stock Options) was added to the Internal Revenue Code of 1954 (Code), as section 422A, by section 251(a) of the Economic Recovery Tax Act of 1981, Public Law 97–34, 95 Stat. 172 (1981). Subsequently, section 11801(c)(9)(A)(i) of the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508, 104 Stat. 1388 (1990), repealed former section 422 (Qualified Stock Options) and re-designated former Code section 422A as section 422 of the Internal Revenue Code of 1986.

comments on the anticipated guidance. In response to the request for comments, the IRS received a number of comments addressing a variety of topics pertaining to the application of FICA, FUTA, and income tax withholding to transactions involving statutory stock options. Because the proposed regulations address only the application of the FICA, FUTA, and income tax withholding at the time of exercise of a statutory stock option, only comments relating to these types of transactions are addressed.

The IRS also received comments regarding an employer's income tax withholding and reporting obligations upon the sale or disposition of stock acquired by an individual pursuant to the exercise of a statutory stock option. The IRS intends to publish two notices, discussed more fully below, at the time of publication of these proposed regulations. One notice includes proposed rules addressing an employer's income tax withholding and reporting obligations upon the sale or disposition of stock acquired by an individual pursuant to the exercise of a statutory stock option. That notice discusses the comments received in response to Notice 2001–14 relating to those types of transactions.

Most commentators who addressed the application of FICA and FUTA tax at the time of exercise of a statutory stock option argued that there was no statutory basis for such application. As discussed more fully previously, the applicable Code provisions do not provide an exception from FICA or FUTA tax for wages paid to an employee arising from the exercise of a statutory stock option.

Several comments were received requesting that the IRS's acquiescence on decision in *Sun Microsystems v. Commissioner*, T.C.M. 1995–69, *acq*. 1997–2 C.B. 1, not be affected by the proposed regulations. The proposed regulations address only the application of FICA and FUTA to statutory stock options and do not address the section 41 issues raised in the *Sun Microsystems* decision.

Some commentators also expressed concern about the administrative burden of applying FICA and FUTA tax at the time of exercise, especially as to former employees, because there is often no payment of cash compensation to the employee at that time. As a result, some employees may need to sell some shares of the acquired stock to fund the employment tax obligations, resulting in a disqualifying disposition of the shares sold. In addition, some commentators expressed concern that the administrative burdens stemming from the application of FICA and FUTA tax upon the exercise of statutory stock options would make the use of these options less attractive to employers and employees. However, commentators did not cite applicable Code provisions that provide a statutory basis for excluding this type of compensation from the relevant employment taxes. As discussed below, the proposed regulations would enable the IRS to issue rules of administrative convenience to lessen the administrative burdens that commentators cited.

**Explanation of Provisions**

These proposed regulations would clarify current law regarding FICA tax, FUTA tax, and income tax withholding on the transfer of stock pursuant to the exercise of statutory stock options. These proposed regulations would provide that at the time of the exercise of a statutory stock option, the individual who was granted the statutory stock option receives wages for FICA and FUTA purposes. These proposed regulations would also provide that the amount of wages received equals the excess of the fair market value of the stock acquired pursuant to the exercise of the statutory stock option over the amount paid for the stock.

The position taken in these regulations is based upon the broad statutory definition of wages for FICA and FUTA purposes and the absence of any statutory exclusion for this form of remuneration. These regulations follow the Congressional directive that no exception from FICA taxes should be created without a specific exclusion and the section 3121(a) and 3306(b) provisions that no exception from FICA and FUTA taxes should be inferred from the fact that income tax withholding does not apply.

These proposed regulations would also provide that income tax withholding is not required when an individual exercises a statutory stock option because no income is recognized at the time of the exercise by reason of section 421(a)(1).

In response to the concerns about administrative burdens, the proposed regulations authorize the IRS to adopt rules of administrative convenience to assist employers and employees in meeting the employment tax obligations. Specifically, the proposed regulations permit the IRS to adopt rules permitting employers to deem the payment of wages resulting from the exercise of a statutory stock option as occurring at a specific date or dates, including over a period of dates, as well as any other appropriate rules of administrative convenience.

Section 424(h) provides that for purposes of the rules governing incentive stock option plans and employee stock purchase plans, if the terms of any option to purchase stock are modified, extended, or renewed, such *modification*, extension, or renewal is considered as the grant of a new option. Section 424(h)(3) generally defines the term *modification* as any change in the terms of the option which gives the employee additional benefits. The proposed regulations clarify that the adoption of any of the rules of administrative convenience that may be prescribed by the IRS pursuant to the proposed regulations, and the application of those rules to outstanding incentive stock options under section 422 or outstanding options under an employee stock purchase plan under section 423, will not constitute a modification for purposes of section 424(h).

These regulations are proposed to apply only upon publication of final regulations in the **Federal Register** and cannot be relied upon prior to publication. These proposed regulations, upon becoming final, would be effective only for the exercise of a statutory stock option that occurs on or after January 1, 2003. If these regulations are finalized as proposed, neither FICA nor FUTA tax will apply to the exercise of a statutory stock option prior to January 1, 2003. Consistent with this proposed position, the IRS will not assert FICA or FUTA tax which is based upon the exercise of a statutory stock option that occurs prior to January 1, 2003.

While neither FICA nor FUTA tax will apply to the exercise of a statutory stock option prior to January 1, 2003, if these regulations are finalized as proposed, an employer will be able to apply the final regulations to the exercise of a statutory stock option that occurs prior to January 1, 2003, if the employer elects to do so.

*Related administrative guidance*

As noted above, the IRS is concurrently publishing two notices. One of the two notices sets forth proposed rules of administrative convenience under the authority provided to the IRS in the proposed regulations. These proposed rules would permit employers to deem the payment of wages resulting from the exercise of a statutory stock option as occurring at a specific date or dates, including over a period of dates. The notice also describes certain arrangements available under the current federal tax law that may assist employers and employees, including employee pre-funding of the employee portion of FICA tax and employer advances of funds to satisfy the employee portion of FICA tax.

The IRS is publishing a second notice that proposes rules regarding an employer's income tax withholding and reporting obligations upon the sale or disposition of stock acquired by an individual pursuant to the exercise of a statutory stock option. As indicated above, the proposed rule in this notice would state that the employer has no income tax withholding obligation when an employee sells or disposes of stock acquired by the employee pursuant to the exercise of a statutory stock option.[3]

**Special Analyses**

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

**Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (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.

Treasury and the IRS specifically request comments on the clarity of the proposed regulations, how they can be made easier to understand, and the administerability of the rules in the proposed regulations. In addition, the proposed regulations do not include special rules for transactions in which an individual exercising a statutory stock option receives stock subject to a restriction, such as a substantial risk of forfeiture. Treasury and the IRS also specifically request comments as to whether the proposed regulations should include such special rules, including comments as to the prevalence of incentive stock option plans or employee stock purchase plans that impose such terms on stock received pursuant to the exercise of a statutory stock option.

A public hearing has been scheduled for March 7, 2002, 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 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by February 14, 2002. 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 Stephen Tackney, Office of the Associate Chief Counsel (Tax Exempt and Government Entities). 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 31 are proposed to be amended as follows:

Part 1 — INCOME TAXES

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

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

Par. 2. Section 1.425–1, as proposed at 49 FR 4519 (February 7, 1984), is amended by adding a sentence immediately after the third sentence of paragraph (e)(5)(i) to read as follows:

*§1.425–1 Definitions and special rules applicable to statutory options.*

* * * * *

(e) * * *

(5)(i) * * * In addition, the application to an outstanding option of any of the methods for the payment or withholding of employment taxes under sections

[3] These proposed regulations, along with the two notices, are intended to clarify the application of employment taxes to statutory stock options in a manner that recognizes and addresses the practical burdens that are imposed, including the imposition of withholding when neither the employer nor any other person (other than the employee) has control over a payment of remuneration, while also ensuring that "amounts exempt from income tax withholding should not be exempt from FICA unless Congress provides an explicit FICA tax exclusion." Social Security Amendments of 1983 at S. Rep. No. 98–23, 42, 98th Cong., 1st Sess.

3101, 3111, or 3301 that may be prescribed under §31.3121(a)–1(k)(2) or §31.3306(b)–1(l)(2) of this chapter is not a modification. * * *

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Part 31 — EMPLOYMENT TAXES AND COLLECTION OF INCOME TAXES AT THE SOURCE

Par. 3. The authority citation for part 31 continues to read in part as follows:

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

Par. 4. In §31.3121(a)–1, paragraph (k) is added to read as follows:

*§31.3121(a)–1 Wages.*

* * * * *

(k) *Statutory stock options* — (1) *When an individual receives wages* — (i) *Statutory stock option defined.* For purposes of this section, a statutory stock option is an option that either satisfies the requirements of section 422(b) or is granted under a plan that satisfies the requirements of section 423(b).

(ii) *Wages at exercise*. If an individual is granted a statutory stock option, the individual receives wages when stock is transferred to the individual pursuant to the exercise of the option. The amount of the wages received by the individual is equal to the excess of the fair market value of the stock, determined at the time of exercise, over the amount paid for the stock by the individual. The provisions of this paragraph (k) are illustrated by the following example:

*Example*. (i) Individual X is granted an option under a plan that satisfies the requirements of section 423(b). The option allows X to acquire 50 shares of stock of X's employer, Y, at an exercise price equal to 85% of the fair market value of the stock at the time the option is granted. The fair market value of the Y stock at the time the option is granted is $100 per share. X exercises the option later when the fair market value of the Y stock is $120 per share. Thus, at the time of exercise, X acquires 50 shares of Y stock having a fair market value of $120 per share for $85 per share.

(ii) In this *Example*, at the time of exercise, X has received wages equal to the excess of the fair market value of the stock ($120 per share) over the amount paid for the stock ($85 per share). Thus, for purposes of section 3121, X has received wages equal to $35 per share, for a total of $1,750.

(2) *Rules of administrative convenience*. The Commissioner may prescribe rules of administrative convenience for employers and employees to satisfy obligations under sections 3101 and 3111 that arise with respect to wages received pursuant to the exercise of a statutory stock option. Such rules may include, but are not limited to, permitting employers to deem the payment of wages due to the exercise of the statutory stock option as occurring at a specific date or dates, including over a period of dates.

(3) *Effective date*. This paragraph (k) is applicable to the exercise of a statutory option that occurs on or after January 1, 2003.

Par. 5. In §31.3306(b)–1, paragraph (l) is added to read as follows:

*§31.3306(b)–1 Wages.*

* * * * *

(l) *Statutory stock options* — (1) *When an individual receives wages* — (i) *Statutory stock option defined*. For purposes of this section, a statutory stock option is an option that either satisfies the requirements of section 422(b) or is granted under a plan that satisfies the requirements of section 423(b).

(ii) *Wages at exercise*. If an individual is granted a statutory stock option, the individual receives wages when stock is transferred to the individual pursuant to the exercise of the option. The amount of the wages received by the individual is equal to the excess of the fair market value of the stock, determined at the time of exercise, over the amount paid for the stock by the individual. The provisions of this paragraph (l) are illustrated by the following example:

*Example*. (i) Individual X is granted an option under a plan that satisfies the requirements of section 423(b). The option allows X to acquire 50 shares of stock of X's employer, Y, at an exercise price equal to 85% of the fair market value of the stock at the time the option is granted. The fair market value of the Y stock at the time the option is granted is $100 per share. X exercises the option later when the fair market value of the Y stock is $120 per share. Thus, at the time of exercise, X acquires 50 shares of Y stock having a fair market value of $120 per share for $85 per share.

(ii) In this *Example*, at the time of exercise, X has received wages equal to the excess of the fair market value of the stock ($120 per share) over the amount paid for the stock ($85 per share). Thus, for purposes of section 3306, X has received wages equal to $35 per share, for a total of $1,750.

(2) *Rules of administrative convenience*. The Commissioner may prescribe rules of administrative convenience for employers to satisfy obligations under section 3301 that arise with respect to wages received pursuant to the exercise of a statutory stock option. Such rules may include, but are not limited to, permitting employers to deem the payment of wages due to the exercise of the statutory stock option as occurring at a specific date or dates, including over a period of dates.

(3) *Effective date*. This paragraph (l) is applicable to the exercise of a statutory option that occurs on or after January 1, 2003.

Par. 6. In §31.3401(a)–1, paragraph (b)(15) is added to read as follows:

*§31.3401(a)–1 Wages.*

* * * * *

(b) * * *

(15) *Statutory stock options* — (i) *When stock is transferred pursuant to an exercise* — (A) *Statutory stock option defined*. For purposes of this section, a statutory stock option is an option that either satisfies the requirements of section 422(b) or is granted under a plan that satisfies the requirements of section 423(b).

(B) *Withholding at exercise*. If an individual is granted a statutory stock option, withholding is not required when stock is transferred to the individual pursuant to the exercise of the option to the extent that the individual does not recognize income by reason of section 421(a)(1). The provisions of this paragraph (b)(15) are illustrated by the following example:

*Example*. (i) Individual X is granted an option under a plan that satisfies the requirements of section 423(b). The option allows X to acquire 50 shares of stock of X's employer, Y, at an exercise price equal to 85% of the fair market value of the stock at the time the option is granted. The fair market value of the Y stock at the time the option is granted is $100 per share. X exercises the option later when the fair market value of the Y stock is $120 per share. Thus, at the time of exercise, X acquires 50 shares of Y stock having a fair market value of $120 per share for $85 per share. X continues to hold the Y stock after exercise. Under section 421(a), no income is recognized at the time of exercise.

(ii) In this *Example*, for purposes of section 3401, X has not received wages at the time of exercise.

(ii) *Effective date*. This paragraph (b)(15) is applicable to the exercise of a statutory stock option that occurs on or after January 1, 2003.

* * * * *

Robert E. Wenzel,
*Deputy Commissioner*
*of Internal Revenue.*

(Filed by the Office of the Federal Register on November 13, 2001, 8:45 a.m., and published in the issue of the Federal Register for November 14, 2001, 66 F.R. 56944)

## Disaster Relief for Taxpayers With an Interest in Passthrough Entities

## Announcement 2001–117

Notice 2001–61 (2001–40 I.R.B. 305) provided filing and paying extensions and postponements for taxpayers affected by the September 11, 2001, Terrorist Attack. An affected taxpayer for purposes of Notice 2001–61 includes, among others, business entities whose principal place of business is located in a covered disaster area, and business entities whose principal place of business is not located in a covered disaster area but whose records necessary to meet a filing or paying deadline are located in a covered disaster area. Affected taxpayers also include trusts and estates whose tax records necessary to meet a filing or paying deadline are located in a covered disaster area. The IRS received a number of inquiries about the scope of Notice 2001–61 with respect to the partners, shareholders and beneficiaries of partnerships, S corporations, trusts and estates (passthrough entities). In response to those inquiries, Notice 2001–68 (2001–47 I.R.B. 504) noted that the deadline for filing of income tax returns of the partners, shareholders, or beneficiaries of passthrough entities is not postponed or extended **solely** because the passthrough entity is an affected taxpayer. Notice 2001–68 also noted the availability of other types of relief for those owners of passthrough entities.

Some taxpayer representatives have informed the IRS that they interpreted Notice 2001–61 as including owners of passthrough entities as affected taxpayers regardless of whether the owners themselves were otherwise affected. Those taxpayer representatives believed that if the records of the passthrough entity necessary to prepare Schedule K–1s were located in a covered disaster area, then the owners who would receive copies of the Schedule K–1s for use in preparing their own returns had records in a covered disaster area within the meaning of Notice 2001–61. Some taxpayers who relied on the advice of these taxpayer representatives missed certain tax deadlines between September 11, 2001, and November 2, 2001, when the IRS issued Notice 2001–68.

Although Notice 2001–61 did not grant the relief that some taxpayer representatives believed it did, the extraordinary circumstances surrounding the September 11, 2001, terrorist attacks justify granting limited additional relief to those taxpayers who missed deadlines in reliance on the interpretation of Notice 2001–61 described above. Accordingly, the IRS grants the following relief to partners, shareholders, or beneficiaries of passthrough entities that had income tax returns due (either originally or on extension) on or after September 11, 2001, and on or before November 2, 2001 (the date the IRS released Notice 2001–68), but did not file the return because the taxpayer believed that the IRS had granted a 120 day postponement solely by virtue of the taxpayer's interest in an affected entity. Those taxpayers will have until December 17, 2001, to file a timely return (and make any election required to be made with a timely filed return). The IRS will waive any failure to file penalty if the taxpayer files the return by December 17, 2001. The IRS will waive any failure to pay penalty that accrues from September 11, 2001, through December 17, 2001, as long as the taxpayer pays any balance due by December 17, 2001. Taxpayers that qualify for relief under this notice should mark "Extended pursuant to Announcement 2001–117" in red ink on the top of their returns or other documents filed with the IRS.

This announcement was drafted by the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, you may call (202) 622–4940 (not a toll-free call).

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

## Section 42.— Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, page 570.

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## Section 141.— Private Activity Bond; Qualified Bond

*26 CFR 1.141–3: Definition of private business use.*

## T.D. 8967

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Part 1

## Definition of Private Business Use

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document amends the final regulations on the definition of private business use applicable to tax-exempt bonds issued by State and local governments. The amendments provide that certain arrangements do not result in private business use if the term of the use does not exceed 50, 100 or 200 days, as applicable.

DATES: *Effective Date:* These regulations are effective November 20, 2001.

*Applicability Date:* For dates of applicability, see § 1.141–15.

FOR FURTHER INFORMATION CONTACT: Michael P. Brewer at (202) 622–3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

Section 103(a) of the Internal Revenue Code (Code) provides that, generally, interest on any State or local bond is not included in gross income. However, this exclusion does not apply to any private activity bond that is not a qualified bond.

Under section 141, a bond is a private activity bond if it is issued as part of an issue that meets either the private business use test and the private security or payment test, or the private loan financing test.

The private business use test is met if more than 10 percent of the proceeds of an issue are to be used for any private business use. Section 141(b)(6)(A) defines the term *private business use* as use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For this purpose, use as a member of the general public is not taken into account.

Section 1.141–3 provides guidance regarding the private business use test. Generally, the private business use test is met only if a nongovernmental person has special legal entitlements to use the financed property under an arrangement with the issuer. The existing regulations provide the following three special rules for use by nongovernmental persons under short-term arrangements:

1. Section 1.141–3(c)(3) states that an arrangement is not treated as general public use if the term of the use under the arrangement, including all renewal options, is greater than 180 days.
2. Section 1.141–3(d)(3)(i) provides that certain arrangements are not private business use if the term of the use under the arrangement, including all renewal options, is not longer than 90 days.
3. Section 1.141–3(d)(3)(ii) provides that certain arrangements are not private business use if the term of the use under the arrangement, including all renewal options, is not longer than 30 days.

Section 1.141–3(f) contains examples that illustrate these special rules.

**Explanation of Provisions**

Comments have been received requesting that the regulations provide for additional flexibility in structuring short-term arrangements with nongovernmental persons. For example, commentators have requested that the 180–day, 90–day, and 30–day rules of § 1.141–3 be changed to accommodate six-month, three-month, and one-month arrangements, respectively (*i.e.*, arrangements with terms of use based on months that exceed 30 days). This Treasury decision adopts this suggested modification by amending § 1.141–3(c)(3), (d)(3) and (f) to change all references to 180 days, 90 days, and 30 days to 200 days, 100 days, and 50 days, respectively.

**Effective Dates**

The changes made by this Treasury decision apply to any bond sold on or after November 20, 2001. The changes made by this Treasury decision may be applied by issuers to any bond outstanding on November 20, 2001, to which § 1.141–3 applies.

**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because no notice of proposed rulemaking is required, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this final regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal authors of these final regulations are Bruce M. Serchuk and Michael P. Brewer, Office of Chief Counsel (TE/GE), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

Part 1—INCOME TAXES

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

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

**§ 1.141–3 [Amended]**

Par. 2. In the list below, for each paragraph indicated in the left column, remove the words indicated in the middle column from wherever they appear in the paragraph, and add the words indicated in the right column:

| Paragraph | Remove | Add |
|---|---|---|
| 1.141–3(c)(3), first sentence of introductory text | 180 days | 200 days |
| 1.141–3(d)(3)(i)(A) | 90 days | 100 days |
| 1.141–3(d)(3)(ii)(A) | 30 days | 50 days |
| 1.141–3(f) *Example 10*, penultimate sentence | 180 days | 200 days |
| 1.141–3(f) *Example 12*, third sentence (twice) | 180 days | 200 days |
| 1.141–3(f) *Example 13*, fifth sentence | 180 days | 200 days |
| 1.141–3(f) *Example 15*, fourth sentence | 90 days | 100 days |
| 1.141–3(f) *Example 16(i)*, last sentence | 30 days | 50 days |

Par. 3. Section 1.141–15 is amended as follows:

1. Paragraph (b) is redesignated (b)(1).
2. A paragraph heading for newly designated paragraph (b)(1) is added.
3. Paragraph (b)(2) is added.

The additions read as follows:

*§ 1.141–15 Effective dates.*

* * * * *

(b) *Effective Dates*—(1) *In general*.

* * *

(2) *Certain short-term arrangements*. The provisions of § 1.141–3 that refer to arrangements for 200 days, 100 days, or 50 days apply to any bond sold on or after November 20, 2001, and may be applied to any bond outstanding on November 20, 2001, to which § 1.141–3 applies.

* * * * *

David A. Mader,
*Assistant Deputy Commissioner of Internal Revenue.*

Approved November 14, 2001.

Mark Weinberger,
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on November 19, 2001, 8:45 a.m., and published in the issue of the Federal Register for November 20, 2001, 66 F.R. 58061)

## Section 280G.— Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, page 570.

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

The adjusted applicable federal long-term rate is set forth for the month of December 2001. See Rev. Rul. 2001–58, page 570.

## Section 412.— Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, page 570.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, on this page.

## Section 482.— Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, on this page.

## Section 483.— Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, on this page.

## Section 642.— Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, on this page.

## Section 807.— Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, on this page.

## Section 846.— Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, on this page.

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

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

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate**. For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for December 2001.

## Rev. Rul. 2001–58

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2001 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the 2002 interest rate for purposes of sections 846 and 807.

REV. RUL. 2001–58 TABLE 1

Applicable Federal Rates (AFR) for December 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| *Short-Term* | | | | |
| AFR | 2.48% | 2.46% | 2.45% | 2.45% |
| 110% AFR | 2.73% | 2.71% | 2.70% | 2.69% |
| 120% AFR | 2.97% | 2.95% | 2.94% | 2.93% |
| 130% AFR | 3.23% | 3.20% | 3.19% | 3.18% |
| *Mid-Term* | | | | |
| AFR | 3.97% | 3.93% | 3.91% | 3.90% |
| 110% AFR | 4.37% | 4.32% | 4.30% | 4.28% |
| 120% AFR | 4.78% | 4.72% | 4.69% | 4.67% |
| 130% AFR | 5.18% | 5.11% | 5.08% | 5.06% |
| 150% AFR | 5.99% | 5.90% | 5.86% | 5.83% |
| 175% AFR | 7.00% | 6.88% | 6.82% | 6.78% |
| *Long-Term* | | | | |
| AFR | 5.05% | 4.99% | 4.96% | 4.94% |
| 110% AFR | 5.57% | 5.49% | 5.45% | 5.43% |
| 120% AFR | 6.08% | 5.99% | 5.95% | 5.92% |
| 130% AFR | 6.60% | 6.49% | 6.44% | 6.40% |

REV. RUL. 2001–58 TABLE 2

Adjusted AFR for December 2001

*Period for Compounding*

| | *Annual* | *Semiannual* | *Quarterly* | *Monthly* |
|---|---|---|---|---|
| Short-term adjusted AFR | 2.30% | 2.29% | 2.28% | 2.28% |
| Mid-term adjusted AFR | 3.27% | 3.24% | 3.23% | 3.22% |
| Long-term adjusted AFR | 4.65% | 4.60% | 4.57% | 4.56% |

REV. RUL. 2001–58 TABLE 3

Rates Under Section 382 for December 2001

| | |
|---|---|
| Adjusted federal long-term rate for the current month | 4.65% |
| Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.) | 4.74% |

REV. RUL. 2001–58 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for December 2001

| | |
|---|---|
| Appropriate percentage for the 70% present value low-income housing credit | 8.05% |
| Appropriate percentage for the 30% present value low-income housing credit | 3.45% |

REV. RUL. 2001–58 TABLE 5

Rate Under Section 7520 for December 2001

| | |
|---|---|
| Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest | 4.8% |

REV. RUL. 2001–58 TABLE 6

Rate under Sections 846 and 807

| | |
|---|---|
| Applicable rate of interest for 2002 for purposes of sections 846 and 807 | 5.71% |

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, page 570.

## Section 6109.— Identifying Numbers

*26 CFR 301.6109–1: Identifying numbers.*
*(Also § 301.7701–3.)*

**Employer Identification Numbers**. This ruling provides guidance on the retention of an entity's employer identification number upon changing under § 301.7701–3 from a partnership to a disregarded entity or from a disregarded entity to a partnership.

## Rev. Rul. 2001–61

ISSUES

(1) If an entity classified as a partnership becomes disregarded as an entity separate from its owner (disregarded entity) for federal tax purposes and if the disregarded entity chooses to calculate, report, and pay its employment tax obligations under its own name and employer identification number (EIN) pursuant to Notice 99–6 (1999–1 C.B. 321) does the disregarded entity retain the same EIN it used as a partnership?

(2) If an entity classified as a disregarded entity for federal tax purposes calculates, reports, and pays its employment tax obligations under its own name and EIN pursuant to Notice 99–6 and if the federal tax classification of that entity changes to a partnership, does the partnership retain the same EIN it used as a disregarded entity?

FACTS

In each of the following situations, the eligible entity (as defined in § 301.7701–3(a) of the Procedure and Administration Regulations) does not elect under § 301.7701–3(c) to be treated as an association for federal tax purposes at any time.

*Situation 1*. *X*, an eligible entity classified as a partnership, becomes a disregarded entity for federal tax purposes when the entity's ownership is reduced to one member. (See, for example, Rev. Rul. 99–6 (1999–1 C.B. 432.) *X* chooses to calculate, report, and pay its employment tax obligations under its own name and EIN pursuant to Notice 99–6.

*Situation 2*. *Y* is a disregarded entity for federal tax purposes. Pursuant to Notice 99–6, *Y* calculates, reports, and pays its employment tax obligations under its own name and EIN. *Y* becomes a partnership for federal tax purposes when the entity's ownership expands to include more than one member. (See, for example, Rev. Rul. 99–5 (1999–1 C.B. 434.)

LAW & ANALYSIS

Section 6109(a)(1) of the Internal Revenue Code provides that any person required to make a return, statement, or other document shall include in the return, statement, or other document the identifying number as may be prescribed for securing proper identification of the person.

Section 301.6109–1(h)(1) provides that any entity that has an EIN will retain that EIN if its federal tax classification changes under § 301.7701–3.

Section 301.6109–1(h)(2)(i) provides that except as otherwise provided in regulations or other guidance, a single owner entity that is disregarded as an entity separate from its owner under § 301.7701–3 must use its owner's taxpayer identification number (TIN) for federal tax purposes.

Section 301.6109–1(h)(2)(ii) provides that if a single owner entity's classification changes so that it is recognized as a separate entity for federal tax purposes, and that entity had an EIN, then the entity must use that EIN and not the TIN of the single owner. If the entity did not already have its own EIN, then the entity must acquire an EIN and not use the TIN of the single owner.

Section 301.7701–3(a) provides that a business entity that is not classified as a corporation under § 301.7701–2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701–2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Section 301.7701–3(f)(2) provides that an eligible entity classified as a partnership becomes a disregarded entity when the entity's membership is reduced to one member. A disregarded entity becomes classified as a partnership when the entity's membership is increased to more than one member.

Notice 99–6 provides that the Service generally will accept reporting and payment of employment taxes with respect to the employees of a disregarded entity if made in one of two ways: (1) calculation, reporting, and payment of all employment tax obligations with respect to employees of a disregarded entity by its owner (as though the employees of the disregarded entity are employed directly by the owner) and under the owner's name and TIN; or (2) separate calculation, reporting, and payment of all employment tax obligations by each state law entity with respect to its employees under its own name and TIN.

In *Situation 1*, *X*'s change in federal tax classification from a partnership to a disregarded entity is a change described in § 301.7701–3(f)(2). Thus *X* is required to retain its EIN under § 301.6109–1(h)(1) if it chooses to calculate, report, and pay its employment tax obligations under its own name and EIN pursuant to Notice 99–6 upon its federal tax classification changing to a disregarded entity. For all federal tax purposes other than employment obligations or except as otherwise provided in regulations or other guidance, *X* must use the TIN of its owner pursuant to § 301.6109–1(h)(2)(i).

In *Situation 2*, because *Y* calculates, reports, and pays its employment tax obligations under its own name and EIN prior to its federal tax classification changing from a disregarded entity to a partnership, § 301.6109–1(h)(2)(ii) requires that *Y* retain its EIN for use for all federal tax purposes as a partnership.

HOLDINGS

(1) If an entity classified as a partnership becomes a disregarded entity for federal tax purposes and if the disregarded entity chooses to calculate, report, and pay its employment tax obligations under its own name and EIN pursuant to Notice 99–6, the disregarded entity must retain the same EIN for employment tax purposes it used as a partnership. For all federal tax purposes other than employment obligations or except as otherwise provided in regulations or other guidance, a disregarded entity must use the TIN of its owner.

(2) If an entity classified as a disregarded entity for federal tax purposes calculates, reports, and pays its employment tax obligations under its own name and EIN pursuant to Notice 99–6 and if the federal tax classification of that entity changes to a partnership, the partnership must retain the same EIN it used as a disregarded entity.

DRAFTING INFORMATION

The principal author of this revenue ruling is Craig Gerson of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Craig Gerson at (202) 622–3050 (not a toll-free call).

## Section 7520.— Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, page 570.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2001. See Rev. Rul. 2001–58, page 570.

# Part II. Treaties and Tax Legislation

## Subpart A.— Tax Conventions and Other Related Items

## Luxembourg Treaty Election

## Announcement 2001–119

Following is a copy of the News Release issued by the Director International (U.S. Competent Authority) on November 9, 2001 (IR–2001–108).

U.S., LUXEMBOURG AGREE ON INTERPRETATION OF TAX TREATY'S TRANSITION RULES

WASHINGTON—The competent authorities of the United States and Luxembourg have entered into a mutual agreement concerning the interpretation of the transition rules set forth in Article 30 (Entry Into Force) of the Convention Between the Government of the United States of America and the Government of the Grand Duchy of Luxembourg for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, signed at Luxembourg on April 3, 1996, and entered into force on December 20, 2000 (the "Treaty" or "1996 Treaty").

Paragraph 2 of Article 30 provides that in the case of taxes withheld at source, the Treaty generally has effect for amounts paid or credited on or after the first day of January next following the date on which the Treaty enters into force, *i.e.*, for amounts paid or credited on or after January 1, 2001. In the case of taxes on other income and on capital ("other taxes"), paragraph 2 provides that the Treaty generally has effect for fiscal periods beginning on or after the first day of January next following the date on which the Treaty enters into force, *i.e.*, for fiscal periods beginning on or after January 1, 2001.

Paragraph 3 of Article 30 provides that where any greater relief from tax would have been afforded to a person entitled to the benefits of the Convention between the United States and Luxembourg with respect to taxes on income and property, signed in Washington on December 18, 1962 (the "1962 Treaty"), the 1962 Treaty shall, at the election of such person, continue to have effect in its entirety for the first assessment period or taxable year following the date on which the 1996 Treaty would otherwise have effect under the provisions of paragraph 2.

Paragraph 4 of Article 30 provides that the 1962 Treaty shall cease to have effect in respect of income and capital to which the 1996 Treaty applies in accordance with paragraphs 2 or 3 of Article 30.

Questions have arisen concerning the application of paragraphs 3 and 4 of Article 30 of the 1996 Treaty, regarding fiscal year taxpayers receiving income that is subject to tax withheld at source. In order to resolve potential ambiguities and to provide certainty to taxpayers, the United States and Luxembourg have agreed to the following application of the transition rules:

*Calendar year taxpayers*. If a calendar year taxpayer in existence on December 19, 2000, makes the election under paragraph 3 of Article 30 of the 1996 Treaty, the 1962 Treaty will continue to apply to the taxpayer through December 31, 2001, with respect to both taxes withheld at source and taxes on other income and on capital. The 1962 Treaty will cease to have effect with respect to the taxpayer beginning on January 1, 2002.

*Fiscal year taxpayers.* If a fiscal year taxpayer in existence on December 19, 2000, makes the election under paragraph 3 of Article 30 of the 1996 Treaty, the 1962 Treaty will continue to apply to the taxpayer with respect to both taxes withheld at source and taxes on other income and on capital through the last day of the taxpayer's first fiscal year beginning on or after January 1, 2001. The 1962 Treaty will cease to have effect with respect to the taxpayer beginning on the first day of the taxpayer's second fiscal year beginning on or after January 1, 2001. Thus, for example, if a taxpayer in existence on December 19, 2000, with a fiscal year that terminates on November 30, makes the election under paragraph 3 of Article 30 of the 1996 Treaty, the 1962 Treaty will continue to apply to the taxpayer with respect to both taxes withheld at source and taxes on other income and on capital through November 30, 2002, and the 1962 Treaty will cease to have effect with respect to the taxpayer beginning on December 1, 2002.

* * *

Taxpayers that did not exist prior to the date of entry into force of the 1996 Treaty, and taxpayers that were in existence but did not qualify for benefits under the 1962 Treaty, will not be entitled to claim the benefits of the 1962 Treaty under the grandfather rule of Article 30(3).

An election to apply the 1962 Treaty means that the 1962 Treaty, and not the 1996 Treaty, will apply in all respects to the electing taxpayer.

For further information in the United States, please contact Lynn Bartlett, IRS Large & Mid-Size Business, Office of the Director, International, Tax Treaty, ((202) 874–1550 (not a toll-free number)). For further information in Luxembourg, please contact Guy Heintz, Head of the Division international relations of the Administration of Direct Taxes, 40800–2204.

# Part III. Administrative, Procedural, and Miscellaneous

## Disaster Relief With Respect to Air Transportation Excise Taxes

## Notice 2001–77

This notice provides additional tax relief under section 301(a) of the Air Transportation Safety and System Stabilization Act (the Act), Pub. L. No. 107–42, 115 Stat. 236, and informs taxpayers of a change that will be made to the regulations under § 6071 of the Internal Revenue Code.

Section 301(a) of the Act provides relief to eligible air carriers with respect to the deposit of taxes imposed by subchapter C of chapter 33 of the Code (the air transportation excise taxes). Under section 301(a) of the Act, any deposit of those taxes required to be made by an eligible air carrier after September 10, 2001, and before November 15, 2001, shall be treated for purposes of the Code as timely made if the deposit is made on or before November 15, 2001. Section 301(a) of the Act also provides that the Secretary of the Treasury may extend the November 15, 2001, date to January 15, 2002.

Section 6071 of the Code provides that the Secretary may prescribe the time for filing any return by regulations when that time is not prescribed in the Code. Section 40.6071(a)–2 of the Excise Tax Procedural Regulations, as in effect for calendar quarters beginning before October 1, 2001, provides that returns of the air transportation excise taxes for the third calendar quarter of 2001 are due by November 30, 2001. Under § 6151 of the Code, the tax shown or required to be shown on the return must be paid by the due date of the return.

Under the authority granted to the Secretary of the Treasury in section 301(a) of the Act, any deposit of air transportation excise taxes required to be made by an eligible air carrier after September 10, 2001, and before January 15, 2002, shall be treated for purposes of the Code as timely made if the deposit is made on or before January 15, 2002.

In addition, under the authority granted the Secretary in § 6071 of the Code, the Service and Treasury Department will issue regulations changing the due date of certain returns filed by eligible air carriers. Under these regulations, an eligible air carrier's Form 720, *Quarterly Federal Excise Tax Return*, for the third calendar quarter of 2001 will be due by January 15, 2002. Consequently, the time for paying the air transportation excise taxes shown or required to be shown on the return also will be deferred. Under § 6151 of the Code, an eligible air carrier will be required to pay such taxes for the third calendar quarter of 2001 by January 15, 2002.

Eligible air carriers that believe that they are entitled to relief under this notice should mark "Notice 2001–77" in red ink at the top of their return and other documents submitted to the IRS.

The principal author of this notice is Susan Athy of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, please contact Ms. Athy at (202) 622–3130 (not a toll-free call).

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## Disaster Relief Distributions by Charities to Victims of September 11, 2001, Terrorist Attacks

## Notice 2001–78

Several charities have raised questions about the practical application of existing legal standards for distributing funds to victims of the September 11, 2001, terrorist attacks against the United States. The Internal Revenue Service recognizes the unique circumstances caused by this tragedy and wishes to alleviate concerns that might otherwise delay relief to victims.

Congress is considering clarifying legislation in this area. While Congress is considering legislation, the Service recognizes the need to provide interim guidance to charities regarding payments made by reason of the death, injury, or wounding of an individual incurred as a result of the September 11, 2001, terrorist attacks against the United States. Accordingly, the Service will treat such payments made by a charity to individuals and their families as related to the charity's exempt purpose provided that the payments are made in good faith using objective standards.

This administrative treatment will continue to apply to any payments made to such individuals before the earlier of final legislative action addressing these issues or December 31, 2002. The Service will consider what, if any, additional guidance is needed in this area.

Organizations that have questions concerning this notice may contact Marvin Friedlander at (202) 283–2300 (not a toll-free number).

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## Rent Holidays for Qualified Aircraft Leases

## Notice 2001–79

PURPOSE

This notice provides tax relief under § 467 of the Internal Revenue Code for certain aircraft leases entered into or modified during the period beginning on September 11, 2001, and ending on June 28, 2002. On September 11, 2001, terrorists used commercial airliners to damage the Pentagon and to destroy the two World Trade Center towers and other buildings in the World Trade Center complex. They also caused the crash of a commercial airliner in Pennsylvania. In response to dislocations in the aviation industry resulting from these attacks, the Air Transportation Safety and System Stabilization Act (the Act), Pub. L. No. 107–42, established a loan guarantee program for air carriers. The purpose of the program is to assist air carriers who suffered losses due to the terrorist attacks and to whom credit is not otherwise reasonably available, in order to facilitate a safe, efficient, and viable commercial aviation system. Office of Management and Budget regulations implementing the loan guarantee program provide that applications to be included in the program must be received on or before June 28, 2002. The regulations specify a number of factors to be considered in evaluating applications, including whether the applicant's creditors have made concessions that will improve the financial condition of the applicant in a manner that will enable the applicant to repay its Federally guaranteed loan and provide commercial air service on a financially sound basis after repayment.

The Internal Revenue Service has determined that it is appropriate, for the period beginning on September 11, 2001, and ending on June 28, 2002, to modify the manner in which the regulations under § 467 are applied so as not to inhibit the ability of lessors to provide favorable financing terms to air carriers.

BACKGROUND

Section 467(a) provides that in the case of a lessor or lessee under any § 467 rental agreement, there shall be taken into account for any taxable year the sum of (1) the amount of rent that accrues during such taxable year as determined under § 467(b), and (2) the interest for the year on unpaid amounts taken into account as rent or interest on rent for prior taxable years. Under § 467(b)(2), constant rental accrual applies in the case of any rental agreement that is a disqualified leaseback or long-term agreement. Section 467(b)(4) provides that an agreement is a leaseback if it is part of a leaseback transaction, or a long-term agreement if it is for a term in excess of 75 percent of the statutory recovery period for the property.

Section 1.467–3 of the Income Tax Regulations provides that a leaseback or long-term agreement will not be subject to constant rental accrual unless (1) a principal purpose for providing increasing or decreasing rents is the avoidance of tax and (2) the Commissioner determines that, because of the tax avoidance purpose, the agreement should be treated as a disqualified leaseback or long-term agreement. Under § 1.467–3(a), the Commissioner has the authority to determine, either on a case-by-case basis or in published guidance relating to a certain type or class of agreements, whether an agreement is disqualified and thus subject to constant rental accrual.

