Internal Revenue
bulletin

Bulletin No. 2000–7
February 14, 2000

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 8864, page 614.
Final and temporary regulations under section 274 of the Code relate to the substantiation of certain business expenses.

T.D. 8865, page 589.
Final regulations under sections 167(f) and 197 of the Code provide guidance concerning the amortization of goodwill and certain other intangible property.

T.D. 8867, page 620.
Final regulations under section 1296 of the Code relate to the new mark-to-market election for stock of a passive foreign investment company (PFIC) and define the term "marketable stock."

EMPLOYEE PLANS

Rev. Rul. 2000–8, page 617.
Cash or deferred arrangements; elective deferrals. This ruling specifies the criteria to be met in order to automatically reduce an employee's compensation by a certain amount and have that amount contributed as an elective deferral to an employer's section 401(k) plan. Rev. Rul. 98–30 amplified and superseded.

REG–113572–99, page 624.
Proposed regulations under section 132(f) of the Code provide guidance on qualified transportation fringe benefits provided by employers to employees. A public hearing is scheduled for June 1, 2000.

ADMINISTRATIVE

REG–100163–00, PAGE 633.
Proposed regulations under section 197 of the Code provide guidance on how the anti-churning rules of section 197(f) apply to partnership transactions involving sections 732(b) and 734(b). A public hearing is scheduled for May 24, 2000.

Actions Relating to Court Decisions is on the page following the Introduction.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Actions Relating to Court Decisions

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

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

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

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

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in result only in the following decision:

Ahadpour v. Commissioner,[1]
T.C. Memo. 1999–9
T.C. Dkt. No. 4843–96

[1] Acquiescence in result only relating to whether certain payments received by petitioners, pursuant to a sales agreement for real property, should be included in gross income in the year received.

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

Section 197.—Amortization of Goodwill and Certain Other Intangibles

26 CFR 1.197–2: Amortization of goodwill and certain other intangibles.

T.D. 8865

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

Amortization of Intangible Property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the amortization of certain intangible property. The final regulations reflect changes to the law made by the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) and affect taxpayers who acquired intangible property after August 10, 1993, or made a retroactive election to apply OBRA '93 to intangibles acquired after July 25, 1991.

DATES: *Effective Date*: January 25, 2000.

Applicability Dates: These regulations apply to property acquired after January 25, 2000]. Regulations to implement section 197(e)(4)(D) are applicable August 11, 1993, for property acquired after August 10, 1993 (or July 26, 1991, for property acquired after July 25, 1991, if a valid retroactive election has been made under §1.197–1T).

FOR FURTHER INFORMATION CONTACT: John Huffman at (202) 622-3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545-1671.

The collection of information in this regulation is in §1.197–2(h)(9). This information is required in order to provide guidance on the time and manner of making the election under section 197(f)(9)(B). Under this election, the seller of a section 197 intangible may pay a tax on the sale in order to avoid the application of the anti-churning rules of section 197(f)(9) to the purchaser. This information will be used to confirm the parties to the transaction, calculate any additional tax due, and notify the purchaser of the seller's election. The likely respondents are business or other for-profit institutions.

Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by March 27, 2000. Comments are specifically requested concerning:

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

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

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

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

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

Estimated total annual reporting burden: 1500 hours.

Estimated average annual burden hours per respondent varies from 2 to 4 hours, depending on individual circumstances, with an estimated average of 3 hours.

Estimated number of respondents: 500 per year.

Estimated annual frequency of responses: 1

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

Background

On January 16, 1997, the IRS published proposed regulations REG–209709–94, 1997–1 C.B. 731, in the **Federal Register** (62 F.R. 2336) inviting comments under sections 167(f) and 197. A public hearing was held May 15, 1997. Numerous comments have been received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 162(k) Application

Example 4 of the proposed regulation §1.197–2(k) provided that amounts paid for a covenant not to compete entered into in connection with a redemption was nondeductible under section 162(k) and thus not subject to section 197. Commentators suggested that guidance on the application of section 162(k) to transactions involving section 197 intangibles should be addressed in regulations under section 162(k). No reference to section 162(k) is made in the final regulations.

Purchase of a Trade or Business

Certain intangibles are excepted from the application of section 197 if they are not acquired as part of a purchase of a trade or business. The proposed regulations provide that, for purposes of section 197, a group of assets constitutes a trade or business if their use would constitute a trade or business under section 1060 (that is, if goodwill or going concern value could, under any circumstances, attach to the assets). In addition, the proposed regulations treat a group of assets as a trade or business if they include any customer-based intangibles or, with certain exceptions, any franchise, trademark, or trade name (the per se rules). The preamble of the proposed regulations state that the IRS intends to provide additional guidance on the circumstances in which a group of assets is treated as a trade or business in regulations under section 1060.

Although a number of comments requested that the final regulations under section 197 provide such additional guidance, the final regulations generally retain, without amplification, the rules in the proposed regulations. The IRS and Treasury Department will, however, continue to consider this issue during the development of final regulations under section 1060.

Commentators also requested modifications to the per se rules. In response to these comments, the final regulations limit the applicability of these rules to the cases specifically described in the legislative history of section 197 (that is, the acquisition of a franchise, trademark, or trade name). The final regulations retain the proposed exceptions under which certain franchises, trademarks, and trade names are disregarded in applying the per se rules. In addition, the regulations clarify that a license of a trademark or trade name is also disregarded in applying the per se rules.

Computer Software

The final regulations contain rules that supersede certain of the procedures set forth in Revenue Procedure 69–21 (1969–2 C.B. 303), which provides guidelines relating to costs incurred to develop, purchase, or lease computer software. Specifically, the final regulations provide that purchased computer software is amortizable over 15 years if section 197 applies and over 36 months if the software is not a section 197 intangible. In addition, the regulations clarify that section 197 (rather than §1.162–11) applies to certain costs incurred with respect to leased software (that is, costs to acquire a section 197 intangible that is a limited interest in software). Computer software costs included, without being separately stated, in the cost of the computer hardware (bundled software) continue to be capitalized and depreciated as part of the computer hardware. In addition, the final regulations treat software costs as currently deductible (and not subject to section 197) if they are not chargeable to capital account under the rules applicable to licensing transactions (discussed below) and are otherwise currently deductible. The final regulations clarify that, for this purpose, an amount described in §1.162–11 is not currently deductible if, without regard to §1.162–11, such amount is properly chargeable to capital account. A proper and consistent practice of taking software costs into account under §1.162–11 may, however, be continued if the costs are not subject to section 197.

A revenue procedure superseding Rev. Proc. 69–21 and providing procedures consistent with the rules in the final regulations will be issued in the near future. In the meantime, taxpayers may not rely on the procedures in Rev. Proc. 69–21 to the extent they are inconsistent with section 167(f), section 197, or the final regulations.

Mortgage Servicing Rights

The proposed regulations treat mortgage servicing rights relating to a pool of mortgages as a single asset under section 167(f) (relating to mortgage servicing rights not acquired as part of a purchase of a trade or business). Thus, if some but not all mortgages in a pool prepay, no loss is recognized. Commentators assert that each right in the pool is a discrete asset, and thus, taxpayers should be able to recognize a loss upon the prepayment of an individual mortgage within the pool. The Service and the Treasury Department believe this is generally inappropriate in cases where depreciation is based on the average useful life of the assets. See §1.167(a)–8. Thus, the regulations retain the rule that no loss is recognized if some but not all mortgages in a pool prepay or are sold or exchanged. The final regulations provide, however, that if a taxpayer establishes multiple accounts within a pool at the time of its acquisition, gain or loss is recognized on the sale or exchange of all mortgage servicing rights within any such account.

When Section 197 Amortization Begins

The proposed regulations provide that amortization begins the later of the first day of the month in which the property is acquired, or the first month in which the active conduct of a trade or business begins. Commentators suggest that the literal language of section 197(a) allows amortization beginning with the month the intangible is acquired. Under section 197(c)(1), however, a section 197 intangible is amortizable only if it is held in connection with the conduct of a trade or business or an activity described in section 212. Moreover, there is no suggestion in the legislative history that Congress intended to apply a rule differing from those applicable under section 167 and former section 1253(d).

Former section 1253(d)(2) provided, in language similar to that in section 197(a), that the amortization of certain amounts begins in the taxable year in which the amounts are paid. Although section 1253(d)(2) did not contain any reference to section 162 or to use in a trade or business, it was nevertheless well established at the time of the enactment of section 197 that the provision embodied a trade or business requirement and that amounts were not deductible thereunder unless the taxpayer was operating or conducting a trade or business after the amounts were paid.

Commentators suggest that it is significant that section 167 refers to "property used in the trade or business" while property can qualify for amortization under section 197 if it is "held in connection with the conduct of a trade or business." Further, commentators assert that the language used in section 197 is closer to the "held in connection with his trade or business" language used in section 174, which does not require the current conduct of a trade or business, than to the language of section 167. The different language used in these provisions can be explained, however, without departing from previous practice under sections 167 and 1253(d) regarding the time at which amortization commences. Broader language under section 197 is necessary because it applies to assets, such as goodwill, that although held in connection with the conduct of a trade or business are not commonly viewed as being used in the trade or business. Further, modifying the language used in section 174 by adding the words "*conduct of*" indicates that Congress did not intend to change the longstanding trade or business requirement for purposes of determining when amortization commences.

Consequently, the final regulations retain the rule in the proposed regulations that amortization begins no earlier than the first day of the month in which the active trade or business or the activity described in section 212 begins.

Transactions Involving Partnerships

The final regulations relating to partnership transactions have been changed from the proposed regulations in several respects to reflect the recommendations of commentators. *Example 17* of the proposed regulation § 1.197-2(k) provided that a partner may amortize a § 743 adjustment with respect to a section 197 intangible only if the formation of the partnership and the sale of the partnership interest are "unrelated transactions." Commentators suggested that an unrelated transaction standard would create significant confusion for taxpayers. According to the commentators, taxpayers would have greater certainty with respect to their transactions, and the government still would be adequately protected, if these transactions were analyzed under general tax principles, including the step transaction doctrine. The final regulations remove the unrelated transaction requirement. However, if the transaction is structured so that, under general principles of tax law, the transaction is not properly characterized as a sale of a partnership interest, then section 197 will apply to the transaction as recast to reflect its true economic substance.

Certain commentators also requested that *Example 16* of proposed regulation § 1.197–2(k) be modified to allow a partnership to amortize an intangible contributed to the partnership under the transferred basis rules under section 197(f)(2), even if a partner related to the partnership under section 197(f)(9)(C) had owned the intangible during the transition period and, as part of an integrated transaction, had sold the intangible to an unrelated party before forming the partnership. The commentators suggested that because section 197(f)(9)(E) generally permits amortization for the stepped-up basis in a partnership transaction under section 743 where a section 754 election was in effect, amortization also should be allowed in a sale of an intangible followed by a contribution of the intangible to a partnership, an economically similar transaction. This recommendation was not adopted. In general, a partnership is treated as an entity separate from its partners in characterizing related party transfers. See, e.g., Section 707(b)(1) (specifically referenced in section 197(f)(9)(C)(i)(I)). Section 197(f)(9)(E) does provide a special anti-churning rule for certain partnership transactions. However, this special rule is not applicable in situations where a partnership has a transferred basis in the intangible under section 723. With respect to the analogy under section 743, where a transferee is allowed to amortize a section 743 basis step-up, it is only the increase in basis that may be amortized, and the amortization attributable to the basis increase is segregated for use only by the transferee partner. Neither of these results necessarily follow from a sale of property followed by a contribution of the property to the partnership.

The proposed regulations did not allow partners to deduct, for federal income tax purposes, curative or remedial amortization allocations from the partnership in situations where the asset was a section 197(f)(9) intangible (and thus nonamortizable) in the hands of the contributing partner. Commentators have suggested allowing curative and remedial allocations under section 704(c). The final regulations generally permit a partnership to make curative or remedial allocations to its noncontributing partners of amortization relating to an asset that was amortizable (or a zero-basis intangible that otherwise would have been amortizable) in the hands of the contributor. For assets that were section 197(f)(9) intangibles (and thus nonamortizable) in the hands of the contributor, however, the partnership may make deductible amortization allocations to the noncontributing partners under the remedial method only. The final regulations permit remedial allocations because, under section 704(c), remedial allocations treat the amortizable portion of contributed property like newly purchased property, with a new holding period and determinable allocation of tax items. This result, which is similar to the result obtained for basis increases under section 743, does not follow under the curative method because curative allocations are not determined as if the applicable property were newly purchased property. The decision to allow amortization for remedial allocations in these regulations also is consistent with the decisions regarding fungibility of partnership interests that are inherent in the recently finalized regulations under sections 743 and 755. Finally, the rules governing section 704(c) allocations of amortization from section 197 intangibles contributed to a partnership in a nonrecognition transaction are still subject to the anti-churning provisions. Accordingly, remedial allocations of deductible amortization expenses may not be made to a partner who is related to a partner that contributes an intangible subject to the anti-churning rules. Certain problems may arise in maintaining capital accounts where a partnership elects to make remedial allocations, and the anti-churning rules apply with respect to one or more partners. These problems also arise in the context of section 734(b) adjustments and are discussed in the preamble to the proposed regulations relating to the application of the anti-churning rules to basis adjustments under sections 732(b) and 734(b), which are being issued at the same date as these final regulations.

Commentators requested that the final regulations provide additional guidance on how the special anti-churning rule of section 197(f)(9)(E) applies to increases in the basis of property under sections 732, 734, and 743. In accordance with these comments, the final regulations provide rules for determining the amount of a basis adjustment under sections 732(d) and 743 that will be subject to the anti-churning rules. The Treasury Department and the IRS also are issuing, at the same time as these final regulations, proposed regulations addressing how to determine the amount of a basis adjustment under sections 732(b) and 734(b) that will be subject to the anti-churning rules.

Finally, the final regulations provide that where, for purposes of the anti-churning rules, a partner is treated as holding its proportionate share of partnership property under section 197(f)(9)(E), the continued or subsequent use (by license or otherwise) of an intangible by a partner could cause the anti-churning rules to apply with respect to that partner's share of the intangible in situations where a basis step-up under section 732(d) or 743(b) otherwise would be amortizable.

This rule is necessary in order to prevent the circumvention of section 197(f)(9)(A) through the use of a partnership. The proposed regulations being issued in conjunction with these final regulations expand the application of this rule to basis adjustments under sections 732(b) and 734(b).

Contracts for the Use of a Section 197 Intangible

The proposed regulations provide that a right to use a section 197 intangible pursuant to a license, contract, or other arrangement is, itself, a section 197 intangible. The proposed regulations further provide that amounts paid for such a right are chargeable to capital account, whether or not the payments would have been deductible (for example, as a royalty) if the right were not a section 197 intangible. Under the proposed regulations, the amount chargeable to capital account is generally determined without regard to sections 483 and 1274 (that is, no part of the amount paid is recharacterized as unstated interest or original issue discount). Finally, the proposed regulations treat the acquisition of a franchise, trademark, or trade name as the acquisition of a trade or business, thereby preventing other intangibles acquired in the same transaction or series of related transactions from qualifying for any of the exceptions applicable to separately acquired property.

Commentators suggested that these rules have negative consequences for common cross-border and affiliate licenses, which frequently include, in addition to rights that would not be subject to section 197 if not acquired as part of a purchase of a trade or business, rights to use a trademark or trade name. Under prior law, amounts paid for these licenses were generally currently deductible. The proposed regulations, however, require amortization over 15 years. In addition, cost recovery over the 15-year period is significantly backloaded because the licenses generally involve contingent payments that are not includible in basis until the year in which they are paid or incurred and, in addition, the proposed regulations provide that sections 483 and 1274 are generally inapplicable.

After further consideration of this issue in light of the concerns raised by the commentators, the IRS and Treasury Department have concluded that, particularly in the case of common licensing transactions involving technology and similar intangible property, a different approach is appropriate. The clearest indication of Congressional intent on this issue is the statement in the legislative history to the effect that, with certain exceptions, section 197 generally does not apply to amounts that were otherwise currently deductible before the enactment of section 197. Nevertheless, the IRS and Treasury Department are also mindful that Congress directed the issuance of such regulations as may be appropriate to prevent avoidance of the purposes of section 197.

The final regulations generally provide that royalty payments under a contract for the use of section 197 intangibles unconnected with the purchase of a trade or business are not required to be capitalized. Licensing transactions will, however, be closely scrutinized under the principles of section 1235 for purposes of determining whether the payments are, in fact, deductible royalties or, instead, represent purchase price that should be charged to capital account.

The final regulations also modify the rule that treats the acquisition of a franchise, trademark, or trade name as the acquisition of a trade or business. Under the final regulations, the acquisition of an interest in a trademark or trade name is disregarded in determining whether acquired property is a trade or business if, under the principles of section 1253, the grant of the interest is not a transfer of all substantial rights in the trademark or trade name. Thus, the acquisition of such an interest in a trademark or trade name will not subject other intangibles acquired in the same transaction or series of related transactions to the generally less favorable rules applicable to intangibles acquired as part of a purchase of a trade or business.

To prevent abuses, the final regulations provide that if the right to use a section 197 intangible is provided under a license entered into as part of a purchase of a trade or business, amounts paid for the right are, as under the proposed regulations, chargeable to capital account. An exception, not contained in the proposed regulations, is provided for licenses of technology, know-how, and other similar items (including most types of information base). Royalties paid under these licenses are not required to be capitalized if the taxpayer establishes that the payments are, in fact, deductible royalties under general tax principles and represent an arm's-length consideration for the transferred rights.

Finally, any amount otherwise chargeable to capital account with respect to a section 197 intangible and payable after the acquisition of the intangible to which it relates is treated, in determining the tax treatment of the purchaser, as an amount payable under a debt instrument. Thus, the extent to which such amounts are treated as payments of principal and the time at which the amount treated as principal is included in basis is determined under generally applicable rules relating to imputed interest and original issue discount. If, under these rules, a basis increase occurs after the beginning of the 15-year amortization period, the increase is amortized over the remainder of the 15-year period (or, in the case of an increase occurring after the end of the amortization period, is immediately deductible).

Anti-churning Rules

The anti-churning rules of section 197 prevent taxpayers from converting goodwill, going concern value, and similar assets held or used at any time during the transition period into amortizable section 197 intangibles through transactions such as transfers to related parties. The proposed regulations provide guidance on a number of specific issues arising under the anti-churning rules. The final regulations retain this guidance with certain modifications and, in addition, set forth the purpose of the anti-churning rules (generally, to prevent the amortization of certain intangibles that are not acquired after the applicable effective date in a transaction giving rise to a significant change in ownership or use). The final regulations further provide that the anti-churning rules are to be applied in a manner that carries out their purpose. The final regulations include a rule providing that a transaction will be presumed to have a principal purpose of avoiding the anti-churning rules if it does not effect a significant change in ownership or use.

The final regulations also provide additional guidance concerning the circumstances in which persons are treated as related for purposes of the anti-churning rules. Section 197 provides that a relationship is tested for purposes of the anti-churning rules both immediately before and immediately after the acquisition. The proposed regulations further provide that, in the case of intangibles acquired in a series of related transactions, testing begins immediately before the first acquisition and continues until immediately after the last acquisition. Comments suggested that momentary relationships created in the course of the acquisition should be disregarded for purposes of the anti-churning rules. Such relationships can arise, for example, in the course of a stock acquisition followed by a liquidation or when assets are contributed to a newly created subsidiary and, pursuant to a binding commitment, all stock of the subsidiary is sold to an unrelated person or persons immediately after the contribution.

To address these and similar situations, the final regulations provide that in the case of a series of related transactions (or a series of transactions that together comprise a qualified stock purchase within the meaning of section 338(d)(3)) a person is treated as related to another person if the relationship exists immediately before the earliest such transaction or immediately after the last such transaction. In addition, any relationship created as part of a series of related transactions in which a person acquires stock of a corporation followed by a liquidation of the acquired corporation under section 331 generally is disregarded. Further, as with all other provisions of the regulations relating to the anti-churning rules, these provisions are to be applied in a manner that carries out the purpose of the anti-churning rules.

The final regulations also provide guidance on the exemption from the anti-churning rules if the person from whom the taxpayer acquires an intangible elects to recognize gain and agrees to pay a specified amount of tax. In general, these rules are the same as those contained in the proposed regulations, except that the proposed regulations do not prescribe procedures for making the election. The final regulations provide guidance on the manner of making the election, including procedures that apply to persons not otherwise subject to Federal income tax.

Effective Dates

The regulations under sections 167(f) and 197 were proposed to apply on the date on which the final regulations are published in the **Federal Register** (January 25, 2000). Regulations to implement section 197(e)(4)(D) (separately acquired contracts of fixed duration or amount) were proposed to apply August 11, 1993, for property acquired after August 10, 1993 (or July 26, 1991, if a valid retroactive election has been made under §1.197–1T). Comments suggested that the applicability date should be modified to clarify that the regulations (other than the implementation of section 197(e)(4)(D)) apply only to property acquired on or after the date final regulations are published. This suggestion has been adopted. Accordingly, the final regulations generally apply only to intangible property acquired after January 25, 2000.

The applicability date of the rules implementing section 197(e)(4)(D) is similarly clarified. Thus, the final regulations provide that these rules apply to property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T). The regulations also provide consent for changes in method of accounting to comply with the rules and automatic procedures for making the change.

In addition, the final regulations permit taxpayers to apply the rules in the final regulations to property acquired before the applicability date of the final regulations (or to rely on the proposed regulations for such property) and provide similar consent and automatic change procedures for taxpayers that choose to apply the final regulations to pre-effective date acquisitions.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant impact on a substantial number of small entities. This certification is based on the fact that the time required to prepare and file the election statement and notify acquirers is minimal and will not have a significant impact on those few small entities that choose to make the election. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) 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. 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 John Huffman, Office of Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

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

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * *
Section 1.197–2 also issued under 26 U.S.C. 197(g). * * *

Par. 2. Section 1.162–11 is amended by adding a sentence at the end of paragraph (a) to read as follows:

§1.162–11 Rentals.

(a) * * * See §1.197–2 for rules governing the amortization of costs to acquire limited interests in section 197 intangibles.

* * * * *

Par. 3. Section 1.167(a)–3 is amended by adding a sentence at the end to read as follows:

§1.167(a)–3 Intangibles.

* * * See sections 197 and 167(f) and, to the extent applicable, §§1.197–2 and 1.167(a)–14 for amortization of goodwill and certain other intangibles acquired after August 10, 1993, or after July 25, 1991, if a valid retroactive election under §1.197–1T has been made.

Par. 4. Section 1.167(a)–6 is amended by adding two sentences at the end of paragraph (a) to read as follows:

§1.167(a)–6 Depreciation in special cases.

(a) * * * See §1.167(a)–14(c)(4) for depreciation of a separately acquired interest in a patent or copyright described in section 167(f)(2) acquired after January 25, 2000. See §1.197–2 for amortization of interests in patents and copyrights that constitute amortizable section 197 intangibles.

* * * * *

Par. 5. Section 1.167(a)–14 is added to read as follows:

§1.167(a)–14 Treatment of certain intangible property excluded from section 197.

(a) *Overview*. This section provides rules for the amortization of certain intangibles that are excluded from section 197 (relating to the amortization of goodwill and certain other intangibles). These excluded intangibles are specifically described in §1.197–2(c)(4), (6), (7), (11), and (13) and include certain computer software and certain other separately acquired rights, such as rights to receive tangible property or services, patents and copyrights, certain mortgage servicing rights, and rights of fixed duration or amount. Intangibles for which an amortization amount is determined under section 167(f) and intangibles otherwise excluded from section 197 are amortizable only if they qualify as property subject to the allowance for depreciation under section 167(a).

(b) *Computer software*—(1) *In general*. The amount of the deduction for computer software described in section 167(f)(1) and §1.197–2(c)(4) is determined by amortizing the cost or other basis of the computer software using the straight line method described in §1.167(b)–1 (except that its salvage value is treated as zero) and an amortization period of 36 months beginning on the first day of the month that the computer software is placed in service. If costs for developing computer software that the taxpayer properly elects to defer under section 174(b) result in the development of property subject to the allowance for depreciation under section 167, the rules of this paragraph (b) will apply to the unrecovered costs. In addition, this paragraph (b) applies to the cost of separately acquired computer software where these costs are separately stated and the costs are required to be capitalized under section 263(a).

(2) *Exceptions*. Paragraph (b)(1) of this section does not apply to the cost of computer software properly and consistently taken into account under §1.162–11. The cost of acquiring an interest in computer software that is included, without being separately stated, in the cost of the hardware or other tangible property is treated as part of the cost of the hardware or other tangible property that is capitalized and depreciated under other applicable sections of the Internal Revenue Code.