Under § 1.467–3(c)(4), tax avoidance will not be considered to be a principal purpose for providing increasing or decreasing rents if the annualized rents allocable to each calendar year of the rental agreement do not vary from the average annual rents over the entire lease term by more than 10 percent (the uneven rent test). If this test is met, the leaseback or long-term agreement will not be considered disqualified and will not be subject to constant rental accrual. In applying the uneven rent test, certain rent holiday periods are ignored.

GRANT OF RELIEF

In the case of a qualified aircraft lease that does not meet the uneven rent test and is entered into after September 10, 2001, and before June 29, 2002, the Commissioner, under the authority set forth in § 1.467–3(a), will not treat the agreement as a disqualified leaseback or long-term agreement if, disregarding one aviation stabilization rent holiday period and any rent allocated to such period, the agreement meets the test set forth in § 1.467–3(c)(4). For purposes of this notice—

> A rental agreement is a qualified aircraft lease if the lessee is an air carrier (within the meaning of 49 U.S.C. § 40102(a)(2)) and at least 90 percent of the property subject to the agreement (determined on the basis of fair market value as of the agreement date) consists of aircraft (within the meaning of 49 U.S.C. § 40102(a)(6)) and replacement components; and
>
> An aviation stabilization rent holiday period is a consecutive period that meets the following conditions: (1) the period does not exceed six months; (2) the period ends before January 1, 2003; and (3) annualized fixed rent during the period (determined by treating such period as a rental period for purposes of § 1.467–1(j)(3)) is less than the average rent allocated to all calendar years in the lease term (determined by taking into account the rent allocated to the rent holiday period).

If a substantial modification of a rental agreement occurs after September 10, 2001, and before June 29, 2002, and the post-modification agreement is a qualified aircraft lease, the relief granted in this notice applies to the post-modification agreement. For this purpose, a modification is treated as a substantial modification if the agreement (as in effect before its modification) meets the test set forth in § 1.467–3(c)(4) and the entire agreement (as modified) does not meet that test.

The relief granted in this notice does not affect whether an agreement (as in effect before its modification) is a disqualified leaseback or long-term agreement, and, if so, whether the carryover rule set forth in § 1.467–1(f)(4)(iii) applies.

The principal author of this notice is Forest Boone of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Mr. Boone at 202-622-4960 (not a toll-free call).

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*26 CFR 601.201: Rulings and determination letters. (Also Part I, §§ 851(b)(3), 852(b)(5), 853(a); 1.851–2, 1.853–1)*

## Rev. Proc. 2001–57

SECTION 1. PURPOSE

This revenue procedure sets forth conditions under which a regulated investment company (RIC) that holds a partnership interest is treated for certain purposes as if it directly invested in the assets held by the partnership. This revenue procedure applies to an affected taxpayer for purposes of qualifying as a RIC under section 851(b)(3), for purposes of the payment of exempt-interest dividends under section 852(b)(5), and for purposes of the passthrough of the foreign tax credit under section 853.

SECTION 2. BACKGROUND

.01 The Internal Revenue Service responds to a large number of letter ruling requests from RICs that hold partnership interests in master-feeder structures. In order to save these taxpayers the time and expense involved in obtaining a ruling, the Service is issuing this revenue procedure.

.02 In a typical master-feeder structure, a domestic corporation (Feeder Fund) invests substantially all its assets in an investment partnership (Master Partnership). Some Feeder Funds may invest in more than one Master Partnership. A Feeder Fund is registered as an open-end management investment company under the Investment Company Act of 1940 (the

1940 Act), 15 U.S.C. 80a–1 *et seq.*, and elects to be treated as a RIC under subchapter M, part I, of the Code. A Master Partnership is registered as a management company under the 1940 Act.

.03. For purposes of determining its required distribution under § 4982(a) of the Code, a Feeder Fund accounts for its share of items of income, gain, loss, and deduction of the Master Partnership as they are taken into account by the Master Partnership. *See* Rev. Rul. 94–40 (1994–1 C.B. 274) modified by Rev. Rul. 94–40A (1994–1 C.B. 276) (requiring a RIC to include its share of partnership income on a current basis in calculating the required distribution to avoid excise tax liability under § 4982(a)(1) of the Code). *See also* Rev. Proc. 94–71 (1994–2 C.B. 810) (defining circumstances in which a RIC may apply the income inclusion timing rule of § 706 rather than the current inclusion rule of Rev. Rul. 94–40).

.04 A Feeder Fund commonly requests that the Internal Revenue Service rule that it will be deemed to own a proportionate share of each asset of the Master Partnership for purposes of determining whether it satisfies the requirements of §§ 851(b)(3), 852(b)(5), and 853 of the Code.

.05 Section 851(b) provides that certain requirements must be satisfied in order for a domestic corporation to be taxed as a RIC under subchapter M, part I, of the Code.

.06 Section 851(b)(2) provides that, in order to qualify as a RIC, at least 90 percent of a corporation's gross income must be derived from dividends, interest, payments with respect to securities loans (as defined in § 512(a)(5)), gains from the sale or other disposition of stocks, securities, foreign currencies, or other income derived with respect to its business of investing in such stocks, securities, or currencies.

.07 Section 851(b)(3)(A) requires that, in order for a corporation to qualify as a RIC, at the close of each quarter of the taxable year, at least 50 percent of the value of the corporation's total assets must be represented by cash and cash items (including receivables), Government securities, securities of other RICs, and other securities generally limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the total assets of the corporation and to not more than 10 percent of the outstanding voting securities of such issuer.

.08 Section 851(b)(3)(B) provides that, in order for a corporation to qualify as a RIC, not more than 25 percent of the corporation's total assets may be invested in the securities (other than Government securities and the securities of other RICs) of any one issuer, or of two or more issuers that the corporation controls and which are determined, under regulations, to be engaged in the same or similar trades or businesses or related trades or businesses.

.09 Section 852(b)(5) provides that, if at least 50 percent of the value (as defined in § 851(c)(4)) of a RIC's total assets at the close of each calendar quarter consists of obligations described in § 103(a), the RIC is eligible to pay exempt-interest dividends, which are treated by the RIC's shareholders as interest excludable from gross income pursuant to § 103(a).

.10 Section 853(a) provides that, if more than 50 percent of the value (as defined in § 851(c)(4)) of a RIC's total assets at the close of the taxable year consists of stock or securities in foreign corporations and if the RIC meets the requirements of § 852(a) for the taxable year, then, for purposes of determining a shareholder's foreign tax credit under § 901, the RIC may elect to treat its shareholders as if they had paid certain foreign taxes paid by the RIC.

.11 A RIC's allocable share of items of income, gain, loss, deduction, and credit of a partnership in which it holds an interest is determined under subchapter K of the Code. Section 702(a) provides that a partner, in determining his income tax, shall take into account separately his distributive share of such items as are set forth in that section. Section 702(b) provides that the character of items stated in § 702(a) that are included in a partner's distributive share shall be determined as if such items were realized directly from the source from which they were realized by the partnership, or incurred in the same manner as incurred by the partnership. Section 702(c) provides that, where it is necessary to determine the gross income of a partner, such amount shall include that partner's distributive share of the gross income of the partnership. A partner's distributive share of income, gain, loss, deduction, or credit is determined in accordance with the rules set forth in section 704.

.12 The flush language of § 851(b) states that income derived from a partnership or trust shall be treated as satisfying the 90 percent requirement of § 851(b)(2) only to the extent that such income is attributable to items of income of the partnership or trust which would be described in § 851(b)(2) if earned directly by the RIC. The legislative history of that sentence indicates that it was intended to clarify the general rule used to characterize items of income, gain, loss, deduction, or credit includable in a partner's distributive share, as applied to RICs that are partners. It therefore explains the relationship of § 702 to the 90 percent test under § 851(b)(2). *See* S. Rep. No. 445, 100th Cong., 2d Sess. 93 (1988).

## SECTION 3. SCOPE

This revenue procedure applies to a domestic corporation that meets the following requirements:

.01 It is registered as an open-end management investment company under the 1940 Act and elects to be treated as a RIC under subchapter M, part I, of the Code.

.02 It is a publicly offered RIC as defined in § 67(c)(2)(B) of the Code and § 1.67–2T(g)(3)(iii) of the regulations.

.03 It invests substantially all its assets in one or more Master Partnerships that are registered as management companies under the 1940 Act.

.04 Except as required by § 1.704–3 of the regulations, its allocable share of each item of the Master Partnership's income, gain, loss, deduction, and credit is proportionate to its percentage of ownership of the capital interests in the Master Partnership.

## SECTION 4. PROCEDURE

For purposes of qualifying as a RIC under section 851(b)(3), for purposes of the payment of exempt-interest dividends under section 852(b)(5), and for purposes of the passthrough of the foreign tax credit under section 853, a domestic corporation meeting the requirements of Section 3 of this procedure is treated as if it directly invested in the assets held by the Master Partnership in which it invests. For these purposes, its interest in Master Partnership assets is determined in accordance with its percentage of ownership of the capital interests in the Master Partnership.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for asset determinations that are made as of dates after December 10, 2001.

DRAFTING INFORMATION

The principal author of this revenue procedure is Susan Thompson Baker of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contact her at (202) 622–3940 (not a toll-free call).

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*26 CFR 601.104: Collection functions.*
*(Also Part I, sections 6302, 6656; 31.6302–1, 1.6302–2, 31.6302–2, 40.6302(c)–1, 40.6302(c)–2, 31.6302(c)–3, 40.6302(c)–3, 40.6302(c)–4)*

## Rev. Proc. 2001–58

SECTION 1. PURPOSE

This revenue procedure provides guidance with respect to the failure-to-deposit penalty provisions of section 6656 of the Internal Revenue Code (Code), as amended by section 3304(c) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat. 742 (1998) (RRA). This revenue procedure describes how the Service will credit Federal tax deposits to determine whether a failure-to-deposit penalty under section 6656 should apply to deposit periods beginning after December 31, 2001. This revenue procedure applies only with respect to situations in which deposits have not been made in sufficient amounts to satisfy the cumulative deposit obligations as of at least one deposit due date.

SECTION 2. BACKGROUND

.01 Section 6656 of the Code provides that in the case of any failure by any person to deposit (as required by the Code or regulations) on the date prescribed any amount of tax in a government depository, there will be imposed upon such person a penalty equal to the applicable percentage of the amount of the underpayment, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The applicable percentage ranges from 2 to 15 percent depending upon the lateness of the deposit.

.02 Rev. Proc. 90–58 (1990–2 C.B. 642) effective for deposit periods beginning after March 31, 1991, provided that the Service will apply deposits for a specified tax period in a date-made order against deposit liabilities in a due-date order. Thus, the Service applies a deposit first to satisfy the oldest past due deposit liability within the specified tax period. The Service applies other credits to the taxpayer's account, such as overpayments from previous tax periods, in a similar fashion. Rev. Proc. 91–52 (1991–2 C.B 781) clarified and amplified the provisions relating to the application of other credits to taxpayer accounts.

.03 Under Rev. Proc. 90–58, the oldest deposit liability in the specified tax period is satisfied first, thus preventing the penalty rate on that liability from escalating. If, however, a depositor inadvertently missed a single deposit early in a specified tax period, multiple cascading penalties could result as payments that would otherwise be sufficient to satisfy current liabilities were applied to satisfy earlier shortfalls.

.04 Notice 98–14 (1998–1 C.B. 585) provided interim procedures that depositors may use to request abatement of the failure-to-deposit penalty imposed by section 6656 when the order in which the Service applies deposits against deposit liabilities, as set forth in Rev. Proc. 90–58, produces multiple failure-to-deposit penalties as a result of a single failure to deposit. Under that Notice, depositors that wish to request relief are instructed to call the toll-free number shown on the penalty notice. Notice 98–14 applies to return periods beginning after December 31, 1997.

.05 Section 3304(a) of RRA added subsection (e) to section 6656 of the Code, which permits a depositor receiving a penalty notice (with respect to any deposit of tax made for a specific tax return period) to designate, during the 90–day period beginning on the date of the penalty notice, the deposit period or periods within the specified tax period to which a deposit of tax shall apply. Section 3304(d)(1) of RRA provides that section 6656(e) is effective for Federal tax deposits required to be made after January 18, 1999 (180 days after the July 22, 1998, enactment of RRA).

.06 Rev. Proc. 99–10 (1999–1 C.B. 272) provided procedures for implementing section 6656(e) of the Code as added by RRA section 3304(a). In particular, Rev. Proc. 99–10 provided guidance on how a depositor may designate the application of its Federal tax deposits for a specified tax period to minimize the failure-to-deposit penalty under section 6656 with respect to deposits required to be made after January 18, 1999.

.07 Section 6656(e)(1) of the Code (as added by section 3304(a) of RRA) was amended by section 3304(c) of RRA to provide that a deposit shall be applied to the most recent period or periods within the specified tax period to which the deposit relates, unless the person making such deposit designates a different period or periods to which such deposit is to be applied. Section 3304(d)(2) of RRA provides that this amendment is effective for Federal tax deposits required to be made after December 31, 2001.

SECTION 3. SCOPE

This procedure will apply with respect to all taxes required to be deposited under section 6302 of the Code and underlying regulations that are reported on the following Internal Revenue Service forms:

Form 720, *Quarterly Federal Excise Tax Return*

Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*

Form 941, *Employer's Quarterly Federal Tax Return*

Form 943, *Employer's Annual Tax Return for Agricultural Employees*

Form 945, *Annual Return of Withheld Federal Income Tax*

Form CT-1, *Employer's Annual Railroad Retirement Tax Return*

Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*

SECTION 4. APPLICATION

.01 Except as otherwise provided in this revenue procedure, the Service will apply Federal tax deposits for deposit periods beginning after December 31, 2001, to the most recently ended deposit period or periods within the specified tax period to which the deposit relates and will apply any excess to deposit periods ending on or after the date of the deposit in period-ending-date order. The application of deposits to the most recently ended deposit period will, in some cases, prevent the cascading of penalties where a depositor either fails to make deposits or makes late deposits.

.02 Any depositor to whom the Service mails a penalty notice for a specified tax period beginning after December 31, 2001, may, within 90 days of the date of the penalty notice, contact the Service and designate the deposit period, or periods, within such specified tax period to which the deposit(s) of, or credit(s) against, the tax for the tax period are to be applied. The depositor may either call the toll-free number shown on the penalty notice or write (including a revised schedule of deposits) to the Accounts Management Unit at the address of the IRS's Account Management site shown on the penalty notice. The Service will adjust the penalty amount to reflect the revised schedule of deposits and notify the taxpayer of the adjustment in writing.

.03 Under certain circumstances, employers may deposit employment taxes under the "safe harbor" rule of section 31.6302–1(f) of the Employment Taxes and Collection of Income Tax at the Source Regulations. Under circumstances in which this rule applies, the Service considers a depositor to have satisfied its deposit obligations even if there is a shortfall in the amount of taxes required to be deposited for a deposit period. For purposes of this revenue procedure, a shortfall will be treated as a liability for a deposit period (the make-up period) ending immediately before the shortfall make-up date and after the end of any other deposit period ending before the shortfall make-up date. Thus, if a shortfall make-up date falls on the same date a deposit is due for another deposit period, the Service will apply a deposit made on the shortfall make-up date to the shortfall liability first. Any excess will then be applied to deposit periods other than the make-up period beginning with the most recently ended of such other periods. If a deposit is made before the shortfall make-up date but after the end of a deposit period for which the deposit obligation has not been satisfied, the Service will apply the deposit to the liability for that deposit period first before applying any excess to the shortfall. Similar rules apply with regard to withheld income taxes by agents withholding from nonresident aliens and foreign corporations under section 1.6302–2(a)(1)(ii) of the Income Tax Regulations. Under sections 40.6302(c)–1, 40.6302(c)–2, 40.6302(c)–3, and 40.6302(c)–4 of the Excise Tax Procedural Regulations, depositors of excise taxes reportable on Form 720 also are eligible to use certain safe harbor rules. Because the safe harbor underdeposits are satisfied by later payments, rather than later deposits, no special rule regarding the application of deposits is needed with respect to satisfaction of the safe harbor underdeposits. The rule for employment taxes is illustrated in section 5.04 of this revenue procedure.

.04 Under section 31.6302–1(c)(3) of the regulations, a depositor that has accumulated $100,000 or more of employment taxes must deposit those taxes by the close of the next banking day. For purposes of applying the rules of this revenue procedure, the deposit required by section 31.6302–1(c)(3) is treated as a liability for a deposit period ending on the day in which the depositor accumulates in excess of $100,000 in employment taxes.

SECTION 5. EXAMPLES

.01 *Example 1—Elimination of Cascading Penalty for Insufficient Timely Deposit.*

The following employment tax example illustrates how the Service will apply deposits to the most recently ended deposit period. This ordering rule is similarly applicable to deposits under section 6302 of railroad retirement taxes, FUTA taxes, excise taxes, and income tax withheld from nonresident aliens and foreign corporations.

For the second calendar quarter of 2002, A, a semi-weekly employment tax depositor within the meaning of section 31.6302–1 of the regulations, accumulates the following employment tax deposit liabilities for its bi-weekly pay dates, and makes the following deposits on the deposit due dates:

| Deposit Due Date | Required Deposit | Actual Deposit |
|---|---|---|
| 04/17/02 | $ 8,000 | $ 6,000 |
| 05/01/02 | $ 6,000 | $ 6,000 |
| 05/15/02 | $ 5,000 | $ 5,000 |
| 05/30/02 | $ 7,000 | $ 7,000 |
| 06/12/02 | $ 8,000 | $ 7,000 |
| 06/26/02 | $ 9,000 | $ 9,000 |

During July 2002, A completes its Form 941 for the second quarter and discovers the April 17, 2002, and June 12, 2002, underdeposits. On July 31, 2002, the due date for the Form 941, A files the Form 941 and deposits $3,000. The Service applies the deposits actually made to the most recently ended deposit periods. The Service then mails a notice to A dated October 21, 2002, advising that A is subject to the failure-to-deposit penalty in the amount of $300. The penalty is calculated as follows:

| Deposit Due Date | Underdeposits | Days Late | Penalty Rate | Penalty Amount |
|---|---|---|---|---|
| 04/17/02 | $ 2,000 | 105 | 10% | $ 200 |
| 05/01/02 | $ 0 | 0 | N/A | $ 0 |
| 05/15/02 | $ 0 | 0 | N/A | $ 0 |
| 05/30/02 | $ 0 | 0 | N/A | $ 0 |
| 06/12/02 | $ 1,000 | 49 | 10% | $ 100 |
| 06/26/02 | $ 0 | 0 | N/A | $ 0 |
| TOTAL | | | | $ 300 |

A would have 90 days from October 21, 2002, in which to call the toll-free number on the notice, or write the Accounts Management Unit at the appropriate IRS Service Center, and designate the deposit period, or periods, within the specified tax period to which the deposits are to be applied. In this case, however, the manner in which the Service applied the deposits avoids cascading penalties and minimizes the failure-to-deposit penalty for the quarter.

.02 *Example 2—Cascading Penalty Under Section 6656(e).*

This example will show how the application of deposits to the most recently ended deposit period will not always eliminate cascading penalties. For the second calendar quarter of 2002, B, a monthly employment tax depositor within the meaning of section 31.6302–1 of the regulations, pays its employees on the first of every month. Instead of waiting until the 15th day of the following month to make its deposits, B normally makes deposits on the 25th (or next banking day thereafter) of each month in which the liability is incurred. B pays its employees on April 1, 2002. For some reason, B fails to make the deposit on April 25, 2002. For May, B pays its employees on May 1, 2002. On May 28, 2002 (the first banking day after Saturday, May 25, 2002), unaware of the underdeposit for April, B makes a deposit to cover its May liability. The Service applies this deposit to the most recently ended deposit period, which in this case is April 2002, instead of the May 2002 liability as intended by B. This cycle of deposits continues until the end of the quarter. Instead of having a failure-to-deposit penalty only for April, B will be subject to a penalty for every month in the quarter. B can, however, minimize cascading penalties and reduce the penalty amount by timely following the procedures in section 4.02 of this revenue procedure and designating May and June as the deposit periods to which the deposits are to be applied.

.03 *Example 3—Elimination of Cascading Penalty for Late Deposits.*

This example will show how the application of deposits to the most recently ended deposit period or periods will affect the calculation of the failure-to-deposit penalty in situations where the depositor is late in making some or all of its deposits. For the second calendar quarter of 2002, C, a semi-weekly employment tax depositor, pays its employees every Friday. C accumulates $10,000 in employment tax deposit liability for each of its weekly pay dates.

The table below shows the deposit period ending date and due date for C's deposits. It also shows the date of each deposit and the deposit period to which it is applied under section 6656(e) of the Code. The table shows how, under section 6656(e) and this revenue procedure, the Service applies C's deposits to the most recently ended deposit period. Accordingly, under section 6656(e), the Service applies C's deposit of April 22, 2002, and subsequent deposits through June 24, 2002, to deposit liabilities for periods which have ended, but for which the due dates have not occurred. Applying deposits in this manner, C's deposit liability for the period ending April 12, 2002, is not satisfied until C makes its deposit of June 26, 2002. Nonetheless, applying the deposits to the most recently ended deposit period avoids cascading penalties and minimizes the failure-to-deposit penalty for the quarter.

| Deposit Period Ending Date | Due Date of Deposit | Date of Deposit that Service Applies to Deposit Period and Applicable Penalty under Section 6656(e) | |
|---|---|---|---|
| 04/05/02 | 04/10/02 | 04/10/02 | $ 0 |
| 04/12/02 | 04/17/02 | 06/26/02 | $ 1,000 |
| 04/19/02 | 04/24/02 | 04/22/02 | $ 0 |
| 04/26/02 | 05/01/02 | 04/29/02 | $ 0 |
| 05/03/02 | 05/08/02 | 05/06/02 | $ 0 |
| 05/10/02 | 05/15/02 | 05/13/02 | $ 0 |
| 05/17/02 | 05/22/02 | 05/20/02 | $ 0 |
| 05/24/02 | 05/30/02 | 05/27/02 | $ 0 |
| 05/31/02 | 06/05/02 | 06/03/02 | $ 0 |
| 06/07/02 | 06/12/02 | 06/10/02 | $ 0 |
| 06/14/02 | 06/19/02 | 06/17/02 | $ 0 |

| Deposit Period Ending Date | Due Date of Deposit | Date of Deposit that Service Applies to Deposit Period and Applicable Penalty under Section 6656(e) | |
|---|---|---|---|
| 06/21/02 | 06/26/02 | 06/24/02 | $ 0 |
| 06/28/02 | 07/03/02 | 07/03/02 | $ 0 |
| TOTAL | PENALTY | | $ 1,000 |

.04 *Example 4—Safe Harbor Deposits.*

(1) *Facts.* This example will show how the application of employment tax deposits to the most recently ended deposit period or periods will be accomplished in situations where the depositor is also making a deposit by the shortfall make-up date in order to qualify for the safe harbor in section 31.6302–1(f) of the regulations. For the second calendar quarter of 2002, D, a semi-weekly employment tax depositor, pays its employees every Friday. D accumulates $10,000 in employment tax deposit liability for each of its weekly pay dates. D makes timely deposits of employment taxes in the amount of $9,800 on April 10, 17, and 24, 2002. Under section 31.6302–1(f), D must make a deposit of $600 by the shortfall make-up date, May 15, 2002. D also must make a deposit of employment taxes for the deposit period May 8–10, 2002, on or before May 15, 2002.

(2) *Deposit made on shortfall make-up date.* D deposits $9,800 on May 1 and May 8, 2002, and $10,200 on May 15, 2002. The May 1 deposit is applied to the deposit period April 24–26, 2002, and the May 8 deposit is applied to the deposit period May 1–3, 2002. Because the May 15 deposit is made on the shortfall make-up date, under section 4.03 of this revenue procedure, the Service first applies $600 to the shortfall liability for April. Accordingly, D has satisfied section 31.6302–1(f) of the regulations for the three deposits in April and owes no penalty with respect to those deposits. The Service applies the remaining $9,600 to the deposit period ending May 10, 2002, leaving an underdeposit of $400. As this amount is greater than 2 percent of the deposit liability, D will not satisfy section 31.6302–1(f), and will be subject to the failure-to-deposit penalty. The amount of the penalty will depend on when D satisfies the underdeposit.

(3) *Deposit made prior to shortfall make-up date*. Instead of making the deposit on May 15, 2002, as in (2) above, D makes the $10,200 deposit on May 14, 2002. Because the deposit is made prior to the shortfall make-up date, under section 4.03 of this revenue procedure, the Service first applies $10,000 to the deposit liability for the deposit period ending May 10, 2002. This liability is fully satisfied. The Service applies the remaining $200 to satisfy the remainder of the deposit liability for the deposit period ending May 3, 2002. D will not satisfy section 31.6302–1(f) of the regulations for the three deposits in April, and will be subject to the failure-to-deposit penalty. The amount of the penalty will depend on when D satisfies the underdeposits.

(4) *Designation*. In either situation described in this example, D may timely contact the Service under the procedures in section 4.02 of this revenue procedure and designate the deposit periods (including the make-up period) to which the deposits are to be applied.

.05 *Example 5—Deposits Made Under the One-Day Rule.*

This example will show how the application of deposits to the most recently ended deposit period or periods will be accomplished in situations where the depositor becomes subject to the one-day rule of section 31.6302–1(c)(3) of the regulations. For the second calendar quarter of 2002, E, a semi-weekly employment tax depositor, makes a timely deposit of employment taxes on April 10, 2002, for the deposit period April 3, 2002, through April 5, 2002. On Monday, April 8, 2002, E accumulates $110,000 in employment taxes with respect to wages paid on that date. Under section 31.6302–1(c)(3), E deposits those taxes by the end of the next business day, April 9, 2002. Under this revenue procedure, the deposit required by section 31.6302–1(c)(3) is treated as a liability for a deposit period ending on the day in which E accumulates in excess of $100,000 in employment taxes. Accordingly, the Service applies E's deposit on April 9, 2002, to the one-day deposit liability for the deposit period ending April 8, 2002. E's deposit on April 10, 2002, is then applied to the liability for the deposit period ending April 5, 2002.

## SECTION 6. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 99–10 is obsoleted with respect to federal tax deposit periods beginning after December 31, 2001. Rev. Proc. 99–10 continues to apply to deposits that are required to be made after January 18, 1999, and relate to deposit periods ending on and before December 31, 2001.

.02 Notice 98–14 continues to apply to deposits required to be made on or before January 18, 1999, with respect to return periods beginning after December 31, 1997.

.03 Rev. Proc. 90–58 and Rev. Proc. 91–52 are obsoleted.

## SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for federal tax deposit periods beginning after December 31, 2001.

## SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Charles A. Hall of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this revenue procedure, contact Charles A. Hall at (202) 622–4940 (not a toll-free call).

# Part IV. Items of General Interest

## Additional Notice Explaining the Saver's Tax Credit for Contributions by Individuals to Employer Retirement Plans and IRAs

## Announcement 2001–120

This announcement provides a notice in Spanish that employers can use to inform Spanish-speaking employees of the new saver's credit available to eligible employees beginning next year. Previously, in Announcement 2001–106 (2001–44 I.R.B. 416) the Internal Revenue Service published a series of questions and answers concerning the saver's credit. That announcement also provided a notice to employees in English.

Employers are encouraged to tell their employees about the credit. Employers can inform employees in any way they choose, including use of the notice set out below.

**Notificación para los empleados sobre el Crédito de Ahorro**

En esta notificación se le explica cómo podría usted pagar menos impuestos contribuyendo a [insert name of employer's plan/inserte el nombre del plan proporcionado por el empleador o patrono] (en adelante denominado el "Plan") o a un plan de ahorro para la jubilación (en adelante denominado "IRA").

A partir del 2002, si usted hace contribuciones al Plan o a una cuenta IRA, podrá reclamar un crédito tributario llamado "crédito de ahorro". Este crédito podría reducir el impuesto federal sobre el ingreso que usted paga dólar por dólar. La cuantía del crédito que usted puede obtener se basará en las contribuciones que haga y en su tasa de crédito correspondiente. Esta tasa puede variar desde un mínimo del 10% hasta un máximo del 50%, dependiendo de su ingreso bruto ajustado, o sea, que cuanto más bajo sea su ingreso tanto más alta será su tasa de crédito. La tasa de crédito depende también de su estado civil para efectos de la declaración. Véase la tabla que aparece al final de esta notificación para calcular su tasa de crédito.

La contribución máxima que se puede hacer para el crédito para un individuo es de $2,000. Si usted es casado que presenta una declaración conjunta, la contribución máxima que usted y su cónyuge pueden hacer para el crédito es de $2,000 cada uno.

Usted puede obtener este crédito si reúne los requisitos siguientes:

- Ha cumplido los 18 años de edad.
- No es un estudiante a tiempo completo.
- No es reclamado como dependiente en la declaración de otro.
- Tiene un ingreso bruto ajustado (indicado en su declaración de impuesto para el año del crédito) que no excede de:

$50,000, si es casado que presenta una declaración conjunta;
$37,500 si es cabeza de familia con una persona calificada;
$25,000 si es soltero o casado que presenta una declaración separada.

**Ejemplo:** Susana y Juan están casados y presentan una declaración conjunta del impuesto federal sobre el ingreso. Para el 2002, su ingreso bruto ajustado habría sido $34,000 si no hubieran hecho ninguna contribución para su jubilación. En el año 2002, Susana decidió hacer una contribución de $2,000 a su plan 401(k). Juan hizo una contribución deducible de $2,000 a una cuenta IRA para el año 2002. Debido a estas contribuciones su ingreso bruto ajustado para el 2002 será de $30,000. Si su impuesto federal sobre el ingreso hubiera sido $3,000 (después de aplicar cualquier otro crédito al que tuvieran derecho) sin haber hecho ninguna contribución para la jubilación, entonces su impuesto federal sobre el ingreso como resultado de haber hecho contribuciones a la jubilación por un total de $4,000 sería solamente de $400 después de aplicar el crédito de ahorro y otros beneficios tributarios aplicables a las contribuciones para la jubilación. Por lo tanto, al poner $4,000 para su jubilación, Susana y Juan han reducido también su impuesto en $2,600.

De la contribución anual que puede hacerse para el crédito habrá que deducir cualquier distribución tributable de un plan de jubilación o de una cuenta IRA que usted o su cónyuge reciba durante el año en que usted reclame el crédito, durante los 2 años precedentes o durante el período después de finalizar el año para el que usted reclame el crédito o antes del plazo establecido para presentar su declaración para ese año. Una distribución de una cuenta IRA Roth que no sea una reinversión se tendrá en cuenta para esta deducción, aunque la distribución no sea tributable. Después de estas deducciones, la contribución anual máxima que puede hacerse para el crédito por persona es de $2,000.

**Ejemplo:** El ingreso bruto ajustado de Marco para el 2002 es lo suficientemente bajo como para poder reclamar el crédito ese año y él difiere $3,000 de su paga para su plan 401(k) en el 2002. En el año 2001, Marco hizo un retiro por dificultades excepcionales de $400 de su plan patronal y en el 2002 hace un retiro de $800 de su cuenta IRA. El crédito de ahorro para el 2002 de Marco se basará en las contribuciones de $1,800 ($3,000 – $400 – $800).

La cantidad de su crédito de ahorro no cambiará la cantidad de sus créditos tributarios reembolsables. Un crédito tributario reembolsable, como el crédito por ingreso del trabajo o la cantidad reembolsable de su crédito tributario por hijos, es una cantidad que usted recibiría como un reembolso, aún en el caso de que no debiera ningún impuesto.

La cantidad de su crédito de ahorro en cualquier año no puede exceder de la cantidad del impuesto que de otro modo usted tendría que pagar (sin incluir cualquier otro crédito reembolsable o el crédito por gastos de adopción) en cualquier año. Si su impuesto debido se reduce a cero debido a otros créditos reembolsables, tales como el Crédito Hope, entonces usted no tendrá derecho al crédito de ahorro.

**TASAS DE CRÉDITO**

| | |
|---|---|
| Si su estado civil para efectos de la declaración es “casado que presenta una declaración conjunta” y su ingreso bruto ajustado es: | Su tasa de crédito será: |
| $0–$30,000 | 50% de la contribución |
| $30,001–$32,500 | 20% de la contribución |
| $32,501–$50,000 | 10% de la contribución |
| Más de $50,000 | Crédito no disponible |
| Si su estado civil para efectos de la declaración es “cabeza de familia” y su ingreso bruto ajustado es: | Su tasa de crédito será: |
| $0–$22,500 | 50% de la contribución |
| $22,501–$24,375 | 20% de la contribución |
| $24,376–$37,500 | 10% de la contribución |
| Más de $37,500 | Crédito no disponible |
| Si su estado civil para efectos de la declaración es “soltero”, “casado que presenta una declaración separada” o “viudo(a) calificado(a) y su ingreso bruto ajustado es: | Su tasa de crédito será: |
| $0–$15,000 | 50% de la contribución |
| $15,001–$16,250 | 20% de la contribución |
| $16,251–$25,000 | 10% de la contribución |
| Más de $25,000 | Crédito no disponible |

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## Withdrawal of Proposed Regulations Relating to Certain Corporate Reorganizations Involving Disregarded Entities

## Announcement 2001–121

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws a notice of proposed rulemaking (REG–106186–98, 2000–23 I.R.B. 1226) relating to certain corporate reorganizations involving disregarded entities. The proposed regulations were published in the **Federal Register** on May 16, 2000. After consideration of the comments received, the IRS and Treasury have decided to withdraw the proposed regulations and issue new proposed regulations.

DATES: These proposed regulations are withdrawn November 15, 2001.

FOR FURTHER INFORMATION CONTACT: Reginald Mombrun (202) 622–7750 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

**Background**

On May 16, 2000, the IRS issued proposed regulations relating to certain corporate reorganizations involving disregarded entities (65 FR 31115). After consideration of comments received on the proposed regulations, the IRS and Treasury have decided to issue new proposed regulations on this matter. Accordingly, the proposed regulations published on May 16, 2000, are withdrawn.

**Drafting Information**

The principal author of this withdrawal announcement is Reginald Mombrun of the Office of the Associate Chief Counsel (Corporate).

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**Withdrawal of Notices of Proposed Rulemaking**

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking published in the **Federal Register** on May 16, 2000 (65 FR 31115), is hereby withdrawn.

Robert E. Wenzel,
*Deputy Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on November 14, 2001, 8:45 a.m., and published in the issue of the Federal Register for November 15, 2001, 66 F.R. 57400)

## Section 166.— Bad Debts

*26 CFR 1.166–2: Evidence of worthlessness.*

**Bank bad debts; clarification of the conformity method.** A bank has classified loans as loss assets under the conformity election if the loans are charged off pursuant to a board of director's resolution authorizing the charge-offs only if required under regulatory standards. Also, the conclusive presumption of worthlessness under the conformity election applies to loans erroneously charged off for regulatory purposes, if the bank's charge-offs are not substantially in excess of those warranted by reasonable business judgment.

## Rev. Rul. 2001–59

ISSUES

1. What steps are necessary to record or memorialize the assignment of a loan (or loan portion) as a "loss asset" for purposes of the conformity method of accounting for worthless bad debts?

2. Does the conclusive presumption of worthlessness under the conformity method apply to loans erroneously classified as loss assets?

FACTS

*ABC* corporation is a "bank" (as defined in § 1.166–2(d)(4)(i) of the Income Tax Regulations) and is subject to supervision by Federal authorities. *ABC* has elected under § 1.166–2(d)(3) to use the conformity method of accounting to determine when debts owed to *ABC* become worthless bad debts.

Under a resolution adopted by *ABC's* board of directors, *ABC's* officers and employees are authorized to charge off loans (or portions of loans) only when the charge-off is required under the loan loss classification standards issued by the bank's supervisory authority. Thus, when *ABC's* officers and employees charge off a loan for regulatory purposes, they do not take any additional steps to record or memorialize whether, in their judgment, the charge-off is required by the loan loss standards that have been issued by *ABC's* supervisory authority.

The loan loss standards require *ABC* to charge off "loss assets." Loss assets are loans (or portions of loans) determined to be uncollectible and of such little value that their continuance as bankable assets is not warranted. In the case of a consumer loan or credit card debt, regardless whether there is specific adverse information about the borrower, *ABC* is required to charge off the asset when its delinquency exceeds certain established thresholds. Thus, *ABC* must charge off installment loans that are 120 days, or five payments, past due and credit card debts that are 180 days past due after seven zero billings. In addition, if *ABC* receives specific adverse borrower information (for example, the borrower's death or bankruptcy) confirming a loss before the applicable 120 day or 180 day threshold date has passed, then an immediate charge-off is required. *See* Comptroller of the Currency, "Allowance for Loan and Lease Losses," *Comptroller's Handbook* 10, 19 (June 1996); "Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks," Attachment to Comptroller of the Currency Banking Circular No. 127, Rev. 4–26–91.

*ABC's* supervisory authority, in connection with its most recent examination of the bank's loan review process, made an express determination that *ABC* maintains and applies loan loss standards that are consistent with the regulatory standards issued by the Comptroller of the Currency.

During the taxable year ending on December 31, 2000, *ABC* charged off for regulatory purposes certain credit card debts that were not required to be charged off under applicable regulatory loan loss standards. Except for the erroneously charged off credit card debts, *ABC* charged off only loans required to be charged off under the loan loss standards.

On its Federal income tax return for 2000, *ABC* deducted as wholly worthless debts all assets that it had charged off for regulatory purposes, including the debts that had been erroneously charged off despite the absence of an applicable regulatory requirement. Even so, the total amount of worthless bad debts claimed on the return was not substantially in excess of the amount that would be warranted by the exercise of reasonable business judgment in applying the loan loss standards of *ABC's* supervisory authority.

LAW AND ANALYSIS

Section 166(a)(1) of the Internal Revenue Code allows a deduction for a debt that becomes worthless during the taxable year. In addition, § 166(a)(2) permits a deduction for "partially worthless debts" if the taxpayer charges off an appropriate amount on the taxpayer's books and records and the Internal Revenue Service is satisfied that the debt is recoverable only in part.

No precise test exists for determining whether a debt is worthless. In many situations, no single factor or identifiable event clearly demonstrates whether a debt has become worthless. Instead, a series of factors or events in the aggregate establishes whether the debt is worthless. Among the factors indicating worthlessness are: a debtor's serious financial reverses, insolvency, lack of assets, continued refusal to respond to demands for payment, ill health, death, disappearance, abandonment of business, and bankruptcy. Additionally, a debt's unsecured or subordinated status and expiration of the statute of limitations can provide an indication that the debt is worthless. Conversely, availability of collateral or third party guarantees, a debtor's earning capacity, payment of interest, a creditor's failure to press for payment, and a creditor's willingness to make further advances are factors suggesting that the debt is not worthless. Accordingly, § 1.166–2 of the regulations requires consideration of all pertinent evidence and provides that a deduction is warranted if the surrounding circumstances indicate that the debt is uncollectible and that legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment.

In the case of a "bank" (as defined in § 1.166–2(d)(4)(i) of the regulations) or other corporation subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, § 1.166–2(d)(1) provides administrative simplicity by creating a conclusive presumption of worthlessness for loans charged off in whole or in part in obedience to specific orders or in accordance with the established policies of those authorities.

Additional simplification is provided by § 1.166–2(d)(3) of the regulations for tax years ending on or after December 31, 1991. Under the regulation, a bank subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, may elect to use the conformity method of accounting to determine when a debt becomes worthless. Under the conformity method, a conclusive presumption of worthlessness applies to loans charged off, in whole or in part, for regulatory purposes if the charge-offs correspond to the bank's classification of the loans, in whole or in part, as loss assets under applicable regulatory standards. Section 1.166–2(d)(3)(ii)(A)(2) provides that a bad debt deduction is allowed for the taxable year in which a debt is conclusively presumed to have become worthless.