(3) *Additional rules*. Rules similar to those in §1.197–2(f)(1)(iii), (f)(1)(iv), and (f)(2) (relating to the computation of amortization deductions and the treatment of contingent amounts) apply for purposes of this paragraph (b).

(c) *Certain interests or rights not acquired as part of a purchase of a trade or business*—(1) *Certain rights to receive tangible property or services*. The amount of the deduction for a right (other than a right acquired as part of a purchase of a trade or business) to receive tangible property or services under a contract or from a governmental unit (as specified in section 167(f)(2) and §1.197–2(c)(6)) is determined as follows:

(i) *Amortization of fixed amounts*. The basis of a right to receive a fixed amount of tangible property or services is amortized for each taxable year by multiplying the basis of the right by a fraction, the numerator of which is the amount of tangible property or services received during the taxable year and the denominator of which is the total amount of tangible property or services received or to be received under the terms of the contract or governmental grant. For example, if a taxpayer acquires a favorable contract right to receive a fixed amount of raw materials during an unspecified period, the taxpayer must amortize the cost of acquiring the contract right by multiplying the total cost by a fraction, the numerator of which is the amount of raw materials received under the contract during the taxable year and the denominator of which is the total amount of raw materials received or to be received under the contract.

(ii) *Amortization of unspecified amount over fixed period*. The cost or other basis of a right to receive an unspecified amount of tangible property or services over a fixed period is amortized ratably over the period of the right. (See paragraph (c)(3) of this section regarding renewals).

(iii) *Amortization in other cases.* [Reserved]

(2) *Rights of fixed duration or amount.* The amount of the deduction for a right (other than a right acquired as part of a purchase of a trade or business) of fixed duration or amount received under a contract or granted by a governmental unit (specified in section 167(f)(2) and §1.197–2(c)(13)) and not covered by paragraph (c)(1) of this section is determined as follows:

(i) *Rights to a fixed amount.* The basis of a right to a fixed amount is amortized for each taxable year by multiplying the basis by a fraction, the numerator of which is the amount received during the taxable year and the denominator of which is the total amount received or to be received under the terms of the contract or governmental grant.

(ii) *Rights to an unspecified amount over fixed duration of less than 15 years.* The basis of a right to an unspecified amount over a fixed duration of less than 15 years is amortized ratably over the period of the right.

(3) *Application of renewals.* (i) For purposes of paragraphs (c)(1) and (2) of this section, the duration of a right under a contract (or granted by a governmental unit) includes any renewal period if, based on all of the facts and circumstances in existence at any time during the taxable year in which the right is acquired, the facts clearly indicate a reasonable expectancy of renewal.

(ii) The mere fact that a taxpayer will have the opportunity to renew a contract right or other right on the same terms as are available to others, in a competitive auction or similar process that is designed to reflect fair market value and in which the taxpayer is not contractually advantaged, will generally not be taken into account in determining the duration of such right provided that the bidding produces a fair market value price comparable to the price that would be obtained if the rights were purchased immediately after renewal from a person (other than the person granting the renewal) in an arm's-length transaction.

(iii) The cost of a renewal not included in the terms of the contract or governmental grant is treated as the acquisition of a separate intangible asset.

(4) *Patents and copyrights.* If the purchase price of a interest (other than an interest acquired as part of a purchase of a trade or business) in a patent or copyright described in section 167(f)(2) and §1.197–2(c)(7) is payable on at least an annual basis as either a fixed amount per use or a fixed percentage of the revenue derived from the use of the patent or copyright, the depreciation deduction for a taxable year is equal to the amount of the purchase price paid or incurred during the year. Otherwise, the basis of such patent or copyright (or an interest therein) is depreciated either ratably over its remaining useful life or under section 167(g) (income forecast method). If a patent or copyright becomes valueless in any year before its legal expiration, the adjusted basis may be deducted in that year.

(5) *Additional rules*. The period of amortization under paragraphs (c)(1) through (4) of this section begins when the intangible is placed in service, and rules similar to those in §1.197–2(f)(2) apply for purposes of this paragraph (c).

(d) *Mortgage servicing rights*—(1) *In general.* The amount of the deduction for mortgage servicing rights described in section 167(f)(3) and §1.197–2(c)(11) is determined by using the straight line method described in §1.167(b)–1 (except that the salvage value is treated as zero) and an amortization period of 108 months beginning on the first day of the month that the rights are placed in service. Mortgage servicing rights are not depreciable to the extent the rights are stripped coupons under section 1286.

(2) *Treatment of rights acquired as a pool*—(i) *In general.* Except as provided in paragraph (d)(2)(ii) of this section, all mortgage servicing rights acquired in the same transaction or in a series of related transactions are treated as a single asset (the pool) for purposes of determining the depreciation deduction under this paragraph (d) and any gain or loss from the sale, exchange, or other disposition of the rights. Thus, if some (but not all) of the rights in a pool become worthless as a result of prepayments, no loss is recognized by reason of the prepayment and the adjusted basis of the pool is not affected by the unrecognized loss. Similarly, any amount realized from the sale or exchange of some (but not all) of the mortgage servicing rights is included in income and the adjusted basis of the pool is not affected by the realization.

(ii) *Multiple accounts*. If the taxpayer establishes multiple accounts within a pool at the time of its acquisition, gain or loss is recognized on the sale or exchange of all mortgage servicing rights within any such account.

(3) *Additional rules*. Rules similar to those in §1.197–2(f)(1)(iii), (f)(1)(iv), and (f)(2) (relating to the computation of amortization deductions and the treatment of contingent amounts) apply for purposes of this paragraph (d).

(e) *Effective date* — (1) *In general*. This section applies to property acquired after January 25, 2000, except that §1.167(a)–14(c)(2) (depreciation of the cost of certain separately acquired rights) and so much of §1.167(a)–14(c)(3) as relates to §1.167(a)–14(c)(2) apply to property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T).

(2) *Change in method of accounting*. See §1.197–2(l)(4) for rules relating to changes in method of accounting for property to which §1.167(a)–14 applies.

Par. 6. Section 1.197–0 is added to read as follows:

§1.197–0 Table of contents.

This section lists the headings that appear in §1.197–2.

§1.197–2 Amortization of goodwill and certain other intangibles.

(2) Treatment of contingent amounts.
(i) Amounts added to basis during 15-year period.
(ii) Amounts becoming fixed after expiration of 15-year period.
(iii) Rules for including amounts in basis.
(3) Basis determinations for certain assets.
(i) Covenants not to compete.
(ii) Contracts for the use of section 197 intangibles; acquired as part of a trade or business.
(A) In general.
(B) Know-how and certain information base.
(iii) Contracts for the use of section 197 intangibles; not acquired as part of a trade or business.
(iv) Applicable rules.
(A) Franchises, trademarks, and trade names.
(B) Certain amounts treated as payable under a debt instrument.
(*1*) In general.
(*2*) Rights granted by governmental units.
(*3*) Treatment of other parties to transaction.
(*4*) Basis determinations in certain transactions.
(i) Certain renewal transactions.
(*ii*) Transactions subject to section 338 or 1060.
(*iii*) Certain reinsurance transactions.
(g) Special rules.
(1) Treatment of certain dispositions.
(i) Loss disallowance rules.
(A) In general.
(B) Abandonment or worthlessness.
(C) Certain nonrecognition transfers.
(ii) Separately acquired property.
(iii) Disposition of a covenant not to compete.
(iv) Taxpayers under common control.
(A) In general.
(B) Treatment of disallowed loss.
(2) Treatment of certain nonrecognition and exchange transactions.
(i) Relationship to anti-churning rules.
(ii) Treatment of nonrecognition and exchange transactions generally.
(A) Transfer disregarded.
(B) Application of general rule.
(C) Transactions covered.
(iii) Certain exchanged-basis property.
(iv) Transfers under section 708(b)(1).
(A) In general.
(B) Termination by sale or exchange of interest.
(C) Other terminations.
(3) Increase in the basis of partnership property under section 732(b), 734(b), 743(b), or 732(d).
(4) Section 704(c) allocations.
(i) Allocations where the intangible is amortizable by the contributor.
(ii) Allocations where the intangible is not amortizable by the contributor.
(5) Treatment of certain reinsurance transactions.
(i) In general.
(ii) Determination of adjusted basis.
(A) Acquisitions (other than under section 338) of specified insurance contracts.
(B) Insolvent ceding company
(C) Other acquisitions. [Reserved]
(6) Amounts paid or incurred for a franchise, trademark, or trade name.
(7) Amounts properly taken into account in determining the cost of property that is not a section 197 intangible.
(8) Treatment of amortizable section 197 intangibles as depreciable property.
(h) Anti-churning rules.
(1) Scope and purpose.
(i) Scope.
(ii) Purpose.
(2) Treatment of section 197(f)(9) intangibles.
(3) Amounts deductible under section 1253(d) or §1.162–11.
(4) Transition period.
(5) Exceptions.
(6) Related person.
(i) In general.
(ii) Time for testing relationships.
(iii) Certain relationships disregarded.
(iv) De minimis rule.
(A) In general.
(B) Determination of beneficial ownership interest.
(7) Special rules for entities that owned or used property at any time during the transition period and that are no longer in existence.
(8) Special rules for section 338 deemed acquisitions.
(9) Gain-recognition exception.
(i) Applicability.
(ii) Effect of exception.
(iii) Time and manner of election.
(iv) Special rules for certain entities.
(v) Effect of nonconforming elections.
(vi) Notification requirements.
(vii) Revocation.
(viii) Election Statement.
(ix) Determination of highest marginal rate of tax and amount of other Federal income tax on gain.
(A) Marginal rate.
(*1*) Noncorporate taxpayers.
(*2*) Corporations and tax-exempt entities.
(B) Other Federal income tax on gain.
(x) Coordination with other provisions.
(A) In general.
(B) Section 1374.
(C) Procedural and administrative provisions.
(D) Installment method.
(xi) Special rules for persons not otherwise subject to Federal income tax.
(10) Transactions subject to both anti-churning and nonrecognition rules.
(11) Avoidance purpose.
(12) Additional partnership anti-churning rules
(i) In general.
(ii) Section 732(b) adjustments. [Reserved]
(iii) Section 732(d) adjustments.
(iv) Section 734(b) adjustments. [Reserved]
(v) Section 743(b) adjustments.
(vi) Partner is or becomes a user of partnership intangible.
(A) General rule.
(B) Anti-churning partner.
(C) Effect of retroactive elections.
(vii) Section 704(c) elections.
(A) Allocations where the intangible is amortizable by the contributor.
(B) Allocations where the intangible is not amortizable by the contributor.
(viii) Operating rule for transfers upon death.
(i) Reserved
(j) General anti-abuse rule.
(k) Examples.
(l) Effective dates.
(1) In general.
(2) Application to pre-effective date acquisitions.
(3) Application of regulation project REG–209709–94 to pre-effective date acquisitions.
(4) Change in method of accounting.
(i) In general.
(ii) Application to pre-effective date transactions.
(iii) Automatic change procedures.

Par. 7. Section 1.197–2 is added to read as follows:

§1.197–2 Amortization of goodwill and certain other intangibles.

(a) *Overview*—(1) *In general*. Section

197 allows an amortization deduction for the capitalized costs of an amortizable section 197 intangible and prohibits any other depreciation or amortization with respect to that property. Paragraphs (b), (c), and (e) of this section provide rules and definitions for determining whether property is a section 197 intangible, and paragraphs (d) and (e) of this section provide rules and definitions for determining whether a section 197 intangible is an amortizable section 197 intangible. The amortization deduction under section 197 is determined by amortizing basis ratably over a 15-year period under the rules of paragraph (f) of this section. Section 197 also includes various special rules pertaining to the disposition of amortizable section 197 intangibles, nonrecognition transactions, anti-churning rules, and anti-abuse rules. Rules relating to these provisions are contained in paragraphs (g), (h), and (j) of this section. Examples demonstrating the application of these provisions are contained in paragraph (k) of this section. The effective date of the rules in this section is contained in paragraph (l) of this section.

(2) *Section 167(f) property*. Section 167(f) prescribes rules for computing the depreciation deduction for certain property to which section 197 does not apply. See §1.167(a)–14 for rules under section 167(f) and paragraphs (c)(4), (6), (7), (11), and (13) of this section for a description of the property subject to section 167(f).

(3) *Amounts otherwise deductible*. Section 197 does not apply to amounts that are not chargeable to capital account under paragraph (f)(3) (relating to basis determinations for covenants not to compete and certain contracts for the use of section 197 intangibles) of this section and are otherwise currently deductible. For this purpose, an amount described in §1.162–11 is not currently deductible if, without regard to §1.162–11, such amount is properly chargeable to capital account.

(b) *Section 197 intangibles; in general*. Except as otherwise provided in paragraph (c) of this section, the term *section 197 intangible* means any property described in section 197(d)(1). The following rules and definitions provide guidance concerning property that is a section 197 intangible unless an exception applies:

(1) *Goodwill*. Section 197 intangibles include goodwill. Goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor.

(2) *Going concern value*. Section 197 intangibles include going concern value. Going concern value is the additional value that attaches to property by reason of its existence as an integral part of an ongoing business activity. Going concern value includes the value attributable to the ability of a trade or business (or a part of a trade or business) to continue functioning or generating income without interruption notwithstanding a change in ownership, but does not include any of the intangibles described in any other provision of this paragraph (b). It also includes the value that is attributable to the immediate use or availability of an acquired trade or business, such as, for example, the use of the revenues or net earnings that otherwise would not be received during any period if the acquired trade or business were not available or operational.

(3) *Workforce in place*. Section 197 intangibles include workforce in place. Workforce in place (sometimes referred to as agency force or assembled workforce) includes the composition of a workforce (for example, the experience, education, or training of a workforce), the terms and conditions of employment whether contractual or otherwise, and any other value placed on employees or any of their attributes. Thus, the amount paid or incurred for workforce in place includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a highly-skilled workforce, an existing employment contract (or contracts), or a relationship with employees or consultants (including, but not limited to, any key employee contract or relationship). Workforce in place does not include any covenant not to compete or other similar arrangement described in paragraph (b)(9) of this section.

(4) *Information base. Section* 197 intangibles include any information base, including a customer-related information base. For this purpose, an information base includes business books and records, operating systems, and any other information base (regardless of the method of recording the information) and a customer-related information base is any information base that includes lists or other information with respect to current or prospective customers. Thus, the amount paid or incurred for information base includes, for example, any portion of the purchase price of an acquired trade or business attributable to the intangible value of technical manuals, training manuals or programs, data files, and accounting or inventory control systems. Other examples include the cost of acquiring customer lists, subscription lists, insurance expirations, patient or client files, or lists of newspaper, magazine, radio, or television advertisers.

(5) *Know-how, etc*. Section 197 intangibles include any patent, copyright, formula, process, design, pattern, know-how, format, package design, computer software (as defined in paragraph (c)(4)(iv) of this section), or interest in a film, sound recording, video tape, book, or other similar property. (See, however, the exceptions in paragraph (c) of this section.)

(6) *Customer-based intangibles*. Section 197 intangibles include any customer- based intangible. A customer-based intangible is any composition of market, market share, or other value resulting from the future provision of goods or services pursuant to contractual or other relationships in the ordinary course of business with customers. Thus, the amount paid or incurred for customer-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a customer base, a circulation base, an undeveloped market or market growth, insurance in force, the existence of a qualification to supply goods or services to a particular customer, a mortgage servicing contract (as defined in paragraph (c)(11) of this section), an investment management contract, or other relationship with customers involving the future provision of goods or services. (See, however, the exceptions in paragraph (c) of this section.) In addition, customer-based intangibles include the deposit base and any similar asset of a financial institution. Thus, the amount paid or incurred for customer-based intangibles also includes any portion of the purchase price of an acquired financial institution attributable to the value represented

by existing checking accounts, savings accounts, escrow accounts, and other similar items of the financial institution. However, any portion of the purchase price of an acquired trade or business attributable to accounts receivable or other similar rights to income for goods or services provided to customers prior to the acquisition of a trade or business is not an amount paid or incurred for a customer-based intangible.

(7) *Supplier-based intangibles.* Section 197 intangibles include any supplier-based intangible. A supplier-based intangible is the value resulting from the future acquisition, pursuant to contractual or other relationships with suppliers in the ordinary course of business, of goods or services that will be sold or used by the taxpayer. Thus, the amount paid or incurred for supplier-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a favorable relationship with persons providing distribution services (such as favorable shelf or display space at a retail outlet), the existence of a favorable credit rating, or the existence of favorable supply contracts. The amount paid or incurred for supplier-based intangibles does not include any amount required to be paid for the goods or services themselves pursuant to the terms of the agreement or other relationship. In addition, see the exceptions in paragraph (c) of this section, including the exception in paragraph (c)(6) of this section for certain rights to receive tangible property or services from another person.

(8) *Licenses, permits, and other rights granted by governmental units*. Section 197 intangibles include any license, permit, or other right granted by a governmental unit (including, for purposes of section 197, an agency or instrumentality thereof) even if the right is granted for an indefinite period or is reasonably expected to be renewed for an indefinite period. These rights include, for example, a liquor license, a taxi-cab medallion (or license), an airport landing or takeoff right (sometimes referred to as a slot), a regulated airline route, or a television or radio broadcasting license. The issuance or renewal of a license, permit, or other right granted by a governmental unit is considered an acquisition of the license, permit, or other right. (See, however, the exceptions in paragraph (c) of this section, including the exceptions in paragraph (c)(3) of this section for an interest in land, paragraph (c)(6) of this section for certain rights to receive tangible property or services, paragraph (c)(8) of this section for an interest under a lease of tangible property, and paragraph (c)(13) of this section for certain rights granted by a governmental unit. See paragraph (b)(10) of this section for the treatment of franchises.)

(9) *Covenants not to compete and other similar arrangements.* Section 197 intangibles include any covenant not to compete, or agreement having substantially the same effect, entered into in connection with the direct or indirect acquisition of an interest in a trade or business or a substantial portion thereof. For purposes of this paragraph (b)(9), an acquisition may be made in the form of an asset acquisition (including a qualified stock purchase that is treated as a purchase of assets under section 338), a stock acquisition or redemption, and the acquisition or redemption of a partnership interest. An agreement requiring the performance of services for the acquiring taxpayer or the provision of property or its use to the acquiring taxpayer does not have substantially the same effect as a covenant not to compete to the extent that the amount paid under the agreement represents reasonable compensation for the services actually rendered or for the property or use of the property actually provided.

(10) *Franchises, trademarks, and trade names*. (i) Section 197 intangibles include any franchise, trademark, or trade name. The term *franchise* has the meaning given in section 1253(b)(1) and includes any agreement that provides one of the parties to the agreement with the right to distribute, sell, or provide goods, services, or facilities, within a specified area. The term *trademark* includes any word, name, symbol, or device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others. The term *trade name* includes any name used to identify or designate a particular trade or business or the name or title used by a person or organization engaged in a trade or business. A license, permit, or other right granted by a governmental unit is a franchise if it otherwise meets the definition of a franchise. A trademark or trade name includes any trademark or trade name arising under statute or applicable common law, and any similar right granted by contract. The renewal of a franchise, trademark, or trade name is treated as an acquisition of the franchise, trademark, or trade name.

(ii) Notwithstanding the definitions provided in paragraph (b)(10)(i) of this section, any amount that is paid or incurred on account of a transfer, sale, or other disposition of a franchise, trademark, or trade name and that is subject to section 1253(d)(1) is not included in the basis of a section 197 intangible. (See paragraph (g)(6) of this section.)

(11) *Contracts for the use of, and term interests in, section 197 intangibles*. Section 197 intangibles include any right under a license, contract, or other arrangement providing for the use of property that would be a section 197 intangible under any provision of this paragraph (b) (including this paragraph (b)(11)) after giving effect to all of the exceptions provided in paragraph (c) of this section. Section 197 intangibles also include any term interest (whether outright or in trust) in such property.

(12) *Other similar items*. Section 197 intangibles include any other intangible property that is similar in all material respects to the property specifically described in section 197(d)(1)(C)(i) through (v) and paragraphs (b)(3) through (7) of this section. (See paragraph (g)(5) of this section for special rules regarding certain reinsurance transactions.)

(c) *Section 197 intangibles; exceptions*. The term *section 197 intangible* does not include property described in section 197(e). The following rules and definitions provide guidance concerning property to which the exceptions apply:

(1) *Interests in a corporation, partnership, trust, or estate*. Section 197 intangibles do not include an interest in a corporation, partnership, trust, or estate. Thus, for example, amortization under section 197 is not available for the cost of acquiring stock, partnership interests, or interests in a trust or estate, whether or not the interests are regularly traded on an established market. (See paragraph (g)(3) of this section for special rules applicable to property of a partnership when a section 754 election is in effect for the partner-

ship.)

(2) *Interests under certain financial contracts*. Section 197 intangibles do not include an interest under an existing futures contract, foreign currency contract, notional principal contract, interest rate swap, or other similar financial contract, whether or not the interest is regularly traded on an established market. However, this exception does not apply to an interest under a mortgage servicing contract, credit card servicing contract, or other contract to service another person's indebtedness, or an interest under an assumption reinsurance contract. (See paragraph (g)(5) of this section for the treatment of assumption reinsurance contracts. See paragraph (c)(11) of this section and §1.167(a)–14(d) for the treatment of mortgage servicing rights.)

(3) *Interests in land*. Section 197 intangibles do not include any interest in land. For this purpose, an interest in land includes a fee interest, life estate, remainder, easement, mineral right, timber right, grazing right, riparian right, air right, zoning variance, and any other similar right, such as a farm allotment, quota for farm commodities, or crop acreage base. An interest in land does not include an airport landing or takeoff right, a regulated airline route, or a franchise to provide cable television service. The cost of acquiring a license, permit, or other land improvement right, such as a building construction or use permit, is taken into account in the same manner as the underlying improvement.

(4) *Certain computer software*—(i) *Publicly available*. Section 197 intangibles do not include any interest in computer software that is (or has been) readily available to the general public on similar terms, is subject to a nonexclusive license, and has not been substantially modified. Computer software will be treated as readily available to the general public if the software may be obtained on substantially the same terms by a significant number of persons that would reasonably be expected to use the software. This requirement can be met even though the software is not available through a system of retail distribution. Computer software will not be considered to have been substantially modified if the cost of all modifications to the version of the software that is readily available to the general public does not exceed the greater of 25 percent of the price at which the unmodified version of the software is readily available to the general public or $2,000. For the purpose of determining whether computer software has been substantially modified—

(A) Integrated programs acquired in a package from a single source are treated as a single computer program; and

(B) Any cost incurred to install the computer software on a system is not treated as a cost of the software. However, the costs for customization, such as tailoring to a user's specifications (other than embedded programming options) are costs of modifying the software.

(ii) *Not acquired as part of trade or business*. Section 197 intangibles do not include an interest in computer software that is not acquired as part of a purchase of a trade or business.

(iii) *Other exceptions*. For other exceptions applicable to computer software, see paragraph (a)(3) of this section (relating to otherwise deductible amounts) and paragraph (g)(7) of this section (relating to amounts properly taken into account in determining the cost of property that is not a section 197 intangible).

(iv) *Computer software defined*. For purposes of this section, computer software is any program or routine (that is, any sequence of machine-readable code) that is designed to cause a computer to perform a desired function or set of functions, and the documentation required to describe and maintain that program or routine. It includes all forms and media in which the software is contained, whether written, magnetic, or otherwise. Computer programs of all classes, for example, operating systems, executive systems, monitors, compilers and translators, assembly routines, and utility programs as well as application programs, are included. Computer software also includes any incidental and ancillary rights that are necessary to effect the acquisition of the title to, the ownership of, or the right to use the computer software, and that are used only in connection with that specific computer software. Such incidental and ancillary rights are not included in the definition of trademark or trade name under paragraph (b)(10)(i) of this section. For example, a trademark or trade name that is ancillary to the ownership or use of a specific computer software program in the taxpayer's trade or business and is not acquired for the purpose of marketing the computer software is included in the definition of computer software and is not included in the definition of trademark or trade name. Computer software does not include any data or information base described in paragraph (b)(4) of this section unless the data base or item is in the public domain and is incidental to a computer program. For this purpose, a copyrighted or proprietary data or information base is treated as in the public domain if its availability through the computer program does not contribute significantly to the cost of the program. For example, if a word-processing program includes a dictionary feature used to spell-check a document or any portion thereof, the entire program (including the dictionary feature) is computer software regardless of the form in which the feature is maintained or stored.