For the conclusive presumption of worthlessness to arise, a bank must satisfy the express determination requirement of § 1.166–2(d)(3)(iii)(D) of the regulations and must classify the loan, in whole or in part, as a loss asset as described in § 1.166–2(d)(3)(ii)(C). The express determination requirement is satisfied if the bank's supervisory authority, in connection with its most recent examination of the bank's loan review process, has made an express determination that the bank maintains and applies loan loss classification standards that are consistent with the authority's regulatory standards. *See* Rev. Proc. 92–84 (1992–2 C.B. 489) (providing the form for the determination letter). Section 1.166–2(d)(3)(ii)(C) defines the term "loss asset" as a debt that the bank has assigned to a class that corresponds to a loss asset classification under the standards set forth in the "Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks" or similar guidance issued by the bank's supervisory authority.

Various procedures can be used by a bank to classify loans (or loan portions) as loss assets. For example, an officer or employee may record or memorialize on a form the determination that a loan (or loan portion) is a loss asset. Loan or credit committee reports or internal credit rating reports also can demonstrate that a loan has been classified as a loss asset. Additionally, if officers and employees are authorized to charge off loans (or loan portions) only if the loans (or loan portions) are loss assets, then the charge-offs of the loans (or loan portions) demonstrate that the loans (or loan portions) have been classified as loss assets.

*ABC* has made the conformity election under § 1.166–2(d)(3) of the regulations and has satisfied the express determination requirement described in § 1.166–2(d)(3)(iii)(D). Additionally, under the resolution adopted by *ABC's* board of directors, *ABC's* officers and employees are authorized to charge off loans (or portions of thereof) only if the charge-offs are required under applicable loan loss standards issued by *ABC's* supervisory authority. Under these circumstances, *ABC's* charge-offs of certain loans (or loan portions) are sufficient to demonstrate classification of those loans (or loan portions) as loss assets under standards issued by *ABC's* supervisory authority.

Under § 1.166–2(d)(3)(ii) of the regulations, the conclusive presumption of worthlessness applies to loans charged off, in whole or in part, for regulatory purposes if the charge-off corresponds to the bank's classification of the loans, in whole or in part, as loss assets under applicable regulatory standards. Although the applicable loan loss regulatory standards did not require *ABC* to charge off certain credit card debts, the conclusive presumption of worthlessness attached to those debts when *ABC* erroneously charged off the debts for regulatory purposes.

Under § 1.166–2(d)(3)(iv)(D) of the regulations, if an electing bank fails to follow the conformity method of accounting to determine when debts become worthless, or if the bank's charge-offs are substantially in excess of those warranted by reasonable business judgment in applying the regulatory standards of the bank's supervisory authority, then the Commissioner may revoke the bank's election to use the conformity method. Under the facts described above, however, except for the erroneously charged off credit card debts, *ABC* properly used regulatory loan loss standards to determine its worthless bad debts and did not claim a deduction on its return for bad debts substantially in excess of the amount warranted by reasonable business judgment under the applicable regulatory standards. If the deduction claimed had been substantially in excess of that amount, the Commissioner could have revoked the conformity election.

## HOLDINGS

1. *ABC's* charge-offs of certain loans (or portions thereof), pursuant to a board of directors' resolution authorizing the charge-off of a loan (or portion thereof) only if the charge-off is required under applicable regulatory standards issued by the bank's supervisory authority, are sufficient to demonstrate classification of the loans (or loan portions) as loss assets for purposes of § 1.166–2(d)(3) of the regulations.

2. The conclusive presumption of worthlessness applies to the credit card debts that *ABC* erroneously charged off for regulatory purposes during the taxable year ending on December 31, 2000. *ABC*, on its 2000 income tax return, properly deducted the credit card debts as worthless bad debts.

## DRAFTING INFORMATION

The principal author of this revenue ruling is Craig Wojay of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Wojay at (202) 622–3920 (not a toll-free call).

## Section 167.— Depreciation

*26 CFR 1.167(a)–2: Tangible property.*
*(Also § 168.)*

**Golf course greens land preparation costs.** The costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of push-up or natural soil golf course greens are not depreciable, but the costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of modern golf course greens that is so closely associated with depreciable assets, such as a network of underground drainage tiles or pipes, that the land preparation will be retired, abandoned, or replaced contemporaneously with those depreciable assets are depreciable.

## Rev. Rul. 2001–60

ISSUE

Are land preparation costs incurred by a taxpayer in the original construction or reconstruction of golf course greens subject to an allowance for depreciation under § 167 of the Internal Revenue Code?

FACTS

Two types of golf course greens that are currently in use are "push-up" or natural soil greens and "modern" greens. Push-up or natural soil greens are essentially landscaping that involves some reshaping or regrading of the land. The soil is pushed up or reshaped to form the green. While push-up or natural soil greens may have limited irrigation systems (such as hoses and sprinklers adjacent to the greens), a subsurface drainage system is not utilized.

Modern greens make use of technological changes in green design and construction and contain sophisticated integrated drainage systems. The construction of the modern green occurs after the general earthmoving, grading, and initial shaping of the area surrounding and underneath the green. These greens are constructed with a network of subsurface drainage tiles or interconnected pipes, one or more layers of gravel and/or sand particles, a rootzone layer, and a variety of turfgrass. Over time, the modern green loses its effectiveness as a drainage system due to tile or pipe deterioration, or sediment blockage. Replacement of the subsurface drainage tiles or pipes requires excavation and replacement of the gravel layer, rootzone layer, and turfgrass above the tiles or pipes. The subsurface drainage tiles or pipes typically are replaced within 20 years.

LAW AND ANALYSIS

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion and wear and tear of property used in a trade or business or held for the production of income.

Section 1.167(a)–2 of the Income Tax Regulations provides that in the case of tangible property, the depreciation allowance applies only to that part of the property that is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence. The allowance does not apply to land apart from the improvements or physical development added to it.

The depreciation deduction provided by § 167(a) for tangible property placed in service after 1986 generally is determined under § 168. This section prescribes two methods of accounting for determining depreciation allowances: (1) the general depreciation system in § 168(a); and (2) the alternative depreciation system in § 168(g). Under either depreciation system, the depreciation deduction is computed by using a prescribed depreciation method, recovery period, and convention.

The applicable recovery period for purposes of § 168(a) or § 168(g) is determined by reference to class life. Section 168(i)(1) provides that the term "class life" means the class life (if any) that would be applicable with respect to any property as of January 1, 1986, under former § 167(m) as if it were in effect and the taxpayer had elected under that section. Prior to its revocation, § 167(m) provided that in the case of a taxpayer who elected the asset depreciation range system of depreciation, the depreciation deduction would be computed based on the class life prescribed by the Secretary that reasonably reflects the anticipated useful life of that class of property to the industry or other group.

Rev. Proc. 87–56 (1987–2 C.B. 674) sets forth the class lives of property that are necessary to compute the depreciation allowance under § 168. This revenue procedure establishes two broad categories of depreciable assets: (1) asset classes 00.11 through 00.4 that consist of specific assets used in all business activities; and (2) asset classes 01.1 through 80.0 that consist of assets used in specific business activities.

Asset class 00.3, Land Improvements, of Rev. Proc. 87–56 includes improvements directly to or added to land, whether the improvements are § 1245 or § 1250 property, provided the improvements are depreciable. Examples of these assets might include sidewalks, roads, canals, waterways, drainage facilities, sewers, wharves and docks, bridges, fences, landscaping, shrubbery, or radio and television transmitting towers. Assets included in asset class 00.3 have a recovery period of 15 years for purposes of § 168(a) and 20 years for purposes of § 168(g).

Rev. Rul. 55–290 (1955–1 C.B. 320) concludes that expenditures incurred by a taxpayer in the original construction of golf course greens are capital expenditures that are added to the original cost of the land and are not subject to an allowance for depreciation. The revenue ruling also concludes that subsequent operating expenses for sod, seed, soil, and other sundry maintenance are ordinary and necessary business expenses that are deductible from gross income for federal income tax purposes.

In *Edinboro Company v. United States*, 224 F. Supp. 301 (W.D.Pa. 1963), the court held that golf course improvements, such as greens, tees, fairways, and traps, were not depreciable under § 167(a) because they are not distinguishable from the land, which is molded and reshaped to form them, and, like the land, they have an unlimited useful life. The court concluded that "[a] golf course is primarily a landscaping proposition[, although] [o]ccasionally a green or a trap or bunker is altered or rebuilt." The taxpayer in *Edinboro* failed to demonstrate a determinable useful life of the golf course improvements, or that the improvements were subject to wear and tear, exhaustion, or obsolescence that could not be fully reversed by annual maintenance.

Although the depreciation allowance generally does not apply to land because land has no determinable useful life, land preparation may be depreciable if it is closely associated with depreciable assets so that it is possible to establish a determinable period over which the land preparation will be useful in a particular trade or business. A useful life for land preparation is established if it will be replaced contemporaneously with a related depreciable asset. Whether land preparation will be replaced contemporaneously with a related depreciable asset is a question of fact, but if the replacement of the asset will require the physical destruction of the land preparation, this test will be considered satisfied. Rev. Rul. 68–193 (1968–1 C.B. 79) clarifying Rev. Rul. 65–265 (1965–2 C.B. 52) (costs for a roadway grading that would be retired contemporaneously with a building are depreciable); Rev. Rul. 72–96 (1972–1 C.B. 66) (land preparation costs for a reservoir that would be retired contemporaneously with an electric generating plant are depreciable); Rev. Rul. 74–265 (1974–1 C.B. 56) (the cost of shrubbery immediately adjacent to apartment buildings is depreciable because the shrubbery would be retired contemporaneously with the buildings); Rev. Rul. 80–93 (1980–1 C.B. 50) (costs for excavation and backfilling that would be retired contemporaneously with laundry facilities and a storm sewer system are depreciable).

While § 168 determines the amount of the depreciation allowance provided by § 167(a) for tangible property placed in service generally after 1986, § 167 determines whether the tangible property is depreciable property. Under § 167 and the regulations thereunder, land is not depreciable. Similarly, the costs of general grading or shaping of land are not depreciable because the land preparation is inextricably associated with the land. However, if the land preparation is so closely associated with depreciable assets that it will be retired, abandoned, or replaced contemporaneously with those assets, a useful life for land preparation is established and, therefore, the cost of the land preparation is depreciable.

Push-up or natural soil greens are representative of the type of green commonly in use when Rev. Rul. 55–290 was issued and *Edinboro* was decided. Push-up or natural soil greens are essentially landscaping that involves some reshaping or regrading of the land. Accordingly, the Service will continue to follow the holdings in Rev. Rul. 55–290 and *Edinboro* with respect to push-up or natural soil greens.

Unlike push-up or natural soil greens, the modern green is a sophisticated improvement to the land carefully designed to facilitate drainage. Essential components of the modern green are the underground drainage tiles or interconnected pipes. Because these tiles or pipes deteriorate over time, they have a determinable useful life and, therefore, are depreciable. Asset class 00.3, Land Improvements, of Rev. Proc. 87–56, includes drainage facilities. The gravel layer, rootzone layer, and turfgrass above the network of underground drainage tiles or interconnected pipes are so closely associated with these tiles or pipes that replacement of the tiles or pipes will require the contemporaneous physical destruction of that land preparation. Thus, it is possible to establish a determinable useful life for the land preparation above the underground tiles and pipes.

HOLDINGS

Land preparation undertaken by a taxpayer in the original construction or reconstruction of push-up or natural soil greens is inextricably associated with the land and, therefore, the costs attributable to this land preparation are added to the taxpayer's cost basis in the land and are not depreciable.

The costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of modern greens that is so closely associated with depreciable assets, such as a network of underground drainage tiles or pipes, that the land preparation will be retired, abandoned, or replaced contemporaneously with those depreciable assets are to be capitalized and depreciated over the recovery period of the depreciable assets with which the land preparation is associated. For purposes of § 168, the modern green described above is includible in asset class 00.3, Land Improvements, of Rev. Proc. 87–56. However, the general earthmoving, grading, and initial shaping of the area surrounding and underneath the modern green that occur before the construction are inextricably associated with the land and, therefore, the costs attributable to this land preparation are added to the taxpayer's cost basis in the land and are not depreciable.

Subsequent operating expenses for sod, seed, soil, and other sundry maintenance are ordinary and necessary business expenses that are deductible from gross income for federal income tax purposes.

CHANGE IN METHOD OF ACCOUNTING

Any change in a taxpayer's treatment of the cost of modern greens to conform with this revenue ruling is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A taxpayer wanting to change the method of accounting for the cost of modern greens owned by the taxpayer at the beginning of the year of change to conform with this revenue ruling must follow the automatic change in method of accounting provisions in Rev. Proc. 99–49 (1999–2 C.B. 725) (or its successor), unless the scope limitations in section 4.02 of Rev. Proc. 99–49 apply.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 55–290 is modified and superseded. Rev. Proc. 99–49 is modified and amplified to include this accounting method change in the APPENDIX.

PROSPECTIVE APPLICATION

A taxpayer may continue to use its present method of treating the cost of modern greens placed in service during any taxable year beginning before November 29, 2001, as a nondepreciable capital expenditure.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mark Pitzer of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mark Pitzer at (202) 622–3110 (not a toll-free call).

## Section 168.— Accelerated Cost Recovery System

If the costs of land preparation undertaken by a taxpayer in the original construction or reconstruction of modern golf course greens are depreciable, what is the classification of these costs under § 168(e)(1) of the Internal Revenue Code? See Rev. Rul. 2001–60, page 587.

# Part III. Administrative, Procedural, and Miscellaneous

## Section 45D.— New Markets Tax Credit

## Notice 2001–75

PURPOSE

This notice clarifies that certain equity investments may be eligible for the new markets tax credit under § 45D of the Internal Revenue Code, notwithstanding that they are made before the receipt of a credit allocation from the Secretary of the Treasury under § 45D(f)(2).

BACKGROUND

Section 45D(a)(1) provides a new markets tax credit on certain credit allowance dates described in § 45D(a)(3) with respect to a qualified equity investment in a qualified community development entity (CDE).

Section 45D(b)(1) provides that an investment in a CDE is a qualified equity investment only if, among other things, the CDE designates the investment as a qualified equity investment.

Section 45D(c)(1) provides that an entity is a CDE only if, among other things, the entity is certified by the Secretary as a CDE.

Section 45D(b)(2) provides that the maximum amount of equity investments issued by a CDE that may be designated by the CDE as qualified equity investments may not exceed the portion of the new markets tax credit limitation set forth in § 45D(f) that is allocated to the CDE by the Secretary under § 45D(f)(2).

The Secretary has delegated certain administrative functions relating to the new markets tax credit program to the Under Secretary (Domestic Finance), who in turn has delegated those functions to the Community Development Financial Institutions Fund (CDFI Fund). In accordance with procedures to be issued by the CDFI Fund in the future, the CDFI Fund will request and evaluate applications for CDE certification and for new markets tax credit allocations. Under those procedures, if a CDE is selected to receive a credit allocation, the CDFI Fund will provide to the CDE a notification of credit allocation. However, the CDE's actual receipt of a credit allocation under § 45D(f)(2) will be contingent upon the CDE subsequently entering into an allocation agreement with the CDFI Fund.

DISCUSSION

Questions have arisen as to whether an equity investment in an entity may be eligible to be designated as a qualified equity investment if it is made before the entity is certified by the CDFI Fund as a CDE under § 45D(c)(1) and before the entity enters into an allocation agreement with the CDFI Fund. In such a situation, an equity investment in an entity will be eligible to be designated as a qualified equity investment under § 45D(b)(1) if:

1. The equity investment is made on or after April 20, 2001;
2. The entity in which the equity investment is made is certified by the CDFI Fund as a CDE under § 45D(c)(1) before January 1, 2003;
3. The entity in which the equity investment is made receives notification of a credit allocation (with the actual receipt of such credit allocation contingent upon subsequently entering into an allocation agreement) from the CDFI Fund before January 1, 2003; and
4. The equity investment otherwise satisfies the requirements of § 45D.

In the case of an equity investment that is designated as a qualified equity investment in accordance with this notice, the first credit allowance date under § 45D(a)(3)(A) will be the effective date of the allocation agreement between the CDE and the CDFI Fund.

Regulations to be issued in the near future will incorporate the guidance set forth in this notice. Taxpayers may rely on this notice until those regulations are issued.

DRAFTING INFORMATION

The principal author of this notice is Paul Handleman of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Handleman at (202) 622–3040 (not a toll-free call).

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SECTION 1. PURPOSE AND SCOPE

***Q–1. What is the purpose of this revenue procedure?***

A–1. This revenue procedure provides optional simplified methods for determining the value of the use of demonstration automobiles provided to employees by automobile dealerships. The methods in this revenue procedure include —

- *Simplified Method for the Full Exclusion of Qualified Automobile Demonstration Use. (Simplified Out/In Method)* This is a simplified method for keeping records to support the full exclusion of the use of a demonstration automobile from the income of a full-time automobile salesperson. This method is discussed in section 4, Questions and Answers 11 through 25.
- *Partial Exclusion of Demonstration Automobile Use by Full-Time Salespeople.* This is a simplified method for determining the excludible business use of a demonstration automobile provided to a full-time salesperson and the amount included in income if the full exclusion is not applicable. This method is discussed in section 5, Questions and Answers 26 through 39.
- *Inclusion of the Value of Demonstration Automobile Use When No Exclusion Applies.* This is a simplified method for determining the amount to be included in income of any employee provided the use of a demonstration automobile if neither the full nor partial exclusion for full-time salespeople is available. This method is discussed in section 6, Questions and Answers 40 through 47.
- *Application of General Rule When Methods in Revenue Procedure are Not Used.* Question 51 in section 7 provides that if the requirements of the simplified methods provided under this revenue procedure are not satisfied, generally the amount required to be included in an employee's income is the fair market value of the use of the demonstration automobile. Question 51 also provides that if errors are identified and corrected during the calendar year in which the vehicle is provided, an employer may continue to use the simplified methods under this revenue procedure.

This revenue procedure is designed to provide a comprehensive framework for addressing the tax treatment of demonstration automobiles provided by automobile dealers to employees. The simplified methods have been structured sequentially so that if the use by an employee does not qualify for treatment under one method, the use can nonetheless be taken into account under a subsequent method with no additional recordkeeping or change in determination period. For example, if the use of a demonstration automobile by a full-time salesperson fails to qualify for full exclusion under the simplified full exclusion method, the use may still be accounted for under the partial exclusion method based on records otherwise available or already maintained under the full exclusion method. At the same time, employers can choose to use the partial exclusion method immediately for all full-time salespeople without first attempting to satisfy the requirements of the full exclusion method. Moreover, an employer can choose to apply the different optional methods on an employee by employee basis. Thus, if some employees are unwilling to maintain the records necessary to satisfy the full exclusion method, the employer can account for their use under the partial or full inclusion methods while still retaining the ability to use the full exclusion method for the other employees.

***Q–2. Who may use the simplified methods in this revenue procedure?***

A–2. The simplified methods provided in this revenue procedure are available to any automobile dealer engaged in the business of retail sales of new or used vehicles described in Question and Answer 3.

***Q–3. What vehicles are demonstration automobiles that qualify for the simplified methods?***

A–3. The application of the simplified methods provided in this revenue procedure for determining the tax-treatment of employer-provided vehicles is limited to demonstration automobiles as defined in Treas. Reg. § 1.132–5(o)(3). That regulation requires that the vehicle be currently in the inventory of the automobile dealership and be available for test drives by customers during the normal business hours of the employee provided its use. For purposes of this revenue procedure, demonstration automobiles can include passenger vans, sport utility vehicles, and light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which are also referred to as class 1, 2, or 3 trucks.

***Q–4. For which employees can the simplified methods be used?***

A–4. The application of the simplified methods provided in this revenue procedure for the full or partial exclusion of demonstration automobile use is limited to use by full-time salespeople as defined in Treas. Reg. § 1.132–5(o)(2). That regulation requires that the individual be employed by an automobile dealer, customarily spend at least half of a normal business day performing the functions of a floor salesperson or sales manager, directly engage in substantial promotion and negotiation of sales to customers, customarily work a number of hours considered full-time in the industry (but at a rate not less than 1,000 hours per year), and derive at least 25 percent of gross income from sales activities.

The simplified method for full inclusion may be applied with respect to the use of a demonstration automobile by any employee of an automobile dealer.

***Q–5. Does this revenue procedure describe all of the methods for determining and substantiating the value of the use of demonstration vehicles provided to employees by automobile dealerships?***

A–5. No. An automobile dealer is not required to use the optional simplified methods described in this revenue procedure. An automobile dealer may use any other applicable method that complies with the Internal Revenue Code and Treasury regulations to account for the use of demonstration automobiles by employees.

## SECTION 2. BACKGROUND

***Q–6. What provisions of the tax law may apply to a vehicle provided to an employee by an employer?***

A–6. In general, section 61(a)(1) of the Internal Revenue Code (the Code) provides that gross income means all income, including compensation for services. Fringe benefits are specifically listed as an example of compensation for services. The examples of fringe benefits under Treas. Reg. § 1.61–2T(a)(1) include an employer-provided automobile.

However, section 132(a) of the Code permits certain fringe benefits, including working condition fringes, to be excluded from gross income. In certain circumstances, all or part of the value of the use of an employer-provided automobile may be a working condition fringe.

***Q–7. When is the use of an employer-provided automobile a working condition fringe?***

A–7. Section 132(d) of the Code generally defines a working condition fringe as any property or services provided to an employee by an employer to the extent that, if the employee paid for such property or services, the payment would be allowable as a business expense deduction. Thus, generally any business use of an employer-provided vehicle, including a demonstration automobile, by any employee is a working condition fringe.

In addition, section 132(j)(3) of the Code specifically provides that "qualified automobile demonstration use" by a full-time automobile salesperson is treated as a working condition fringe.

However, regulations related to working condition fringe benefits at section 1.132–5(c)(1) generally provide that working condition fringe benefits may not be excluded unless the substantiation requirements of either section 274(d) or section 162 and corresponding regulations are satisfied. Thus, even if business use of an employer-provided vehicle is a working condition fringe, it may not be excluded from the employee's gross income unless that business use is properly substantiated.

## SECTION 3. FULL EXCLUSION FOR QUALIFIED AUTOMOBILE DEMONSTRATION USE

***Q–8. What is the full exclusion for qualified automobile demonstration use?***

A–8. As noted above, section 132(j)(3) specifically provides that "qualified automobile demonstration use" is treated as a working condition fringe. Generally, "qualified automobile demonstration use" is the use of a demonstration automobile by a full-time salesperson if the specific restrictions described in Question and Answer 9 are observed. If there is "qualified automobile demonstration use," the value of the use of the demonstration automobile is excluded from the full-time salesperson's wages. As a result, the salesperson will not owe income or FICA taxes on the value of use and the employer will not be required to withhold income taxes or pay FICA taxes with respect to the value of the use.

***Q–9. What are the requirements for the full exclusion of automobile demonstration use by a full-time salesperson?***

A–9. The requirements for the full exclusion of automobile demonstration use by a full-time salesperson contained in section 132(j)(3) of the Code are as follows:

a. The use must be in the sales area in which the automobile dealer's sales office is located.

b. The use must be provided primarily to facilitate the salesperson's performance of services for the employer.

c. There must be substantial restrictions on the personal use of the automobile by the salesperson.

Under Treas. Reg. § 1.132–5(o)(4), substantial restrictions on the personal use of a demonstration automobile exist when all of the following conditions are satisfied:

a. Use by individuals other than the full-time salesperson (*e.g.*, the salesperson's family) is prohibited;

b. Use for personal vacation trips is prohibited;

c. The storage of personal possessions in the automobile is prohibited; and

d. The total use by mileage of the automobile by the salesperson outside the salesperson's normal working hours ("personal use") is limited.

To use the simplified full and partial exclusion methods contained in this revenue procedure, the employer must also have a written policy limiting the use of the demonstration automobile. To use the full exclusion method, the employer must also determine that the personal use of the vehicle is limited to establish that the restrictions provided by the Code and regulations are satisfied.

***Q–10. What is the treatment if the requirements for the full exclusion are not met?***

A–10. If the use of the demonstration automobile by one or more employees does not satisfy the requirements for full exclusion, the employer must include some or all of the value of the use of the vehicle in the gross income of those employees using the methods for partial exclusion or full inclusion described in section 5 and 6, respectively, below.

## SECTION 4. SIMPLIFIED METHOD FOR THE FULL EXCLUSION OF QUALIFIED AUTOMOBILE DEMONSTRATION USE

***Q–11. What are the requirements under this revenue procedure for the Simplified Method for Full Exclusion of Qualified Automobile Demonstration use?***

A–11. The requirements are as follows:

a. The employer must have a qualified written policy limiting the use of the demonstration automobile;

b. The employer must reasonably believe that the full-time automobile salesperson complies with the written policy; and

c. The employer must determine, no less often than monthly, that the personal use of the vehicle by the full-time salesperson was limited and maintain the records described in Answer 23 supporting the determination. (But see Question and Answer 51 regarding correcting errors identified during the calendar year.)

***Q–12. What is a qualified written policy for purposes of the full exclusion?***

A–12. A qualified written policy is in place if the employer establishes and communicates to each full-time automobile salesperson allowed the use of a demonstration automobile a written policy which —

(1) Prohibits use of the vehicle outside of normal business hours by individuals other than full-time salespeople.

(2) Prohibits use of the vehicle for personal vacation trips.

(3) Prohibits use outside of the sales area in which the employer's sales office is located.

(4) Prohibits storage of personal possessions in the vehicle.

(5) Limits the total use by mileage of the vehicle by the salesperson outside normal working hours to commuting between the salesperson's home and the dealer's sales office and to an additional average number of miles per day of 10 miles or less.

A model qualified written policy for purposes of the full exclusion is provided in Appendix A.

***Q–13. When may the employer reasonably believe that the full-time automobile salesperson complies with the written policy?***

A–13. Under the full exclusion method, the employer may reasonably believe that a salesperson complies with the written policy where the calculations of total mileage outside of normal working hours indicate that the limit on personal use was not exceeded and the employer has no actual knowledge that the other requirements of the policy are not satisfied. For example, if the employer had actual knowledge that a salesperson's family members used the demonstration automobile in violation of the policy, the use during the period does not qualify for the full exclusion even if the mileage records indicate that the limits on mileage outside of normal working hours have not been exceeded during the period.

***Q–14. What is the sales area of an automobile dealer?***

A–14. Under Treas. Reg. § 1.132–5(o)(5)(i), sales area is generally defined as the geographic area surrounding the automobile dealer's sales office from which the office regularly derives customers. Paragraph (ii) under that regulation provides a safe harbor rule that, as a minimum, allows that an automobile dealer's sales area may be treated as the area within a radius of 75 miles of the sales office.

***Q–15. When is the personal use of the demonstration automobile limited for purposes of the full exclusion?***

A–15. For a full-time salesperson, personal use is considered limited as required under section 132(j)(3) if the total mileage a demonstration automobile is used outside normal working hours, less commuting mileage, does not exceed an average of 10 miles per day. For this purpose, the mileage on each demonstration automobile a salesperson uses for either commuting or personal purposes must be taken into account.

***Q–16. How does an employer determine the total mileage that a demonstration automobile is used outside of normal working hours?***

A–16. For purposes of this revenue procedure, an employer can determine the total mileage that a demonstration automobile is used outside of normal working hours under the Simplified Out/In Method. Under this method, the total miles that a demonstration automobile is used during normal working hours is not taken into account and only mileage outside of normal working hours is considered. To satisfy this method, the mileage on the automobile must be recorded under a reasonable system (1) at the end of the working hours of the salesperson using the automobile (out mileage) and (2) at the beginning of that salesperson's working hours on the next working day (in mileage).

***Q–17. What is a reasonable system for recording out and in mileage?***

A–17. Any reasonable system may be used for recording out and in mileage. For example, an employee other than the salesperson could record the mileage on the demonstration automobiles at the arrival and departure of the vehicle at the sales office on each workday. A reasonable system would also include mileage entries for the vehicles by the full-time salespeople using the vehicle if there was random verification of the accuracy of the entries by an employee other than the salespeople at least once in every determination period, as described in Question and Answer 18.

***Q–18. What is the applicable period for determining whether the average 10 miles per day is exceeded?***

A–18. Under the simplified full exclusion method provided by this revenue procedure, the employer must determine whether the average 10 miles per day of personal use has been exceeded no less often than once each calendar month. If an employer chooses to make the determination every two weeks, the applicable period is two weeks, and the amount of personal use in addition to commuting allowed for the two weeks is 140 miles (14 days multiplied times 10 miles per day). If the employer chooses to make the determination monthly, the amount varies from month to month, depending on the number of days in the calendar month.

***Q–19. What is commuting mileage?***

A–19. Commuting mileage is the total number of miles a demonstration automobile is driven by a salesperson when commuting to and from the dealer's sales office during the period at issue. For this purpose, commuting mileage includes only one round trip to and from the sales office per workday. The employer should assume that the commuting distance is the same for every day the employee drives the automobile to work unless the employer has reason to believe that the employee has moved.

***Q–20. How does an employer determine the commuting mileage for a full-time salesperson?***

A–20. A full-time salesperson's commuting mileage can be determined by any reasonable method. Reasonable methods include employee mileage records of a single commute, computer research programs identifying distance between the employee's home address and the dealer's sales office, or employee self-reporting that reasonably corresponds to the driving distance between the employee's home address and the dealer's sales office.

***Q–21. Is commuting mileage limited to the most direct route between the employee's home and the sales office?***

A–21. No. An employee can use any commuting route that is reasonable in time or mileage. However, an employee may not increase his or her reported commuting mileage to allow for additional personal use; the average 10 miles per day allowance is intended to provide limited personal use in addition to commuting.

**Example 1.** A salesperson employee lives in a subdivision on the opposite side of a significant urban area from the sales office. Although a direct route through the urban area is shorter, using a highway around the urban area generally takes less time, although the actual mileage is greater. In this case, the employer can use the longer commuting mileage reflecting the use of the highway for purposes of determining the employee's personal use mileage in excess of commuting.

**Example 2.** A salesperson belongs to a fitness club located eight miles outside of any reasonable commuting route between the sales office and the salesperson's home. Even if the salesperson regularly stops at the fitness club on the trip home, the employer cannot include the additional eight miles in the commuting mileage for purposes of determining the employee's personal use mileage in excess of commuting.

***Q–22. How does an employer using the full exclusion method calculate personal use?***

A–22. The following examples illustrate calculations of personal use and determinations of whether the requirement that personal use outside of working hours was limited in accordance with the qualified policy.

**Example 1.** The employer adopts the simplified out/in method and implements a written policy that satisfies the requirements of this revenue procedure. The employer chooses to determine personal use monthly. For a 30 day month, the total mileage for the automobiles used by full-time salesperson Y during the month is 1,450 miles. Based on the mileage recorded at arrival and departure during the month, 800 miles relate to use during normal working hours and is not taken into account. Salesperson Y's round trip commute is 15 miles and Y works 20 days during the month, for a total commuting mileage of 300 miles during the month. The total use outside of normal working hours is calculated by taking the 1,450 total miles and subtracting the use during working hours, resulting in 650 miles. Total use outside of normal working hours for the month, 650 miles, less commuting miles for the month, 300 miles, results in 350 miles. This is greater than 10 miles per day for 30 days (300 miles). Thus, use by salesperson Y is not considered to be limited during the month and salesperson Y does not qualify for the exclusion for the month. Nonetheless, salesperson Y may qualify for the partial exclusion under this revenue procedure if the requirements for that method are satisfied.

**Example 2.** The same facts as in Example 1, except that for a 31 day month, the total mileage for the automobiles used by full-time salesperson X for the month is 1,600 miles. Based on the mileage recorded at arrival and departure during the month, 720 miles relate to use during working hours. Salesperson X's round trip commute is 30 miles and X works 22 days during the month, for total commuting mileage of 660 miles during the month. The total use outside of normal working hours is calculated by taking the 1,600 total miles and subtracting 720 miles, the use during working hours, resulting in 880 miles. Total use outside of working hours for the month, 880 miles, less commuting miles for the month, 660 miles, results in 220 miles. This is less than 10 miles per day for 31 days (310 miles). Thus, use by X is considered to be limited during the month.

***Q–23. What records must an employer maintain to satisfy the requirements for the full exclusion?***

A–23. An employer must maintain the following records to satisfy the requirements for the full exclusion for any month —

a. A copy of the written policy on use and evidence that it was communicated to employees, such as a copy of a poster notifying employees of the policy, a copy of a letter or an electronic communication notifying the employee of the policy, or signed statements by the employees acknowledging receipt of the written policy.

b. Records establishing that the salesperson's personal use by mileage was calculated no less often than once each calendar month. This may include:

(i) Records identifying each demonstration automobile assigned to each salesperson during the period.

(ii) Records identifying the total mileage for each demonstration automobile assigned to a salesperson during the period.

(iii) Records supporting the total use outside of normal working hours under the Simplified Out/In Method described in Question and Answer 16 and any verification of those records. In particular, the employer would maintain records of out and in mileage of the demonstration automobiles provided to full-time salespeople for each day the automobile is used.

(iv) Records identifying the round trip commuting mileage of each salesperson assigned a demonstration automobile from salesperson's home to the dealer's sales office during the period. See Questions and Answers 19, 20 and 21 regarding the determination of commuting mileage.

***Q–24. What records must an employee maintain to satisfy the requirements for the full exclusion?***

A–24. The employee is required to maintain no records except to the extent the employee is required to provide information to the employer to allow the employer to maintain the records as noted above.

***Q–25. What are the tax consequences if one or more employees fail to satisfy the limited personal use requirement?***

A–25. For each full-time salesperson whose personal use mileage exceeds the 10 miles per day average for the applicable determination period, the employer must include all or a portion of the value of the use of the demonstration automobile for the period in the income of that full-time salesperson. The employer may continue to use the full exclusion for all other full-time salespeople whose personal use mileage is limited.

The employer may implement the partial exclusion method by including amounts in income either in the current period or in the period immediately following the current period. Whichever method is chosen, the employer must implement the exclusion in a consistent manner. Thus, after determining that an employee does not qualify for the full exclusion for the month, the employer can include an amount in the employee's income for the current month. Alternatively, the employer can include an amount in the employee's income during the next month. In that case, the amount included in the next month under the partial or full inclusion method is determined by the number of days in the next month.

## SECTION 5. SIMPLIFIED METHOD FOR PARTIAL EXCLUSION OF DEMONSTRATION AUTOMOBILE USE BY FULL-TIME SALESPEOPLE

***Q–26. What is the partial exclusion of demonstration automobile use?***

A–26. Under the partial exclusion method, an amount is included in the full-time automobile salesperson's income and wages no less often than monthly. The amount reflects personal use of the demonstration automobile and is based on the value of the use of that vehicle as determined in Question and Answer 33 below. The remaining portion is deemed to represent business use that is excludable from income and wages as a working condition fringe.

***Q–27. When can an employer use the partial exclusion method?***

A–27. An employer choosing not to use the full exclusion method can use the partial exclusion method to account for the use of any demonstration automobile by a full-time salesperson if the requirements of this revenue procedure are satisfied. Moreover, the partial exclusion method is also available if a full-time salesperson employed by a dealer otherwise satisfying the requirements for the full exclusion exceeds the average 10 miles per day of personal use or does not provide records with respect to business use of a demonstration automobile. In such cases, the employer will generally be able to account for the use of the demonstration automobile by using the partial exclusion method rather than including the full value of the use of demonstration automobile in the income of the full-time salesperson.

***Q–28. What are the requirements for the partial exclusion of demonstration automobile use by a full-time salesperson?***

A–28. The requirements are as follows:

a. The employer must have a qualified written policy limiting the use of the demonstration automobile;

b. The employer must reasonably believe that the full-time automobile salesperson complies with the written policy; and

c. The employer must account for the nondeductible personal use by any full-time automobile salesperson by including in gross income and wages the amount specified in the table in Answer 35 no less often than monthly and maintain records specified in Answer 38, which are necessary to support that accounting.

***Q–29. What is the treatment if the requirements for the partial exclusion are not met?***

A–29. If the use of the demonstration automobile by a full-time salesperson does not satisfy the requirements for partial exclusion, the employer must include all of the value of the use of the vehicle in gross income of that employee using the method for full inclusion described in Answers 40–47 below. But see special rule regarding self-correction below in Question and Answer 51.

***Q–30. What is a qualified written policy for purposes of the partial exclusion?***

A–30. A qualified written policy is in place if the employer establishes and communicates to each full-time automobile salesperson allowed the use of a demonstration automobile a written policy which—

(1) Prohibits use of the vehicle outside of normal business hours by individuals other than full-time salespeople.

(2) Prohibits use of the vehicle for personal vacation trips.

(3) Prohibits storage of personal possessions in the vehicle.

A model written policy for purposes of the partial exclusion is provided in Appendix B.

***Q–31. May a qualified written policy under the full exclusion method be used for the partial exclusion method?***

A–31. Yes.

***Q–32. When may the employer reasonably believe that the full-time automobile salesperson complies with the written policy?***

A–32. Under the partial exclusion method, the employer may reasonably believe that a salesperson complies with the written policy if the employer has no actual knowledge that the other requirements of the policy are not satisfied. For example, if the employer had actual knowledge that a salesperson's family members used the demonstration automobile, the use does not qualify for the partial exclusion.

***Q–33. What method does the employer use to determine the value of the demonstration automobile used by a full-time salesperson?***

A–33. An employer may use any reasonable method to determine the value of the demonstration automobile used by a full-time salesperson. That value is used in applying the table in Answer 35. The following method is considered a reasonable method.

*Annual Average Look Back Method.* Under the annual average look back method, the value of the use of any new demonstration automobile is based on the average sales price of all vehicles sold in the prior year. The average sales price is calculated by taking the sum of the sales prices of all new car and truck sales in the prior calendar year and dividing that sum by the number of new vehicles sold in the prior year. The average sales price is used to determine the value of the demonstration automobile and the corresponding daily inclusion amount under the table in Answer 35. This amount is included in the employee's income and wages for each day the employee used a demonstration automobile. The amount must be included in income at least monthly. The average sales price must be determined in January of each year and must be applied no later than February of that year.

For used vehicles, the average sales price is calculated by taking the sum of the sales prices of all used vehicles for the prior year and dividing by the number of vehicles sold in the prior year. The value of a demonstration automobile may only be based on used cars for salespeople using only used cars as demonstration automobiles; the average sales price of used cars cannot be combined with the average sales price of new cars for purposes of determining the value of demonstration automobiles that are new. If a dealership sells both new and used vehicles, the employer may use the value based on new vehicles as the value of the demonstration automobiles used by all salespeople. Alternatively, the employer may calculate the value of the demonstration automobiles separately for salespeople using used vehicles and salespeople using new vehicles.

An employer using the annual average look back method must maintain evidence supporting the calculation of the annual average sales price.

**Example 1.** In 2001, an employer sold 948 new vehicles for total gross sales of $23, 226,000 (as shown on the year-end standard financial statement that the dealer provided to the manufacturer). In January 2002, the employer calculates the average sales price by dividing $23,226,000 by 948 vehicles, resulting in $24,500. For each month ending on or after February 1, 2002, to January 31, 2003, of the next year, for each full-time salesperson provided the use of a demonstration automobile, the employer includes in the salesperson's gross income $6, the amount from the table in Answer 35 based on that value, for each day in the month. This treatment is proper even if one full-time salesperson was provided only used demonstration automobiles. In addition, the employer keeps a copy of the factory statement that provided the amount of the 2001 sales and the number of vehicles sold as a record of his calculation.