(5) *Certain interests in films, sound recordings, video tapes, books, or other similar property*. Section 197 intangibles do not include any interest (including an interest as a licensee) in a film, sound recording, video tape, book, or other similar property (such as the right to broadcast or transmit a live event) if the interest is not acquired as part of a purchase of a trade or business. A film, sound recording, video tape, book, or other similar property includes any incidental and ancillary rights (such as a trademark or trade name) that are necessary to effect the acquisition of title to, the ownership of, or the right to use the property and are used only in connection with that property. Such incidental and ancillary rights are not included in the definition of trademark or trade name under paragraph (b)(10)(i) of this section. For purposes of this paragraph (c)(5), computer software (as defined in paragraph (c)(4)(iv) of this section) is not treated as other property similar to a film, sound recording, video tape, or book. (See section 167 for amortization of excluded intangible property or interests.)

(6) *Certain rights to receive tangible property or services*.
Section 197 intangibles do not include any right to receive tangible property or services under a contract or from a governmental unit if the right is not acquired

as part of a purchase of a trade or business. Any right that is described in the preceding sentence is not treated as a section 197 intangible even though the right is also described in section 197(d)(1)(D) and paragraph (b)(8) of this section (relating to certain governmental licenses, permits, and other rights) and even though the right fails to meet one or more of the requirements of paragraph (c)(13) of this section (relating to certain rights of fixed duration or amount). (See §1.167(a)–14(c)(1) and (3) for applicable rules.)

(7) *Certain interests in patents or copyrights*. Section 197 intangibles do not include any interest (including an interest as a licensee) in a patent, patent application, or copyright that is not acquired as part of a purchase of a trade or business. A patent or copyright includes any incidental and ancillary rights (such as a trademark or trade name) that are necessary to effect the acquisition of title to, the ownership of, or the right to use the property and are used only in connection with that property. Such incidental and ancillary rights are not included in the definition of trademark or trade name under paragraph (b)(10)(i) of this section. (See §1.167(a)–14(c)(4) for applicable rules.)

(8) *Interests under leases of tangible property*—(i) *Interest as a lessor.* Section 197 intangibles do not include any interest as a lessor under an existing lease or sublease of tangible real or personal property. In addition, the cost of acquiring an interest as a lessor in connection with the acquisition of tangible property is taken into account as part of the cost of the tangible property. For example, if a taxpayer acquires a shopping center that is leased to tenants operating retail stores, any portion of the purchase price attributable to favorable lease terms is taken into account as part of the basis of the shopping center and in determining the depreciation deduction allowed with respect to the shopping center. (See section 167(c)(2).)

(ii) *Interest as a lessee*. Section 197 intangibles do not include any interest as a lessee under an existing lease of tangible real or personal property. For this purpose, an airline lease of an airport passenger or cargo gate is a lease of tangible property. The cost of acquiring such an interest is taken into account under section 178 and §1.162–11(a). If an interest as a lessee under a lease of tangible property is acquired in a transaction with any other intangible property, a portion of the total purchase price may be allocable to the interest as a lessee based on all of the relevant facts and circumstances.

(9) *Interests under indebtedness*—(i) *In general*. Section 197 intangibles do not include any interest (whether as a creditor or debtor) under an indebtedness in existence when the interest was acquired. Thus, for example, the value attributable to the assumption of an indebtedness with a below-market interest rate is not amortizable under section 197. In addition, the premium paid for acquiring a debt instrument with an above-market interest rate is not amortizable under section 197. See section 171 for rules concerning the treatment of amortizable bond premium.

(ii) *Exceptions*. For purposes of this paragraph (c)(9), an interest under an existing indebtedness does not include the deposit base (and other similar items) of a financial institution. An interest under an existing indebtedness includes mortgage servicing rights, however, to the extent the rights are stripped coupons under section 1286.

(10) *Professional sports franchises*. Section 197 intangibles do not include any franchise to engage in professional baseball, basketball, football, or any other professional sport, and any item (even though otherwise qualifying as a section 197 intangible) acquired in connection with such a franchise.

(11) *Mortgage servicing rights.* Section 197 intangibles do not include any right described in section 197(e)(7) (concerning rights to service indebtedness secured by residential real property that are not acquired as part of a purchase of a trade or business). (See §1.167(a)–14(d) for applicable rules.)

(12) *Certain transaction costs*. Section 197 intangibles do not include any fees for professional services and any transaction costs incurred by parties to a transaction in which all or any portion of the gain or loss is not recognized under part III of subchapter C of the Internal Revenue Code.

(13) *Rights of fixed duration or amount*. (i) Section 197 intangibles do not include any right under a contract or any license, permit, or other right granted by a governmental unit if the right—

(A) Is acquired in the ordinary course of a trade or business (or an activity described in section 212) and not as part of a purchase of a trade or business;

(B) Is not described in section 197(d)(1)(A), (B), (E), or (F);

(C) Is not a customer-based intangible, a customer-related information base, or any other similar item; and

(D) Either—

(*1*) Has a fixed duration of less than 15 years; or

(*2*) Is fixed as to amount and the adjusted basis thereof is properly recoverable (without regard to this section) under a method similar to the unit-of-production method.

(ii) See §1.167(a)–14(c)(2) and (3) for applicable rules.

(d) *Amortizable section 197 intangibles*—(1) *Definition*. Except as otherwise provided in this paragraph (d), the term *amortizable section 197 intangible* means any section 197 intangible acquired after August 10, 1993 (or after July 25, 1991, if a valid retroactive election under §1.197–1T has been made), and held in connection with the conduct of a trade or business or an activity described in section 212.

(2) *Exception for self-created intangibles*—(i) *In general*. Except as provided in paragraph (d)(2)(iii) of this section, amortizable section 197 intangibles do not include any section 197 intangible created by the taxpayer (a self-created intangible).

(ii) *Created by the taxpayer*—(A) *Defined*. A section 197 intangible is created by the taxpayer to the extent the taxpayer makes payments or otherwise incurs costs for its creation, production, development, or improvement, whether the actual work is performed by the taxpayer or by another person under a contract with the taxpayer entered into before the contracted creation, production, development, or improvement occurs. For example, a technological process developed specifically for a taxpayer under an arrangement with another person pursuant to which the taxpayer retains all rights to the process is created by the taxpayer.

(B) *Contracts for the use of intangibles*. A section 197 intangible is not a self- created intangible to the extent that it results from the entry into (or renewal of) a contract for the use of an existing section 197 intangible. Thus, for example, the exception for self-created intangibles does not apply to capitalized costs, such as legal and other professional fees, incurred by a licensee in connection with the entry into (or renewal of) a contract for the use of know-how or similar property.

(C) *Improvements and modifications*. If an existing section 197 intangible is improved or otherwise modified by the taxpayer or by another person under a contract with the taxpayer, the existing intangible and the capitalized costs (if any) of the improvements or other modifications are each treated as a separate section 197 intangible for purposes of this paragraph (d).

(iii) *Exceptions*. (A) The exception for self-created intangibles does not apply to any section 197 intangible described in section 197(d)(1)(D) (relating to licenses, permits or other rights granted by a governmental unit), 197(d)(1)(E) (relating to covenants not to compete), or 197(d)(1)(F) (relating to franchises, trademarks, and trade names). Thus, for example, capitalized costs incurred in the development, registration, or defense of a trademark or trade name do not qualify for the exception and are amortized over 15 years under section 197.

(B) The exception for self-created intangibles does not apply to any section 197 intangible created in connection with the purchase of a trade or business (as defined in paragraph (e) of this section).

(C) If a taxpayer disposes of a self-created intangible and subsequently reacquires the intangible in an acquisition described in paragraph (h)(5)(ii) of this section, the exception for self-created intangibles does not apply to the reacquired intangible.

(3) *Exception for property subject to anti-churning rules*. Amortizable section 197 intangibles do not include any property to which the anti-churning rules of section 197(f)(9) and paragraph (h) of this section apply.

(e) *Purchase of a trade or business*. Several of the exceptions in section 197 apply only to property that is not acquired in (or created in connection with) a transaction or series of related transactions involving the acquisition of assets constituting a trade or business or a substantial portion thereof. Property acquired in (or created in connection with) such a transaction or series of related transactions is referred to in this section as property acquired as part of (or created in connection with) a purchase of a trade or business. For purposes of section 197 and this section, the applicability of the limitation is determined under the following rules:

(1) *Goodwill or going concern value.* An asset or group of assets constitutes a trade or business or a substantial portion thereof if their use would constitute a trade or business under section 1060 (that is, if goodwill or going concern value could under any circumstances attach to the assets). See §1.1060–1T(b)(2). For this purpose, all the facts and circumstances, including any employee relationships that continue (or covenants not to compete that are entered into) as part of the transfer of the assets, are taken into account in determining whether goodwill or going concern value could attach to the assets.

(2) *Franchise, trademark, or trade name*—(i) *In general.* The acquisition of a franchise, trademark, or trade name constitutes the acquisition of a trade or business or a substantial portion thereof.

(ii) *Exceptions*. For purposes of this paragraph (e)(2)—

(A) A trademark or trade name is disregarded if it is included in computer software under paragraph (c)(4) of this section or in an interest in a film, sound recording, video tape, book, or other similar property under paragraph (c)(5) of this section;

(B) A franchise, trademark, or trade name is disregarded if its value is nominal or the taxpayer irrevocably disposes of it immediately after its acquisition; and

(C) The acquisition of a right or interest in a trademark or trade name is disregarded if the grant of the right or interest is not, under the principles of section 1253, a transfer of all substantial rights to such property or of an undivided interest in all substantial rights to such property.

(3) *Acquisitions to be included*. The assets acquired in a transaction (or series of related transactions) include only assets (including a beneficial or other indirect interest in assets where the interest is of a type described in paragraph (c)(1) of this section) acquired by the taxpayer and persons related to the taxpayer from another person and persons related to that other person. For purposes of this paragraph (e)(3), persons are related only if their relationship is described in section 267(b) or 707(b) or they are engaged in trades or businesses under common control within the meaning of section 41(f)(1).

(4) *Substantial portion.* The determination of whether acquired assets constitute a substantial portion of a trade or business is to be based on all of the facts and circumstances, including the nature and the amount of the assets acquired as well as the nature and amount of the assets retained by the transferor. The value of the assets acquired relative to the value of the assets retained by the transferor is not determinative of whether the acquired assets constitute a substantial portion of a trade or business.

(5) *Deemed asset purchases under section 338.* A qualified stock purchase that is treated as a purchase of assets under section 338 is treated as a transaction involving the acquisition of assets constituting a trade or business only if the direct acquisition of the assets of the corporation would have been treated as the acquisition of assets constituting a trade or business or a substantial portion thereof.

(6) *Mortgage servicing rights*. Mortgage servicing rights acquired in a transaction or series of related transactions are disregarded in determining for purposes of paragraph (c)(11) of this section whether the assets acquired in the transaction or transactions constitute a trade or business or substantial portion thereof.

(7) *Computer software acquired for internal use.* Computer software acquired in a transaction or series of related transactions solely for internal use in an existing trade or business is disregarded in determining for purposes of paragraph (c)(4) of this section whether the assets acquired in the transaction or series of related transactions constitute a trade or business or substantial portion thereof.

(f) *Computation of amortization deduction*—(1) *In general*. Except as provided in paragraph (f)(2) of this section, the amortization deduction allowable under section 197(a) is computed as follows:

(i) The basis of an amortizable section 197 intangible is amortized ratably over the 15-year period beginning on the later of—

(A) The first day of the month in which

the property is acquired; or

(B) In the case of property held in connection with the conduct of a trade or business or in an activity described in section 212, the first day of the month in which the conduct of the trade or business or the activity begins.

(ii) Except as otherwise provided in this section, basis is determined under section 1011 and salvage value is disregarded.

(iii) Property is not eligible for amortization in the month of disposition.

(iv) The amortization deduction for a short taxable year is based on the number of months in the short taxable year.

(2) *Treatment of contingent amounts*—(i) *Amounts added to basis during 15-year period*. Any amount that is properly included in the basis of an amortizable section 197 intangible after the first month of the 15-year period described in paragraph (f)(1)(i) of this section and before the expiration of that period is amortized ratably over the remainder of the 15-year period. For this purpose, the remainder of the 15-year period begins on the first day of the month in which the basis increase occurs.

(ii) *Amounts becoming fixed after expiration of 15-year period*. Any amount that is not properly included in the basis of an amortizable section 197 intangible until after the expiration of the 15-year period described in paragraph (f)(1)(i) of this section is amortized in full immediately upon the inclusion of the amount in the basis of the intangible.