**Example 2.** The same facts as in Example 1, except in addition to the new cars, the employer sold 233 used vehicles in 2001 for a total sales price of $2,903,248. Thus, the average sales price for the used vehicles is $12,456. While all the full-time salespeople sell used vehicles, only two full-time salespeople are provided used vehicles as demonstration automobiles. In this example, the value of the demonstration automobiles for the salespeople provided new cars as demonstration automobiles may not be based on the used cars sold in 2001. However, the employer may use $12,456 to determine the amount included in the income of the two full-time salespeople provided used cars as demonstration automobiles.

***Q–34. How does an employer determine the annual average sales price if more than one franchise is operated at or from a single location?***

A–34. The employer must use a consistent method for calculating the value of the demonstration automobiles. If more than one franchise is operated at a single physical location ("store"), the annual average sales price for all salespeople may be based on the combined sales of all franchises operating at the store. The value of a demonstration automobile may only be based on used cars for salespeople provided used cars as demonstration automobiles; the average sales price of used cars cannot be combined with the average sales price of new cars for purposes of determining the value of the use of demonstration automobiles that are new.

However, if a salesperson is only provided demonstration automobiles from a single franchise operating out of the store, the employer may base the annual calculation of value for that salesperson on the sales of the specific franchise. In that case, the value for all salespeople in the store must also be based on specific franchises.

Similarly, if some salespeople receive demonstration automobiles exclusively from the store's used car inventory and other salespeople received demonstration automobiles exclusively from the store's new car inventory, the value must generally be calculated separately for each group of salespeople. However, as noted in Question and Answer 33, if the store sells both new and used vehicles, the employer may also use the value based on sales of new vehicles as the value of the demonstration automobiles for all salespeople.

A special consistency rule is available if some salespeople sell automobiles and provide demonstration automobiles from more than one franchise operating out of the store; in that case, the value must be calculated consistently within groups of salespeople. For example, all salespeople assigned demonstration automobiles from a single franchise may have the value based on the specific franchise, and all salespeople assigned demonstration automobiles from more than one franchise may have the value based on the combined inventories of the franchises.

However, if two franchises operate out of a store, the employer could not base the value for salespeople of the less expensive franchise on the less expensive franchise while basing the value for salespeople of the more expensive franchise on the combined inventory. In that case, either the value for all salespeople must be based on the combined sales or the value for the two groups of salespeople must be based on the respective franchise sales.

***Q–35. What is the amount included in the full-time salesperson's income and wages for use of the demonstration automobile under the partial exclusion method?***

A–35. For each day (including nonworkdays) a full-time salesperson is provided the use of a demonstration automobile, the appropriate amount from the table below, based on the value of the demonstration automobile as determined under a reasonable method as described in Question and Answer 33, must be included in the full-time salesperson's income and wages no less often than monthly.

| Value of the Demonstration Automobile | Daily Inclusion Amount |
|---|---|
| 0 — $14,999 | $3 |
| $15,000 — $29,999 | $6 |
| $30,000 — $44,999 | $9 |
| $45,000 — $59,999 | $13 |
| $60,000 — $74,999 | $17 |
| $75,000 and above | $21 |

***Q–36. How does an employer determine the number of days that a salesperson has the use of a demonstration automobile?***

A–36. Absent evidence to the contrary, full-time salespeople are assumed to have the use of a demonstration automobile for every day of the period under consideration. Salespeople hired during the period are assumed to have use for every day from the date of hire to the end of the period. Salespeople that separate from service are assumed to have the use of an automobile from the first day of the period to the date of separation.

***Q–37. May an employer elect under section 3402(s) of the Code not to withhold income taxes from the portion of the vehicle fringe benefit required to be included under the partial exclusion method provided under this revenue procedure?***

A–37. No. Under this revenue procedure, the periodic inclusion inherent in the requirement to include amounts in income not less often than monthly is intended to substitute for more specific recordkeeping requirements for substantiating the use of the demonstration automobile. Annual inclusion and withholding of other employment taxes with respect to noncash fringe benefits allowed under Announcement 85–113 (1985–31 I.R.B. 31) is unavailable under the methods provided by this revenue procedure.

***Q–38. What records must an employer maintain to satisfy the requirements for the partial exclusion?***

A–38. An employer must maintain the following records to satisfy the requirements for the partial exclusion—

a. Records supporting the determination of the value of the use of demonstration automobiles. For these purposes, records identified above in the description of annual average look back method for determining value in Question and Answer 33 will be considered adequate.

b. Evidence that the amount was timely included in the employee's income and wages. For example, copies of wage statements showing inclusion of the amounts no less often than monthly.

c. A copy of the written policy on use and evidence that it was communicated to employees, such as a copy of a poster notifying employees of the policy, a copy of a letter or an electronic communication notifying the employee of the policy, or signed statements by the employees acknowledging receipt of the written policy.

***Q–39. What records must an employee maintain to satisfy the requirements for the partial exclusion?***

A–39. The employee is required to maintain no records.

## SECTION 6. SIMPLIFIED METHOD FOR INCLUSION OF THE VALUE OF DEMONSTRATION AUTOMOBILE IF NEITHER FULL NOR PARTIAL EXCLUSION APPLIES

***Q–40. What method does an employer use to account for the use of demonstration automobiles provided to employees who are not full-time salespeople?***

A–40. If the employee provided the use of a demonstration automobile is not a full-time salesperson, the full exclusion and the partial exclusion in this revenue procedure do not apply. To reduce record keeping with respect to use of a demonstration automobile by an employee who is not a full-time salesperson, the employer may include in the employee's income and wages each month the full value of the demonstration automobile determined with no reduction to take into account business use (the "full inclusion method"). See Questions and Answers 43 through 45 below which discuss the use of the annual lease value table to determine the amount included under this method.

Of course, other methods for excluding from an employee's income a portion of the value of the use of an employer-provided automobile remain available for those employees that are not full-time salespeople. Specifically, see Questions and Answers 48 through 50 below regarding the application of Treas. Reg. § 1.274–6T. Section 1.274–6T generally allows an employer implementing certain written policies restricting personal use to account for commuting and *de minimis* personal use by any employee by including the $1.50 per one-way commute provided under Treas. Reg. § 1.61–21(f)(3) in the employee's income and providing other evidence allowing a determination that use was actually limited.

***Q–41. What method is used to account for the use of a demonstration automobile by a full-time salesperson who does not qualify for the full exclusion or partial exclusion?***

A–41. If use of a demonstration automobile by a full-time salesperson does not qualify for the full exclusion or the partial exclusion, an amount is included in the full-time salesperson's income and wages no less often than monthly that reflects the full value of the demonstration automobile, with no reduction to take into account business use. See Questions and Answers 42 through 44 below which discuss the use of the annual lease value table to determine the amount included under this method.

***Q–42. What are the requirements for using the full inclusion method for demonstration automobiles used by employees who are not full-time salespeople or who are full-time salespeople?***

A–42. The employer must account for the use by an employee who is not a full-time salesperson by including in gross income and wages for each day in each period (no less often than monthly) the greater of $3 per day or the *pro rata* portion of the amount specified in the annual lease value table at Treas. Reg. § 1.61–21(d)(2)(iii) using the value of the demonstration automobile.

***Q–43. Under the full inclusion method, how does an employer determine the value of the demonstration automobiles provided to employees?***

A–43. An employer may use any reasonable method to determine the value of the demonstration automobile provided to the employee. For this purpose, a reasonable method includes the annual average look back method listed as a reasonable method for determining the value of a demonstration automobile under the partial exclusion method in Answer 33 above.

***Q–44. How is the pro rata portion of the annual lease value amount included in income calculated?***

A–44. The *pro rata* portion of the annual lease value amount is the amount specified in annual lease value table at Treas. Reg. § 1.61–21(d)(2)(iii) using the full value of the demonstration automobile, divided by 365, rounding to nearest dollar amounts.

For ease of reference, the following table provides the daily inclusion amount under the annual lease value table.

| Value of Demonstration Automobile | Daily Inclusion Amount |
|---|---|
| $0–2,999 | $3 |
| 3,000–4,999 | 4 |
| 5,000–5,999 | 5 |
| 6,000–7,999 | 6 |
| 8,000–8,999 | 7 |
| 9,000–10,999 | 8 |
| 10,000–11,999 | 9 |
| 12,000–12,999 | 10 |
| 13,000–14,999 | 11 |
| 15,000–15,999 | 12 |
| 16,000–17,999 | 13 |
| 18,000–18,999 | 14 |
| 19,000–20,999 | 15 |
| 21,000–21,999 | 16 |
| 22,000–23,999 | 17 |
| 24,000–24,999 | 18 |
| 25,000–25,999 | 19 |
| 26,000–27,999 | 20 |
| 28,000–29,999 | 21 |
| 30,000–31,999 | 23 |
| 32,000–33,999 | 24 |
| 34,000–35,999 | 25 |
| 36,000–37,999 | 27 |
| 38,000–39,999 | 28 |
| 40,000–41,999 | 29 |
| 42,000–43,999 | 31 |
| 44,000–45,999 | 32 |
| 46,000–47,999 | 34 |
| 48,000–49,999 | 35 |
| 50,000–51,999 | 36 |
| 52,000–53,999 | 38 |
| 54,000–55,999 | 39 |
| 56,000–57,999 | 40 |
| 58,000–59,999 | 42 |
| For vehicles with value in excess of $59,999, the dollar inclusion amount is (.25 x value) + $500, divided by 365, rounded to nearest dollar amount. | |

***Q–45. Under the full inclusion method, how does an employer determine the number of days that an employee has the use of a demonstration automobile?***

A–45. Absent evidence to the contrary, employees provided the use of a demonstration automobile are assumed to have the use of the automobile for every day (including non-workdays) of the period under consideration.

***Q–46. What records must an employer maintain to satisfy the requirements for the full inclusion method?***

A–46. An employer must maintain the following records to satisfy the requirements for the full inclusion method—

a. Adequate records supporting the determination of the value of the demonstration automobile provided to the employee. For these purposes, records identified above in the description of the deemed reasonable method for determining value will be considered adequate.

b. Evidence that the amount was timely included in the employee's income and wages. For example, copies of wage statements showing inclusion of the amounts no less often than monthly.

***Q–47. What records must an employee maintain to satisfy the requirements for the full inclusion method?***

A–47. No records must be maintained by an employee under the full inclusion method.

SECTION 7. APPLICATION OF GENERAL RULE WHEN METHODS IN REVENUE PROCEDURE ARE NOT USED

***Q–48. What is the interaction of the method under Treas. Reg. § 1.274–6T for an employer implementing a policy of no personal use except commuting through a written policy with the full exclusion or partial exclusion methods?***

A–48. Under Treas. Reg. § 1.274–6T, certain types of written policy statements can be used to implement a policy of no personal use, or no personal use except commuting, of a vehicle provided by an employer. Under the regulation, the employee is not required to keep a separate set of records for purposes of the employer's substantiation requirements under section 274(d) of the Code with respect to the use of a vehicle satisfying the written policy statement rules. Among the requirements under Treas. Reg. § 1.274–6T for a policy of no personal use except commuting is that the employer reasonably believe there is no personal use except for *de minimis* personal use in addition to commuting and that the employee does not use the vehicle for any personal use except for *de minimis* personal use in addition to commuting. Also among the requirements is that there be evidence that would enable the Commissioner to determine whether the use of the vehicle met the requirements.

Generally, in the case of a full-time salesperson, satisfying the requirements of Treas. Reg. § 1.274–6T would satisfy the requirements for the full exclusion under this revenue procedure. Moreover, in the case of a full-time salesperson, the employer would not be required to include an amount in the income of the salesperson representing the value of commuting.

***Q–49. What amount of personal use mileage in addition to commuting would satisfy the de minimis personal use in addition to commuting under Treas. Reg. § 1.274–6T ?***

A–49. For purposes of Treas. Reg. § 1.274–6T and this revenue procedure, *de minimis* personal use means personal use during the employee's commute and in conjunction with business use. In contrast, the limited personal use permitted under section 132(j)(3) and the full exclusion in this revenue procedure allow the employee to use the vehicle for personal purposes, even if that use involves a departure from the commuting route. Thus, if the employee stops on the commuting route for a personal purpose, that use constitutes *de minimis* personal use. However, if the employee travels to a location that is five miles away from the commuting route for a personal purpose, that use exceeds *de minimis* personal use even though it may be permitted under the full exclusion method described in this revenue procedure.

***Q–50. What evidence would satisfy the requirement under Treas. Reg. § 1.274–6T that the employer must maintain evidence that would enable a determination whether the use of the vehicle met the requirements?***

A–50. Evidence establishing that each salesperson's personal use by mileage was calculated no less often than monthly would support an employer's reasonable belief that the vehicle was not used for any personal purpose other than *de minimis* personal use in addition to commuting. For that purpose, the out and in records under the simplified full exclusion method described in section 4 would constitute evidence that would enable a determination that the use of the vehicle met the requirements. Of course, as noted in Question and Answer 49, the additional average 10 miles per day would not be permitted as *de minimis* use.

***Q–51. What amount is included in the income of an employee if the use was not taken into account and included in income for the month in which the use of a demonstration automobile was provided?***

A–51. If the error is identified and corrected during the calendar year the demonstration automobile was provided, the amount included may be determined under this revenue procedure. If the error is not corrected during the calendar year in which the demonstration automobile is provided, the amount included is determined under general valuation and substantiation rules.

**Example 1.** In August, the employer determines that three employees provided the use of demonstration automobiles without limitations on personal mileage (and for whom amounts were included in income and wages under the partial exclusion method) did not qualify as full-time salespeople since June of that year. Beginning in August, the employer accounts for the use of demonstration automobiles by these three employees using the full inclusion method. In addition, no later than December 31, the employer includes an amount in the three employees' income that is the difference between the amount that should have been included in their incomes under the full inclusion method for June and July and the amount actually included under the partial exclusion method. With respect to these employees, the employer satisfies the requirements of Question and Answer 51 of this revenue procedure.

**Example 2.** Two years after a demonstration automobile was provided to an employee, it is determined that the employee was not a full-time salesperson qualifying for the full exclusion or the partial exclusion. The employer did not include any amount in the employee's income with respect to the demonstration automobile. The amount required to be included in income and wages for the year the vehicle was provided is the full fair market value of the demonstration automobile. If there are not records substantiating the business use of the demonstration automobile, the full fair market value is included without reduction.

SECTION 8. INTENT TO REVISE REGULATIONS TO EXTENT NECESSARY

The Service intends to issue regulations modifying existing regulations to the extent required to authorize the procedures set out in this revenue procedure.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning on or after January 1, 2002.

SECTION 10. REQUEST FOR COMMENTS

We welcome comments regarding this revenue procedure. We specifically request comments concerning two issues:

Question and Answer 32 of this revenue procedure describes one reasonable method for determining the value of demonstration automobiles, an annual look back at the average sales price of all vehicles sold in the prior calendar year, for purposes of applying the daily inclusion value table under the partial exclusion method. Comments are specifically requested regarding the usefulness of specifying additional reasonable methods, including:

- A method basing the daily inclusion amount on an annual look back at the average sales price of only those vehicles used as demonstration automobiles in the prior year. For example, an employer has a full-time sales staff of six employees. During January, the employer reviews the permanent records of all vehicles sold during the prior year. This review identifies 38 vehicles that were sold as new vehicles with over 1,000 miles on the odometer at the time of sale. Totaling the price for which the 38 vehicles sold and dividing by 38 results in an average value of $26,980. For each month from February 1 of the present year to January 31 of the next year, the employer includes in each of the 38 full-time salesperson's gross income the amount from the table based on that value for each day in the month.
- A method basing the daily inclusion amount for each employee on the value of the specific demonstration automobiles provided to the employees for the month; in particular where records identifying which salesperson is provided which vehicle are already maintained pursuant to the simplified out/in method under the full exclusion.

Question and Answer 51 allows employers to correct errors identified in the calendar year during the calendar year. Comments are also specifically requested regarding the need for more detailed correction procedures where errors are identified preventing the employer from satisfying the requirements for the simplified methods under this revenue procedure.

Comments regarding this revenue procedure should be sent by March 1, 2002, in writing, and should reference Rev. Proc. 2001–56. Comments can be addressed to:

CC:ITA:RU (Rev. Proc. 2001–56), room 5226
Internal Revenue Service
POB 7604, Ben Franklin Station
Washington, DC 20044

Comments also may be hand delivered between the hours of 8 a.m. and 5 p.m. to:

CC:ITA:RU (Rev. Proc. 2001–56)
Courier's Desk
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC.

Alternatively, taxpayers may transmit comments electronically via the following email address:

***Notice.Comments@m1.irscounsel.treas.gov***

SECTION 11. DRAFTING INFORMATION

The principal author of this revenue procedure is Neil D. Shepherd of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), IRS. However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue procedure, call (202) 622–6040 (not a toll-free number.)

SECTION 12. 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 1545–1756.

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

The collections of information in this revenue procedure are in sections 4, 5, and 6. This information is required to comply with the optional simplified methods for determining the value of the use of demonstration automobiles provided to employees by automobile dealerships. This information will be used to satisfy the substantiation requirements of section 274(d) and the regulations thereunder and is required to obtain a benefit under the optional simplified methods. The likely respondents are business or other for-profit institutions.

The estimated total annual recordkeeping burden is 100,000 hours.

The estimated annual burden per recordkeeper varies from 2.5 hours to 7.5 hours, depending on individual circumstances, with an estimated average of 5 hours. The estimated number of recordkeepers is 20,000.

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.

APPENDIX A

MODEL QUALIFIED WRITTEN POLICY FOR FULL EXCLUSION

[INSERT NAME OF DEALERSHIP]

DEMONSTRATOR VEHICLE POLICY

*This policy statement is designed for use by dealers that wish to adopt the out/in or partial exclusion methods of accounting for use of demonstrator vehicles provided to full-time automobile salespeople. It may also be used to explain the full inclusion method for vehicles provided to employees other than full-time automobile salespeople.*

*Material in italics explains how to use the policy and should be deleted from the policy provided to employees and maintained by the dealership. Material in* ***bold*** *is optional and should be included only if it reflects the choices made by the dealership. Material IN CAPITALS is information that is specific to the dealership—the dealership should insert the appropriate information.*

*Because the optional language in this model provides for specifying the amount included in employee income, any dealer adopting that language should review the model annually to determine if inclusion amounts have changed; if the inclusion amounts have changed, the dealer should modify the policy to reflect the change and reissue it to employees provided demonstration automobiles.*

Full-time automobile salespeople at [INSERT NAME OF DEALERSHIP] **and certain other employees** may be provided with the use of a demonstration vehicle. We want you to understand the restrictions on use of demonstration vehicles and how employees who use demonstration vehicles will be taxed on that use.

*Restrictions on Use of Demonstration Vehicles*

- The demonstration vehicle must be available for test drives by customers during the normal working hours of the employee to whom the vehicle is assigned. Personal possessions may not be stored in the vehicle. Any personal possessions must be removed by the beginning of normal working hours.
- The demonstrator vehicle is provided so that employees can become familiar with the features of the vehicles we sell. Only the employee to whom the vehicle is assigned may use the vehicle outside of normal working hours. It may not be used by family, friends, or neighbors.
- The demonstrator vehicle is part of our inventory and must be available for sale to customers. It may not be used outside the dealership's sales area or for vacation travel.
- *Insert any other restrictions the dealership has concerning use or maintenance of the vehicle.*

*Insert the following two paragraphs only if the "out/in" method will be used for full-time automobile salespeople.*

- **The demonstration vehicle may be used only for tests drives by customers or other dealer business, for a daily commute between the employee's home and the dealership, and for other limited personal use. Personal use is limited to [INSERT NUMBER NO GREATER THAN 10 MULTIPLIED BY THE NUMBER OF DAYS IN THE DETERMINATION PERIOD] miles during each [INSERT LENGTH OF A DETERMINATION PERIOD WHICH IS NOT MORE THAN ONE MONTH]. In order to minimize recordkeeping, all use during the employee's normal working hours will be treated as business use, and all use outside the employee's normal working hours will be treated as commuting or personal use.**
- **The employee must ensure that mileage on the vehicle at the end of each working day, and at the beginning of the next working day, is properly [recorded] OR [verified] by [INSERT NAME, TITLE, OR JOB DESCRIPTION OF THE PERSON OR PEOPLE RESPONSIBLE FOR RECORDING OR VERIFYING MILEAGE].**

*Tax Treatment of Use of Demonstrator Vehicles*

*Insert the next paragraph only if the "out/in" method is being used.*

- **Any full-time automobile salesperson who meets all of the above requirements, including limiting personal use to [INSERT NUMBER NO GREATER THAN 10 MULTIPLIED BY THE NUMBER OF DAYS IN THE DETERMINATION PERIOD] miles during each [INSERT LENGTH OF A DETERMINATION PERIOD WHICH IS NOT MORE THAN ONE MONTH] will not owe any federal [INSERT STATE OR LOCAL, IF APPROPRIATE] income tax or any Social Security or Medicare tax on the use of the demonstrator vehicle.**
- Any full-time automobile salesperson who meets all of the above requirements [*insert this material only if the "out/in" method is used* **except for limiting personal use or ensuring that mileage is recorded and verified]** will have **[INSERT APPROPRIATE NUMBER FROM TABLE IN ANSWER 35] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.**
- Any full-time salesperson who is provided with the use of a demonstration vehicle but does not comply with the restrictions on storage of personal possessions, use by people other than the employee, use outside the sales area, and vacation travel during a pay period will have the full value of the use of the demonstrator automobile included in wages for the pay period, resulting in [INSERT APPROPRIATE NUMBER FROM ANNUAL LEASE VALUE TABLE UNDER ANSWER 44] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.

*Insert the following bullet only if demonstration vehicles are provided to employees other than full-time salespeople.*

- **Any other employee who is provided with use of a demonstration vehicle and meets all of the above requirements [***insert this material only if the "out/in" method is used* **except for limiting personal use or ensuring that mileage is recorded and verified] will have:**

  **[INSERT APPROPRIATE NUMBER FROM ANNUAL LEASE VALUE TABLE AT QUESTION AND ANSWER 44] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.**

APPENDIX B

MODEL QUALIFIED WRITTEN POLICY FOR PARTIAL EXCLUSION

[INSERT NAME OF DEALERSHIP]

DEMONSTRATOR VEHICLE POLICY

*This policy statement is designed for use by dealers that wish to adopt the partial exclusion methods of accounting for use of demonstrator vehicles provided to full-time automobile salespeople.*

*Material in italics explains how to use the policy and should be deleted from the policy provided to employees and maintained by the dealership. Material in* ***bold*** *is optional and should be included only if it reflects the choices made by the dealership. Material IN CAPITALS is information that is specific to the dealership—the dealership should insert the appropriate information.*

*Because the language in this model provides for specifying the amount included in employee income, any dealer adopting that language should review the model annually to determine if inclusion amounts have changed; if the inclusion amounts have changed, the dealer should modify the policy to reflect the change* *and reissue it to employees provided demonstration automobiles.*

Full-time automobile salespeople at [INSERT NAME OF DEALERSHIP] may be provided with the use of a demonstration vehicle. We want you to understand the restrictions on use of demonstration vehicles and how full-time salespeople who use demonstration vehicles will be taxed on that use.

*Restrictions on Use of Demonstration Vehicles*

- The demonstration vehicle must be available for test drives by customers during the normal working hours of the employee to whom the vehicle is assigned. Personal possessions may not be stored in the vehicle. Any personal possessions must be removed by the beginning of normal working hours.
- The demonstrator vehicle is provided so that employees can become familiar with the features of the vehicles we sell. Only the employee to whom the vehicle is assigned may use the vehicle outside of normal working hours. It may not be used by family, friends, or neighbors.
- The demonstrator vehicle is part of our inventory and must be available for sale to customers. It may not be used for vacation travel.
- *Insert any other restrictions the dealership has concerning use or maintenance of the vehicle.*

*Tax Treatment of Use of Demonstrator Vehicles*

- Any full-time automobile salesperson who meets all of the above requirements will have [INSERT APPROPRIATE NUMBER FROM TABLE IN ANSWER 35] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.
- Any full-time salesperson who is provided with the use of a demonstration vehicle but does not comply with the restrictions on storage of personal possessions, use by people other than the employee, and vacation travel during a pay period will have the full value of the use of the demonstrator automobile included in wages for the pay period, resulting in [INSERT APPROPRIATE NUMBER FROM ANNUAL LEASE VALUE TABLE UNDER ANSWER 44] dollars per day included in wages for each day on which the salesperson was assigned a demonstrator vehicle. Income tax, Social Security tax, and Medicare tax on this amount will be withheld from other wages owed to the salesperson.

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## Social Security Contribution and Benefit Base for 2002

Under authority contained in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (66 F.R. 54047, dated October 25, 2001) that the contribution and benefit base for remuneration paid in 2002, and self-employment income earned in taxable years beginning in 2002 is $84,900.

**"Old-Law" Contribution and Benefit Base**

*General*

The "old-law" contribution and benefit base for 2002 is $63,000. This is the base that would have been effective under the Act without the enactment of the 1977 amendments. The base is computed under section 230(b) of the Act as it read prior to the 1977 amendments.

The "old-law" contribution and benefit base is used by:

(a) The Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(b) The Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Social Security Act),

(c) Social Security to determine a year of coverage in computing the special minimum benefit, as described earlier, and

(d) Social Security to determine a year of coverage (acquired whenever earnings equal or exceed 25 percent of the "old-law" base for this purpose only) in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

**Domestic Employee Coverage Threshold**

*General*

The minimum amount a domestic worker must earn so that such earnings are covered under Social Security or Medicare is the domestic employee coverage threshold. For 2002, this threshold is $1,300. Section 3121(x) of the Internal Revenue Code provides the formula for increasing the threshold.

*Computation*

Under the formula, the domestic employee coverage threshold amount for 2002 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 2000 to that for 1993. If the resulting amount is not a multiple of $100, it shall be rounded to the next lower multiple of $100.

*Domestic Employee Coverage Threshold Amount*

Multiplying the 1995 domestic employee coverage threshold amount ($1,000) by the ratio of the national average wage index for 2000 ($32,154.82) to that for 1993 ($23,132.67) produces the amount of $1,390.02. We then round this amount to $1,300. Accordingly, the domestic employee coverage threshold amount is $1,300 for 2002.

(Filed by the Office of the Federal Register on October 24, 2001, 8:45 a.m., and published in the issue of the Federal Register for October 25, 2001, 66 F.R. 54047)

# Part IV. Items of General Interest

## Extension of Cut-Off Date for Use of Prior Revision of Determination Letter Application Forms

## Announcement 2001–122

The Service is extending the cut-off date for use of the prior revision of certain forms used to apply for determination letters on the tax-qualified status of employee benefit plans. This extension will allow determination letter applicants to use the prior revision of the forms in accordance with the transition rules described in section I.G. of Announcement 2001–77 (2001–30 I.R.B. 83) through March 31, 2002.

Announcement 2001–77 described changes that the Service has made to simplify its application procedures for determination letters on the qualification of pension, profit-sharing, stock bonus and annuity plans under §§ 401(a) and 403(a) of the Internal Revenue Code. Announcement 2001–77 noted that the Service was revising the determination letter application forms. Section I.G. of Announcement 2001–77 required determination letter applications filed after December 31, 2001, to be submitted on the revised application forms. For determination letter applications filed on or before December 31, 2001, section I.G. provided transition rules that allowed the prior revision of the application forms to be used.

Announcement 2001–109 (2001–45 I.R.B. 485) announced the availability of several of the revised application forms. Rev. Proc. 2001–55 (2001–49 I.R.B. 552) extended the remedial amendment period for amending plans for GUST[1] until February 28, 2002.

The availability of the transition rules in section I.G. of Announcement 2001–77 is extended through March 31, 2002. Thus, the Service will accept applications that are filed on the July, 1998 revision of the following forms in accordance with the procedures in section I.G. through March 31, 2002: Form 5300, Schedule Q (Form 5300), Form 5307, and Form 6406. Of course, applicants may instead use the 2001 revision of these forms. In addition, Form 5303 (Rev. 7/98), which is being discontinued, and the September, 1999 revision of Form 5309 may be used through March 31, 2002. Applications for determination letters on plan termination should be filed on the June, 1997 revision of Form 5310 and, if applicable, Form 6088 (Rev. 6/97) until further notice. Also, notices of plan merger, etc., and qualified separate lines of business, should be filed on the June, 1997 revision of Form 5310–A until further notice.

DRAFTING INFORMATION

The principal author of this announcement is James Flannery of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this announcement, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 9:30 p.m. Eastern Time, Monday through Friday. Mr. Flannery may be reached at (202) 283–9888 (not a toll-free number).

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## Notice of Disposition of Declaratory Judgment Proceedings Under Section 7428

This announcement serves notice to donors that on July 26, 1999, the Court of Appeals for the Eleventh Circuit affirmed the decision of the United States Tax Court which was entered on August 28, 1998. The Courts agreed with the Service that the organization listed below is not an organization recognized as tax exempt under section 501(a) of the Internal Revenue Code and is not described in section 501(c)(3) effective October 1, 1982.

Anclote Psychiatric Center, Inc.
Tarpon Springs, FL

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[1] "GUST" refers to the following:
- the Uruguay Round Agreements Act, Pub. L. 103–465;
- the Uniformed Services Employment and Reemployment Rights Act of 1994, Pub. L. 103–353;
- the Small Business Job Protection Act of 1996, Pub. L. 104–188;
- the Taxpayer Relief Act of 1997, Pub. L. 105–34;
- the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105–206; and
- the Community Renewal Tax Relief Act of 2000, Pub. L. 106–554.

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

## Section 1.— Tax Imposed

The Service provides inflation adjustments to the tax rate tables for individuals, trusts, and estates for taxable years beginning in 2002. In addition, the amounts of certain reductions allowed against the unearned income of minor children in computing the “kiddie tax” are adjusted. Also adjusted are the amounts used to determine whether a parent may elect to report the “kiddie tax” on the parent’s return. See Rev. Proc. 2001–59, page 623.

## Section 24.— Child Tax Credit

The Service provides inflation adjustments for the value used in determining the amount of the credit that may be refundable beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 25A.— Hope and Lifetime Learning Credits

The Service provides inflation adjustments for the amount of qualified tuition and related expenses that are taken into account in determining the amount of the Hope Scholarship Credit for taxable years beginning in 2002, and for the amount of a taxpayer’s modified adjusted gross income that is taken into account in determining the reduction in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise available. See Rev. Proc. 2001–59, page 623.

## Section 32.— Earned Income

The Service provides inflation adjustments to the limitations on the earned income tax credit for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 59.— Other Definitions and Special Rules for the Alternative Minimum Tax

The Service provides an inflation adjustment to the exemption amount used in computing the alternative minimum tax for a minor child subject to the “kiddie tax” for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 63.— Taxable Income Defined

The Service provides inflation adjustments to the standard deduction amounts (including the limitation in the case of certain dependents, and the additional standard deduction for the aged or blind) for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 68.— Overall Limitation on Itemized Deductions

The Service provides inflation adjustments to the overall limitation on itemized deductions for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 132.— Certain Fringe Benefits

The Service provides inflation adjustments to the limitations on the exclusion of income for a qualified transportation fringe for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 135.— Income From United States Savings Bonds Used to Pay Higher Education Tuition and Fees

The Service provides inflation adjustments to the limitation on the exclusion of income from United States savings bonds for taxpayers who pay qualified higher education expenses for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 151.— Allowance of Deductions for Personal Exemptions

The Service provides inflation adjustments to the personal exemption and to the threshold amounts of adjusted income above which the exemption amount phases out for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 170.— Charitable, etc., Contributions and Gifts

The Service provides inflation adjustments to the “insubstantial benefit” guidelines for calendar year 2002. Under the guidelines, a charitable contribution is fully deductible even though the contributor receives “insubstantial benefits” from the charity. See Rev. Proc. 2001–59, page 623.

## Section 213.— Medical, Dental, etc., Expenses

The Service provides inflation adjustments to the limitation on the amount of eligible long-term care premiums includible in the term “medical care,” for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 220.— Archer MSAs

The Service provides inflation adjustments to the amounts used to determine whether a health plan is a “high deductible health plan” for purposes of determining whether an individual is eligible for a deduction for cash paid to a medical savings account for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 512.— Unrelated Business Taxable Income

The Service provides an inflation adjustment to the maximum amount of annual dues that can be paid to certain agricultural or horticultural organizations without any portion being treated as unrelated trade or business income by reason of any benefits or privileges available to members for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 513.— Unrelated Trade or Business

The Service provides inflation adjustments to the maximum amount of a “low cost article” for taxable years beginning in 2002. Funds raised through a charity’s distribution of “low cost articles” will not be treated as unrelated business income to the charity. See Rev. Proc. 2001–59, page 623.

## Section 685.— Treatment of Funeral Trusts

The Service provides an inflation adjustment to the maximum amount of contributions that may be made to a qualified funeral trust for contracts entered in calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 877.— Expatriation to Avoid Tax

The Service provides inflation adjustments to amounts used to determine whether an individual's loss of United States citizenship had the avoidance of United States tax as one of its principal purposes for calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 2032A.— Valuation of Certain Farm, etc., Real Property

The Service provides an inflation adjustment to the maximum amount by which the value of certain farm and other qualified real property included in a decedent's gross estate may be decreased for purposes of valuing the estate of a decedent dying in calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 2503.— Taxable Gifts

The Service provides an inflation adjustment to the amount of gifts that may be made to a person in a calendar year without including the amount in taxable gifts for calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 2523.— Gift to Spouse

The Service provides an inflation adjustment to the amount of gifts that may be made in a calendar year to a spouse who is not a citizen of the United States without including the amount in taxable gifts for calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 2631.— GST Exemption

The Service provides an inflation adjustment to the amount of the generation-skipping transfer tax exemption for calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 4001.— Imposition of Tax

The Service provides inflation adjustments to the price above which a passenger vehicle becomes subject to an excise tax for transactions occurring in calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 4003.— Special Rules

The Service provides inflation adjustments to the price above which a passenger vehicle becomes subject to an excise tax for transactions occurring in calendar year 2002. (Price includes the price of installation of parts or accessories on a passenger vehicle within six months of the date after the vehicle was first placed in service.) See Rev. Proc. 2001–59, page 623.

## Section 4261.— Imposition of Tax

The Service provides an inflation adjustment to the amount of the excise tax on passenger air transportation beginning or ending in the United States for calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 6033.— Returns by Exempt Organizations

The Service provides an inflation adjustment to the amount of dues certain exempt organizations with nondeductible lobbying expenditures can charge and still be excepted from reporting requirements for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 6039F.— Notice of Large Gifts Received From Foreign Persons

The Service provides an inflation adjustment to the amount of gifts in a taxable year from foreign person(s) that triggers a reporting requirement for a United States person for taxable years beginning in 2002. See Rev. Proc. 2001–59, page 623.

## Section 6323.— Validity and Priority Against Certain Persons

The Service provides inflation adjustments for calendar year 2002 to (1) the maximum amount of a casual sale of personal property below which a federal tax lien will not be valid against a purchaser of the property, and (2) the maximum amount of a contract for the repair or improvement of certain residential property at or below which a federal tax lien will not be valid against a mechanic's lienor. See Rev. Proc. 2001–59, page 623.

## Section 6334.— Property Exempt From Levy

The Service provides inflation adjustments to the value of certain property exempt from levy (fuel, provisions, furniture, household personal effects, arms for personal use, livestock, poultry, and books and tools of a trade, business, or profession) for calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 6601.— Interest on Underpayment, Nonpayment, or Extension of Time for Payment, of Tax

The Service provides an inflation adjustment to the amount used to determine the amount of interest charged on a certain portion of the estate tax payable in installments for the estate of a decedent dying in calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 6621.— Determination of Rate of Interest

*26 CFR 301.6621–1: Interest rate.*

**Interest rates; underpayments and overpayments.** The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 2002, will be 6 percent for overpayments (5 percent in the case of a corporation), 6 percent for underpayments, and 8 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 is 3.5 percent.

## Rev. Rul. 2001–63

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under § 6621(a)(1), the overpayment rate beginning January 1, 2002, is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under § 6601 on any large corporate underpayment, the underpayment rate under § 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See § 6621(c) and § 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and § 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under § 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(2)(B) provides that in determining the addition to tax under § 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate that applies during the third month following such taxable year also applies during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59 (1988–1 C.B. 546) announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under § 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with § 6621 which, pursuant to § 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of October 2001 is 3 percent. Accordingly, an overpayment rate of 6 percent (5 percent in the case of a corporation) and an underpayment rate of 6 percent are established for the calendar quarter beginning January 1, 2002. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 2002, is 3.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 2002, is 8 percent. These rates apply to amounts bearing interest during that calendar quarter.

The 6 percent rate also applies to estimated tax underpayments for the first calendar quarter in 2002 and for the first 15 days in April 2002.

Interest factors for daily compound interest for annual rates of 3.5 percent, 5 percent, 6 percent, and 8 percent are published in Tables 12, 15, 17, and 21 of Rev. Proc. 95–17 (1995–1 C.B. 556, 566, 569, 571, and 575).

Annual interest rates to be compounded daily pursuant to § 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

### DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Assistant Chief Counsel (Administrative Provisions and Judicial Practice). For further information regarding this revenue ruling, contact Mr. Bailey at (202) 622–6226 (not a toll-free call).

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

| PERIOD | RATE | In 1995–1 C.B. DAILY RATE TABLE |
|---|---|---|
| Before Jul. 1, 1975 | 6% | Table 2, pg. 557 |
| Jul. 1, 1975—Jan. 31, 1976 | 9% | Table 4, pg. 559 |
| Feb. 1, 1976—Jan. 31, 1978 | 7% | Table 3, pg. 558 |
| Feb. 1, 1978—Jan. 31, 1980 | 6% | Table 2, pg. 557 |
| Feb. 1, 1980—Jan. 31, 1982 | 12% | Table 5, pg. 560 |
| Feb. 1, 1982—Dec. 31, 1982 | 20% | Table 6, pg. 560 |
| Jan. 1, 1983—Jun. 30, 1983 | 16% | Table 37, pg. 591 |
| Jul. 1, 1983—Dec. 31, 1983 | 11% | Table 27, pg. 581 |
| Jan. 1, 1984—Jun. 30, 1984 | 11% | Table 75, pg. 629 |

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS—CONTINUED

| PERIOD | RATE | In 1995–1 C.B. DAILY RATE TABLE |
|---|---|---|
| Jul. 1, 1984—Dec. 31, 1984 | 11% | Table 75, pg. 629 |
| Jan. 1, 1985—Jun. 30, 1985 | 13% | Table 31, pg. 585 |
| Jul. 1, 1985—Dec. 31, 1985 | 11% | Table 27, pg. 581 |
| Jan. 1, 1986—Jun. 30, 1986 | 10% | Table 25, pg. 579 |
| Jul. 1, 1986—Dec. 31, 1986 | 9% | Table 23, pg. 577 |

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 - DEC. 31, 1998

| | OVERPAYMENTS | | | UNDERPAYMENTS | | |
|---|---|---|---|---|---|---|
| | | 1995–1 C.B. | | | 1995–1 C.B. | |
| | RATE | TABLE | PG | RATE | TABLE | PG |
| Jan. 1, 1987—Mar. 31, 1987 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1987—Jun. 30, 1987 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jul. 1, 1987—Sep. 30, 1987 | 8% | 21 | 575 | 9% | 23 | 577 |
| Oct. 1, 1987—Dec. 31, 1987 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jan. 1, 1988—Mar. 31, 1988 | 10% | 73 | 627 | 11% | 75 | 629 |
| Apr. 1, 1988—Jun. 30, 1988 | 9% | 71 | 625 | 10% | 73 | 627 |
| Jul. 1, 1988—Sep. 30, 1988 | 9% | 71 | 625 | 10% | 73 | 627 |
| Oct. 1, 1988—Dec. 31, 1988 | 10% | 73 | 627 | 11% | 75 | 629 |
| Jan. 1, 1989—Mar. 31, 1989 | 10% | 25 | 579 | 11% | 27 | 581 |
| Apr. 1, 1989—Jun. 30, 1989 | 11% | 27 | 581 | 12% | 29 | 583 |
| Jul. 1, 1989—Sep. 30, 1989 | 11% | 27 | 581 | 12% | 29 | 583 |
| Oct. 1, 1989—Dec. 31, 1989 | 10% | 25 | 579 | 11% | 27 | 581 |
| Jan. 1, 1990—Mar. 31, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Apr. 1, 1990—Jun. 30, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Jul. 1, 1990—Sep. 30, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Oct. 1, 1990—Dec. 31, 1990 | 10% | 25 | 579 | 11% | 27 | 581 |
| Jan. 1, 1991—Mar. 31, 1991 | 10% | 25 | 579 | 11% | 27 | 581 |
| Apr. 1, 1991—Jun. 30, 1991 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jul. 1, 1991—Sep. 30, 1991 | 9% | 23 | 577 | 10% | 25 | 579 |
| Oct. 1, 1991—Dec. 31, 1991 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jan. 1, 1992—Mar. 31, 1992 | 8% | 69 | 623 | 9% | 71 | 625 |
| Apr. 1, 1992—Jun. 30, 1992 | 7% | 67 | 621 | 8% | 69 | 623 |
| Jul. 1, 1992—Sep. 30, 1992 | 7% | 67 | 621 | 8% | 69 | 623 |
| Oct. 1, 1992—Dec. 31, 1992 | 6% | 65 | 619 | 7% | 67 | 621 |
| Jan. 1, 1993—Mar. 31, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |
| Apr. 1, 1993—Jun. 30, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 - DEC. 31, 1998–CONTINUED

| | OVERPAYMENTS | | | UNDERPAYMENTS | | |
|---|---|---|---|---|---|---|
| | 1995–1 C.B. | | | 1995–1 C.B. | | |
| | RATE | TABLE | PG | RATE | TABLE | PG |
| Jul. 1, 1993 – Sep. 30, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |
| Oct. 1, 1993—Dec. 31, 1993 | 6% | 17 | 571 | 7% | 19 | 573 |
| Jan. 1, 1994—Mar. 31, 1994 | 6% | 17 | 571 | 7% | 19 | 573 |
| Apr. 1, 1994—Jun. 30, 1994 | 6% | 17 | 571 | 7% | 19 | 573 |
| Jul. 1, 1994—Sep. 30, 1994 | 7% | 19 | 573 | 8% | 21 | 575 |
| Oct. 1, 1994—Dec. 31, 1994 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jan. 1, 1995—Mar. 31, 1995 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1995—Jun. 30, 1995 | 9% | 23 | 577 | 10% | 25 | 579 |
| Jul. 1, 1995—Sep. 30, 1995 | 8% | 21 | 575 | 9% | 23 | 577 |
| Oct. 1, 1995—Dec. 31, 1995 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jan. 1, 1996—Mar. 31, 1996 | 8% | 69 | 623 | 9% | 71 | 625 |
| Apr. 1, 1996—Jun. 30, 1996 | 7% | 67 | 621 | 8% | 69 | 623 |
| Jul. 1, 1996—Sep. 30, 1996 | 8% | 69 | 623 | 9% | 71 | 625 |
| Oct. 1, 1996—Dec. 31, 1996 | 8% | 69 | 623 | 9% | 71 | 625 |
| Jan. 1, 1997—Mar. 31, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1997—Jun. 30, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jul. 1, 1997—Sep. 30, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Oct. 1, 1997—Dec. 31, 1997 | 8% | 21 | 575 | 9% | 23 | 577 |
| Jan. 1, 1998—Mar. 31, 1998 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 1998—Jun. 30, 1998 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jul. 1, 1998—Sep. 30, 1998 | 7% | 19 | 573 | 8% | 21 | 575 |
| Oct. 1, 1998—Dec. 31, 1998 | 7% | 19 | 573 | 8% | 21 | 575 |

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 - PRESENT
NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

| | 1995–1 C.B. | | |
|---|---|---|---|
| | RATE | TABLE | PAGE |
| Jan. 1, 1999—Mar. 31, 1999 | 7% | 19 | 573 |
| Apr. 1, 1999—Jun. 30, 1999 | 8% | 21 | 575 |
| Jul. 1, 1999—Sep. 30, 1999 | 8% | 21 | 575 |
| Oct. 1, 1999—Dec. 31, 1999 | 8% | 21 | 575 |
| Jan. 1, 2000—Mar. 31, 2000 | 8% | 69 | 623 |
| Apr. 1, 2000—Jun. 30, 2000 | 9% | 71 | 625 |
| Jul. 1, 2000—Sep. 30, 2000 | 9% | 71 | 625 |
| Oct. 1, 2000—Dec. 31, 2000 | 9% | 71 | 625 |
| Jan. 1, 2001—Mar. 31, 2001 | 9% | 23 | 577 |

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 - PRESENT
NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS—CONTINUED

| | RATE | 1995–1 C.B. TABLE | PAGE |
|---|---|---|---|
| Apr. 1, 2001—Jun. 30, 2001 | 8% | 21 | 575 |
| Jul. 1, 2001—Sep. 30, 2001 | 7% | 19 | 573 |
| Oct. 1, 2001—Dec. 31, 2001 | 7% | 19 | 573 |
| Jan. 1, 2002—Mar. 31, 2002 | 6% | 17 | 571 |

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 - PRESENT
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

| | OVERPAYMENTS | | | UNDERPAYMENTS | | |
|---|---|---|---|---|---|---|
| | | 1995–1 C.B. | | | 1995–1 C.B. | |
| | RATE | TABLE | PG | RATE | TABLE | PG |
| Jan. 1, 1999—Mar. 31, 1999 | 6% | 17 | 571 | 7% | 19 | 573 |
| Apr. 1, 1999—Jun. 30, 1999 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jul. 1, 1999—Sep. 30, 1999 | 7% | 19 | 573 | 8% | 21 | 575 |
| Oct. 1, 1999—Dec. 31, 1999 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jan. 1, 2000—Mar. 31, 2000 | 7% | 67 | 621 | 8% | 69 | 623 |
| Apr. 1, 2000—Jun. 30, 2000 | 8% | 69 | 623 | 9% | 71 | 625 |
| Jul. 1, 2000—Sep. 30, 2000 | 8% | 69 | 623 | 9% | 71 | 625 |
| Oct. 1, 2000—Dec. 31, 2000 | 8% | 69 | 623 | 9% | 71 | 625 |
| Jan. 1, 2001—Mar. 31, 2001 | 8% | 21 | 575 | 9% | 23 | 577 |
| Apr. 1, 2001—Jun. 30, 2001 | 7% | 19 | 573 | 8% | 21 | 575 |
| Jul. 1, 2001—Sep. 30, 2001 | 6% | 17 | 571 | 7% | 19 | 573 |
| Oct. 1, 2001—Dec. 31, 2001 | 6% | 17 | 571 | 7% | 19 | 573 |
| Jan. 1, 2002—Mar. 31, 2002 | 5% | 15 | 569 | 6% | 17 | 571 |

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 - PRESENT

| | RATE | 1995–1 C.B. TABLE | PG |
|---|---|---|---|
| Jan. 1, 1991—Mar. 31, 1991 | 13% | 31 | 585 |
| Apr. 1, 1991—Jun. 30, 1991 | 12% | 29 | 583 |
| Jul. 1, 1991—Sep. 30, 1991 | 12% | 29 | 583 |
| Oct. 1, 1991—Dec. 31, 1991 | 12% | 29 | 583 |
| Jan. 1, 1992—Mar. 31, 1992 | 11% | 75 | 629 |
| Apr. 1, 1992—Jun. 30, 1992 | 10% | 73 | 627 |
| Jul. 1, 1992—Sep. 30, 1992 | 10% | 73 | 627 |

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 - PRESENT—CONTINUED

| | | 1995–1 C.B. | |
|---|---|---|---|
| | RATE | TABLE | PG |
| Oct. 1, 1992—Dec. 31, 1992 | 9% | 71 | 625 |
| Jan. 1, 1993—Mar. 31, 1993 | 9% | 23 | 577 |
| Apr. 1, 1993—Jun. 30, 1993 | 9% | 23 | 577 |
| Jul. 1, 1993—Sep. 30, 1993 | 9% | 23 | 577 |
| Oct. 1, 1993—Dec. 31, 1993 | 9% | 23 | 577 |
| Jan. 1, 1994—Mar. 31, 1994 | 9% | 23 | 577 |
| Apr. 1, 1994—Jun. 30, 1994 | 9% | 23 | 577 |
| Jul. 1, 1994—Sep. 30, 1994 | 10% | 25 | 579 |
| Oct. 1, 1994—Dec. 31, 1994 | 11% | 27 | 581 |
| Jan. 1, 1995—Mar. 31, 1995 | 11% | 27 | 581 |
| Apr. 1, 1995—Jun. 30, 1995 | 12% | 29 | 583 |
| Jul. 1, 1995—Sep. 30, 1995 | 11% | 27 | 581 |
| Oct. 1, 1995—Dec. 31, 1995 | 11% | 27 | 581 |
| Jan. 1, 1996—Mar. 31, 1996 | 11% | 75 | 629 |
| Apr. 1, 1996—Jun. 30, 1996 | 10% | 73 | 627 |
| Jul. 1, 1996—Sep. 30, 1996 | 11% | 75 | 629 |
| Oct. 1, 1996—Dec. 31, 1996 | 11% | 75 | 629 |
| Jan. 1, 1997—Mar. 31, 1997 | 11% | 27 | 581 |
| Apr. 1, 1997—Jun. 30, 1997 | 11% | 27 | 581 |
| Jul. 1, 1997—Sep. 30, 1997 | 11% | 27 | 581 |
| Oct. 1, 1997—Dec. 31, 1997 | 11% | 27 | 581 |
| Jan. 1, 1998—Mar. 31, 1998 | 11% | 27 | 581 |
| Apr. 1, 1998—Jun. 30, 1998 | 10% | 25 | 579 |
| Jul. 1, 1998—Sep. 30, 1998 | 10% | 25 | 579 |
| Oct. 1, 1998—Dec. 31, 1998 | 10% | 25 | 579 |
| Jan. 1, 1999—Mar. 31, 1999 | 9% | 23 | 577 |
| Apr. 1, 1999—Jun. 30, 1999 | 10% | 25 | 579 |
| Jul. 1, 1999—Sep. 30, 1999 | 10% | 25 | 579 |
| Oct. 1, 1999—Dec. 31, 1999 | 10% | 25 | 579 |
| Jan. 1, 2000—Mar. 31, 2000 | 10% | 73 | 627 |
| Apr. 1, 2000—Jun. 30, 2000 | 11% | 75 | 629 |
| Jul. 1, 2000—Sep. 30, 2000 | 11% | 75 | 629 |
| Oct. 1, 2000—Dec. 31, 2000 | 11% | 75 | 629 |
| Jan. 1, 2001—Mar. 31, 2001 | 11% | 27 | 581 |
| Apr. 1, 2001—Jun. 30, 2001 | 10% | 25 | 579 |
| Jul. 1, 2001—Sep. 30, 2001 | 9% | 23 | 577 |
| Oct. 1, 2001—Dec. 31, 2001 | 9% | 23 | 577 |
| Jan. 1, 2002—Mar. 31, 2002 | 8% | 21 | 575 |

TABLE OF INTEREST RATES FOR
CORPORATE OVERPAYMENTS EXCEEDING $10,000
FROM JANUARY 1, 1995 - PRESENT

| | | 1995–1 C.B. | |
|---|---|---|---|
| | RATE | TABLE | PG |
| Jan. 1, 1995—Mar. 31, 1995 | 6.5% | 18 | 572 |
| Apr. 1, 1995—Jun. 30, 1995 | 7.5% | 20 | 574 |
| Jul. 1, 1995—Sep. 30, 1995 | 6.5% | 18 | 572 |
| Oct. 1, 1995—Dec. 31, 1995 | 6.5% | 18 | 572 |
| Jan. 1, 1996—Mar. 31, 1996 | 6.5% | 66 | 620 |
| Apr. 1, 1996—Jun. 30, 1996 | 5.5% | 64 | 618 |
| Jul. 1, 1996—Sep. 30, 1996 | 6.5% | 66 | 620 |
| Oct. 1, 1996—Dec. 31, 1996 | 6.5% | 66 | 620 |
| Jan. 1, 1997—Mar. 31, 1997 | 6.5% | 18 | 572 |
| Apr. 1, 1997—Jun. 30, 1997 | 6.5% | 18 | 572 |
| Jul. 1, 1997—Sep. 30, 1997 | 6.5% | 18 | 572 |
| Oct. 1, 1997—Dec. 31, 1997 | 6.5% | 18 | 572 |
| Jan. 1, 1998—Mar. 31, 1998 | 6.5% | 18 | 572 |
| Apr. 1, 1998—Jun. 30, 1998 | 5.5% | 16 | 570 |
| Jul. 1, 1998—Sep. 30, 1998 | 5.5% | 16 | 570 |
| Oct. 1, 1998—Dec. 31, 1998 | 5.5% | 16 | 570 |
| Jan. 1, 1999—Mar. 31, 1999 | 4.5% | 14 | 568 |
| Apr. 1, 1999—Jun. 30, 1999 | 5.5% | 16 | 570 |
| Jul. 1, 1999—Sep. 30, 1999 | 5.5% | 16 | 570 |
| Oct. 1, 1999—Dec. 31, 1999 | 5.5% | 16 | 570 |
| Jan. 1, 2000—Mar. 31, 2000 | 5.5% | 64 | 618 |
| Apr. 1, 2000—Jun. 30, 2000 | 6.5% | 66 | 620 |
| Jul. 1, 2000—Sep. 30, 2000 | 6.5% | 66 | 620 |
| Oct. 1, 2000—Dec. 31, 2000 | 6.5% | 66 | 620 |
| Jan. 1, 2001—Mar. 31, 2001 | 6.5% | 18 | 572 |
| Apr. 1, 2001—Jun. 30, 2001 | 5.5% | 16 | 570 |
| Jul. 1, 2001—Sep. 30, 2001 | 4.5% | 14 | 568 |
| Oct. 1, 2001—Dec. 31, 2001 | 4.5% | 14 | 568 |
| Jan. 1, 2002—Mar. 31, 2002 | 3.5% | 12 | 566 |

## Section 7430.— Awarding of Costs and Certain Fees

The Service provides an inflation adjustment to the hourly limit on attorney fees that may be awarded in a judgment or settlement of an administrative or judicial proceeding concerning the determination, collection, or refund of tax, interest, or penalty for calendar year 2002. See Rev. Proc. 2001–59, page 623.

## Section 7702B.— Treatment of Qualified Long-Term Care Insurance

The Service provides an inflation adjustment to the stated dollar amount of the *per diem* limitation regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual for calendar year 2002. See Rev. Proc. 2001–59, page 623.

# Part III. Administrative, Procedural, and Miscellaneous

## Proposed Revenue Procedure Regarding the Cash Method

## Notice 2001–76

Pursuant to the discretion granted the Commissioner of Internal Revenue under §§ 446 and 471 of the Internal Revenue Code, this notice provides a proposed revenue procedure that will allow qualifying small business taxpayers with gross receipts of less than $10 million to use the cash receipts and disbursements method of accounting as described in the proposed revenue procedure with respect to eligible trades or businesses. This proposed revenue procedure is intended to reduce the administrative and tax compliance burdens on certain small business taxpayers and to minimize disputes between the Internal Revenue Service (Service) and these taxpayers regarding the requirement to use an accrual method of accounting under § 446 of the Code because of the requirement to account for inventories under § 471. Although this revenue procedure is being issued in proposed form, taxpayers may rely on it for taxable years ending on or after December 31, 2001.

The Service believes that § 263A will have limited applicability to resellers and producers with gross receipts of $10,000,000 or less because of the exception for resellers in § 263A(b)(2)(B) and the indirect cost exception for producers in §1.263A–2(b)(3)(iv). However, the Service requests comments on any additional relief that should be considered for taxpayers with gross receipts of $10,000,000 or less to relieve any administrative burden of § 263A. The Service also welcomes other comments on the proposed revenue procedure provided in this notice. Comments should be submitted by March 1, 2002, either to:

Internal Revenue Service
P. O. Box 7604
Ben Franklin Station
Washington, DC 20044
Attn: CC:PA:T:CRU (ITA)
Room 5529

or electronically via the Service internet site at:
*Notice.Comments@m1.irscounsel.treas.gov* (the Service Comments e-mail address).

## Rev. Proc. 2001–XX

SECTION 1. PURPOSE

In order to reduce the administrative and tax compliance burdens on certain small business taxpayers and to minimize disputes between the Internal Revenue Service (Service) and small business taxpayers regarding the requirement to use an accrual method of accounting (accrual method) under § 446 of the Internal Revenue Code because of the requirement to account for inventories under § 471, this revenue procedure provides that the Commissioner of Internal Revenue will exercise his discretion to allow qualifying small business taxpayers to use the cash receipts and disbursements method of accounting (cash method) as described in this revenue procedure with respect to eligible trades or businesses. This revenue procedure also provides the procedures for these qualifying small business taxpayers to obtain automatic consent to change to the cash method for such trades or businesses.

SECTION 2. BACKGROUND

.01 Section 446(a) provides that taxable income must be determined under the method of accounting on the basis of which the taxpayer regularly computes income in keeping its books.

.02 Section 446(c) generally allows a taxpayer to select the method of accounting it will use to compute its taxable income. A taxpayer is entitled to adopt any one of the permissible methods for each separate trade or business, including the cash method and an accrual method, subject to certain restrictions. For example, § 446(b) provides that the selected method must clearly reflect income. In addition, § 1.446–1(c)(2)(i) of the Income Tax Regulations requires that a taxpayer use an accrual method with regard to purchases and sales of merchandise whenever § 471 requires the taxpayer to account for inventories, unless otherwise authorized by the Commissioner under § 1.446–1(c)(2)(ii). Under § 1.446–1(c)(2)(ii), the Commissioner has the authority to permit a taxpayer to use a method of accounting that clearly reflects income even though the method is not specifically authorized by the regulations.

.03 Section 447 generally requires the taxable income from farming of a C corporation engaged in the trade or business of farming, or a partnership engaged in the trade or business of farming with a C corporation partner, to be determined using an accrual method, unless the C corporation meets the $1,000,000 ($25,000,000 for family corporations) gross receipts test.

.04 Section 448 generally prohibits the use of the cash method by a C corporation (other than a farming business and a qualified personal service corporation) and a partnership with a C corporation partner (other than a farming business and a qualified personal service corporation), unless the C corporation or partnership with a C corporation partner meets the $5,000,000 gross receipts test. Section 448 also prohibits tax shelters from using the cash method.

.05 The cash method generally requires an item of income to be included in income when actually or constructively received and permits a deduction for an expense when paid. Section 1.446–1(c)(1)(i). Other provisions of the Code or regulations applicable to cash method taxpayers may change these general rules, including, for example, § 263 (requiring the capitalization of expenses paid out for a new building or for permanent improvements or betterments made to increase the value of any property or estate, or for restoring property or making good the exhaustion of property for which an allowance is or has been made); § 263A (requiring capitalization of direct and allocable indirect costs of real or tangible personal property produced by a taxpayer or real or personal property that is acquired by a taxpayer for resale); § 460 (requiring the use of the percentage-of-completion method for certain long-term contracts); and § 475 (requiring dealers in securities to mark securities to market).

.06 Section 471 provides that whenever, in the opinion of the Secretary, the use of inventories is necessary to clearly determine the income of the taxpayer, inventories must be taken by the taxpayer. Section 1.471–1 requires a taxpayer to account for inventories when the production, purchase, or sale of merchandise is an income-producing factor in the taxpayer's business.

.07 Section 1.162–3 requires taxpayers carrying materials and supplies (other than incidental materials and supplies) on hand to deduct the cost of materials and supplies only in the amount that they are actually consumed and used in operations during the taxable year.

.08 Section 263A generally requires direct costs and an allocable portion of indirect costs of certain property produced or acquired for resale by a taxpayer to be included in inventory costs, in the case of property that is inventory, or to be capitalized, in the case of other property. However, resellers with gross receipts of $10,000,000 or less are not required to capitalize costs under § 263A and certain producers with $200,000 or less of indirect costs are not required to capitalize certain costs under § 263A. See §§ 263A(b)(2)(B) and 1.263A–2(b)(3)(iv).

.09 Sections 446(e) and 1.446–1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

.10 Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when the taxpayer's taxable income is determined under a method of accounting different from the method used to determine taxable income for the preceding taxable year.

SECTION 3. SCOPE

.01 Applicability. This revenue procedure applies to a qualifying small business taxpayer. A qualifying small business taxpayer is any taxpayer with "average annual gross receipts" of more than $1,000,000 but less than or equal to $10,000,000 that is not prohibited from using the cash method under § 448.

.02 Taxpayers not within the scope of this revenue procedure.

(1) Notwithstanding section 3.01 of this revenue procedure, this revenue procedure does not apply to a farming business (within the meaning of § 263A(e)(4)) of a qualifying small business taxpayer. If a qualifying small business taxpayer is engaged in the trade or business of farming, this revenue procedure may apply to the taxpayer's nonfarming trades or businesses, if any. A taxpayer engaged in the trade or business of farming generally is allowed to use the cash method for any farming business, unless the taxpayer is required to use an accrual method under § 447 or is prohibited from using the cash method under § 448.

(2) Although this revenue procedure does not apply to a taxpayer with average annual gross receipts of $1,000,000 or less, such taxpayer generally is allowed to use the cash method pursuant to Rev. Proc. 2001–10 (2001–2 I.R.B. 272).

SECTION 4. QUALIFYING SMALL BUSINESS TAXPAYER EXCEPTION

.01 Pursuant to his discretion under §§ 446 and 471, and to simplify the recordkeeping requirements of a qualifying small business taxpayer, the Commissioner, as a matter of administrative convenience, will allow a qualifying small business taxpayer to use the cash method as described in this revenue procedure for a trade or business described in this section 4.01 (eligible trade or business). No inference is intended regarding whether a taxpayer that does not satisfy the qualifying small business taxpayer exception of this section 4.01 is permitted to use the cash method.

(1) A qualifying small business taxpayer that reasonably determines that its principal business activity (*i.e.*, the activity from which the taxpayer derived the largest percentage of its gross receipts) for its prior taxable year is described in a North American Industry Classification System ("NAICS") code other than one of the ineligible codes listed below may use the cash method as described in this revenue procedure for all of its trades or businesses. The ineligible NAICS codes are as follows:

(a) mining activities within the meaning of NAICS codes 211 and 212;

(b) manufacturing within the meaning of NAICS codes 31 – 33;

(c) wholesale trade within the meaning of NAICS code 42;

(d) retail trade within the meaning of NAICS codes 44 – 45; and,

(e) information industries within the meaning of NAICS codes 5111 and 5122.

Information regarding the NAICS codes can be found at *www.census.gov.* Visitors to the site should select "Subjects A to Z," followed by "N," and then should select "NAICS (North America)." Taxpayers also may find a partial list of NAICS codes, described as "Principal Business Activity Codes," in the instructions to their tax return forms.

(2) A qualifying small business taxpayer may use the cash method as described in this revenue procedure for all of its trades or businesses if its principal business activity is the provision of services, including the provision of property incident to those services. For example, a publisher whose principal business activity is the sale of advertising space in its publications is eligible to use the cash method as described in this revenue procedure, notwithstanding that the taxpayer's principal business activity is described in an ineligible NAICS code.

(3) A qualifying small business taxpayer may use the cash method as described in this revenue procedure (subject to the potential application of § 460) for all of its trades or businesses if its principal business activity is the fabrication or modification of tangible personal property upon demand in accordance with customer design or specifications. For purposes of this rule, tangible personal property is not fabricated or modified in accordance with customer design or specifications if the customer merely chooses among pre-selected options (*e.g.*, size, color, or materials) offered by the taxpayer or if the taxpayer must make only minor modifications to its basic design to meet the customer's specifications.

(4) Notwithstanding the taxpayer's principal business activity, a qualifying

small business taxpayer may use the cash method as described in this revenue procedure with respect to any separate and distinct trade or business whose principal business activity is not described in an ineligible NAICS code in section 4.01(1)(a) through (e) or is described in either section 4.01(2) or section 4.01(3). No trade or business will be considered separate and distinct unless a complete and separable set of books and records is kept for such trade or business. See § 1.446–1(d)(2).

.02 Notwithstanding § 1001 and the regulations thereunder, qualifying taxpayers that use the cash method for an eligible trade or business under section 4.01 of this revenue procedure include amounts in income attributable to open accounts receivable (*i.e.*, receivables due in 120 days or less) as amounts are actually or constructively received. However, § 1001 may be applicable to other transactions.

.03 Qualifying small business taxpayers that are permitted to use the cash method for an eligible trade or business under section 4.01 of this revenue procedure and that do not want to account for inventories under section 471 must treat all inventoriable items (*e.g.*, items purchased for resale to customers and raw materials purchased for use in producing finished goods) in such trade or business in the same manner as materials and supplies that are not incidental under § 1.162–3. Items that would be accounted for as incidental materials and supplies for purposes of § 1.162–3 may still be accounted for in that manner. Whether an item is purchased for resale (and thus must be accounted for as a non-incidental material and supply) or is purchased to provide to customers incident to services (and thus may be accounted for as either an incidental or a non-incidental material and supply depending on the facts and circumstances) must be determined under general tax principles.

.04 Under § 1.162–3, materials and supplies that are not incidental are deductible only in the year in which they are actually consumed and used in the taxpayer's business. For purposes of this revenue procedure, inventoriable items that are treated as materials and supplies that are not incidental are consumed and used in the year the qualifying small business taxpayer sells the items to a customer. Thus, under the cash method as described in this revenue procedure, the cost of such inventoriable items are deductible only in that year, or in the year in which the taxpayer actually pays for the goods, whichever is later. A qualifying small business taxpayer may use any reasonable method to determine the amount of the allowable deduction (*e.g.*, first in, first out or average cost) provided that the method is used consistently.

## SECTION 5. DEFINITIONS

.01 Average annual gross receipts. A taxpayer has average annual gross receipts of $10,000,000 or less if, for each prior taxable year ending on or after December 31, 2000, the taxpayer's average annual gross receipts for the 3–taxable-year period ending with the applicable prior taxable year does not exceed $10,000,000.

.02 Gross receipts. Gross receipts is defined consistent with § 1.448–1T(f)(2)(iv) of the Temporary Income Tax Regulations. Thus, gross receipts for a taxable year equal all receipts derived from all of a taxpayer's trades or businesses that must be recognized under the method of accounting actually used by the taxpayer for that taxable year for federal income tax purposes. For example, gross receipts include total sales (net of returns and allowances), all amounts received from services, interest, dividends, and rents. However, gross receipts do not include amounts received by the taxpayer with respect to sales tax or other similar state and local taxes if, under the applicable state or local law, the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the tax to the taxing authority. *See also* § 448(c)(3)(C).

.03 Aggregation of gross receipts. For purposes of computing gross receipts, all taxpayers treated as a single employer under subsection (a) or (b) of § 52 or subsection (m) or (o) of § 414 (or that would be treated as a single employer under these sections if the taxpayers had employees) will be treated as a single taxpayer. However, when transactions occur between taxpayers that are treated as a single taxpayer by the previous sentence, gross receipts arising from these transactions will not be treated as gross receipts for purposes of the average annual gross receipts limitation. *See* §§ 448(c)(2) and 1.448–1T(f)(2)(ii).

.04 Taxpayer not in existence for 3 taxable years. If a taxpayer has been in existence for less than the 3–taxable-year period referred to in section 5.01 of this revenue procedure, the taxpayer must determine its average annual gross receipts for the number of years (including short taxable years) that the taxpayer has been in existence. *See* § 448(c)(3)(A).

.05 Treatment of short taxable years. In the case of a short taxable year, a taxpayer's gross receipts must be annualized by multiplying the gross receipts for the short taxable year by 12 and then dividing the result by the number of months in the short taxable year. *See* §§ 448(c)(3)(B) and 1.448–1T(f)(2)(iii).

.06 Treatment of predecessors. Any reference to taxpayer in this section 5 includes a reference to any predecessor of that taxpayer. *See* § 448(c)(3)(D).

## SECTION 6. EXAMPLES

Assume for purposes of the following examples that the taxpayers are not prohibited from using the cash method under § 448. Also assume for purposes of examples 2 through 10 that the taxpayers have average annual gross receipts of $10,000,000 or less.

*Example 1.* Taxpayer is a calendar year plumbing contractor that installs plumbing fixtures in customers' homes and businesses. Taxpayer reasonably determines that its principal business activity is construction, which is described in NAICS code 23. Taxpayer's gross receipts at the end of the three preceding taxable years are:

| | *Gross receipts* |
|---|---|
| 1998: | $ 6,000,000 |
| 1999: | 9,000,000 |
| 2000: | 12,000,000 |

Taxpayer's average annual gross receipts for the 3–taxable year-period ending in the 2000 taxable year is $9,000,000 ($6,000,000 + $9,000,000 + $12,000,000 = $27,000,000/3). Taxpayer may use the cash method for all its trades or businesses pursuant to this revenue procedure for its 2001 taxable year because its average annual gross receipts for each prior taxable year ending on or after December 31, 2000, is $10,000,000 or less and its principal business activity is not described in the ineligible NAICS codes listed in section 4.01(1)(a) – (e).

*Example 2.* Taxpayer is a plumbing contractor that installs plumbing fixtures in customers' homes and businesses. Taxpayer also has a store that sells plumbing equipment to homeowners and other plumbers who visit the store. Taxpayer derives 60 percent of its total receipts from plumbing installation (including amounts charged for parts and fixtures used in installation) and 40 percent of its total receipts from the sale of plumbing equipment through its store. Taxpayer reasonably determines that its principal business activity is plumbing installation, which is included in the construction activities described in NAICS code 23. Taxpayer may use the cash method for both business activities because Taxpayer is a qualifying small business taxpayer whose principal business activity—plumbing installation—is not described in the ineligible NAICS codes listed in section 4.01(a)–(e).

*Example 3.* Same as *Example 2*, except Taxpayer derives 40 percent of its total receipts from plumbing installation (including amounts charged for parts and fixtures used in installation) and 60 percent of its total receipts from the sale of plumbing equipment through its store. Taxpayer's principal business activity is described in the ineligible NAICS code 44. Moreover, Taxpayer's principal business activity is neither the provision of services under section 4.01(2) nor the fabrication or modification of tangible personal property under section 4.01(3). Therefore, Taxpayer may not use the cash method under this revenue procedure for its plumbing retail business. Taxpayer may use the cash method for its plumbing installation business if the Taxpayer keeps complete and separate books and records for its plumbing installation business and its plumbing retail business. If Taxpayer keeps one set of books and records for its plumbing installation business and its plumbing retail business, then Taxpayer is required to use an accrual method for both businesses.

*Example 4.* Taxpayer sells refrigerators. As part of the sale price, Taxpayer will deliver the refrigerator to the customer and confirm that the refrigerator is functioning properly at the customer's site. Taxpayer's principal business activity is described in the ineligible NAICS code 44. Moreover, taxpayer's principal business activity is not the provision of services under section 4.01(2). Taxpayer does not provide refrigerators incident to the performance of services. Rather, Taxpayer performs certain services (delivery and confirmation of functionality) incident to the sale of refrigerators. In addition, Taxpayer does not fabricate or modify tangible personal property under section 4.01(3). Taxpayer may not use the cash method under this revenue procedure.

*Example 5.* Taxpayer is a sofa manufacturer that only produces sofas upon receipt of a customer order. Customers are allowed to pick among 150 different fabrics offered by the taxpayer or to provide their own fabric, which the taxpayer will use to finish the customer's sofa. Taxpayer's principal business activity is described in the ineligible NAICS code 33. Taxpayer does not provide sofas incident to the performance of services for purposes of section 4.01(2). Rather, Taxpayer performs certain services (upholstering) incident to the sale of sofas. Taxpayer also does not fabricate or modify tangible personal property for purposes of section 4.01(3) because customers merely choose among pre-selected options offered by Taxpayer and Taxpayer only makes minor modifications to the basic design of its sofa. Taxpayer may not use the cash method under this revenue procedure.

*Example 6.* Taxpayer makes tools based entirely on specific designs and specifications provided to it by customers in their orders. Taxpayer's principal business activity is described in the ineligible NAICS code 33. However, Taxpayer's principal business activity is the fabrication of tangible personal property for purposes of section 4.01(3). Taxpayer may use the cash method under this revenue procedure (subject to the potential application of § 460).

*Example 7.* Taxpayer is a roofing contractor that is a qualifying small business taxpayer eligible to use the cash method under sections 3 and 4 of this revenue procedure. Taxpayer, who uses the calendar year, chooses to use the cash method as described in this revenue procedure and to not account for inventories under § 471. Taxpayer enters into a contract with a homeowner in December 2001 to replace the homeowner's roof. Taxpayer purchases roofing shingles from a local supplier and has them delivered to the homeowner's residence. Taxpayer pays the supplier $5,000 for the shingles upon their delivery later that month. Taxpayer replaces the homeowner's roof in December 2001, and gives the homeowner a bill for $15,000 at that time. Taxpayer receives a check from the homeowner in January 2002.

Taxpayer deducts the $5,000 cost of the shingles on its 2001 Federal income tax return (the year the shingles are paid for by Taxpayer and provided to the customer in connection with the performance of roofing services). Taxpayer includes the $15,000 in income in 2002 when it receives the check from the homeowner.

*Example 8.* The facts are the same as in *Example 7*, except that Taxpayer does not replace the roof until January 2002 and is not paid until March 2002. Because the shingles are not used until 2002, their cost can only be deducted on Taxpayer's 2002 Federal income tax return notwithstanding that Taxpayer paid for the shingles in 2001. Thus, on its 2002 return, Taxpayer must report $15,000 of income and $5,000 of deductions.

*Example 9.* Taxpayer, a qualifying small business taxpayer, elects to use the cash method as described in this revenue procedure. Taxpayer is a speculative builder of houses that are built on land it owns. In 2001, Taxpayer builds a house using various items such as lumber, piping, and metal fixtures that it had paid for in 2000. In 2002, Taxpayer sells the house to a buyer. Because the house is real property held for sale by Taxpayer, it is not an inventoriable item under section 4.03 of this revenue procedure. Thus, the taxpayer may not account for the items used to build the house as non-incidental materials and supplies under § 1.162–3. Rather, Taxpayer must capitalize the costs of the lumber, piping, metal fixtures and other goods used by Taxpayer to build the house. Upon the sale of the house in 2002, the costs capitalized by Taxpayer will be offset against the house sales price to determine Taxpayer's gain or loss from the sale.

*Example 10.* The facts are the same as in *Example 9*, except that Taxpayer builds houses on land its customers own. Because Taxpayer does not own the house, the lumber, piping, metal fixtures and other goods used by Taxpayer in the provision of construction services are not real property held for sale. Taxpayer must deduct the cost of the lumber, piping, metal fixtures and other non-incidental materials and supplies that are used by it to build the house in 2001 (the year those items were used by Taxpayer to build the house) notwithstanding that Taxpayer had paid for the items in 2000. Taxpayer will report income it receives from its customer as the income is actually or constructively received.

## SECTION 7. CHANGE IN ACCOUNTING METHOD

.01 In general. Any change in a taxpayer's method of accounting pursuant to this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply.

.02 Automatic change for taxpayers within the scope of this revenue procedure.

(1) Automatic change to the cash method. A qualifying small business taxpayer that wants to use the cash method as described in this revenue procedure for an eligible trade or business must follow the automatic change in accounting method provisions of Rev. Proc. 99–49 (1999-2 C.B. 725) (or its successor) with the following modifications:

(a) The scope limitations in section 4.02 of Rev. Proc. 99–49 do not apply. However, if the taxpayer is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the Form 3115, *Application for Change in Accounting Method,* to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate;

(b) Taxpayers filing Form 3115 for a change in method of accounting under this revenue procedure must complete all applicable parts of the form but need not complete Part II of Schedule A of Form 3115. Specifically, Part II, line 17 (regarding information on gross receipts in previous years) and Part III (regarding the § 481(a) adjustment) must be completed. Taxpayers should write "Filed under Rev. Proc. 2001–XX" at the top of their Form 3115.

(2) Automatic change to section 1.162–3. A qualifying taxpayer that does not want to account for inventories under § 471 of an eligible trade or business must make any necessary change from the taxpayer's current method of accounting for inventoriable items in that trade or business to treat such inventoriable items in the same manner as materials and supplies that are not incidental under section 1.162–3. For purposes of such a change, the rules of section 6.02(1) of this revenue procedure apply. Taxpayers may file a single Form 3115 for both changes described in sections 7.02(1) and 7.02(2).

.03 Section 481(a) adjustment. The net amount of the § 481(a) adjustment computed under this revenue procedure must take into account both increases and decreases in the applicable account balances such as accounts receivable, accounts payable, and inventory. For example, the § 481(a) adjustment may include the difference resulting from changing from taking inventory accounts under § 471 to treating the goods as materials and supplies that are not incidental under § 1.162–3.

.04 Taxpayers not within the scope of this revenue procedure. A taxpayer that ceases to qualify for the qualifying small business taxpayer exception described in section 4 of this revenue procedure for any trade or business and otherwise is required to use an accrual method for that trade or business must change to an accrual method (and, if applicable an inventory method that complies with § 471) for that trade or business using either the automatic change in accounting method provisions of section 5.01 of the APPENDIX to Rev. Proc. 99–49, if applicable, or the advance consent provisions of Rev. Proc. 97–27 (1997–1 C.B. 680) (or its successor).

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99–49 (1999–2 C.B. 725) is modified and amplified to include this automatic change in section 10 of the APPENDIX.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2001. However, the Service will not challenge a taxpayer's use of the cash method under § 446, or a taxpayer's failure to account for inventories under § 471, for a trade or business in an earlier year if the taxpayer, for that year, was a qualifying small business taxpayer as described in section 3 of this revenue procedure and the taxpayer was eligible to use the cash method for such trade or business under section 4.01 of this revenue procedure.

CONTACT INFORMATION

For further information regarding this revenue procedure, contact Cheryl Lynn Oseekey of the Office of Associate Chief Counsel (Income Tax and Accounting) at (202) 622–4970 (not a toll-free call).

## Weighted Average Interest Rate Update

## Notice 2001–80

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30–year Treasury Constant Maturities for November 2001 is 5.12 percent.

The following rates were determined for the plan years beginning in the month shown below.

| Month | Year | Weighted Average | 90% to 105% Permissible Range | 90% to 110% Permissible Range |
|---|---|---|---|---|
| December | 2001 | 5.72 | 5.15 to 6.01 | 5.15 to 6.29 |

DRAFTING INFORMATION

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283–9888 (not a toll-free number).

## Section 529 Programs

## Notice 2001–81

This notice provides guidance regarding certain recordkeeping, reporting, and other requirements applicable to qualified tuition programs described in § 529 of the Internal Revenue Code, in light of certain amendments made to § 529 by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Pub. L. No. 107–16, 115 Stat. 38) (EGTRRA).

Among other changes to § 529, EGTRRA: (1) expands the definition of "qualified tuition program" to include certain prepaid tuition programs established and maintained by one or more eligible educational institutions; (2) provides an exclusion from gross income for distributions from a State § 529 program (and, beginning in 2004, a prepaid tuition program established and maintained by one or more eligible educational institutions) which are used to pay for qualified higher education expenses of the designated beneficiary; (3) repeals the requirement that a § 529 program impose a more than *de minimis* penalty on any refund of earnings not used for qualified higher education expenses of the beneficiary; and (4) replaces that penalty with an additional 10–percent tax on the amount of a distribution from a § 529 program that is includible in gross income (with certain exceptions). In general, these amendments are effective for taxable years beginning after December 31, 2001.[1]

In light of these changes, and to give § 529 programs adequate time to implement appropriate recordkeeping and reporting procedures, the Internal Revenue Service and the Treasury Department are issuing this guidance, which they intend to incorporate in final regulations under § 529. Section 529 programs and their participants may rely on this notice pending the issuance of final regulations under § 529.