(iii) *Rules for including amounts in basis*. See §§1.1275–4(c)(4) and 1.483–4(a) for rules governing the extent to which contingent amounts payable under a debt instrument given in consideration for the sale or exchange of an amortizable section 197 intangible are treated as payments of principal and the time at which the amount treated as principal is included in basis. See §1.461–1(a)(1) and (2) for rules governing the time at which other contingent amounts are taken into account in determining the basis of an amortizable section 197 intangible.

(3) *Basis determinations for certain assets*—(i) *Covenants not to compete*. In the case of a covenant not to compete or other similar arrangement described in paragraph (b)(9) of this section (a covenant), the amount chargeable to capital account includes, except as provided in this paragraph (f)(3), all amounts that are required to be paid pursuant to the covenant, whether or not any such amount would be deductible under section 162 if the covenant were not a section 197 intangible.

(ii) *Contracts for the use of section 197 intangibles; acquired as part of a trade or business*—(A) *In general*. Except as provided in this paragraph (f)(3), any amount paid or incurred by the transferee on account of the transfer of a right or term interest described in paragraph (b)(11) of this section (relating to contracts for the use of, and term interests in, section 197 intangibles) by the owner of the property to which such right or interest relates and as part of a purchase of a trade or business is chargeable to capital account, whether or not such amount would be deductible under section 162 if the property were not a section 197 intangible.

(B) *Know-how and certain information base*. The amount chargeable to capital account with respect to a right or term interest described in paragraph (b)(11) of this section is determined without regard to the rule in paragraph (f)(3)(ii)(A) of this section if the right or interest relates to property (other than a customer-related information base) described in paragraph (b)(4) or (5) of this section and the acquiring taxpayer establishes that—

(*1*) The transfer of the right or interest is not, under the principles of section 1235, a transfer of all substantial rights to such property or of an undivided interest in all substantial rights to such property; and

(*2*) The right or interest was transferred for an arm's-length consideration.

(iii) *Contracts for the use of section 197 intangibles; not acquired as part of a trade or business*. The transfer of a right or term interest described in paragraph (b)(11) of this section by the owner of the property to which such right or interest relates but not as part of a purchase of a trade or business will be closely scrutinized under the principles of section 1235 for purposes of determining whether the transfer is a sale or exchange and, accordingly, whether amounts paid on account of the transfer are chargeable to capital account. If under the principles of section 1235 the transaction is not a sale or exchange, amounts paid on account of the transfer are not chargeable to capital account under this paragraph (f)(3).

(iv) *Applicable rules*—(A) *Franchises, trademarks, and trade names*. For purposes of this paragraph (f)(3), section 197 intangibles described in paragraph (b)(11) of this section do not include any property that is also described in paragraph (b)(10) of this section (relating to franchises, trademarks, and trade names).

(B) *Certain amounts treated as payable under a debt instrument*—(*1*) *In general*. For purposes of applying any provision of the Internal Revenue Code to a person making payments of amounts that are otherwise chargeable to capital account under this paragraph (f)(3) and are payable after the acquisition of the section 197 intangible to which they relate, such amounts are treated as payable under a debt instrument given in consideration for the sale or exchange of the section 197 intangible.

(*2*) *Rights granted by governmental units*. For purposes of applying any provision of the Internal Revenue Code to any amounts that are otherwise chargeable to capital account with respect to a license, permit, or other right described in paragraph (b)(8) of this section (relating to rights granted by a governmental unit or agency or instrumentality thereof) and are payable after the acquisition of the section 197 intangible to which they relate, such amounts are treated, except as provided in paragraph (f)(4)(i) of this section (relating to renewal transactions), as payable under a debt instrument given in consideration for the sale or exchange of the section 197 intangible.

(*3*) *Treatment of other parties to transaction*. No person shall be treated as having sold, exchanged, or otherwise disposed of property in a transaction for purposes of any provision of the Internal Revenue Code solely by reason of the application of this paragraph (f)(3) to any other party to the transaction.

(*4*) *Basis determinations in certain transactions*—(i) *Certain renewal transactions*. The costs paid or incurred for the renewal of a franchise, trademark, or trade name or any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof are amortized over the 15-year period that begins with the month of renewal. Any costs paid or incurred for the issuance, or earlier renewal, continue to be taken into account over the remaining portion of the amortization period that began at the time of the issuance, or earlier renewal. Any amount paid or incurred for the protection, expansion, or defense of a trademark or trade name and chargeable to capital account is treated as an amount paid or incurred for a renewal.

(*ii*) *Transactions subject to section 338 or 1060*. In the case of a section 197 intangible deemed to have been acquired as the result of a qualified stock purchase within the meaning of section 338(d)(3), the basis shall be determined pursuant to section 338(b)(5) and the regulations thereunder. In the case of a section 197 intangible acquired in an applicable asset acquisition within the meaning of section 1060(c), the basis shall be determined pursuant to section 1060(a) and the regulations thereunder.

(*iii*) *Certain reinsurance transactions*. See paragraph (g)(5)(ii) of this section for special rules regarding the adjusted basis of an insurance contract acquired through an assumption reinsurance transaction.

(g) *Special rules*—(1) *Treatment of certain dispositions*—(i) *Loss disallowance rules*—(A) *In general*. No loss is recognized on the disposition of an amortizable section 197 intangible if the taxpayer has any retained intangibles. The retained intangibles with respect to the disposition of any amortizable section 197 intangible (the transferred intangible) are all amortizable section 197 intangibles, or rights to use or interests (including beneficial or other indirect interests) in amortizable section 197 intangibles (including the transferred intangible) that were acquired in the same transaction or series of related transactions as the transferred intangible and are retained after its disposition. Except as otherwise provided in paragraph (g)(1)(iv)(B) of this section, the adjusted basis of each of the retained intangibles is increased by the product of—

(*1*) The loss that is not recognized solely by reason of this rule; and

(*2*) A fraction, the numerator of which is the adjusted basis of the retained intangible on the date of the disposition and the denominator of which is the total adjusted bases of all the retained intangibles on that date.

(B) *Abandonment or worthlessness*. The abandonment of an amortizable section 197 intangible, or any other event rendering an amortizable section 197 intangible worthless, is treated as a disposition of the intangible for purposes of this paragraph (g)(1), and the abandoned or worthless intangible is disregarded (that is, it is not treated as a retained intangible) for purposes of applying this paragraph (g)(1) to the subsequent disposition of any other amortizable section 197 intangible.

(C) *Certain nonrecognition transfers*. The loss disallowance rule in paragraph (g)(1)(i)(A) of this section also applies when a taxpayer transfers an amortizable section 197 intangible from an acquired trade or business in a transaction in which the intangible is transferred basis property and, after the transfer, retains other amortizable section 197 intangibles from the trade or business. Thus, for example, the transfer of an amortizable section 197 intangible to a corporation in exchange for stock in the corporation in a transaction described in section 351, or to a partnership in exchange for an interest in the partnership in a transaction described in section 721, when other amortizable section 197 intangibles acquired in the same transaction are retained, followed by a sale of the stock or partnership interest received, will not avoid the application of the loss disallowance provision to the extent the adjusted basis of the transferred intangible at the time of the sale exceeds its fair market value at that time.

(ii) *Separately acquired property*. Paragraph (g)(1)(i) of this section does not apply to an amortizable section 197 intangible that is not acquired in a transaction or series of related transactions in which the taxpayer acquires other amortizable section 197 intangibles (a separately acquired intangible). Consequently, a loss may be recognized upon the disposition of a separately acquired amortizable section 197 intangible. However, the termination or worthlessness of only a portion of an amortizable section 197 intangible is not the disposition of a separately acquired intangible. For example, neither the loss of several customers from an acquired customer list nor the worthlessness of only some information from an acquired data base constitutes the disposition of a separately acquired intangible.

(iii) *Disposition of a covenant not to compete*. If a covenant not to compete or any other arrangement having substantially the same effect is entered into in connection with the direct or indirect acquisition of an interest in one or more trades or businesses, the disposition or worthlessness of the covenant or other arrangement will not be considered to occur until the disposition or worthlessness of all interests in those trades or businesses. For example, a covenant not to compete entered into in connection with the purchase of stock continues to be amortized ratably over the 15-year recovery period (even after the covenant expires or becomes worthless) unless all the trades or businesses in which an interest was acquired through the stock purchase (or all the purchaser's interests in those trades or businesses) also are disposed of or become worthless.

(iv) *Taxpayers under common control*—(A) *In general*. Except as provided in paragraph (g)(1)(iv)(B) of this section, all persons that would be treated as a single taxpayer under section 41(f)(1) are treated as a single taxpayer under this paragraph (g)(1). Thus, for example, a loss is not recognized on the disposition of an amortizable section 197 intangible by a member of a controlled group of corporations (as defined in section 41(f)(5)) if, after the disposition, another member retains other amortizable section 197 intangibles acquired in the same transaction as the amortizable section 197 intangible that has been disposed of.

(B) *Treatment of disallowed loss*. If retained intangibles are held by a person other than the person incurring the disallowed loss, only the adjusted basis of intangibles retained by the person incurring the disallowed loss is increased, and only the adjusted basis of those intangibles is included in the denominator of the fraction described in paragraph (g)(1)(i)(A) of this section. If none of the retained intangibles are held by the person incurring the disallowed loss, the loss is allowed ratably, as a deduction under section 197, over the remainder of the period during which the intangible giving rise to the loss would have been amortizable, except that any remaining disallowed loss is allowed in full on the first date on which all other retained intangibles have been disposed of or become worthless.

(2) *Treatment of certain nonrecognition and exchange transactions*—(i) *Relation-*

ship to anti-churning rules. This paragraph (g)(2) provides rules relating to the treatment of section 197 intangibles acquired in certain transactions. If these rules apply to a section 197(f)(9) intangible (within the meaning of paragraph (h)(1)(i) of this section), the intangible is, notwithstanding its treatment under this paragraph (g)(2), treated as an amortizable section 197 intangible only to the extent permitted under paragraph (h) of this section.

(ii) *Treatment of nonrecognition and exchange transactions generally*—(A) *Transfer disregarded*. If a section 197 intangible is transferred in a transaction described in paragraph (g)(2)(ii)(C) of this section, the transfer is disregarded in determining—

(*1*) Whether, with respect to so much of the intangible's basis in the hands of the transferee as does not exceed its basis in the hands of the transferor, the intangible is an amortizable section 197 intangible; and

(*2*) The amount of the deduction under section 197 with respect to such basis.

(B) *Application of general rule*. If the intangible described in paragraph (g)(2)(ii)(A) of this section was an amortizable section 197 intangible in the hands of the transferor, the transferee will continue to amortize its adjusted basis, to the extent it does not exceed the transferor's adjusted basis, ratably over the remainder of the transferor's 15-year amortization period. If the intangible was not an amortizable section 197 intangible in the hands of the transferor, the transferee's adjusted basis, to the extent it does not exceed the transferor's adjusted basis, cannot be amortized under section 197. In either event, the intangible is treated, with respect to so much of its adjusted basis in the hands of the transferee as exceeds its adjusted basis in the hands of the transferor, in the same manner for purposes of section 197 as an intangible acquired from the transferor in a transaction that is not described in paragraph (g)(2)(ii)(C) of this section. The rules of this paragraph (g)(2)(ii) also apply to any subsequent transfers of the intangible in a transaction described in paragraph (g)(2)(ii)(C) of this section.

(C) *Transactions covered*. The transactions described in this paragraph (g)(2)(ii)(C) are—

(*1*) Any transaction described in section 332, 351, 361, 721, or 731; and

(*2*) Any transaction between corporations that are members of the same consolidated group immediately after the transaction.

(iii) *Certain exchanged-basis property*. This paragraph (g)(2)(iii) applies to property that is acquired in a transaction subject to section 1031 or 1033 and is permitted to be acquired without recognition of gain (replacement property). Replacement property is treated as if it were the property by reference to which its basis is determined (the predecessor property) in determining whether, with respect to so much of its basis as does not exceed the basis of the predecessor property, the replacement property is an amortizable section 197 intangible and the amortization period under section 197 with respect to such basis. Thus, if the predecessor property was an amortizable section 197 intangible, the taxpayer will amortize the adjusted basis of the replacement property, to the extent it does not exceed the adjusted basis of the predecessor property, ratably over the remainder of the 15-year amortization period for the predecessor property. If the predecessor property was not an amortizable section 197 intangible, the adjusted basis of the replacement property, to the extent it does not exceed the adjusted basis of the predecessor property, may not be amortized under section 197. In either event, the replacement property is treated, with respect to so much of its adjusted basis as exceeds the adjusted basis of the predecessor property, in the same manner for purposes of section 197 as property acquired from the transferor in a transaction that is not subject to section 1031 or 1033.

(iv) *Transfers under section 708(b)(1)*—(A) *In general*. Paragraph (g)(2)(ii) of this section applies to transfers of section 197 intangibles that occur or are deemed to occur by reason of the termination of a partnership under section 708(b)(1).

(B) *Termination by sale or exchange of interest*. In applying paragraph (g)(2)(ii) of this section to a partnership that is terminated pursuant to section 708(b)(1)(B) (relating to deemed terminations from the sale or exchange of an interest), the terminated partnership is treated as the transferor and the new partnership is treated as the transferee with respect to any section 197 intangible held by the terminated partnership immediately preceding the termination. (See paragraph (g)(3) of this section for the treatment of increases in the bases of property of the terminated partnership under section 743(b).)

(C) *Other terminations*. In applying paragraph (g)(2)(ii) of this section to a partnership that is terminated pursuant to section 708(b)(1)(A) (relating to cessation of activities by a partnership), the terminated partnership is treated as the transferor and the distributee partner is treated as the transferee with respect to any section 197 intangible held by the terminated partnership immediately preceding the termination.

(3) *Increase in the basis of partnership property under section 732(b), 734(b), 743(b), or 732(d)*. Any increase in the adjusted basis of a section 197 intangible under sections 732(b) or 732(d) (relating to a partner's basis in property distributed by a partnership), section 734(b) (relating to the optional adjustment to the basis of undistributed partnership property after a distribution of property to a partner), or section 743(b) (relating to the optional adjustment to the basis of partnership property after transfer of a partnership interest) is treated as a separate section 197 intangible. For purposes of determining the amortization period under section 197 with respect to the basis increase, the intangible is treated as having been acquired at the time of the transaction that causes the basis increase. The provisions of paragraph (f)(2) of this section apply to the extent that the amount of the basis increase is determined by reference to contingent payments. For purposes of the effective date and anti-churning provisions (paragraphs (l)(1) and (h) of this section) for a basis increase under section 732(d), the intangible is treated as having been acquired by the transferee partner at the time of the transfer of the partnership interest described in section 732(d).

(4) *Section 704(c) allocations*—(i) *Allocations where the intangible is amortizable by the contributor*. To the extent that the intangible was an amortizable section 197 intangible in the hands of the contributing partner, a partnership may make allocations of amortization deductions with respect to the intangible to all of its partners under either the curative or reme-

dial allocation methods described in the regulations under section 704(c). See §1.704–3(c) and (d).

(ii) *Allocations where the intangible is not amortizable by the contributor.* To the extent that the intangible was not an amortizable section 197 intangible in the hands of the contributing partner, the intangible is not amortizable by the partnership. However, if a partner contributes a section 197 intangible to a partnership and the partnership adopts the remedial allocation method for making section 704(c) allocations of amortization deductions, the partnership generally may make remedial allocations of amortization deductions with respect to the contributed section 197 intangible in accordance with § 1.704–3(d). See paragraph (h)(12) of this section to determine the application of the anti-churning rules in the context of remedial allocations.

(5) *Treatment of certain reinsurance transactions*—(i) *In general.* Section 197 applies to any insurance contract acquired from another person through an assumption reinsurance transaction. For purposes of section 197, an assumption reinsurance transaction is—

(A) Any arrangement in which one insurance company (the reinsurer) becomes solely liable to policyholders on contracts transferred by another insurance company (the ceding company); and

(B) Any acquisition of an insurance contract that is treated as occurring by reason of an election under section 338.

(ii) *Determination of adjusted basis*—(A) *Acquisitions (other than under section 338) of specified insurance contracts.* The amount taken into account for purposes of section 197 as the adjusted basis of specified insurance contracts (as defined in section 848(e)(1)) acquired in an assumption reinsurance transaction that is not described in paragraph (g)(5)(i)(B) of this section is equal to the excess of—

(*1*) The amount paid or incurred (or treated as having been paid or incurred) by the reinsurer for the purchase of the contracts (as determined under §1.817–4(d)(2)); over

(*2*) The amount of the specified policy acquisition expenses that are attributable to the reinsurer's net positive consideration for the reinsurance agreement (as determined under §1.848–2(f)(3)).

(B) *Insolvent ceding company.* The reduction of the amount of specified policy acquisition expenses by the reinsurer with respect to an assumption reinsurance transaction with an insolvent ceding company where the ceding company and reinsurer have made a valid joint election under section 1.848–2(i)(4) is disregarded in determining the amount of specified policy acquisition expenses for purposes of this paragraph (g)(5)(ii).

(C) *Other acquisitions.* [Reserved]

(6) *Amounts paid or incurred for a franchise, trademark, or trade name.* If an amount to which section 1253(d) (relating to the transfer, sale, or other disposition of a franchise, trademark, or trade name) applies is described in section 1253(d)(1)(B) (relating to contingent serial payments deductible under section 162), the amount is not included in the adjusted basis of the intangible for purposes of section 197. Any other amount, whether fixed or contingent, to which section 1253(d) applies is chargeable to capital account under section 1253(d)(2) and is amortizable only under section 197.

(7) *Amounts properly taken into account in determining the cost of property that is not a section 197 intangible*. Section 197 does not apply to an amount that is properly taken into account in determining the cost of property that is not a section 197 intangible. The entire cost of acquiring the other property is included in its basis and recovered under other applicable Internal Revenue Code provisions. Thus, for example, section 197 does not apply to the cost of an interest in computer software to the extent such cost is included, without being separately stated, in the cost of the hardware or other tangible property and is consistently treated as part of the cost of the hardware or other tangible property.

(8) *Treatment of amortizable section 197 intangibles as depreciable property*. An amortizable section 197 intangible is treated as property of a character subject to the allowance for depreciation under section 167. Thus, for example, an amortizable section 197 intangible is not a capital asset for purposes of section 1221, but if used in a trade or business and held for more than one year, gain or loss on its disposition generally qualifies as section 1231 gain or loss. Also, an amortizable section 197 intangible is section 1245 property and section 1239 applies to any gain recognized upon its sale or exchange between related persons (as defined in section 1239(b)).

(h) *Anti-churning rules*—(1) *Scope and purpose*—(i) *Scope*. This paragraph (h) applies to section 197(f)(9) intangibles. For this purpose, section 197(f)(9) intangibles are goodwill and going concern value that was held or used at any time during the transition period and any other section 197 intangible that was held or used at any time during the transition period and was not depreciable or amortizable under prior law.

(ii) *Purpose*. To qualify as an amortizable section 197 intangible, a section 197 intangible must be acquired after the applicable date (July 25, 1991, if the acquiring taxpayer has made a valid retroactive election pursuant to §1.197–1T; August 10, 1993, in all other cases). The purpose of the anti-churning rules of section 197(f)(9) and this paragraph (h) is to prevent the amortization of section 197(f)(9) intangibles unless they are transferred after the applicable effective date in a transaction giving rise to a significant change in ownership or use. (Special rules apply for purposes of determining whether transactions involving partnerships give rise to a significant change in ownership or use. See paragraph (h)(12) of this section.) The anti-churning rules are to be applied in a manner that carries out their purpose.

(2) *Treatment of section 197(f)(9) intangibles.* Except as otherwise provided in this paragraph (h), a section 197(f)(9) intangible acquired by a taxpayer after the applicable effective date does not qualify for amortization under section 197 if—

(i) The taxpayer or a related person held or used the intangible or an interest therein at any time during the transition period;

(ii) The taxpayer acquired the intangible from a person that held the intangible at any time during the transition period and, as part of the transaction, the user of the intangible does not change; or

(iii) The taxpayer grants the right to use the intangible to a person that held or used the intangible at any time during the transition period (or to a person related to that person), but only if the transaction in which the taxpayer grants the right and the transaction in which the taxpayer acquired the intangible are part of a series of related transactions.

(3) *Amounts deductible under section 1253(d) or §1.162–11*. For purposes of this paragraph (h), deductions allowable under section 1253(d)(2) or pursuant to an election under section 1253(d)(3) (in either case as in effect prior to the enactment of section 197) and deductions allowable under §1.162–11 are treated as deductions allowable for amortization under prior law.

(4) *Transition period*. For purposes of this paragraph (h), the transition period is July 25, 1991, if the acquiring taxpayer has made a valid retroactive election pursuant to §1.197–1T and the period beginning on July 25, 1991, and ending on August 10, 1993, in all other cases.

(5) *Exceptions*. The anti-churning rules of this paragraph (h) do not apply to—

(i) The acquisition of a section 197(f)(9) intangible if the acquiring taxpayer's basis in the intangible is determined under section 1014(a); or

(ii) The acquisition of a section 197(f)(9) intangible that was an amortizable section 197 intangible in the hands of the seller (or transferor), but only if the acquisition transaction and the transaction in which the seller (or transferor) acquired the intangible or interest therein are not part of a series of related transactions.

(6) *Related person*—(i) *In general*. Except as otherwise provided in paragraph (h)(6)(ii) of this section, a person is related to another person for purposes of this paragraph (h) if—

(A) The person bears a relationship to that person that would be specified in section 267(b) (determined without regard to section 267(e)) and, by substitution, section 267(f)(1), if those sections were amended by substituting 20 percent for 50 percent; or

(B) The person bears a relationship to that person that would be specified in section 707(b)(1) if that section were amended by substituting 20 percent for 50 percent; or

(C) The persons are engaged in trades or businesses under common control (within the meaning of section 41(f)(1)(A) and (B)).

(ii) *Time for testing relationships*. Except as provided in paragraph (h)(6)(iii) of this section, a person is treated as related to another person for purposes of this paragraph (h) if the relationship exists—

(A) In the case of a single transaction, immediately before or immediately after the transaction in which the intangible is acquired; and

(B) In the case of a series of related transactions (or a series of transactions that together comprise a qualified stock purchase within the meaning of section 338(d)(3)), immediately before the earliest such transaction or immediately after the last such transaction.

(iii) *Certain relationships disregarded*. In applying the rules in paragraph (h)(7) of this section, if a person acquires an intangible in a series of related transactions in which the person acquires stock (meeting the requirements of section 1504(a)(2)) of a corporation in a fully taxable transaction followed by a liquidation of the acquired corporation under section 331, any relationship created as part of such series of transactions is disregarded in determining whether any person is related to such acquired corporation immediately after the last transaction.

(iv) *De minimis rule*—(A) *In general*. Two corporations are not treated as related persons for purposes of this paragraph (h) if—

(*1*) The corporations would (but for the application of this paragraph (h)(6)(iv)) be treated as related persons solely by reason of substituting "more than 20 percent" for "more than 50 percent" in section 267(f)(1)(A); and

(*2*) The beneficial ownership interest of each corporation in the stock of the other corporation represents less than 10 percent of the total combined voting power of all classes of stock entitled to vote and less than 10 percent of the total value of the shares of all classes of stock outstanding.

(B) *Determination of beneficial ownership interest*. For purposes of this paragraph (h)(6)(iv), the beneficial ownership interest of one corporation in the stock of another corporation is determined under the principles of section 318(a), except that—

(*1*) In applying section 318(a)(2)(C), the 50-percent limitation contained therein is not applied; and

(*2*) Section 318(a)(3)(C) is applied by substituting "20 percent" for "50 percent".

(7) *Special rules for entities that owned or used property at any time during the transition period and that are no longer in existence.* A corporation, partnership, or trust that owned or used a section 197 intangible at any time during the transition period and that is no longer in existence is deemed, for purposes of determining whether a taxpayer acquiring the intangible is related to such entity, to be in existence at the time of the acquisition.

(8) *Special rules for section 338 deemed acquisitions*. In the case of a qualified stock purchase that is treated as a deemed sale and purchase of assets pursuant to section 338, the corporation treated as purchasing assets as a result of an election thereunder (new target) is not considered the person that held or used the assets during any period in which the assets were held or used by the corporation treated as selling the assets (old target). Thus, for example, if a corporation (the purchasing corporation) makes a qualified stock purchase of the stock of another corporation after the transition period, new target will not be treated as the owner during the transition period of assets owned by old target during that period even if old target and new target are treated as the same corporation for certain other purposes of the Internal Revenue Code or old target and new target are the same corporation under the laws of the State or other jurisdiction of its organization. However, the anti-churning rules of this paragraph (h) may nevertheless apply to a deemed asset purchase resulting from a section 338 election if new target is related (within the meaning of paragraph (h)(6) of this section) to old target.