**a. Imposition of a penalty and verification of purpose of a distribution.**

As currently in effect (prior to the effective date of EGTRRA), § 529(b)(3) provides that a program is not treated as a qualified § 529 program unless it imposes a more than *de minimis* penalty on any refund of earnings that is not: (a) used for qualified higher education expenses of the designated beneficiary; (b) made on account of the death or disability of the designated beneficiary; or (c) made on account of certain scholarships or other educational assistance received by the beneficiary. Prop. Treas. Reg. § 1.529–2(e) provides rules on *de minimis* penalties and procedures for verifying the use of distributions and imposing and collecting penalties.

EGTRRA repeals § 529(b)(3), effective for taxable years beginning after December 31, 2001. Therefore, the final regulations under § 529 will provide that, with respect to any distributions made after December 31, 2001, a § 529 program will no longer be required to verify how distributions are used or to collect any penalty. However, with respect to any distributions made on or before December 31, 2001, a § 529 program must continue to verify whether the distribution is used for qualified higher education expenses of the beneficiary and to collect a more than *de minimis* penalty on nonqualified distributions.

**b. Reporting of distributions.**

Section 529(d) provides that a § 529 program shall make reports regarding the program to the Internal Revenue Service and to designated beneficiaries regarding contributions, distributions, and such other matters as the Internal Revenue Service may require. Prop. Treas. Reg. § 1.529–4 requires a State tuition program to report on Form 1099–G, Certain Government Payments, the earnings portion of any distribution made during the year, together with other information such as the name, address and TIN of the distributee. A § 529 program must furnish a statement to the distributee on or before January 31st of the year following the calendar year in which the distribution is made. In addition, a § 529 program must file Form 1099–G on or before February 28th of the year following the calendar year in which the distribution is made.

These reporting requirements continue in effect for distributions made in 2001. Thus, with respect to any distributions made in 2001, a § 529 program must furnish statements to the distributees on or before January 31, 2002, and file returns on Form 1099–G on or before February 28, 2002.

In light of the expansion of § 529 to include prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions), the Internal Revenue Service will issue a new form, Form 1099–Q, for taxable years beginning after December 31, 2001. A copy of Form 1099–Q is available on the IRS website at *www.irs.gov.*

**c. Calculation of earnings.**

**1. In general.**

Section 529(c)(3)(A) provides that a distribution from a § 529 program is includible in the gross income of the distributee in the manner as provided under § 72, to the extent not excluded from gross income under any other provision of Chapter 1 of the Code. Section 529(c)(3)(D)(iii) provides that, except to the extent provided by the Secretary, the value of the contract, income on the contract, and the investment in the contract are to be computed as of the close of the calendar year.

**2. Recordkeeping requirements with respect to rollover contributions.**

Section 529(b)(3)[2] states that a program must provide a separate accounting for each designated beneficiary. Prop. Treas. Reg. § 1.529–2(f) requires a § 529 program to maintain records with respect to the designated beneficiary of each account showing the total investment in the account and any earnings attributable thereto.

In the case of a contribution to a § 529 account that represents a transfer from a Coverdell education savings account described in § 530(b)(2)(B), a transfer of proceeds of a qualified U.S. Savings Bond described in § 135(c)(2)(C), or a "rollover" of amounts from another § 529 program account (each, a "rollover contribution"), the recipient § 529 program must determine the basis and earnings portions of the amounts contributed. (See Prop. Treas. Reg. § 1.529–3(a)(2), which provides that the earnings portion of the rollover amount must be added to the earnings of the account that received the contribution.)

Although this requirement was not changed by EGTRRA, § 529 programs have indicated that there is some confusion about the requirement that a § 529 program determine and maintain records that reflect the basis and earnings portions of any rollover contribution. Accordingly, it is expected that final regulations will clarify that, when accepting a contribution, a § 529 program must ask whether the contribution is a rollover contribution from a Coverdell education savings account, a qualified U.S. Savings Bond, or another § 529 program. If the contribution is a rollover contribution, the § 529 program must determine the earnings portion of the contribution, and add that amount to the earnings recorded in the account to which the rollover contribution

[1] Unless otherwise indicated, references herein are to § 529 of the Internal Revenue Code, as amended by EGTRRA.
[2] Section 529(b)(4) was renumbered as § 529(b)(3) by EGTRRA.

is made. Until the § 529 program receives appropriate documentation showing the earnings portion of the contribution, the program must treat the entire amount of the contribution as earnings in the § 529 account receiving the distribution. For this purpose, "appropriate documentation" means: (1) in the case of a rollover contribution from a Coverdell education savings account, an account statement issued by the financial institution that acted as trustee or custodian of the education savings account that shows basis and earnings in the account; (2) in the case of a rollover contribution from the redemption of qualified U.S. Savings Bonds, an account statement or Form 1099-INT issued by the financial institution that redeemed the bonds showing interest from the redemption of the bonds; and (3) in the case of a rollover contribution from another § 529 program, a statement issued by the distributing § 529 program that shows the earnings portion of the distribution.

**3. Rollover statement between § 529 programs.**

In the case of any direct transfer (*i.e.*, trustee-to-trustee rollover) between § 529 programs, the distributing program must provide to the receiving program a statement setting forth the earnings portion of the rollover distribution within 30 days after the distribution or by January 10th of the year following the calendar year in which the rollover occurred, whichever is earlier. This rule is effective for direct transfers between § 529 programs that occur on or after January 1, 2002.

**4. Timing of earnings calculation.**

Consistent with § 529(c)(3)(D), the proposed regulations provide that the earnings portion of any distribution is determined by applying an earnings ratio, generally the earnings allocable to an account as of the close of the year divided by the total account balance as of the close of the calendar year, determined by adding back the amount of all distributions made during the year. See Prop. Treas. Reg. § 1.529–1(c).

In response to comments received on the proposed regulations, and consistent with the Secretary's authority under § 529(c)(3)(D)(iii) to adopt a different rule, the Treasury Department and the Internal Revenue Service expect that final regulations will revise the time for determining the earnings portion of any distribution from a § 529 account. It is expected that final regulations will provide that, effective for distributions made after December 31, 2002, programs will be required to determine the earnings portion of each distribution as of the date of distribution. In the case of direct transfers between § 529 programs, this requirement is effective for distributions made after December 31, 2001. In the case of any State program for which this change would require legislation and whose State legislature has a biennial legislative session, the program will have until January 1, 2004, to conform to this method of calculating earnings.

**5. Aggregation of Accounts.**

Section 529(c)(3)(D)(i) provides that to the extent provided by the Secretary, all § 529 programs of which an individual is a designated beneficiary shall be treated as one program. Prop. Treas. Reg. § 1.529–3(d) provides that all accounts maintained by a § 529 program for the benefit of a designated beneficiary shall be treated as a single account for purposes of calculating the earnings portion of any distribution. Based on comments received on the proposed regulations, it is expected that the final regulations will provide that only accounts maintained by a § 529 program and having the same account owner and the same designated beneficiary must be aggregated for purposes of computing the earnings portion of any distribution. For this purpose, a State that has both a prepaid § 529 program and a § 529 savings program should consider each program separately for purposes of calculating the earnings portion of any distribution from either the prepaid or the savings program. These changes will apply for purposes of the earnings calculation only, and will not affect the application of § 529(b)(6) (prohibition on excess contributions)[3]. The § 529(b)(6) limit will continue to be applied based upon all accounts, both savings and prepaid, in programs established and maintained by the State for the benefit of the same designated beneficiary.

***Comments on Future Guidance Invited***

The Internal Revenue Service invites comments on the matters described in this notice and any other matters relating to § 529 and the regulations thereunder. Please send written comments by March 25, 2002, to: CC:ITA:RU (Notice 2001–81), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submission may be hand-delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:ITA:RU (Notice 2001–81), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/prod/tax_regs/regslist.html*. Comments will be available for public inspection.

DRAFTING INFORMATION

The principal author of this notice is Monice Rosenbaum of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact Ms. Rosenbaum at (202) 622–6070 (not a toll-free number).

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## Expansion of Safe Harbor Provisions Under Notice 88–129

## Notice 2001–82

PURPOSE

This notice amplifies and modifies Notice 88–129 (1988–2 C.B. 541) as modified and amplified by Notice 90–60 (1990–2 C.B. 345). Notice 88–129 provides that a regulated public utility (utility) will not realize income upon transfers of interties from qualifying small power

[3] Section 529(b)(7) was renumbered as § 529(b)(6) by EGTRRA.

producers and qualifying cogenerators (collectively, Qualifying Facilities), as defined in section 3 of the Federal Power Act, as amended by section 201 of the Public Utilities Regulatory Policies Act of 1978 (PURPA). This notice extends the safe harbor provisions of Notice 88–129 to include transfers of interties from non-Qualifying Facilities. The safe harbor also is extended to transactions in which there is not a long-term power purchase contract between the utility and the power producer but rather the intertie is transferred pursuant to a long-term interconnection agreement and in which the intertie is used exclusively to transmit power across the utility's transmission grid for sale to consumers or intermediaries.

## BACKGROUND

At the time Notice 88–129 was issued, most generators that were not owned by regulated public utilities (stand-alone generators) were Qualifying Facilities for regulatory purposes. As a stand-alone generator, the Qualifying Facility had to be connected to a utility's transmission lines in order to move its power to market. PURPA required that a utility interconnect with a Qualifying Facility for the purpose of allowing the sale of power produced by the Qualifying Facility. A Qualifying Facility generally sold its electricity under a long-term power purchase contract to the local utility with whom it was interconnecting at the utility's avoided cost. A Qualifying Facility also arranged in certain cases for the interconnected utility to transmit electricity across its transmission grid for sale to another utility (wheeling) at that utility's avoided cost.

Deregulation of the electric power industry has significantly changed the operation of the industry. Today, few new stand-alone generators are Qualifying Facilities. The Federal Energy Regulatory Commission (FERC) encouraged the construction of non-Qualifying Facilities starting in the late 1980's by issuing a number of orders to individual projects (known in the industry as independent power producers) approving sales of power at market rates. In addition, the Energy Policy Act of 1992 created a new class of stand-alone generators, called exempt wholesale generators, that are permitted to sell their power at market rates with FERC approval, and are exempted from certain utility regulation. Unlike PURPA, the Energy Policy Act has no requirement that utilities buy electricity from stand-alone generators.

In 1996, FERC issued Order No. 888 in an effort to ensure that every wholesale supplier of electricity, including, for example, power marketers and stand-alone generators, has open access to the national transmission grid. The order requires regulated utilities to allow stand-alone generators to interconnect to the grid and to file nondiscriminatory tariffs under which any wholesale supplier can pay to have its electricity wheeled. Stand-alone generators (including Qualifying Facilities) have additional outlets for their power today that they did not have in 1988, including sales of power at auction on regional power exchanges or spot markets and under short and medium-term contracts to specific customers or to power marketers that trade electricity. Regulated utilities have many more sources of supply for electricity than in 1988. As a result of these changes, very few utilities enter into long-term power purchase contracts with stand-alone generators. Electricity produced by stand-alone generators is more likely today than in 1988 to be wheeled across the transmission grid of the interconnected utility for sale to consumers or intermediaries rather than to be sold directly to the interconnected utility.

The new stand-alone generators still need to be interconnected to the transmission grid in order for a customer to take the power. Therefore, the stand-alone generator enters into a long-term interconnection agreement with the local utility. The term of a long-term interconnection agreement may be tied to the period that the stand-alone generator remains in commercial operation. This agreement may permit assignment of the agreement by the utility to accommodate future consolidation of local grids into regional transmission systems that will cover broad regions of the country.

## MODIFICATIONS TO NOTICE 88–129 AND NOTICE 90–60

In light of the above-mentioned changes in the electric power industry, the safe harbor provisions of Notice 88–129 are modified as follows:

1. The safe harbor provisions are extended to include transfers of interties from non-Qualifying Facilities. Accordingly, the term "QF transfer" appearing in Notice 88–129 will be construed as including "qualified transfers" of interties from non-Qualifying Facilities that meet the other requirements of the safe harbor provisions. Similarly, the term "Qualifying Facility" for purposes of Notice 88–129 will be construed as including "stand-alone generators" that are not Qualifying Facilities.

2. The safe harbor provisions also are extended to include transfers of interties used exclusively or in part to transmit power over the utility's transmission grid for sale to consumers or intermediaries, including affiliated intermediaries (wheeling). This safe harbor only applies to transactions in which the intertie is transferred pursuant to a long-term interconnection agreement and in which ownership of the electricity wheeled passes to the purchaser prior to its transmission on the utility's transmission grid. The ownership requirement of the preceding sentence is deemed satisfied if title to electricity wheeled passes to the purchaser at the busbar on the generator's end of the intertie. The terms "power purchase contract" and "power supply contract" appearing in Notice 88–129 will be construed as including interconnection agreements in transactions in which the intertie is used for wheeling. Accordingly, a long-term interconnection agreement in lieu of a long-term power purchase contract or power supply contract may be used to satisfy the safe harbor provisions of Notice 88–129 in such transactions. The term "dual-use intertie" appearing in Notice 88–129 will be construed as including an intertie which may be used to transmit power from a third party for sale to the Qualifying Facility.

3. Section 6, sentence 4, of Notice 88–129, states, "The cost of property transferred in a QF transfer must be capitalized by the Qualifying Facility as an intangible asset and recovered as appropriate." This sentence is modified to read as follows: "The cost of property transferred in a QF transfer must be capitalized by the Qualified Facility as an intangible asset and recovered using the straight-line method over a useful life of 20 years."

EFFECT ON OTHER DOCUMENTS

Notice 88–129, as amplified and modified by Notice 90–60, is further amplified and modified.

EFFECTIVE DATE

This notice applies to transfers of property to regulated public utilities, pursuant to interconnection agreements, completed after December 26, 2001, the date this notice is published in the Bulletin. For transfers of interties occurring on or before December 26, 2001, and meeting the requirements of this notice, taxpayers may request application of this notice through a request for a private letter ruling (including in appropriate circumstances where the taxpayer's return for the year of transfer has already been filed).

DRAFTING INFORMATION

The principal author of this notice is Gregory N. Doran of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Mr. Doran at (202) 622–3040 (not a toll-free call).

## Tables for Figuring Amount Exempt From Levy on Wages, Salary, and Other Income

## Notice 2001–83

**1. Table for Figuring Amount Exempt From Levy on Wages, Salary, and Other Income (Forms 668–W(c) and 668–W(c)(DO)) 2002**

Publication 1494, shown below, provides tables that show the amount of an individual's income that is exempt from a notice of levy used to collect delinquent tax in 2002.

(Amounts are for each pay period.)

| Filing Status: Single | | | | | | | |
|---|---|---|---|---|---|---|---|
| Pay Period | Number of Exemptions Claimed on Statement | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | More Than 6 |
| Daily | 29.62 | 41.15 | 52.69 | 64.23 | 75.77 | 87.31 | 18.08 plus 11.54 for each exemption |
| Weekly | 148.08 | 205.77 | 263.46 | 321.15 | 378.85 | 436.54 | 90.38 plus 57.69 for each exemption |
| Biweekly | 296.15 | 411.54 | 526.92 | 642.31 | 757.69 | 873.08 | 180.77 plus 115.38 for each exemption |
| Semi-Monthly | 320.83 | 445.83 | 570.83 | 695.83 | 820.83 | 945.83 | 195.83 plus 125.00 for each exemption |
| Monthly | 641.67 | 891.67 | 1141.67 | 1391.67 | 1641.67 | 1891.67 | 391.66 plus 250.00 for each exemption |

| Filing Status: Unmarried Head of Household | | | | | | | |
|---|---|---|---|---|---|---|---|
| Pay Period | Number of Exemptions Claimed on Statement | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | More Than 6 |
| Daily | 38.08 | 49.62 | 61.15 | 72.69 | 84.23 | 95.77 | 26.54 plus 11.54 for each exemption |
| Weekly | 190.38 | 248.08 | 305.77 | 363.46 | 421.15 | 478.85 | 132.69 plus 57.69 for each exemption |
| Biweekly | 380.77 | 496.15 | 611.54 | 726.92 | 842.31 | 957.69 | 265.38 plus 115.38 for each exemption |
| Semi-Monthly | 412.50 | 537.50 | 662.50 | 787.50 | 912.50 | 1037.50 | 287.50 plus 125.00 for each exemption |
| Monthly | 825.00 | 1075.00 | 1325.00 | 1575.00 | 1825.00 | 2075.00 | 575.00 plus 250.00 for each exemption |

| Filing Status: Married Filing Joint Return (and Qualifying Widow(er)s) | | | | | | | |
|---|---|---|---|---|---|---|---|
| Pay Period | Number of Exemptions Claimed on Statement | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | More Than 6 |
| Daily | 41.73 | 53.27 | 64.81 | 76.35 | 87.88 | 99.42 | 30.19 plus 11.54 for each exemption |
| Weekly | 208.65 | 266.35 | 324.04 | 381.73 | 439.42 | 497.12 | 150.96 plus 57.69 for each exemption |
| Biweekly | 417.31 | 532.69 | 648.08 | 763.46 | 878.85 | 994.23 | 301.92 plus 115.38 for each exemption |
| Semi-Monthly | 452.08 | 577.08 | 702.08 | 827.08 | 952.08 | 1077.08 | 327.08 plus 125.00 for each exemption |
| Monthly | 904.17 | 1154.17 | 1404.17 | 1654.17 | 1904.17 | 2154.17 | 654.17 plus 250.00 for each exemption |

| Filing Status: Married Filing Separate Return | | | | | | | |
|---|---|---|---|---|---|---|---|
| Pay Period | Number of Exemptions Claimed on Statement | | | | | | |
| | 1 | 2 | 3 | 4 | 5 | 6 | More Than 6 |
| Daily | 26.63 | 38.17 | 49.71 | 61.25 | 72.79 | 84.33 | 15.10 plus 11.54 for each exemption |
| Weekly | 133.17 | 190.87 | 248.56 | 306.25 | 363.94 | 421.63 | 75.48 plus 57.69 for each exemption |
| Biweekly | 266.35 | 381.73 | 497.12 | 612.50 | 727.88 | 843.27 | 150.96 plus 115.38 for each exemption |
| Semi-Monthly | 288.54 | 413.54 | 538.54 | 663.54 | 788.54 | 913.54 | 163.54 plus 125.00 for each exemption |
| Monthly | 577.08 | 827.08 | 1077.08 | 1327.08 | 1577.08 | 1827.08 | 327.08 plus 250.00 for each exemption |

**2. Table for Figuring Additional Exempt Amount for Taxpayers at Least 65 Years Old and/or Blind**

Additional Exempt Amount

| Filing Status | * | Daily | Wkly | Bi-Wkly | Semi-Mo | Monthly |
|---|---|---|---|---|---|---|
| Single or Head of Household | 1 | 4.42 | 22.12 | 44.23 | 47.92 | 95.83 |
| | 2 | 8.85 | 44.23 | 88.46 | 95.83 | 191.57 |
| Any Other Filing Status | 1 | 3.46 | 17.31 | 34.62 | 37.50 | 75.00 |
| | 2 | 6.92 | 34.62 | 69.23 | 75.00 | 150.00 |
| | 3 | 10.38 | 51.92 | 103.85 | 112.50 | 225.00 |
| | 4 | 13.85 | 69.23 | 138.46 | 150.00 | 300.00 |

* ADDITIONAL STANDARD DEDUCTION claimed on Parts 3, 4, & 5 of levy.

**Examples**

These tables show the amount exempt from a levy on wages, salary, and other income.

For example:

1. A single taxpayer who is paid weekly and claims three exemptions (including one for the taxpayer) has $263.46 exempt from levy.

2. If the taxpayer in number 1 is over 65 and writes 1 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, & 5 of the levy, $285.58 is exempt from this levy ($263.46 plus $22.12).

3. A taxpayer who is married, files jointly, is paid biweekly, and claims two exemptions (including one for the taxpayer) has $532.69 exempt from levy.

4. If the taxpayer in number 3 is over 65 and has a spouse who is blind, this taxpayer should write 2 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, & 5 of the levy. Then, $601.92 is exempt from this levy ($532.69 plus $69.23).

*26 CFR 601.602: Tax forms and instructions.*
*(Also Part I, §§ 1, 24, 25A, 32, 59, 63, 68, 132, 135, 151, 170, 213, 220, 512, 513, 685, 877, 2032A, 2503, 2523, 2631, 4001, 4003, 4261, 6033, 6039F, 6323, 6334, 6601, 7430, 7702B)*

# Rev. Proc. 2001–59

Table of Contents

## SECTION 1. PURPOSE

This revenue procedure sets forth inflation adjusted items for 2002.

## SECTION 2. CHANGES

.01 Section 201 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) amended § 24 to increase the amount of credit under § 24 that may be refundable. The value in § 24(d)(1)(B)(i) used in determining the new potentially refundable amount is adjusted for inflation.

.02 The amounts in § 25A(b)(1) which are used in determining the Hope Scholarship Credit and the amounts in § 25A(d)(2)(A)(ii) which are used in determining the reduction in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise allowable under § 25A(a) are adjusted for inflation.

## SECTION 3. 2002 ADJUSTED ITEMS

.01 *Tax Rate Tables*. For tax years beginning in 2002, the tax rate tables under § 1 are as follows:

TABLE 1—Section 1(a).—MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

| If Taxable Income Is: | The Tax Is: |
|---|---|
| Not Over $12,000 | 10% of the taxable income |
| Over $12,000 but not over $46,700 | $1,200 plus 15% of excess over $12,000 |
| Over $46,700 but not over $112,850 | $6,405 plus 27% of excess over $46,700 |
| Over $112,850 but not over $171,950 | $24,265.50 plus 30% of excess over $112,850 |
| Over $171,950 but not over $307,050 | $41,995.50 plus 35% of excess over $171,950 |
| Over $307,050 | $89,280.50 plus 38.6% of excess over $307,050 |

TABLE 2—Section 1(b).—HEADS OF HOUSEHOLDS

| If Taxable Income Is: | The Tax is: |
|---|---|
| Not Over $10,000 | 10% of the taxable income |
| Over $10,000 but not over $37,450 | $1,000 plus 15% of excess over $10,000 |
| Over $37,450 but not over $96,700 | $5,117.50 plus 27% of the excess over $37,450 |
| Over $96,700 but not over $156,600 | $21,115 plus 30% of the excess over $96,700 |
| Over $156,600 but not over $307,050 | $39,085 plus 35% of the excess over $156,600 |
| Over $307,050 | $91,742.50 plus 38.6% of the excess over $307,050 |

TABLE 3—Section 1(c).—UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS).

| If Taxable Income Is: | The Tax Is: |
|---|---|
| Not over $6,000 | 10% of the taxable income |
| Over $6,000 but not over $27,950 | $600 plus 15% of the excess over $6,000 |
| Over $27,950 but not over $67,700 | $3,892.50 plus 27% of the excess over $27,950 |
| Over $67,700 but not over $141,250 | $14,625 plus 30% of the excess over $67,700 |
| Over $141,250 but not over $307,050 | $36,690 plus 35% of the excess over $141,250 |
| Over $307,050 | $94,720 plus 38.6% of the excess over $307,050 |

TABLE 4—Section 1(d). —MARRIED INDIVIDUALS FILING SEPARATE RETURNS

| If Taxable Income Is: | The Tax Is: |
|---|---|
| Not Over $6,000 | 10% of the taxable income |
| Over $6,000 but not over $23,350 | $600.00 plus 15% of the excess over $6,000 |
| Over $23,350 but not over $56,425 | $3,202.50 plus 27% of the excess over $23,350 |
| Over $56,425 but not over $85,975 | $12,132.75 plus 30% of the excess over $56,425 |
| Over $85,975 but not over $153,525 | $20,997.75 plus 35% of the excess over $85,975 |
| Over $153,525 | $44,640.25 plus 38.6% of the excess over $153,525 |

TABLE 5—Section 1(e). —ESTATES AND TRUSTS

| If Taxable Income Is: | The Tax Is: |
|---|---|
| Not Over $1,850 | 15% of the taxable income |
| Over $1,850 but not over $4,400 | $277.50 plus 27% of the excess over $1,850 |
| Over $4,400 but not over $6,750 | $966.00 plus 30% of the excess over $4,400 |
| Over $6,750 but not over $9,200 | $1,671.00 plus 35% of the excess over $6,750 |
| Over $9,200 | $2,528.50 plus 38.6% of the excess over $9,200 |

.02 *Unearned Income of Minor Children Taxed as if Parent's Income (the "Kiddie Tax").* For tax years beginning in 2002, the amount in § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child's return that is subject to the "kiddie tax," is $750. (This amount is the same as the $750 standard deduction amount provided in section 3.07(2) of this revenue procedure.) The same $750 amount is also used for purposes of § 1(g)(7) (that is, determining whether a parent may elect to include a child's gross income in the parent's gross income and for calculating the "kiddie tax"). For example, one of the requirements for such a parental election is that a child's gross income be more than the amount referenced in § 1(g)(4)(A)(ii)(I) but less than 10 times such amount; thus, a child's gross income for 2002 must be more than $750 but less than $7,500 to satisfy that requirement.

.03 *Child Tax Credit*. Section 201 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) amended § 24 to increase the amount of credit under § 24 that may be refundable. The value in § 24(d)(1)(B)(i) used in determining the new potentially refundable amount is adjusted for inflation. For tax years beginning in 2002, that value is $10,350.

.04 *Hope and Lifetime Learning Credits.*

(1) For taxable years beginning in 2002, 100 percent of qualified tuition and related expenses not in excess of $1,000 and 50 percent of such expenses in excess of $1,000 are taken into account in determining the amount of the Hope Scholarship Credit under § 25A(b)(1).

(2) For tax years beginning in 2002, a taxpayer's modified gross income in excess of $41,000 ($82,000 in the case of a joint return) is taken into account in determining the reduction under § 25A(d)(2)(A)(ii) in the amount of the Hope Scholarship and Lifetime Learning Credits otherwise allowable under § 25A(a).

.05 *Earned Income Tax Credit.*

(1) *In general*. For tax years beginning in 2002, the following amounts are used to determine the earned income tax credit under § 32(b). The "earned income amount" is the amount of earned income at or above which the maximum amount of the earned income tax credit is allowed. The "threshold phaseout amount" is the amount of adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins to phase out. The "completed phaseout amount" is the amount of adjusted gross income (or if greater, earned income) at or above which no credit is allowed.

| *Item* | *Number of Qualifying Children* | | |
|---|---|---|---|
| | One | Two or More | None |
| Earned Income Amount | $ 7,370 | $10,350 | $ 4,910 |
| Maximum Amount of Credit | $ 2,506 | $ 4,140 | $ 376 |
| Threshold Phaseout Amount | $13,520 | $13,520 | $ 6,150 |
| Completed Phaseout Amount | $29,201 | $33,178 | $11,060 |
| Threshold Phaseout Amount (Married Filing Jointly) | $14,520 | $14,520 | $ 7,150 |
| Completed Phaseout Amount (Married Filing Jointly) | $30,201 | $34,178 | $12,060 |

The Internal Revenue Service, in the instructions for the Form 1040 series, provides tables showing the amount of the earned income tax credit for each type of taxpayer.

(2) *Excessive investment income*. For tax years beginning in 2002, the earned income tax credit is denied under § 32(i) if the aggregate amount of certain investment income exceeds $2,550.

.06 *Alternative Minimum Tax Exemption for a Child Subject to the "Kiddie Tax."* For tax years beginning in 2002, in the case of a child to whom the § 1(g) "kiddie tax" applies, the exemption amount under § 55 and § 59(j) for purposes of the alternative minimum tax under § 55 may not exceed the sum of (A) such child's earned income for the taxable year, plus (B) $5,500.

.07 *Standard Deduction.*

(1) *In general*. For tax years beginning in 2002, the standard deduction amounts under § 63(c)(2) are as follows:

| *Filing Status* | *Standard Deduction* |
|---|---|
| MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES (§ 1(a)) | $7,850 |
| HEADS OF HOUSEHOLDS (§ 1(b)) | $6,900 |
| UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS) (§ 1(c)) | $4,700 |
| MARRIED INDIVIDUALS FILING SEPARATE RETURNS (§ 1(d)) | $3,925 |

(2) *Dependent*. For tax years beginning in 2002, the standard deduction amount under § 63(c)(5) for an individual who may be claimed as a dependent by another taxpayer may not exceed the greater of $750, or the sum of $250 and the individual's earned income.

(3) *Aged and blind*. For tax years beginning in 2002, the additional standard deduction amounts under § 63(f) for the aged and for the blind are $900 for each. These amounts are increased to $1,150 if the individual is also unmarried and not a surviving spouse.

.08 *Overall Limitation on Itemized Deductions*. For tax years beginning in 2002, the "applicable amount" of adjusted gross income under § 68(b), above which the amount of otherwise allowable itemized deductions is reduced under § 68, is $137,300 (or $68,650 for a separate return filed by a married individual).

.09 *Qualified Transportation Fringe*. For tax years beginning in 2002, the monthly limitation under § 132(f)(2)(A), regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass, is $100. The monthly limitation under § 132(f)(2)(B) regarding the fringe benefit exclusion amount for qualified parking is $185.

.10 *Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses.* For tax years beginning in 2002, the exclusion under § 135, regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses, begins to phase out for modified adjusted gross income above $86,400 for joint returns and $57,600 for other returns. This exclusion completely phases out for modified adjusted gross income of $116,400 or more for joint returns and $72,600 or more for other returns.

.11 *Personal Exemption.*

(1) *Exemption amount*. For tax years beginning in 2002, the personal exemption amount under § 151(d) is $ 3,000.

(2) *Phase out*. For tax years beginning in 2002, the personal exemption amount begins to phase out at, and is completely phased out after, the following adjusted gross income amounts:

| Filing Status | *AGI — Beginning Phaseout* | *AGI Above Which Exemption Fully Phased Out* |
|---|---|---|
| Code § 1(a) | $206,000 | $328,500 |
| Code § 1(b) | $171,650 | $294,150 |
| Code § 1(c) | $137,300 | $259,800 |
| Code § 1(d) | $103,000 | $164,250 |

.12 *Eligible Long-Term Care Premiums*. For tax years beginning in 2002, the limitations under § 213(d), regarding eligible long-term care premiums includible in the term "medical care," are as follows:

| Attained age before the close of the taxable year: | Limitation on premiums: |
|---|---|
| 40 or less | $ 240 |
| More than 40 but not more than 50 | $ 450 |
| More than 50 but not more than 60 | $ 900 |
| More than 60 but not more than 70 | $2,390 |
| More than 70 | $2,990 |

.13 *Medical Savings Accounts.*

(1) *Self-only coverage*. For tax years beginning in 2002, the term "high deductible health plan" as defined in § 220(c)(2)(A) means, in the case of self-only coverage, a health plan which has an annual deductible that is not less than $1,650 and not more than $2,500, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $3,300.

(2) *Family coverage*. For tax years beginning in 2002, the term "high deductible health plan" means, in the case of family coverage, a health plan which has an annual deductible that is not less than $3,300 and not more than $4,950, and under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $6,050.

.14 *Treatment of Dues Paid to Agricultural or Horticultural Organizations*. For tax years beginning in 2002, the limitation under § 512(d)(1), regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization, is $120.

.15 *Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund-Raising Campaigns.*

(1) *Low cost article*. For tax years beginning in 2002, the unrelated business income of certain exempt organizations under § 513(h)(2) does not include a "low cost article" of $7.90 or less.

(2) *Other insubstantial benefits*. For tax years beginning in 2002, the $5, $25, and $50 guidelines in section 3 of Rev. Proc. 90–12 (1990–1 C.B. 471) (as amplified and modified), for disregarding the value of insubstantial benefits received by a donor in return for a fully deductible charitable contribution under § 170, are $7.90, $39.50, and $79.00, respectively.

.16 *Funeral Trusts*. For a contract entered into during calendar year 2002 for a "qualified funeral trust," as defined in § 685, the trust may not accept aggregate contributions by or for the benefit of an individual in excess of $7,700.

.17 *Expatriation to Avoid Tax*. For calendar year 2002, the thresholds used under § 877(a)(2), regarding whether an individual's loss of United States citizenship had the avoidance of United States taxes as one of its principal purposes, are more than $120,000 for "average annual net income tax" and $599,000 or more for "net worth."

.18 *Valuation of Qualified Real Property in Decedent's Gross Estate*. For an estate of a decedent dying in calendar year 2002, if the executor elects to use the special use valuation method under § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use § 2032A that is taken into account for purposes of the estate tax may not exceed $820,000.

.19 *Annual Exclusion for Gifts.*

(1) For calendar year 2002, the first $11,000 of gifts to any person (other than gifts of future interests in property) are not included in the total amount of taxable gifts under § 2503 made during that year.

(2) For calendar year 2002, the first $110,000 of gifts to a spouse who is not a citizen of the United States (other than gifts of future interests in property) are not included in the total amount of taxable gifts under §§ 2503 and 2523(i)(2) made during that year.

.20 *Generation-Skipping Transfer Tax Exemption*. For calendar year 2002, the generation-skipping transfer tax exemption under § 2631, which is allowed in determining the "inclusion ratio" defined in § 2642, is $1,100,000.

.21 *Luxury Automobile Excise Tax.* For calendar year 2002, the excise tax under §§ 4001 and 4003 is imposed on the first retail sale of a passenger vehicle (including certain parts or accessories installed within six months of the date after the vehicle was first placed in service), to the extent the price exceeds $40,000.

.22 *Passenger Air Transportation Excise Tax*. For calendar year 2002, the tax under § 4261(c) on any amount paid (whether within or without the United States) for any transportation of any person by air, if such transportation begins or ends in the United States, generally is $13.20. However, in the case of a domestic segment beginning or ending in Alaska or Hawaii as described in § 4261(c)(3), the tax only applies to departures and is at the rate of $6.60.

.23 *Reporting Exception for Certain Exempt Organizations with Nondeductible Lobbying Expenditures*. For tax years beginning in 2002, the annual per person, family, or entity dues limitation to qualify for the reporting exception under § 6033(e)(3) (and section 5.05 of Rev. Proc. 98–19, 1998–1 C.B. 547), regarding certain exempt organizations with nondeductible lobbying expenditures, is $83 or less.

.24 *Notice of Large Gifts Received from Foreign Persons*. For tax years beginning in 2002, recipients of gifts from certain foreign persons may have to report these gifts under § 6039F if the aggregate value of gifts received in a taxable year exceeds $11,642.

.25 *Persons against Which a Federal Tax Lien is Not Valid*. For calendar year 2002, a federal tax lien is not valid against (1) certain purchasers under § 6323(b)(4) that purchased personal property in a casual sale for less than $1,130 or (2) a mechanic's lienor under § 6323(b)(7) that repaired or improved certain residential property if the contract price with the owner is not more than $5,660.

.26 *Property Exempt from Levy*. For calendar year 2002, the value of property exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) may not exceed $6,780. The value of property exempt from levy under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) may not exceed $3,390.

.27 *Interest on a Certain Portion of the Estate Tax Payable in Installments*. For an estate of a decedent dying in calendar year 2002, the dollar amount used to determine the "2–percent portion" (for purposes of calculating interest under § 6601(j)) of the estate tax extended as provided in § 6166 is $1,100,000.

.28 *Attorney Fee Awards*. For fees incurred in calendar year 2002, the attorney fee award limitation under § 7430(c)(1)(B)(iii) is $150 per hour.

.29 *Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contracts*. For calendar year 2002, the stated dollar amount of the *per diem* limitation under § 7702B(d)(4), regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is $210.

## SECTION 4. EFFECTIVE DATE

.01 *General Rule*. Except as provided in section 4.02, this revenue procedure applies to tax years beginning in 2002.

.02 *Calendar Year Rule*. This revenue procedure applies to transactions or events occurring in calendar year 2002 for purposes of section 3.16 (funeral trusts), section 3.17 (expatriation to avoid tax), section 3.18 (valuation of qualified real property in decedent's gross estate), section 3.19 (annual exclusion for gifts), section 3.20 (generation-skipping transfer tax exemption), section 3.21 (luxury automobile excise tax), section 3.22 (passenger air transportation excise tax), section 3.25 (persons against which a federal tax lien is not valid), section 3.26 (property exempt from levy), section 3.27 (interest on a certain portion of the estate tax payable in installments), section 3.28 (attorney fee awards), and section 3.29 (periodic payments received under qualified long-term care insurance contracts or under certain life insurance contracts).

## SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Richard Ennis of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Ennis at (202) 622–7057 (not a toll-free call).

# Part IV. Items of General Interest

## Foundations Status of Certain Organizations

## Announcement 2001–123

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

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

4 As-Hope Psychosocial After Care Family Services, Inc., Dearborn, MI
African American Achievers Youth Corps, Inc., Gary, IN
African Anti-Poachins Foundation, Brunswick, ME
African Arts Foundation, Beverly Hills, CA
Always in Season, Inc., Myakka City, FL
American Friends of Ezer Lachim, Inc., Monsey, NY
American Friends of Qatzrin, Inc., New York, NY
American History Studies, Katy, TX
American Pushington University, Pomona, CA
American Sculpture Association, Glenmoore, PA
ARC Foundation of Kentucky, Inc., Frankfort, KY
Art Spirit, Inc., Sea Cliff, NY
B A S U, San Jose, CA
Belvidere Main Street Center, Belvidere, IL
Bernard and Sonya Singer Non Profit Corporation, Englewood, CO
Bridgewater Bears Hockey Club, Inc., Budd Lake, NJ
Broadway Institute of Massage Therapy, Inc., Hollywood, FL
Burnt Hills Hockey Association, Inc., Burnt Hills, NY
Center for Research on Innovation & Society, Santa Barbara, CA
Central Arkansas School-To-Work Council, North Little Rock, AR
Central Kitsap Medic One Foundation, Silverdale, WA
Century One Foundation, Inc., Pasadena, CA
Chattanooga Lafayette Emmaus Community, Inc., Rossville, GA
Child Abuse Awareness, Inc., Batesville, AR
Child Search, Moore, OK
Children's Developmental Services, Inc., Riverdale, NY
Chimney Peak Development Corporation, Jacksonville, AL
Chippewa County Foster and Adoptive Parents Association, Sault Ste Marie, MI
Clams-Computer Literate Advocates for Multiple Sclerosis, Bainbridge Island, WA
Collaborative Research for Endangered Wildlife, Inc., Burlingame, CA
Color Box Foundation, New York, NY
Communities United Together, LaPlace, LA
Community for Progress Association, Kansas City, KS
Community Justice Outreach, Inc., Miami, FL
Cornerstone Community Devlopment Corporation, Inc., Dallas, TX
Delta County Cancer Alliance, Inc., Escanaba, MI
DeVaughn Corporation, Balitmore, MD
East County Youth Soccer Association Inc., Vancouver, WA
El Shaddai, Springfield, MO
Exercise Tiger Memorial Association, Inc., New Bedford, MA
Families for Autism Intervention and Resources, La Mesa, CA
Family Works, Inc., Oceanside, CA
Filipino-American Tennis Club of McAllen, McAllen, TX
Forgotten Treasures, Inc., Denver, CO
Friends of Petoskey Public Library, Petoskey, MI
Friends of the Library for the Blind and Physical Handicap of the State of DE, Inc., Dover, DE
G A N G-Girls of the Ann Norton Gardens, Palm Beach, FL
Great Expectations Foundation, Inc., New Orleans, LA
Great Lakes Non-Profit Housing Corporation, Marquette, MI
Greater Mid-South Junior Chamber of Commerce Foundation, Inc. Memphis, TN
Greenspace Bucks County, Inc., Morrisville, PA
Hall County Homeless Resource Coalition, Inc., Gainesville, GA
Hammerheads Theatre, Incorporated, New York, NY
Helping Ministry Neighborhood Development Corporation, Hayti, MO
Hemangioma and Vascular Birthmarks Foundation, Inc., Latham, NY
Himalayan Instructional Ministries, Madras, OR
House of Angels, Inc., Silver Spring, MD
How to Get an A in Life, Inc., Los Altos, CA
Institute for Global Environmental Issues, Inc., Naples, FL
Institute of World Traditional Medicine, Santa Monica, CA
International Cultural & Educational Exchange Foundation, Inc., Falls Church, VA
Ipswich Equine Rescue Corp., Ipswich, MA
Jimmy's Heart Foundation, Kihei, HI
Kansas City Area Historic Trails Association, Shawnee Mission, KS
Kings Kids Learning Center, Inc., Houston, TX
Lady Monarchs of New Jersey, Inc., Bayonne, NJ
Lafayette County Literacy Council, University, MS
Lancaster County Historical Society & Museum, Whitestone, VA
Legacy Ministries, Inc., California, MO
Lighthouse - Reach Ministries, Incorporated, Plainview, TX

Little Peoples Day Care,
Philadelphia, PA
Long Island Seaport and Ecocenter, Inc.,
Port Jefferson, NY
Longfellow Area Neighborhood
Association, Inc., Roslindale, MA
Majestic Harmony, Inc., Bronx, NY
Malemute Football Booster Club,
Fairbanks, AK
Maui Military Museum, Inc.,
Makawao, HI
Medford High Alumni Association,
Medford, OK
Miami Valley Fandom for Literacy,
Dayton, OH
Mountain Meadow PTA 5 9 15,
Buckley, WA
MSL Barristers, Inc., Andover, MA
Mutual Assisted Senior Housing, Inc.,
New York, NY
National Decubitus Foundation,
Aurora, CO
National Large Cell Braille Foundation,
Incorporated, Orlando, FL
Nelson A. Rockefeller Foundation for
Public Service, Bellevue, WA
New Concept Education and Research,
Inc., San Jose, CA
New Day Foundation, Inc.,
Broken Arrow, OK
New Hope Home for Boys, Inc.,
Memphis, TN
New London Partners in Education,
New London, OH
New Vision Community Church, Inc.,
Valdosta, GA
New Vision House, Inc., Valdosta, GA
Newbury Education Foundation,
Cleveland, OH
North East School Scholarship Fund,
Inc., North East, PA
North Emergency Planning Committee,
Pearland, TX
Northwest Sarcoma Memorial
Foundation, Seattle, WA
Oakfield Historical Society,
Oakfield, ME
Operation Role Models of America, Inc.,
New York, NY
Owerri Cultural Association,
Beverly Hills, CA
Pakistan American Cultural Society, Inc.,
Tenafly, NJ
Peggy Thorns Evangelistic Association,
Charlotte, NC
Perry County Medical Association
Alliance, Inc., Hazard, KY
Phillip Ates Broadcast Group, Inc.,
Maywood, IL
Phoenix Heros Endowment Fund,
Scottsdale, AZ
Pieces of a Dream, Inc., St. Louis, MO
Play Source International, Inc.,
Lousiville, KY
Poimens Family Care, Manteca, CA
Prospect Hill Neighborhood Community
Council, Omaha, NE
Rabbit Rescue, Inc., Hollywood, FL
Railway Memorial Project,
Columbia, MT
Restore Hope Relief International,
Santa Barbara, CA
Rim Civic Orchestra, Incorporated,
Payson, AZ
Rivers of Healing Ministries,
Philadelphia, PA
Rotary Club of Winters Community
Foundation, Winters, CA
Sacramento 21 Community Partnership,
Sacramento, CA
Safari Missions International,
Beverly Hills, CA
Salinas Boxing Club, Inc., Salinas, CA
San Francisco Clidrens Museum,
San Francisco, CA
S E W Sewing Education Workstudy
Foundation, El Cerrito, CA
SGPHS Chey-Anne Booster Club,
Grand Prairie, TX
Southwest Section of the Air & Waste
Management Association,
Arlington, TX
Teen Pregnancy Outreach Development
Center Shelter, Inc., Whitesburg, GA
Theatre Asylum, Ltd., Brooklyn, NY
Tiger Foundation, Newtown Square, PA
Time Dollars Madison, Madison, IN
Tonga Peoples Development Society,
Salt Lake City, UT
Uncle Kens Kitchen, Inc.,
East Setauket, NY
Urban Black Music Project,
Incorporated, New York, NY
Wawasee Area Swim Team, Inc.,
North Webster, IN
Web Cinema Group, New York, NY
West High School Alumni Association,
Denver, CO
West Texas Expo Center, Inc.,
Midland, TX
Wichterich Ministries, Slidell, LA
Women of Georgia for Peace and Life,
Inc., Chevy Chase, MD
Youth Guidance, Plattsmouth, NE

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

## Additional Disaster Relief in Connection With the September 11 Terrorist Attack for Taxpayers With Interests in Passthrough Entities

## Announcement 2001–124

This announces additional relief in connection with the September 11, 2001, terrorist attack for partners, shareholders, and beneficiaries of passthrough entities that are affected taxpayers as defined in Notice 2001–61 (2001–40 I.R.B. 305) (October 1, 2001). This announcement modifies and expands the relief granted by Announcement 2001–117 (2001–49 I.R.B. 567). Under section 301.7508A–1(d)(1)(vii) of the Procedure and Administration Regulations, the IRS may determine whether any person is affected by a Presidentially declared disaster. The IRS has determined that a taxpayer that is a partner, shareholder, or beneficiary of a taxpayer affected by the September 11, 2001, terrorist attack, is also an affected taxpayer. Accordingly, partners, shareholders, and beneficiaries of an affected taxpayer are eligible for all the relief granted by Notice 2001–61 and Notice 2001–68 (2001–47 I.R.B. 504). Thus, for example, a partner that is an individual income taxpayer with an extended due date of October 15, 2001, for the 2000 return will have until February 12, 2002, to file the return.

If a partner, shareholder, or beneficiary of an affected taxpayer qualifies for relief under this notice because an original due date fell within the specified period, and such partner, shareholder, or beneficiary has already obtained an extension of time to file, the IRS will supplement such extension with the relief granted by Notice 2001–61 and/or Notice 2001–68. Thus, for example, a corporate partner with an original due date during the specified period that has obtained the automatic six-month extension of time to file will be granted a six-month extension of time to pay and an additional 120 day postponement of time to file and time to pay.

Taxpayers that qualify for relief under this announcement should mark "September 11, 2001, Terrorist Attacks — Passthrough Entity" in red ink on the top of their returns or other documents filed with the IRS.

This announcement was drafted by the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, you may call (202) 622–4940 (not a toll-free call).

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

## Section 112.— Certain Combat Zone Compensation of Members of the Armed Forces

## Executive Order 13239

## Designation of Afghanistan and the Airspace Above as a Combat Zone

Pursuant to the authority vested in me as President by the Constitution and the laws of the United States of America, including section 112 of the Internal Revenue Code of 1986 (26 U.S.C. 112), I designate, for purposes of that section, Afghanistan, including the airspace above, as an area in which Armed Forces of the United States are and have been engaged in combat.

For purposes of this order, I designate September 19, 2001, as the date of the commencement of combatant activities in such zone.

George W. Bush

The White House,
December 12, 2001.

(Filed by the Office of the Federal Register on December 13, 2001, 11:38 a.m., and published in the issue of the Federal Register for December 14, 2001, 66 F.R. 64905)

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## Section 415.— Limitations on Benefits and Contributions Under Qualified Plans

Whether the limitations on benefits and contributions described in § 415 of the Code are exceeded as a result of the application of new mortality tables. See Rev. Rul. 2001–62, on this page.

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## Section 417.— Definitions and Special Rules for Purposes of Minimum Survivor Annuity Requirements

*26 CFR 1.417(e)–1: Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.*
*(Also, § 415.)*

**Mortality tables.** This ruling describes changes to the mortality tables under section 417(e) of the Internal Revenue Code for employee plans purposes.

## Rev. Rul. 2001–62

ISSUE

What mortality table is the prescribed table under § 415(b)(2)(E)(v) of the Internal Revenue Code (the "Code") and the applicable mortality table under § 417(e)(3)(A)(ii)(I)?

LAW AND ANALYSIS

Section 415(b) provides for limitations on benefits payable under qualified defined benefit plans. Section 415(b)(1) provides, for limitation years ending on or before December 31, 2001, that the limitation on benefits, when expressed as an annual benefit (*i.e.*, a benefit payable annually in the form of a straight life annuity with no ancillary benefits) is the lesser of (a) $90,000 (as adjusted for increases in the cost of living) or (b) 100 percent of the participant's average compensation for the high 3 years. Section 415(b)(2)(B) provides that, if the benefit under the plan is payable in any form other than a straight life annuity, the determination of whether the limitation of § 415(b)(1) has been satisfied is made by adjusting such benefit so that it is equivalent to a straight life annuity. Sections 415(b)(2)(C) and (D) provide, for limitation years ending on or before December 31, 2001, for adjustments to the $90,000 (as adjusted for increases in the cost of living) limit when benefits begin at an age other than at social security retirement age.

For limitation years ending after December 31, 2001, section 611(a) of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16 (EGTRRA), made a number of changes to the limitations under § 415 of the Code. For limitation years ending after December 31, 2001, the adjustments under § 415(b)(2)(C) apply to benefits that commence before age 62 and the adjustments under § 415(b)(2)(D) apply to benefits that begin after age 65.

Section 415(b)(2)(E)(v) provides that, for purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D), the mortality table used is the table prescribed by the Secretary. The statute further provides that the table is based on the prevailing commissioners' standard table (described in § 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on the date the adjustment is being made (without regard to any other subparagraph of § 807(d)(5)).

Section 417(e)(3) provides rules for the determination of the present value of plan benefits for purposes of § 417(e). Section 417(e)(3)(A)(i) generally provides that, for purposes of § 417(e)(1) and (e)(2), the present value is not less than the present value calculated by using the applicable mortality table and the applicable interest rate. In addition, § 411(a)(11)(B) provides that, the determination of present value for purposes of § 411(a)(11)(A) is calculated in accordance with § 417(e)(3). Sections 203(e)(1), 203(e)(2), and 205(g)(3) of the Employee Retirement Income Security Act of 1974 (ERISA) provide corresponding provisions to §§ 411(a)(11)(A), 411(a)(11)(B), and 417(e)(3) of the Code.

Section 417(e)(3)(A)(ii)(I) defines the term "applicable mortality table" as the mortality table prescribed by the Secretary. The statute further provides that the table is based on the prevailing commissioners' standard table (described in § 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on the date the adjustment is being made (without regard to any other subparagraph of § 807(d)(5)).

Section 1.417(e)–1(d)(1) of the Income Tax Regulations provides that a defined benefit plan must provide that the present value of any accrued benefit and the amount (subject to §§ 411(c)(3) and 415) of any distribution, including a single sum, must not be less than the amount calculated using the applicable interest rate described in § 1.417(e)–1(d)(3) (determined for the month described in § 1.417(e)–1(d)(4)) and the applicable mortality table described in § 1.417(e)–1(d)(2). The present value of any optional form of benefit cannot be less than the present value of the normal retirement benefit determined in accordance with the preceding sentence. Under § 1.417(e)–1(d)(1), these rules must also be used to compute the present value of the benefit for purposes of determining whether consent for a distribution is required.

Section 1.417(e)–1(d)(2) provides that the applicable mortality table is the mortality table based on the prevailing commissioners' standard table (described in § 807(d)(5)(A)) used to determine reserves for group annuity contracts issued on the date as of which present value is being determined (without regard to any other subparagraph of § 807(d)(5)), that is prescribed by the Commissioner in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin. The Commissioner may also prescribe rules that apply in the case of a change to the prevailing commissioners' standard table.

For purposes of § 807(d)(5) of the Code, Rev. Rul. 92–19 (1992–1 C.B. 227) sets forth the prevailing commissioners' standard table for group annuities as the 1983 Group Annuity Mortality Table (83 GAM) for contracts issued after January 1, 1985.

The U.S. Supreme Court, in *Arizona v. Norris*, 463 U.S. 1073, 1084–1086 (1983), held that the application of sex-distinct actuarial tables to employees based upon their gender in calculating the amount of retirement benefits violates Title VII of the Civil Rights Act of 1964.

Rev. Rul. 95–6 (1995–1 C.B. 80) provided a mortality table, based upon a fixed blend of 50 percent of the male mortality rates and 50 percent of the female mortality rates from the 83 GAM, as the applicable mortality table for purposes of adjusting benefits or limitations under § 415(b)(2) of the Code and determining the present value of plan benefits under § 417(e)(3). Rev. Rul. 98–1 (1998–1 C.B. 249) Q & A–6, provides that Rev. Rul. 95–6, provides the mortality table which generally must be used for the purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D).

For purposes of § 807(d)(5) of the Code, Rev. Rul. 2001–38 (2001–33 I.R.B 124) supplements Rev. Rul. 92–19 by setting forth, for certain insurance products issued on or after January 1, 1999, the prevailing commissioners' standard table for group annuities as the 1994 Group Annuity Reserving Table (94 GAR).

Section 411(d)(6) of the Code generally prohibits a plan amendment that decreases a participant's accrued benefit. Section 411(d)(6)(B) provides that an amendment that eliminates an optional form of benefit is treated as reducing a participant's accrued benefit, but permits the Secretary of Treasury to provide for the elimination of certain optional forms of benefits under regulations. Section 1.411(d)–4, Q & A–2(b) provides that the Commissioner may, through the publication of revenue rulings, notices, and other items of general applicability, provide for the elimination or reduction of certain § 411(d)(6) protected benefits that have already accrued.

Section 401(b) and the regulations thereunder provide a remedial amendment period during which an amendment to a disqualifying provision may be made retroactively effective, under certain circumstances, to comply with the requirements of § 401(a). In Notice 2001–42 (2001–30 I.R.B. 70) the Service provided that the remedial amendment period for changes in the plan qualification requirements made by EGTRRA would end no earlier than the end of the first plan year beginning on or after January 1, 2005. This "EGTRRA remedial amendment period" is available only if good faith EGTRRA plan amendments have been adopted by, generally, the end of the first plan year beginning on or after January 1, 2002.

HOLDING

The following mortality table, based upon a fixed blend of 50 percent of the unloaded male mortality rates and 50 percent of the unloaded female mortality rates underlying the mortality rates in the 94 GAR, projected to 2002, is the applicable mortality table for purposes of adjusting benefits or limitations under § 415(b)(2) of the Code and for determining the present value of plan benefits under § 417(e)(3) and the corresponding provisions of ERISA. The table shows, for each age, the number living based upon a starting population of one million lives at age 1 ($l_x$), and the annual rate of mortality ($q_x$).

Plans may incorporate this table by reference to this revenue ruling. A plan amendment will not violate section 411(d)(6)(B) of the Code and the corresponding provision of ERISA solely because of a reduction in any annuity distribution with an annuity starting date on or after the later of the adoption date or the effective date of this amendment if the cause of such reduction is the substitution of the table in this revenue ruling for the table in Rev. Rul. 95–6. If the effective date is earlier than the adoption date of this plan amendment, § 415(b)(2)(B) of the Code will not be violated if such amendment provides that any payments made after the adoption date will be reduced actuarially by the value of the excess, if any, of annuity distributions paid before the adoption date of this amendment over annuity distributions that would have been permissible under section § 415(b)(2)(B) if the amendment had been adopted as of such effective date.

Mortality Table
for Sections 415 and 417(e)

| Age | $l_x$ | $q_x$ |
|---|---|---|
| 1 | 1000000.00 | 0.000514 |
| 2 | 999486.00 | 0.000341 |
| 3 | 999145.18 | 0.000270 |
| 4 | 998875.41 | 0.000207 |
| 5 | 998668.64 | 0.000188 |
| 6 | 998480.89 | 0.000179 |
| 7 | 998302.16 | 0.000170 |
| 8 | 998132.45 | 0.000154 |
| 9 | 997978.74 | 0.000148 |
| 10 | 997831.04 | 0.000150 |
| 11 | 997681.37 | 0.000158 |
| 12 | 997523.74 | 0.000171 |
| 13 | 997353.16 | 0.000192 |
| 14 | 997161.67 | 0.000225 |
| 15 | 996937.31 | 0.000262 |
| 16 | 996676.11 | 0.000296 |
| 17 | 996381.09 | 0.000324 |
| 18 | 996058.26 | 0.000343 |
| 19 | 995716.61 | 0.000357 |
| 20 | 995361.14 | 0.000368 |
| 21 | 994994.85 | 0.000381 |
| 22 | 994615.76 | 0.000396 |
| 23 | 994221.89 | 0.000418 |
| 24 | 993806.31 | 0.000441 |
| 25 | 993368.04 | 0.000468 |
| 26 | 992903.14 | 0.000500 |
| 27 | 992406.69 | 0.000523 |
| 28 | 991887.66 | 0.000543 |
| 29 | 991349.07 | 0.000564 |
| 30 | 990789.95 | 0.000588 |

Mortality Table
for Sections 415 and 417(e)

| Age | $l_x$ | $q_x$ |
|---|---|---|
| 31 | 990207.37 | 0.000612 |
| 32 | 989601.36 | 0.000633 |
| 33 | 988974.94 | 0.000649 |
| 34 | 988333.10 | 0.000661 |
| 35 | 987679.81 | 0.000675 |
| 36 | 987013.13 | 0.000695 |
| 37 | 986327.16 | 0.000727 |
| 38 | 985610.10 | 0.000768 |
| 39 | 984853.15 | 0.000819 |
| 40 | 984046.56 | 0.000879 |
| 41 | 983181.58 | 0.000944 |
| 42 | 982253.46 | 0.001014 |
| 43 | 981257.45 | 0.001083 |
| 44 | 980194.75 | 0.001151 |
| 45 | 979066.55 | 0.001224 |
| 46 | 977868.17 | 0.001312 |
| 47 | 976585.21 | 0.001422 |
| 48 | 975196.51 | 0.001554 |
| 49 | 973681.05 | 0.001699 |
| 50 | 972026.77 | 0.001869 |
| 51 | 970210.05 | 0.002065 |
| 52 | 968206.57 | 0.002302 |
| 53 | 965977.76 | 0.002571 |
| 54 | 963494.23 | 0.002854 |
| 55 | 960744.42 | 0.003197 |
| 56 | 957672.92 | 0.003614 |
| 57 | 954211.89 | 0.004124 |
| 58 | 950276.72 | 0.004712 |
| 59 | 945799.02 | 0.005345 |
| 60 | 940743.72 | 0.006062 |

Mortality Table
for Sections 415 and 417(e)

| Age | $l_x$ | $q_x$ |
|---|---|---|
| 61 | 935040.93 | 0.006912 |
| 62 | 928577.93 | 0.007846 |
| 63 | 921292.31 | 0.008958 |
| 64 | 913039.37 | 0.010151 |
| 65 | 903771.11 | 0.011441 |
| 66 | 893431.06 | 0.012870 |
| 67 | 881932.60 | 0.014291 |
| 68 | 869328.90 | 0.015614 |
| 69 | 855755.20 | 0.017000 |
| 70 | 841207.36 | 0.018396 |
| 71 | 825732.51 | 0.020025 |
| 72 | 809197.22 | 0.022026 |
| 73 | 791373.84 | 0.024187 |
| 74 | 772232.88 | 0.026581 |
| 75 | 751706.16 | 0.029310 |
| 76 | 729673.65 | 0.032392 |
| 77 | 706038.06 | 0.036288 |
| 78 | 680417.35 | 0.040636 |
| 79 | 652767.91 | 0.045463 |
| 80 | 623091.12 | 0.050795 |
| 81 | 591441.21 | 0.056655 |
| 82 | 557933.11 | 0.063064 |
| 83 | 522747.62 | 0.069481 |
| 84 | 486426.59 | 0.076539 |
| 85 | 449195.99 | 0.084129 |
| 86 | 411405.58 | 0.092686 |
| 87 | 373274.04 | 0.103014 |
| 88 | 334821.59 | 0.114434 |
| 89 | 296506.62 | 0.126925 |
| 90 | 258872.52 | 0.140650 |

Mortality Table
for Sections 415 and 417(e)

| Age | $l_x$ | $q_x$ |
|---|---|---|
| 91 | 222462.10 | 0.154664 |
| 92 | 188055.22 | 0.170190 |
| 93 | 156050.10 | 0.186631 |
| 94 | 126926.31 | 0.203518 |
| 95 | 101094.52 | 0.222123 |
| 96 | 78639.10 | 0.240233 |
| 97 | 59747.39 | 0.259380 |
| 98 | 44250.11 | 0.278936 |
| 99 | 31907.16 | 0.297614 |
| 100 | 22411.14 | 0.316630 |
| 101 | 15315.10 | 0.338758 |
| 102 | 10126.99 | 0.358830 |
| 103 | 6493.12 | 0.380735 |
| 104 | 4020.96 | 0.404426 |
| 105 | 2394.78 | 0.427883 |
| 106 | 1370.09 | 0.449085 |
| 107 | 754.80 | 0.466012 |
| 108 | 403.05 | 0.478582 |
| 109 | 210.16 | 0.488140 |
| 110 | 107.57 | 0.494813 |
| 111 | 54.34 | 0.498724 |
| 112 | 27.24 | 0.500000 |
| 113 | 13.62 | 0.500000 |
| 114 | 6.81 | 0.500000 |
| 115 | 3.41 | 0.500000 |
| 116 | 1.71 | 0.500000 |
| 117 | 0.86 | 0.500000 |
| 118 | 0.43 | 0.500000 |
| 119 | 0.22 | 0.500000 |
| 120 | 0.11 | 1.000000 |

EFFECTIVE DATE

The required use of the mortality table in this revenue ruling is effective for distributions with annuity starting dates on or after December 31, 2002, except that a plan may specify any earlier date during calendar year 2002 as the effective date for the required use of the mortality table in this revenue ruling under the plan. The effective date for the required use of the mortality table set forth in this revenue ruling for a plan is referred to as the plan's 94 GAR effective date. A plan's 94 GAR effective date must apply uniformly for purposes of §§ 415 and 417(e) of the Code and § 205(g)(3) of ERISA.

PLAN AMENDMENT

The latest date by which a plan may be amended to comply with this revenue ruling is the last day of the plan year that contains the plan's 94 GAR effective date. Thus, a plan with a July 1 to June 30 fiscal plan year ending June 30, 2002, must be amended no later than June 30, 2002, if the effective date is between January 1, 2002, and June 30, 2002. If such a plan is amended during its July 1, 2002, to June 30, 2003, plan year, the plan's 94 GAR effective date may be no earlier than July 1, 2002.

For a plan amendment adopted to comply with this revenue ruling no later than the last day of the plan year that contains the plan's 94 GAR effective date, the remedial amendment period under § 401(b) will end at the end of the EGTRRA remedial amendment period.

DETERMINATION LETTERS

Determination letter applications filed on or after the last day of the plan year that contains the plan's 94 GAR effective date will be reviewed with respect to whether the form of the plan satisfies the requirements of this revenue ruling. Determination letter applications filed before the last day of the plan year that contains the plan's 94 GAR effective date will be reviewed with respect to whether the form of the plan satisfies the requirements of this revenue ruling if an amendment to comply with the ruling is submitted with the request for the determination letter. In either case, determination letters issued with respect to such applications may be relied on with respect to the requirements of this revenue ruling.

MODEL PLAN AMENDMENTS

The Appendix provides two alternative model plan amendments that a plan sponsor, or a sponsor of a pre-approved plan, may adopt to comply with this revenue ruling. The first model amendment is intended to have the effect of adopting the mortality table set forth in this revenue ruling for purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D) and the applicable mortality table used for purposes of satisfying the requirements of § 417(e). The second model amendment is intended to have the effect of substituting the mortality table set forth in this revenue ruling for the mortality table set forth in Rev. Rul. 95–6 for all purposes under the plan for which the use of the mortality table set forth in Rev. Rul. 95–6 is specified. A plan sponsor should consider which of these two approaches is appropriate for the particular plan, or whether some other approach should be chosen for the plan.

A pre-approved plan (that is, a master or prototype or volume submitter plan) may be amended by the document's sponsor to comply with this revenue ruling to the extent authorized. Alternatively, adopting employers may adopt a plan amendment as an addendum to the plan or adoption agreement. The inclusion of either of the model plan amendments below in an addendum to a plan adopted to comply with EGTRRA will not cause a pre-approved plan to be treated as an individually designed plan.

A plan sponsor that adopts either of the model amendments verbatim (or with only minor changes) will have reliance that the form of its plan satisfies the requirements of this revenue ruling, and the adoption of such an amendment will not adversely affect the plan sponsor's reliance on a favorable determination, opinion, or advisory letter.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 95–6 is superseded for distributions with annuity starting dates on or after the earlier of December 31, 2002, or the date specified in the plan for which the use of the mortality table set forth in this revenue ruling is specified (which may be no earlier than January 1, 2002).

Rev. Rul. 98–1 is modified.

COMMENTS REQUESTED

The 94 GAR is designed as a generational table that incorporates mortality improvements on an annual basis. The table in this revenue ruling is based on the 94 GAR projected, using Scale AA, to 2002. Comments are requested in regard to how often the mortality table for §§ 415 and 417(e) of the Code should be updated. Comments should be sent to Commissioner of Internal Revenue Service, Attention T:EP:RA:T:A1, Washington, D.C. 20224.

DRAFTING INFORMATION

The principal author of this revenue ruling is Lawrence Isaacs of Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday (a toll-free number). Mr. Isaacs may be reached at 1–202–283–9710 (not a toll-free number).

**Appendix — MODEL AMENDMENTS**

The following are amendments that sponsors of qualified defined benefit plans may adopt to comply with §§ 415 and 417(e), as required under Rev. Rul. 2001–62.

**MODEL PLAN AMENDMENT 1**

1. Effective date. This section shall apply to distributions with annuity starting dates on or after ____________.
2. Notwithstanding any other plan provisions to the contrary, the applicable mortality table used for purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D) of the Internal Revenue Code as set forth in section_____ of the plan and the applicable mortality table used for purposes of satisfying the requirements of § 417(e) of the Internal Revenue Code as set forth in section ____________of the plan is the table prescribed in Rev. Rul. 2001–62.
3. For any distribution with an annuity starting date on or after the effective date of this section and before the adoption date of this section, if application of the amendment as of the annuity starting date would have caused a reduction in the amount of any distribution, such reduction is not reflected in any payment made before the adoption date of this section. However, the amount of any such reduction that is required under § 415(b)(2)(B) must be reflected actuarially over any remaining payments to the participant.

Note: This amendment should be used for plans that reference the applicable mortality table only for the purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D) of the Internal Revenue Code and satisfying the requirements of § 417(e) of the Internal Revenue Code. Paragraph 3 of this amendment should be used only if the effective date of the amendment is earlier than the adoption date of the amendment.

**MODEL PLAN AMENDMENT 2**

1. Effective date. This section shall apply to distributions with annuity starting dates on or after ____________.
2. Notwithstanding any other plan provisions to the contrary, any reference in the plan to the mortality table prescribed in Rev. Rul. 95–6 shall be construed as a reference to the mortality table prescribed in Rev. Rul. 2001- 62 for all purposes under the plan.
3. For any distribution with an annuity starting date on or after the effective date of this section and before the adoption date of this section, if application of the amendment as of the annuity starting date would have caused a reduction in the amount of any distribution, such reduction is not reflected in any payment made before the adoption date of this section. However, the amount of any such reduction that is required under § 415(b)(2)(B) must be reflected actuarially over any remaining payments to the participant.

Note: This amendment should be used for plans that specifically reference the mortality table provided in Rev. Rul. 95–6 and apply that table for other purposes as well as for purposes of adjusting any benefit or limitation under § 415(b)(2)(B), (C), or (D) and satisfying the requirements of § 417(e), where the plan sponsor wishes to replace the mortality table provided in Rev. Rul. 95–6 with the mortality table provided in Rev. Rul. 2001–62 for all purposes. If the plan references the mortality table prescribed in Rev. Rul. 95–6 using some other label (such as, for example, the GAM 83 blended mortality table), the plan's term should be used in place of the reference to the mortality table prescribed in Rev. Rul. 95–6. Paragraph 3 of this amendment should be used only if the effective date of the amendment is earlier than the adoption date of the amendment.

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

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

**LIFO; price indexes; department stores.** The October 2001 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, October 31, 2001.

## Rev. Rul. 2001–66

The following Department Store Inventory Price Indexes for October 2001 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46 (1986–2 C.B. 739) for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, October 31, 2001.

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

BUREAU OF LABOR STATISTICS,
DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS

(January 1941 = 100, unless otherwise noted)

| Groups | Oct. 2000 | Oct. 2001 | Percent Change from Oct. 2000 to Oct. 2001[1] |
|---|---|---|---|
| 1. Piece Goods | 502.4 | 500.3 | -0.4 |
| 2. Domestics and Draperies | 608.5 | 592.0 | -2.7 |
| 3. Women's and Children's Shoes | 661.5 | 675.5 | 2.1 |
| 4. Men's Shoes | 915.5 | 872.5 | -4.7 |
| 5. Infants' Wear | 649.0 | 631.1 | -2.8 |

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

| Groups | Oct. 2000 | Oct. 2001 | Percent Change from Oct. 2000 to Oct. 2001[1] |
|---|---|---|---|
| 6. Women's Underwear | 579.6 | 575.3 | -0.7 |
| 7. Women's Hosiery | 346.2 | 358.0 | 3.4 |
| 8. Women's and Girls' Accessories | 555.6 | 573.7 | 3.3 |
| 9. Women's Outerwear and Girls' Wear | 414.1 | 398.4 | -3.8 |
| 10. Men's Clothing | 601.0 | 587.3 | -2.3 |
| 11. Men's Furnishings | 632.7 | 628.2 | -0.7 |
| 12. Boys' Clothing and Furnishings | 494.4 | 490.5 | -0.8 |
| 13. Jewelry | 937.1 | 919.6 | -1.9 |
| 14. Notions | 792.8 | 797.1 | 0.5 |
| 15. Toilet Articles and Drugs | 971.1 | 981.6 | 1.1 |
| 16. Furniture and Bedding | 704.3 | 628.8 | -10.7 |
| 17. Floor Coverings | 627.7 | 616.0 | -1.9 |
| 18. Housewares | 778.0 | 767.1 | -1.4 |
| 19. Major Appliances | 228.6 | 224.1 | -2.0 |
| 20. Radio and Television | 57.9 | 52.6 | -9.2 |
| 21. Recreation and Education[2] | 92.6 | 89.2 | -3.7 |
| 22. Home Improvements[2] | 128.9 | 125.4 | -2.7 |
| 23. Auto Accessories[2] | 106.7 | 110.2 | 3.3 |
| Groups 1 — 15: Soft Goods | 607.3 | 598.6 | -1.4 |
| Groups 16 — 20: Durable Goods | 437.8 | 419.1 | -4.3 |
| Groups 21 — 23: Misc. Goods[2] | 100.1 | 98.2 | -1.9 |
| Store Total[3] | 543.6 | 532.4 | -2.1 |

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

[2] Indexes on a January 1986=100 base.

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

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Burkom of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7718 (not a toll-free call).

## Section 483.— Interest on Certain Deferred Payments

*26 CFR 1.483–1: Computation of interest on certain deferred payments.*

As defined by section 1274A, the definitions for both "qualified debt instruments" and "cash method debt instruments" have dollar ceilings on the stated principal amount. The limits to the stated principal amount are adjusted for inflation for sales or exchanges occurring in the 2002 calendar year. See Rev. Rul. 2001–65, page 639.

## Section 832.— Insurance Company Taxable Income

*26 CFR 1.832–4: Gross income.*

The salvage discount factors are set forth for the 2001 accident year. These factors will be used for computing estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 2001–61, page 653.

## Section 846.— Discounted Unpaid Losses Defined

*26 CFR 1.846–1: Application of discount factors.*

The loss payment patterns and discount factors are set forth for the 2001 accident year. These factors will be used for computing discounted unpaid losses under section 846 of the Code. See Rev. Proc. 2001–60, page 643.

The salvage discount factors are set forth for the 2001 accident year. These factors will be used for computing estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 2001–61, page 653.

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

*26 CFR 1.1274A–1: Special rules for certain transactions where stated principal amount does not exceed $2,800,000.*

As defined by section 1274A, the definitions for both "qualified debt instruments" and "cash method debt instruments" have dollar ceilings on the stated principal amount. The limits to the stated principal amount are adjusted for inflation for sales or exchanges occurring in the 2002 calendar year. See Rev. Rul. 2001–65, on this page.

## Section 1274A.— Special Rules for Certain Transactions Where Stated Principal Amount Does Not Exceed $2,800,000.

*(Also §§ 1274, 483; 1.1274A–1, 1.483–1.)*

**Section 1274A—Inflation adjusted numbers for 2002.** This ruling provides the dollar amounts, increased by the 2002 inflation adjustment, for section 1274A of the Code. Rev. Rul. 2000–55 supplemented and superseded.

## Rev. Rul. 2001–65

This revenue ruling provides the dollar amounts, increased by the 2002 inflation adjustment, for § 1274A of the Internal Revenue Code.

BACKGROUND

In general, §§ 483 and 1274 determine the principal amount of a debt instrument given in consideration for the sale or exchange of nonpublicly traded property. In addition, any interest on a debt instrument subject to § 1274 is taken into account under the original issue discount provisions of the Code. Section 1274A, however, modifies the rules under §§ 483 and 1274 for certain types of debt instruments.

In the case of a "qualified debt instrument," the discount rate used for purposes of §§ 483 and 1274 may not exceed 9 percent, compounded semiannually. Section 1274A(b) defines a qualified debt instrument as any debt instrument given in consideration for the sale or exchange of property (other than new § 38 property within the meaning of § 48(b), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990) if the stated principal amount of the instrument does not exceed the amount specified in § 1274A(b). For debt instruments arising out of sales or exchanges before January 1, 1990, this amount is $2,800,000.

In the case of a "cash method debt instrument," as defined in § 1274A(c), the borrower and lender may elect to use the cash receipts and disbursements method of accounting. In particular, for any cash method debt instrument, § 1274 does not apply, and interest on the instrument is accounted for by both the borrower and the lender under the cash method of accounting. A cash method debt instrument is a qualified debt instrument that meets the following additional requirements: (A) In the case of instruments arising out of sales or exchanges before January 1, 1990, the stated principal amount does not exceed $2,000,000; (B) the lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged; (C) § 1274 would have applied to the debt instrument but for an election under § 1274A(c); and (D) an election under § 1274A(c) is jointly made with respect to the debt instrument by the borrower and lender. Section 1.1274A–1(c)(1) of the Income Tax Regulations provides rules concerning the time for, and manner of, making this election.

Section 1274A(d)(2) provides that, for any debt instrument arising out of a sale or exchange during any calendar year after 1989, the dollar amounts stated in § 1274A(b) and § 1274A(c)(2)(A) are increased by the inflation adjustment for the calendar year. Any increase due to the inflation adjustment is rounded to the nearest multiple of $100 (or, if the increase is a multiple of $50 and not of $100, the increase is increased to the nearest multiple of $100). The inflation adjustment for any calendar year is the percentage (if any) by which the CPI for the preceding calendar year exceeds the CPI for calendar year 1988. Section 1274A(d)(2)(B) defines the CPI for any calendar year as the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of that calendar year.

INFLATION-ADJUSTED AMOUNTS

For debt instruments arising out of sales or exchanges after December 31, 1989, the inflation-adjusted amounts under § 1274A are shown in Table 1.

Rev. Rul. 2001–65 Table 1
Inflation-Adjusted Amounts Under § 1274A

| *Calendar Year of Sale or Exchange* | *1274A(b) Amount (qualified debt instrument)* | *1274A(c)(2)(A) Amount (cash method debt instrument)* |
|---|---|---|
| 1990 | $2,933,200 | $2,095,100 |
| 1991 | $3,079,600 | $2,199,700 |
| 1992 | $3,234,900 | $2,310,600 |
| 1993 | $3,332,400 | $2,380,300 |
| 1994 | $3,433,500 | $2,452,500 |
| 1995 | $3,523,600 | $2,516,900 |
| 1996 | $3,622,500 | $2,587,500 |
| 1997 | $3,723,800 | $2,659,900 |
| 1998 | $3,823,100 | $2,730,800 |
| 1999 | $3,885,500 | $2,775,400 |
| 2000 | $3,960,100 | $2,828,700 |
| 2001 | $4,085,900 | $2,918,500 |
| 2002 | $4,217,500 | $3,012,500 |

*Note:* These inflation adjustments were computed using the All-Urban, Consumer Price Index, 1982–1984 base, published by the Bureau of Labor Statistics.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2000–55 (2000–52 I.R.B. 595) is supplemented and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is Courtney Shepardson of the Office of the Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Ms. Shepardson at (202) 622–3930 (not a toll-free call).

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

**CPI adjustment for below-market loans–2002.** The amount that section 7872(g) of the Code permits a taxpayer to lend a qualified continuing care facility without incurring imputed interest is published and adjusted for inflation for years 1987–2002.

## Rev. Rul. 2001–64

This revenue ruling publishes the amount that § 7872(g) of the Internal Revenue Code permits a taxpayer to lend to a qualifying continuing care facility without incurring imputed interest. The amount is adjusted for inflation for the years after 1986.

Section 7872 generally treats loans bearing a below-market interest rate as if they bore interest at the market rate.

Section 7872(g)(1) provides that, in general, § 7872 does not apply for any calendar year to any below-market loan made by a lender to a qualified continuing care facility pursuant to a continuing care contract if the lender (or the lender’s spouse) attains age 65 before the close of the year.

Section 7872(g)(2) provides that, in the case of loans made after October 11, 1985, and before 1987, § 7872(g)(1) applies only to the extent that the aggregate outstanding amount of any loan to which § 7872(g) applies (determined without regard to § 7872(g)(2)), when added to the aggregate outstanding amount of all other previous loans between the lender (or the lender’s spouse) and any qualified continuing care facility to which § 7872(g)(1) applies, does not exceed $90,000.

Section 7872(g)(5) provides that, for loans made during any calendar year after 1986 to which § 7872(g)(1) applies, the $90,000 limit specified in § 7872(g)(2) is increased by an inflation adjustment. The inflation adjustment for any calendar year is the percentage (if any) by which the Consumer Price Index (CPI) for the preceding calendar year exceeds the CPI for calendar year 1985. Section 7872(g)(5) states that the CPI for any calendar year is the average of the CPI as of the close of the 12-month period ending on September 30 of that calendar year.

Table 1 sets forth the amount specified in § 7872(g)(2) of the Code. The amount is increased by the inflation adjustment for the years 1987–2002.

REV. RUL. 2001–64 TABLE 1
Limit Under 7872(g)(2)

| *Year* | *Amount* |
|---|---|
| Before 1987 | $ 90,000 |
| 1987 | $ 92,200 |
| 1988 | $ 94,800 |
| 1989 | $ 98,800 |
| 1990 | $103,500 |
| 1991 | $108,600 |
| 1992 | $114,100 |
| 1993 | $117,500 |
| 1994 | $121,100 |
| 1995 | $124,300 |
| 1996 | $127,800 |
| 1997 | $131,300 |
| 1998 | $134,800 |
| 1999 | $137,000 |
| 2000 | $139,700 |
| 2001 | $144,100 |
| 2002 | $148,800 |

*Note:* These inflation adjustments were computed using the All-Urban, Consumer Price Index 1982–1984 base, published by the Bureau of Labor Statistics.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 2000–56 (2000–52 I.R.B. 598) is supplemented and superseded.

DRAFTING INFORMATION

The author of this revenue ruling is Courtney Shepardson of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Ms. Shepardson at (202) 622–3940 (not a toll-free call).

# Part III.— Administrative, Procedural, and Miscellaneous

## 2002 Limitations Adjusted as Provided in Section 415(d), etc.[1]

## Notice 2001–84

Section 415 of the Internal Revenue Code (the Code) provides for dollar limitations on benefits and contributions under qualified retirement plans. Section 415 also requires that the Commissioner annually adjust these limits for cost-of-living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) reset many of the statutory dollar amounts previously adjusted on an annual basis under § 415 of the Code. Additionally, other new limitation amounts were added by EGTRRA.

***Limitations reset or established by EGTRRA***

Effective for limitation years ending after December 31, 2001, the limitation on the annual benefit under a defined benefit plan under § 415(b)(1)(A) is increased from $140,000 to $160,000 by section 611 of EGTRRA. See, Q&A–1 of Rev. Rul. 2001–51 (2001–45 I.R.B. 427).

The limitation for defined contribution plans under § 415(c)(1)(A) of the Code is increased from $35,000 to $40,000 by section 611 of EGTRRA effective for limitation years beginning after December 31, 2001. However, the limitation for defined contribution plans with non-calendar limitation years beginning before January 1, 2002, and ending after December 31, 2001, remains unchanged at $35,000. *See*, Q&A–9 of Rev. Rul. 2001–51.

The limitation under § 402(g)(1) of the Code on the exclusion for elective deferrals described in § 402(g)(3) is increased from $10,500 to $11,000 by section 611 of EGTRRA. This limitation affects elective deferrals to section 401(k) plans and to the Federal Government's Thrift Savings Plan, among other plans.

The annual compensation limit under §§ 401(a)(17), 404(l), and 408(k)(3)(C) of the Code is increased from $170,000 to $200,000 by section 611 of EGTRRA.

The limitation under § 408(p)(2)(E) of the Code (formerly under § 408(p)(2)(A)) regarding SIMPLE retirement accounts is increased from $6,500 to $7,000 by section 611 of EGTRRA.

The limitation on deferrals under § 457(e)(15) of the Code (formerly under §§ 457(b)(2) and (c)(1)) concerning deferred compensation plans of state and local governments and tax-exempt organizations is increased from $8,500 to $11,000 by section 611 of EGTRRA.

The dollar limitation under § 416(i)(1)(A)(i) of the Code concerning the definition of key employee in a top-heavy plan is $130,000, as added by section 613 of EGTRRA.

The dollar limitation under § 414(v)(2)(B)(i) of the Code for catch-up contributions to an applicable employer plan other than a plan described in § 401(k)(11) or 408(p) for individuals aged 50 or over is $1,000. The dollar limitation under § 414(v)(2)(B)(ii) for catch-up contributions to an applicable employer plan described in § 401(k)(11) or 408(p) for individuals aged 50 or over is $500. Both of these limitations were added by section 631 of EGTRRA.

***Limitations not reset by EGTRRA***

The dollar amounts not reset by EGTRRA are adjusted at the same time and in the same manner as under § 415(d) of the Code as follows:

For participants who separated from service before January 1, 2002, the limitation for defined benefit plans under § 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 2001, by 1.0270.

The dollar amount under § 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5-year distribution period is increased from $780,000 to $800,000, while the dollar amount used to determine the lengthening of the 5-year distribution period is increased from $155,000 to $160,000.

The limitation used in the definition of highly compensated employee under § 414(q)(1)(B) is increased from $85,000 to $90,000.

The annual compensation limitation under § 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limitation under the plan under § 401(a)(17) to be taken into account, is increased from $285,000 to $295,000.

The compensation amount under § 408(k)(2)(C) regarding simplified employee pensions (SEPs) remains unchanged at $450.

The compensation amounts under § 1.61–21(f)(5)(i) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes is increased from $75,000 to $80,000. The compensation amount under § 1.61–21(f)(5)(iii) is increased from $155,000 to $160,000.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.

DRAFTING INFORMATION

The principal author of this notice is John Heil of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding the information in this notice, contact the Employee Plans Customer Assistance Service at 1–877–829–5500 between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday (a toll-free call). For information on the methodology used in arriving at these numbers, contact Mr. Heil at 1–202–283–9888 (not a toll-free call).

[1] Based on News Release IR-2001-115, dated December 11, 2001.

26 CFR 601.201: Rulings and determination letters. (Also Part I, Sections 846; 1.846–1.)

# Rev. Proc. 2001–60

SECTION 1. PURPOSE

This revenue procedure prescribes the loss payment patterns and discount factors for the 2001 accident year. These factors will be used for computing discounted unpaid losses under § 846 of the Internal Revenue Code. *See* Rev. Proc. 98–11 (1998–1 C.B. 358) for background concerning the loss payment patterns and application of the discount factors.

SECTION 2. SCOPE

This revenue procedure applies to any taxpayer that is required to discount its unpaid losses under § 846 for a line of business using discount factors published by the Secretary.

SECTION 3. TABLES OF DISCOUNT FACTORS

.01 The following tables present separately for each line of business the discount factors under § 846 for accident year 2001. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2001, which is 6.00 percent, and by assuming all loss payments occur in the middle of the calendar year.

.02 If the groupings of individual lines of business on the annual statement change, taxpayers must discount the unpaid losses on the affected lines of business in accordance with the discounting patterns that would have applied to those unpaid losses based on their classification on the 1995 annual statement. *See* Rev. Proc. 98–11 (1998–1 C.B. 358) section 2, for additional background on discounting under section 846 and the use of the Secretary's tables.

.03 Section V of Notice 88–100 (1988–2 C.B. 439) provides a composite discount factor to be used in determining the discounted unpaid losses for accident years that are not separately reported on the annual statement. Taxpayers that do not use the methodology set forth in section V of Notice 88–100 should instead use the discount factor for the appropriate year in the Secretary's table for that line of business. If such taxpayers have unpaid losses relating to an accident year that is older than the last accident year for which a discount factor is presented in the Secretary's table, those unpaid losses should be discounted using the discount factor for the last accident year in the Secretary's table. *See* section 2.03(3) of Rev. Proc. 98–11.

.04 Tables

**Accident and Health**
**(Other Than Disability Income or Credit Disability Insurance)**

Discount factor for all years equals 97.1286 percent.

**Auto Physical Damage**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+ 0 | 89.9430 | 89.9430 | 10.0570 | 9.7182 | 96.6309 |
| AY+ 1 | 99.3814 | 9.4384 | 0.6186 | 0.5838 | 94.3797 |
| AY+ 2 | N/A | 0.3093 | 0.3093 | 0.3004 | 97.1286 |

**Commercial Auto/Truck Liability/Medical**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 25.8075 | 25.8075 | 74.1925 | 65.3144 | 88.0336 |
| AY+1 | 49.8793 | 24.0718 | 50.1207 | 44.4497 | 88.6854 |

## Commercial Auto/Truck Liability/Medical—Continued

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+2 | 67.6592 | 17.7799 | 32.3408 | 28.8112 | 89.0862 |
| AY+3 | 79.7711 | 12.1119 | 20.2289 | 18.0699 | 89.3272 |
| AY+4 | 88.2132 | 8.4421 | 11.7868 | 10.4624 | 88.7640 |
| AY+5 | 93.1778 | 4.9646 | 6.8222 | 5.9788 | 87.6375 |
| AY+6 | 95.9623 | 2.7845 | 4.0377 | 3.4707 | 85.9577 |
| AY+7 | 97.0091 | 1.0468 | 2.9909 | 2.6012 | 86.9707 |
| AY+8 | 97.5719 | 0.5628 | 2.4281 | 2.1778 | 89.6931 |
| AY+9 | 98.2191 | 0.6471 | 1.7809 | 1.6422 | 92.2109 |
| AY+10 | N/A | 0.6471 | 1.1338 | 1.0745 | 94.7685 |
| AY+11 | N/A | 0.6471 | 0.4867 | 0.4727 | 97.1286 |

## Composite Discount Factors

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 35.4611 | 35.4611 | 64.5389 | 55.5635 | 86.0930 |
| AY+1 | 59.1449 | 23.6838 | 40.8551 | 34.5133 | 84.4773 |
| AY+2 | 70.8220 | 11.6771 | 29.1780 | 24.5618 | 84.1792 |
| AY+3 | 81.9019 | 11.0799 | 18.0981 | 14.6281 | 80.8265 |
| AY+4 | 86.3688 | 4.4669 | 13.6312 | 10.9068 | 80.0133 |
| AY+5 | 90.0497 | 3.6809 | 9.9503 | 7.7715 | 78.1028 |
| AY+6 | 92.7488 | 2.6991 | 7.2512 | 5.4588 | 75.2820 |
| AY+7 | 93.8259 | 1.0771 | 6.1741 | 4.6775 | 75.7592 |
| AY+8 | 94.2415 | 0.4156 | 5.7585 | 4.5302 | 78.6700 |
| AY+9 | 94.8568 | 0.6153 | 5.1432 | 4.1685 | 81.0493 |
| AY+10 | N/A | 0.6153 | 4.5279 | 3.7851 | 83.5960 |
| AY+11 | N/A | 0.6153 | 3.9125 | 3.3787 | 86.3558 |
| AY+12 | N/A | 0.6153 | 3.2972 | 2.9479 | 89.4060 |
| AY+13 | N/A | 0.6153 | 2.6819 | 2.4912 | 92.8922 |
| AY+14 | N/A | 0.6153 | 2.0665 | 2.0072 | 97.1286 |

## Fidelity/Surety

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 24.1540 | 24.1540 | 75.8460 | 70.3585 | 92.7650 |
| AY+1 | 59.0961 | 34.9421 | 40.9039 | 38.6050 | 94.3797 |
| AY+2 | N/A | 20.4520 | 20.4520 | 19.8647 | 97.1286 |

## Financial Guaranty/Mortgage Guaranty

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 9.2513 | 9.2513 | 90.7487 | 84.1431 | 92.7210 |
| AY+1 | 50.5659 | 41.3146 | 49.4341 | 46.6558 | 94.3797 |
| AY+2 | N/A | 24.7171 | 24.7171 | 24.0073 | 97.1286 |

## International
## (Composite)

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 35.4611 | 35.4611 | 64.5389 | 55.5635 | 86.0930 |
| AY+1 | 59.1449 | 23.6838 | 40.8551 | 34.5133 | 84.4773 |
| AY+2 | 70.8220 | 11.6771 | 29.1780 | 24.5618 | 84.1792 |
| AY+3 | 81.9019 | 11.0799 | 18.0981 | 14.6281 | 80.8265 |
| AY+4 | 86.3688 | 4.4669 | 13.6312 | 10.9068 | 80.0133 |
| AY+5 | 90.0497 | 3.6809 | 9.9503 | 7.7715 | 78.1028 |
| AY+6 | 92.7488 | 2.6991 | 7.2512 | 5.4588 | 75.2820 |
| AY+7 | 93.8259 | 1.0771 | 6.1741 | 4.6775 | 75.7592 |
| AY+8 | 94.2415 | 0.4156 | 5.7585 | 4.5302 | 78.6700 |
| AY+9 | 94.8568 | 0.6153 | 5.1432 | 4.1685 | 81.0493 |
| AY+10 | N/A | 0.6153 | 4.5279 | 3.7851 | 83.5960 |
| AY+11 | N/A | 0.6153 | 3.9125 | 3.3787 | 86.3558 |
| AY+12 | N/A | 0.6153 | 3.2972 | 2.9479 | 89.4060 |
| AY+13 | N/A | 0.6153 | 2.6819 | 2.4912 | 92.8922 |
| AY+14 | N/A | 0.6153 | 2.0665 | 2.0072 | 97.1286 |

**Medical Malpractice — Claims-Made**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 6.3899 | 6.3899 | 93.6101 | 77.4322 | 82.7178 |
| AY+1 | 24.0011 | 17.6112 | 75.9989 | 63.9463 | 84.1411 |
| AY+2 | 42.6970 | 18.6959 | 57.3030 | 48.5345 | 84.6980 |
| AY+3 | 58.0610 | 15.3640 | 41.9390 | 35.6284 | 84.9528 |
| AY+4 | 69.6653 | 11.6043 | 30.3347 | 25.8187 | 85.1128 |
| AY+5 | 75.6033 | 5.9380 | 24.3967 | 21.2542 | 87.1194 |
| AY+6 | 81.8786 | 6.2753 | 18.1214 | 16.0687 | 88.6725 |
| AY+7 | 87.8539 | 5.9753 | 12.1461 | 10.8809 | 89.5834 |
| AY+8 | 89.5207 | 1.6668 | 10.4793 | 9.8176 | 93.6862 |
| AY+9 | 94.3025 | 4.7818 | 5.6975 | 5.4836 | 96.2450 |
| AY+10 | N/A | 4.7818 | 0.9157 | 0.8894 | 97.1286 |

**Medical Malpractice — Occurrence**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 2.1239 | 2.1239 | 97.8761 | 72.4330 | 74.0048 |
| AY+1 | 6.4831 | 4.3592 | 93.5169 | 72.2909 | 77.3025 |
| AY+2 | 15.5987 | 9.1156 | 84.4013 | 67.2433 | 79.6709 |
| AY+3 | 31.9062 | 16.3075 | 68.0938 | 54.4883 | 80.0194 |
| AY+4 | 45.0931 | 13.1868 | 54.9069 | 44.1809 | 80.4650 |
| AY+5 | 50.0751 | 4.9821 | 49.9249 | 41.7024 | 83.5302 |
| AY+6 | 60.9728 | 10.8976 | 39.0272 | 32.9847 | 84.5171 |
| AY+7 | 69.2138 | 8.2411 | 30.7862 | 26.4791 | 86.0097 |
| AY+8 | 72.8658 | 3.6519 | 27.1342 | 24.3079 | 89.5840 |
| AY+9 | 80.0005 | 7.1347 | 19.9995 | 18.4208 | 92.1061 |
| AY+10 | N/A | 7.1347 | 12.8648 | 12.1803 | 94.6798 |
| AY+11 | N/A | 7.1347 | 5.7300 | 5.5655 | 97.1286 |

**Miscellaneous Casualty**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 77.6669 | 77.6669 | 22.3331 | 21.2118 | 94.9792 |
| AY+1 | 94.0673 | 16.4004 | 5.9327 | 5.5993 | 94.3797 |
| AY+2 | N/A | 2.9664 | 2.9664 | 2.8812 | 97.1286 |

**Multiple Peril Lines**
**(Homeowners/Farmowners Multiple Peril, Commercial Multiple Peril, and Special Liability**
**(Ocean Marine, Aircraft (All Perils), Boiler, and Machinery))**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 55.9587 | 55.9587 | 44.0413 | 39.2528 | 89.1272 |
| AY+1 | 77.8939 | 21.9352 | 22.1061 | 19.0243 | 86.0589 |
| AY+2 | 84.0083 | 6.1144 | 15.9917 | 13.8706 | 86.7360 |
| AY+3 | 91.3188 | 7.3105 | 8.6812 | 7.1762 | 82.6633 |
| AY+4 | 92.1670 | 0.8482 | 7.8330 | 6.7334 | 85.9627 |
| AY+5 | 94.3838 | 2.2168 | 5.6162 | 4.8552 | 86.4488 |
| AY+6 | 96.4959 | 2.1121 | 3.5041 | 2.9719 | 84.8124 |
| AY+7 | 97.3670 | 0.8712 | 2.6330 | 2.2533 | 85.5817 |
| AY+8 | 98.0034 | 0.6364 | 1.9966 | 1.7334 | 86.8153 |
| AY+9 | 98.4059 | 0.4025 | 1.5941 | 1.4230 | 89.2642 |
| AY+10 | N/A | 0.4025 | 1.1916 | 1.0940 | 91.8045 |
| AY+11 | N/A | 0.4025 | 0.7892 | 0.7453 | 94.4346 |
| AY+12 | N/A | 0.4025 | 0.3867 | 0.3756 | 97.1286 |

**Other**
**(Including Credit)**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 66.7418 | 66.7418 | 33.2582 | 31.4355 | 94.5195 |
| AY+1 | 89.2755 | 22.5337 | 10.7245 | 10.1217 | 94.3797 |
| AY+2 | N/A | 5.3622 | 5.3622 | 5.2083 | 97.1286 |

**Other Liability — Claims-Made**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 10.2440 | 10.2440 | 89.7560 | 74.4023 | 82.8940 |
| AY+1 | 29.3763 | 19.1323 | 70.6237 | 59.1686 | 83.7800 |
| AY+2 | 44.4111 | 15.0349 | 55.5889 | 47.2393 | 84.9799 |
| AY+3 | 67.8197 | 23.4086 | 32.1803 | 25.9731 | 80.7112 |
| AY+4 | 73.4753 | 5.6555 | 26.5247 | 21.7087 | 81.8434 |
| AY+5 | 78.8604 | 5.3852 | 21.1396 | 17.4669 | 82.6265 |
| AY+6 | 83.5027 | 4.6422 | 16.4973 | 13.7354 | 83.2585 |
| AY+7 | 84.0676 | 0.5649 | 15.9324 | 13.9779 | 87.7327 |
| AY+8 | 85.2129 | 1.1453 | 14.7871 | 13.6374 | 92.2252 |
| AY+9 | 90.5992 | 5.3863 | 9.4008 | 8.9102 | 94.7808 |
| AY+10 | N/A | 5.3863 | 4.0145 | 3.8993 | 97.1286 |

**Other Liability — Occurrence**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 13.5751 | 13.5751 | 86.4249 | 68.4370 | 79.1866 |
| AY+1 | 26.3964 | 12.8213 | 73.6036 | 59.3429 | 80.6249 |
| AY+2 | 40.2725 | 13.8761 | 59.7275 | 48.6171 | 81.3982 |
| AY+3 | 55.4566 | 15.1841 | 44.5434 | 35.9011 | 80.5981 |
| AY+4 | 65.3309 | 9.8742 | 34.6691 | 27.8890 | 80.4434 |
| AY+5 | 74.0647 | 8.7339 | 25.9353 | 20.5703 | 79.3140 |
| AY+6 | 80.9090 | 6.8442 | 19.0910 | 14.7580 | 77.3031 |
| AY+7 | 84.3622 | 3.4532 | 15.6378 | 12.0881 | 77.3006 |
| AY+8 | 84.6163 | 0.2542 | 15.3837 | 12.5517 | 81.5914 |
| AY+9 | 86.7311 | 2.1147 | 13.2689 | 11.1276 | 83.8621 |
| AY+10 | N/A | 2.1147 | 11.1542 | 9.6180 | 86.2277 |
| AY+11 | N/A | 2.1147 | 9.0395 | 8.0178 | 88.6981 |
| AY+12 | N/A | 2.1147 | 6.9247 | 6.3216 | 91.2910 |
| AY+13 | N/A | 2.1147 | 4.8100 | 4.5237 | 94.0479 |
| AY+14 | N/A | 2.1147 | 2.6953 | 2.6179 | 97.1286 |

**Private Passenger Auto Liability/Medical**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 37.9339 | 37.9339 | 62.0661 | 56.5092 | 91.0468 |
| AY+1 | 67.7044 | 29.7705 | 32.2956 | 29.2492 | 90.5670 |
| AY+2 | 81.5316 | 13.8272 | 18.4684 | 16.7681 | 90.7936 |
| AY+3 | 89.8898 | 8.3583 | 10.1102 | 9.1689 | 90.6897 |
| AY+4 | 94.6531 | 4.7633 | 5.3469 | 4.8149 | 90.0509 |
| AY+5 | 97.1265 | 2.4734 | 2.8735 | 2.5573 | 88.9961 |
| AY+6 | 98.4587 | 1.3322 | 1.5413 | 1.3392 | 86.8852 |
| AY+7 | 98.9811 | 0.5224 | 1.0189 | 0.8817 | 86.5309 |
| AY+8 | 99.2330 | 0.2519 | 0.7670 | 0.6752 | 88.0336 |
| AY+9 | 99.4067 | 0.1737 | 0.5933 | 0.5369 | 90.4936 |
| AY+10 | N/A | 0.1737 | 0.4196 | 0.3903 | 93.0125 |
| AY+11 | N/A | 0.1737 | 0.2460 | 0.2349 | 95.5126 |
| AY+12 | N/A | 0.1737 | 0.0723 | 0.0702 | 97.1286 |

**Products Liability — Claims-Made**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 4.9750 | 4.9750 | 95.0250 | 76.1308 | 80.1166 |
| AY+1 | 15.1072 | 10.1322 | 84.8928 | 70.2670 | 82.7714 |
| AY+2 | 30.9560 | 15.8488 | 69.0440 | 58.1656 | 84.2443 |
| AY+3 | 38.2420 | 7.2860 | 61.7580 | 54.1541 | 87.6876 |
| AY+4 | 68.6101 | 30.3681 | 31.3899 | 26.1375 | 83.2673 |
| AY+5 | 78.5966 | 9.9865 | 21.4034 | 17.4241 | 81.4078 |
| AY+6 | 88.3971 | 9.8005 | 11.6029 | 8.3793 | 72.2169 |
| AY+7 | 93.2957 | 4.8986 | 6.7043 | 3.8386 | 57.2557 |
| AY+8 | 88.3815 | -4.9142 | 11.6185 | 9.1284 | 78.5676 |
| AY+9 | 89.6105 | 1.2290 | 10.3895 | 8.4107 | 80.9542 |
| AY+10 | N/A | 1.2290 | 9.1604 | 7.6500 | 83.5111 |
| AY+11 | N/A | 1.2290 | 7.9314 | 6.8436 | 86.2851 |
| AY+12 | N/A | 1.2290 | 6.7024 | 5.9888 | 89.3544 |
| AY+13 | N/A | 1.2290 | 5.4733 | 5.0828 | 92.8653 |
| AY+14 | N/A | 1.2290 | 4.2443 | 4.1224 | 97.1286 |

**Products Liability – Occurrence**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 9.0653 | 9.0653 | 90.9347 | 69.4041 | 76.3230 |
| AY+1 | 14.9035 | 5.8382 | 85.0965 | 67.5575 | 79.3893 |
| AY+2 | 29.2591 | 14.3555 | 70.7409 | 56.8310 | 80.3369 |
| AY+3 | 45.6462 | 16.3871 | 54.3538 | 43.3693 | 79.7908 |
| AY+4 | 57.5945 | 11.9483 | 42.4055 | 33.6700 | 79.4000 |
| AY+5 | 63.8634 | 6.2689 | 36.1366 | 29.2359 | 80.9039 |
| AY+6 | 75.2266 | 11.3632 | 24.7734 | 19.2910 | 77.8696 |
| AY+7 | 78.2679 | 3.0413 | 21.7321 | 17.3172 | 79.6849 |
| AY+8 | 78.1898 | -0.0781 | 21.8102 | 18.4367 | 84.5322 |
| AY+9 | 81.8722 | 3.6825 | 18.1278 | 15.7515 | 86.8918 |
| AY+10 | N/A | 3.6825 | 14.4453 | 12.9053 | 89.3391 |
| AY+11 | N/A | 3.6825 | 10.7628 | 9.8883 | 91.8744 |
| AY+12 | N/A | 3.6825 | 7.0803 | 6.6902 | 94.4902 |
| AY+13 | N/A | 3.6825 | 3.3979 | 3.3003 | 97.1286 |

**Reinsurance A**
**(Nonproportional Property)**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 27.1668 | 27.1668 | 72.8332 | 64.9403 | 89.1631 |
| AY+1 | 68.7008 | 41.5340 | 31.2992 | 26.0748 | 83.3084 |
| AY+2 | 70.0362 | 1.3354 | 29.9638 | 26.2645 | 87.6541 |
| AY+3 | 87.5338 | 17.4976 | 12.4662 | 9.8255 | 78.8169 |
| AY+4 | 90.2132 | 2.6794 | 9.7868 | 7.6564 | 78.2320 |
| AY+5 | 91.3751 | 1.1619 | 8.6249 | 6.9196 | 80.2275 |
| AY+6 | 94.3845 | 3.0095 | 5.6155 | 4.2363 | 75.4399 |
| AY+7 | 93.3293 | -1.0552 | 6.6707 | 5.5769 | 83.6030 |
| AY+8 | N/A | 1.0387 | 5.6320 | 4.8421 | 85.9749 |
| AY+9 | N/A | 1.0387 | 4.5932 | 4.0632 | 88.4598 |
| AY+10 | N/A | 1.0387 | 3.5545 | 3.2375 | 91.0821 |
| AY+11 | N/A | 1.0387 | 2.5158 | 2.3623 | 93.9007 |
| AY+12 | N/A | 1.0387 | 1.4771 | 1.4346 | 97.1286 |

**Reinsurance B**
**(Non-proportional Liability)**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 6.6962 | 6.6962 | 93.3038 | 69.3996 | 74.3802 |
| AY+1 | 22.3944 | 15.6982 | 77.6056 | 57.4013 | 73.9654 |
| AY+2 | 32.6486 | 10.2542 | 67.3514 | 50.2879 | 74.6651 |
| AY+3 | 50.2234 | 17.5748 | 49.7766 | 35.2109 | 70.7379 |
| AY+4 | 53.5839 | 3.3605 | 46.4161 | 33.8637 | 72.9568 |
| AY+5 | 55.6838 | 2.0999 | 44.3162 | 33.7335 | 76.1201 |
| AY+6 | 63.6144 | 7.9306 | 36.3856 | 27.5925 | 75.8336 |
| AY+7 | 66.4211 | 2.8066 | 33.5789 | 26.3584 | 78.4969 |
| AY+8 | N/A | 2.8066 | 30.7723 | 25.0503 | 81.4054 |
| AY+9 | N/A | 2.8066 | 27.9656 | 23.6637 | 84.6171 |
| AY+10 | N/A | 2.8066 | 25.1590 | 22.1939 | 88.2146 |
| AY+11 | N/A | 2.8066 | 22.3524 | 20.6359 | 92.3211 |
| AY+12 | N/A | 2.8066 | 19.5457 | 18.9845 | 97.1286 |

**Reinsurance C**
**(Financial Lines)**

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 11.4622 | 11.4622 | 88.5378 | 77.3623 | 87.3777 |
| AY+1 | 44.5791 | 33.1169 | 55.4209 | 47.9081 | 86.4441 |
| AY+2 | 63.9134 | 19.3343 | 36.0866 | 30.8767 | 85.5627 |
| AY+3 | 65.6185 | 1.7051 | 34.3815 | 30.9737 | 90.0885 |
| AY+4 | 79.9778 | 14.3593 | 20.0222 | 18.0484 | 90.1419 |
| AY+5 | 88.9152 | 8.9374 | 11.0848 | 9.9297 | 89.5793 |
| AY+6 | 91.2490 | 2.3338 | 8.7510 | 8.1227 | 92.8199 |
| AY+7 | 94.7645 | 3.5155 | 5.2355 | 4.9906 | 95.3224 |
| AY+8 | N/A | 3.5155 | 1.7200 | 1.6706 | 97.1286 |

### Special Property
### (Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 57.4895 | 57.4895 | 42.5105 | 40.5227 | 95.3241 |
| AY+1 | 90.5193 | 33.0297 | 9.4807 | 8.9479 | 94.3797 |
| AY+2 | N/A | 4.7404 | 4.7404 | 4.6043 | 97.1286 |

### Workers' Compensation

| Tax Year | Cumulative Losses Paid (%) | Estimated Losses Paid Each Year (%) | Unpaid Losses at Year End (%) | Discounted Unpaid Losses at Year End (%) | Discount Factors (%) |
|---|---|---|---|---|---|
| AY+0 | 23.6461 | 23.6461 | 76.3539 | 62.7199 | 82.1437 |
| AY+1 | 44.8166 | 21.1705 | 55.1834 | 44.6867 | 80.9786 |
| AY+2 | 57.9652 | 13.1486 | 42.0348 | 33.8306 | 80.4824 |
| AY+3 | 72.0542 | 14.0889 | 27.9458 | 21.3550 | 76.4156 |
| AY+4 | 80.5542 | 8.5000 | 19.4458 | 13.8850 | 71.4034 |
| AY+5 | 84.8876 | 4.3334 | 15.1124 | 10.2565 | 67.8684 |
| AY+6 | 87.1173 | 2.2297 | 12.8827 | 8.5763 | 66.5723 |
| AY+7 | 88.2647 | 1.1473 | 11.7353 | 7.9096 | 67.4000 |
| AY+8 | 88.5404 | 0.2757 | 11.4596 | 8.1003 | 70.6858 |
| AY+9 | 88.8062 | 0.2658 | 11.1938 | 8.3126 | 74.2613 |
| AY+10 | N/A | 0.2658 | 10.9279 | 8.5377 | 78.1273 |
| AY+11 | N/A | 0.2658 | 10.6621 | 8.7763 | 82.3127 |
| AY+12 | N/A | 0.2658 | 10.3963 | 9.0291 | 86.8499 |
| AY+13 | N/A | 0.2658 | 10.1304 | 9.2972 | 91.7750 |
| AY+14 | N/A | 0.2658 | 9.8646 | 9.5813 | 97.1286 |

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. Hossofsky at (202) 622–3477 (not a toll-free number).

*26 CFR 601.201: Rulings and determination letters. (Also Part I, Sections 832, 846; 1.832–4, 1.846–1.)*

## Rev. Proc. 2001–61

SECTION 1. PURPOSE

This revenue procedure prescribes the salvage discount factors for the 2001 accident year. These factors will be used for computing discounted estimated salvage recoverable under § 832 of the Internal Revenue Code.

SECTION 2. BACKGROUND

Section 832(b)(5)(A) requires that all estimated salvage recoverable (including that which cannot be treated as an asset for state accounting purposes) be taken into account in computing the deduction for losses incurred. Under § 832(b)(5)(A), paid losses are to be reduced by salvage and reinsurance recovered during the taxable year. This amount is adjusted to reflect changes in discounted unpaid losses on nonlife insurance contracts and in unpaid losses on life insurance contracts. An adjustment is then made to reflect any changes in discounted estimated salvage recoverable and in reinsurance recoverable.

Pursuant to § 832(b), the amount of estimated salvage is determined on a discounted basis in accordance with procedures established by the Secretary.

SECTION 3. SCOPE

This revenue procedure applies to any taxpayer that is required to discount estimated salvage recoverable under § 832.

SECTION 4. APPLICATION

.01 The following tables present separately for each line of business the discount factors under § 832 for the 2001 accident year. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2001, which is 6.00 percent, and by assuming all estimated salvage is recovered in the middle of each calendar year. *See* Rev. Proc. 98–12 (1998–1 C.B. 367) for background regarding the tables.

.02 These tables must be used by taxpayers irrespective of whether they elected to discount unpaid losses using their own historical experience under § 846.

.03 Section V of Notice 88–100 (1988–2 C. B. 439) provides guidance concerning the determination of discount factors for unpaid losses for accident years not separately reported on the annual statement. Taxpayers that do not use the methodology set forth in section V of Notice 88–100 should instead use the discount factors for the appropriate year in the Secretary's table for that line of business. If such taxpayers have unpaid losses relating to an accident year that is older than the last accident year for which a discount factor is presented in the Secretary's table, those unpaid losses should be discounted using the discount factor for the last accident year in the Secretary's table. *See* section 2.03(3) of Rev. Proc. 98–11 (1998–1 C.B. 358).

.04 Tables.

**Accident and Health (Other Than Disability Income or Credit Disability Insurance)**

Discount factor for all years equals 97.1286 percent.

**Auto Physical Damage**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 95.7674 |
| AY+1 | 94.3797 |
| AY+2 | 97.1286 |

**Commercial Auto/Truck Liability/Medical**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 88.5939 |
| AY+1 | 87.7783 |
| AY+2 | 89.4468 |
| AY+3 | 88.7496 |
| AY+4 | 88.5847 |
| AY+5 | 90.8892 |
| AY+6 | 86.3339 |
| AY+7 | 91.7857 |
| AY+8 | 90.2742 |
| AY+9 | 92.7870 |
| AY+10 | 95.2906 |
| AY+11 | 97.1286 |

**Composite Discount Factors**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 86.1785 |
| AY+1 | 84.6206 |
| AY+2 | 84.2139 |
| AY+3 | 84.1124 |
| AY+4 | 84.8349 |
| AY+5 | 85.3994 |
| AY+6 | 85.4575 |
| AY+7 | 85.5553 |
| AY+8 | 88.3172 |
| AY+9 | 90.7912 |
| AY+10 | 93.3259 |
| AY+11 | 95.8396 |
| AY+12 | 97.1286 |

**Fidelity/Surety**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 93.0996 |
| AY+1 | 94.3797 |
| AY+2 | 97.1286 |

**Financial Guaranty/ Mortgage Guaranty**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 94.8732 |
| AY+1 | 94.3797 |
| AY+2 | 97.1286 |

**International (Composite)**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 86.1785 |
| AY+1 | 84.6206 |
| AY+2 | 84.2139 |
| AY+3 | 84.1124 |
| AY+4 | 84.8349 |
| AY+5 | 85.3994 |
| AY+6 | 85.4575 |
| AY+7 | 85.5553 |
| AY+8 | 88.3172 |
| AY+9 | 90.7912 |
| AY+10 | 93.3259 |
| AY+11 | 95.8396 |
| AY+12 | 97.1286 |

**Medical Malpractice — Claims-Made**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 70.9439 |
| AY+1 | 73.5534 |
| AY+2 | 72.1559 |
| AY+3 | 71.5538 |
| AY+4 | 75.0244 |
| AY+5 | 73.4668 |
| AY+6 | 82.8921 |
| AY+7 | 91.7648 |
| AY+8 | 96.4576 |
| AY+9 | 97.1286 |

**Medical Malpractice — Occurrence**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 64.9126 |
| AY+1 | 68.2051 |
| AY+2 | 72.6369 |
| AY+3 | 76.3310 |
| AY+4 | 73.2474 |
| AY+5 | 79.1277 |
| AY+6 | 83.9409 |
| AY+7 | 86.9752 |
| AY+8 | 91.3121 |
| AY+9 | 93.8960 |
| AY+10 | 96.4969 |
| AY+11 | 97.1286 |

**Miscellaneous Casualty**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 95.1962 |
| AY+1 | 94.3797 |
| AY+2 | 97.1286 |

**Multiple Peril Lines (Homeowners/Farmowners Multiple Peril, Commercial Multiple Peril, and Special Liability (Ocean Marine, Aircraft (All Perils), Boiler and Machinery))**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 88.6776 |
| AY+1 | 87.6647 |
| AY+2 | 88.4118 |
| AY+3 | 88.0806 |
| AY+4 | 89.1756 |
| AY+5 | 90.5830 |
| AY+6 | 90.5792 |
| AY+7 | 89.5685 |

**Multiple Peril Lines (Homeowners/Farmowners Multiple Peril, Commercial Multiple Peril, and Special Liability (Ocean Marine, Aircraft (All Perils), Boiler and Machinery))**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+8 | 91.9074 |
| AY+9 | 94.5167 |
| AY+10 | 97.1286 |

**Other (Including Credit)**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 96.2118 |
| AY+1 | 94.3797 |
| AY+2 | 97.1286 |

**Other Liability — Claims-Made**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 78.1587 |
| AY+1 | 83.4921 |
| AY+2 | 82.5351 |
| AY+3 | 80.2819 |
| AY+4 | 83.1960 |
| AY+5 | 87.7328 |
| AY+6 | 86.3005 |
| AY+7 | 91.7967 |
| AY+8 | 93.8594 |
| AY+9 | 96.4520 |
| AY+10 | 97.1286 |

**Other Liability — Occurrence**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 79.1003 |
| AY+1 | 79.8165 |
| AY+2 | 82.1449 |
| AY+3 | 84.0693 |
| AY+4 | 85.2943 |
| AY+5 | 82.9430 |
| AY+6 | 86.9293 |
| AY+7 | 88.8442 |
| AY+8 | 92.8410 |
| AY+9 | 95.3428 |
| AY+10 | 97.1286 |

**Private Passenger Auto Liability/Medical**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 91.8234 |
| AY+1 | 91.2893 |
| AY+2 | 90.3834 |
| AY+3 | 90.0088 |
| AY+4 | 89.5577 |
| AY+5 | 90.0005 |
| AY+6 | 88.8299 |
| AY+7 | 89.5391 |
| AY+8 | 90.2147 |
| AY+9 | 92.7265 |
| AY+10 | 95.2329 |
| AY+11 | 97.1286 |

**Products Liability — Claims-Made**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 79.5379 |
| AY+1 | 81.5337 |
| AY+2 | 85.9078 |
| AY+3 | 85.8225 |
| AY+4 | 81.5464 |
| AY+5 | 88.3645 |
| AY+6 | 81.2686 |
| AY+7 | 88.5406 |
| AY+8 | 96.8633 |
| AY+9 | 97.1286 |

**Products Liability — Occurrence**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 76.1115 |
| AY+1 | 78.6586 |
| AY+2 | 77.0761 |
| AY+3 | 78.3522 |
| AY+4 | 80.0713 |
| AY+5 | 79.4367 |
| AY+6 | 80.7804 |
| AY+7 | 73.1074 |
| AY+8 | 78.4522 |
| AY+9 | 80.8473 |
| AY+10 | 83.4161 |
| AY+11 | 86.2062 |
| AY+12 | 89.2973 |
| AY+13 | 92.8357 |
| AY+14 | 97.1286 |

**Reinsurance A (Nonproportional Property)**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 86.8922 |
| AY+1 | 89.9989 |
| AY+2 | 92.6537 |
| AY+3 | 92.0270 |
| AY+4 | 79.5110 |
| AY+5 | 94.9370 |
| AY+6 | 93.5902 |
| AY+7 | 96.1337 |
| AY+8 | 97.1286 |

**Reinsurance B (Nonproportional Liability)**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 75.2252 |
| AY+1 | 77.4497 |
| AY+2 | 78.1634 |
| AY+3 | 77.5844 |
| AY+4 | 80.0321 |
| AY+5 | 75.2265 |
| AY+6 | 76.9615 |
| AY+7 | 84.2881 |
| AY+8 | 86.6481 |
| AY+9 | 89.1014 |
| AY+10 | 91.6542 |
| AY+11 | 94.3176 |
| AY+12 | 97.1286 |

**Reinsurance C (Financial Lines)**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 81.5339 |
| AY+1 | 83.8710 |
| AY+2 | 87.0718 |
| AY+3 | 92.8074 |
| AY+4 | 91.4169 |
| AY+5 | 93.2543 |
| AY+6 | 89.8633 |
| AY+7 | 97.0178 |
| AY+8 | 97.1286 |

**Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 92.4418 |
| AY+1 | 94.3797 |
| AY+2 | 97.1286 |

**Workers' Compensation**

| Tax Year | Discount Factors (%) |
|---|---|
| AY+0 | 78.9510 |
| AY+1 | 81.3287 |
| AY+2 | 83.1942 |
| AY+3 | 84.7269 |
| AY+4 | 84.8406 |
| AY+5 | 85.0065 |
| AY+6 | 86.1624 |
| AY+7 | 86.8999 |
| AY+8 | 89.2560 |
| AY+9 | 91.7969 |
| AY+10 | 94.4286 |
| AY+11 | 97.1286 |

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. Hossofsky at (202) 622–3477 (not a toll-free number).

# INDEX

The abbreviation and number in parenthesis following the index entry refer to the specific item; the number in italic type following the parenthesis refers to the page number on which the item appears.

Key to Abbreviations:

| | |
|---|---|
| Ann | Announcement |
| CD | Court Decision |
| DO | Delegation Order |
| EO | Executive Order |
| PL | Public Law |
| PTE | Prohibited Transaction Exemption |
| RP | Revenue Procedure |
| RR | Revenue Ruling |
| SPR | Statement of Procedural Rules |
| TC | Tax Convention |
| TD | Treasury Decision |
| TDO | Treasury Department Order |

## EMPLOYEE PLANS



## EMPLOYEE PLANS—Cont.



## EMPLOYEE PLANS—Cont.



## EMPLOYMENT TAX

## EMPLOYMENT TAX—Cont.



## ESTATE TAX



## EXCISE TAX



## EXCISE TAX—Cont.



## EXEMPT ORGANIZATIONS



## INCOME TAX

INCOME TAX—Cont.



INCOME TAX—Cont.