(9) *Gain-recognition exception*—(i) *Applicability.* A section 197(f)(9) intangible qualifies for the gain-recognition exception if—

(A) The taxpayer acquires the intangible from a person that would not be related to the taxpayer but for the substitution of 20 percent for 50 percent under paragraph (h)(6)(i)(A) of this section; and

(B) That person (whether or not otherwise subject to Federal income tax) elects to recognize gain on the disposition of the intangible and agrees, notwithstanding any other provision of law or treaty, to pay for the taxable year in which the disposition occurs an amount of tax on the gain that, when added to any other Federal income tax on such gain, equals the gain on the disposition multiplied by the highest marginal rate of tax for that taxable year.

(ii) *Effect of exception*. The anti-churning rules of this paragraph (h) apply to a section 197(f)(9) intangible that qualifies for the gain-recognition exception only to the extent the acquiring taxpayer's basis in the intangible exceeds the gain recognized by the transferor.

(iii) *Time and manner of election.* The election described in this paragraph (h)(9) must be made by the due date (including extensions of time) of the electing taxpayer's Federal income tax return for the taxable year in which the disposition occurs. The election is made by attaching an election statement satisfying the requirements of paragraph (h)(9)(viii) of this section to the electing taxpayer's original or amended income tax return for that taxable year (or by filing the statement as a return for the taxable year under paragraph (h)(9)(xi) of this section). In addition, the taxpayer must satisfy the notification requirements of paragraph (h)(9)(vi) of this section. The election is binding on the taxpayer and all parties whose Federal tax liability is affected by the election.

(iv) *Special rules for certain entities*. In the case of a partnership, S corporation, estate or trust, the election under this paragraph (h)(9) is made by the entity rather than by its owners or beneficiaries. If a partnership or S corporation makes an election under this paragraph (h)(9) with respect to the disposition of a section 197(f)(9) intangible, each of its partners or shareholders is required to pay a tax determined in the manner described in paragraph (h)(9)(i)(B) of this section on the amount of gain that is properly allocable to such partner or shareholder with respect to the disposition.

(v) *Effect of nonconforming elections*. An attempted election that does not substantially comply with each of the requirements of this paragraph (h)(9) is disregarded in determining whether a section 197(f)(9) intangible qualifies for the gain-recognition exception.

(vi) *Notification requirements*. A taxpayer making an election under this paragraph (h)(9) with respect to the disposition of a section 197(f)(9) intangible must provide written notification of the election on or before the due date of the return on which the election is made to the person acquiring the section 197 intangible. In addition, a partnership or S corporation making an election under this paragraph (h)(9) must attach to the Schedule K-1 furnished to each partner or shareholder a written statement containing all information necessary to determine the recipient's additional tax liability under this paragraph (h)(9).

(vii) *Revocation*. An election under this paragraph (h)(9) may be revoked only with the consent of the Commissioner.

(viii) *Election Statement.* An election statement satisfies the requirements of this paragraph (h)(9)(viii) if it is in writing and contains the information listed below. The required information should be arranged and identified in accordance with the following order and numbering system:

(A) The name and address of the electing taxpayer.

(B) Except in the case of a taxpayer that is not otherwise subject to Federal income tax, the taxpayer identification number (TIN) of the electing taxpayer.

(C) A statement that the taxpayer is making the election under section 197(f)(9)(B).

(D) Identification of the transaction and each person that is a party to the transaction or whose tax return is affected by the election (including, except in the case of persons not otherwise subject to Federal income tax, the TIN of each such person).

(E) The calculation of the gain realized, the applicable rate of tax, and the amount of the taxpayer's additional tax liability under this paragraph (h)(9).

(F) The signature of the taxpayer or an individual authorized to sign the taxpayer's Federal income tax return.

(ix) *Determination of highest marginal rate of tax and amount of other Federal income tax on gain*—(A) *Marginal rate.* The following rules apply for purposes of determining the highest marginal rate of tax applicable to an electing taxpayer:

(*1*) *Noncorporate taxpayers*. In the case of an individual, estate, or trust, the highest marginal rate of tax is the highest marginal rate of tax in effect under section 1, determined without regard to section 1(h).

(*2*) *Corporations and tax-exempt entities*. In the case of a corporation or an entity that is exempt from tax under section 501(a), the highest marginal rate of tax is the highest marginal rate of tax in effect under section 11, determined without regard to any rate that is added to the otherwise applicable rate in order to offset the effect of the graduated rate schedule.

(B) *Other Federal income tax on gain*. The amount of Federal income tax (other than the tax determined under this paragraph (h)(9)) imposed on any gain is the lesser of—

(*1*) The amount by which the taxpayer's Federal income tax liability (determined without regard to this paragraph (h)(9)) would be reduced if the amount of such gain were not taken into account; or

(*2*) The amount of the gain multiplied by the highest marginal rate of tax for the taxable year.

(x) *Coordination with other provisions*—(A) *In general*. The amount of gain subject to the tax determined under this paragraph (h)(9) is not reduced by any net operating loss deduction under section 172(a), any capital loss under section 1212, or any other similar loss or deduction. In addition, the amount of tax determined under this paragraph (h)(9) is not reduced by any credit of the taxpayer. In computing the amount of any net operating loss, capital loss, or other similar loss or deduction, or any credit that may be carried to any taxable year, any gain subject to the tax determined under this paragraph (h)(9) and any tax paid under this paragraph (h)(9) is not taken into account.

(B) *Section 1374*. No provision of paragraph (h)(9)(iv) of this section precludes the application of section 1374 (relating to a tax on certain built-in gains of S corporations) to any gain with respect to which an election under this paragraph (h)(9) is made. In addition, neither paragraph (h)(9)(iv) nor paragraph (h)(9)(x)(A) of this section precludes a taxpayer from applying the provisions of section 1366(f)(2) (relating to treatment of the tax imposed by section 1374 as a loss sustained by the S corporation) in determining the amount of tax payable under paragraph (h)(9) of this section.

(C) *Procedural and administrative provisions*. For purposes of subtitle F, the amount determined under this paragraph (h)(9) is treated as a tax imposed by section 1 or 11, as appropriate.

(D) *Installment method*. The gain subject to the tax determined under paragraph (h)(9)(i) of this section may not be reported under the method described in section 453(a). Any such gain that would, but for the application of this paragraph (h)(9)(x)(D), be taken into account under section 453(a) shall be taken into account in the same manner as if an election under section 453(d) (relating to the election not to apply section 453(a)) had been made.

(xi) *Special rules for persons not otherwise subject to Federal income tax*. If the person making the election under this paragraph (h)(9) with respect to a disposition is not otherwise subject to Federal income tax, the election statement satisfying the requirements of paragraph (h)(9)(viii) of this section must be filed with the Philadelphia Service Center. For purposes of this paragraph (h)(9) and subtitle F, the statement is treated as an income tax return for the calendar year in which the disposition occurs and as a return due on or before March 15 of the following year.

(10) *Transactions subject to both anti-churning and nonrecognition rules*. If a person acquires a section 197(f)(9) intangible in a transaction described in paragraph (g)(2) of this section from a person in whose hands the intangible was an amortizable section 197 intangible, and immediately after the transaction (or series of transactions described in paragraph (h)(6)(ii)(B) of this section) in which such intangible is acquired, the person acquiring the section 197(f)(9) intangible is related to any person described in paragraph (h)(2) of this section, the intangible is, notwithstanding its treatment under paragraph (g)(2) of this section, treated as an amortizable section 197 intangible only to the extent permitted under this paragraph (h). (See, for example, paragraph (h)(5)(ii) of this section.)

(11) *Avoidance purpose*. A section 197(f)(9) intangible acquired by a taxpayer after the applicable effective date does not qualify for amortization under section 197 if one of the principal purposes of the transaction in which it is acquired is to avoid the operation of the anti-churning rules of section 197(f)(9) and this paragraph (h). A transaction will be presumed to have a principal purpose of avoidance if it does not effect a significant change in the ownership or use of the intangible. Thus, for example, if section 197(f)(9) intangibles are acquired in a transaction (or series of related transactions) in which an option to acquire stock is issued to a party to the transaction, but the option is not treated as having been exercised for purposes of paragraph (h)(6) of this section, this paragraph (h)(11) may apply to the transaction.

(12) *Additional partnership anti-churning rules*—(i) *In general*. In determining whether the anti-churning rules of this paragraph (h) apply to any increase in the basis of a section 197(f)(9) intangible under section 732(b), 732(d), 734(b), or 743(b), the determinations are made at the partner level and each partner is treated as having owned and used the partner's proportionate share of partnership property. In determining whether the anti-churning rules of this paragraph (h) apply to any transaction under another section of the Internal Revenue Code, the determinations are made at the partnership level, unless under §1.701–2(e) the Commissioner determines that the partner level is more appropriate.

(ii) *Section 732(b) adjustments—Reserved*.

(iii) *Section 732(d) adjustments*. The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of partnership property under section 732(d) if the distributee partner was not related (at the time of the transfer of the partnership interest) to the person who transferred the partnership interest with respect to which the distribution is being made.

(iv) *Section 734(b) adjustments— Reserved.*

(v) *Section 743(b) adjustments*. The anti-churning rules of this paragraph (h) do not apply to an increase in the basis of partnership property under section 743(b) if the person acquiring the partnership interest is not related to the person transferring the partnership interest.

(vi) *Partner is or becomes a user of partnership intangible*—(A) *General rule*. If, as part of a series of related transactions that includes a transaction described in paragraph (h)(12) (iii) or (v) of this section, an anti-churning partner or a person related to an anti-churning partner becomes (or remains) a user of an intangible that is treated as transferred in the transaction (as a result of the partners being treated as having owned their proportionate share of partnership assets), the anti-churning rules of this paragraph (h) apply to the proportionate share of such intangible that is treated as transferred by the anti-churning partner, notwithstanding the application of paragraph (h)(12) (iii) or (v) of this section.

(B) *Anti-churning partner*. For purposes of this paragraph (h)(12)(vi), anti-churning partner means - -

(*1*) With respect to all intangibles held by a partnership on or before August 10, 1993, any partner, but only to the extent that

(*i*) The partner's interest in the partnership was acquired on or before August 10, 1993, or

(*ii*) The interest was acquired from a person related to the partner on or after August 10, 1993, and such interest was not held by any person other than persons related to such partner at any time after August 10, 1993 (disregarding, for this purpose, a person's holding of an interest if the acquisition of such interest was part of a transaction or series of related transactions in which the partner or persons related to the partner subsequently acquired such interest),

(*2*) With respect to any section 197(f)(9) intangible acquired by a partnership after August 10, 1993, that is not amortizable with respect to the partnership, any partner, but only to the extent that

(*i*) The partner's interest in the partnership was acquired on or before the date the partnership acquired the section 197(f)(9) intangible, or

(*ii*) The interest was acquired from a person related to the partner on or after the date the partnership acquired the section 197(f)(9) intangible, and such interest was not held by any person other than persons related to such partner at any time after the date the partnership acquired the section 197(f)(9) intangible (disregarding, for this purpose, a person's holding of an interest if the acquisition of such interest was part of a transaction or series of related transactions in which the partner or persons related to the partner subsequently acquired such interest), and

(*3*) With respect to any intangible, a partner who received an interest in the partnership in exchange for such intangible (or a portion thereof) or a related person who received such interest in the partnership from such a partner, but only to the extent that the intangible (or portion thereof) transferred by such partner is not an amortizable section 197 intangible with respect to the partnership.

(C) *Effect of retroactive elections*. For purposes of paragraph (h)(12)(vi)(B) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the relevant party made a valid retroactive election under §1.197–1T.

(vii) *Section 704(c) allocations*—(A) *Allocations where the intangible is amortizable by the contributor*. The anti-churning rules of this paragraph (h) do not apply to the curative or remedial allocations of amortization with respect to a section 197(f)(9) intangible if the intangible was an amortizable section 197 intangible in the hands of the contributing partner (unless paragraph (h)(10) of this section applies so as to cause the intangible to cease to be an amortizable section 197 intangible in the hands of the partnership).

(B) *Allocations where the intangible is not amortizable by the contributor*. Notwithstanding paragraph (g)(3)(ii) of this section, where the section 197(f)(9) intangible was not an amortizable section 197 intangible in the hands of the contributing partner, a partner may not receive remedial allocations of amortization under section 704(c) that are deductible for Federal income tax purposes if that partner is related to the partner that contributed the intangible. Taxpayers may use any reasonable method to determine amortization of the asset for book purposes, provided that the method used does not contravene the purposes of the anti-churning rules under section 197 and this paragraph (h). A method will be considered to contravene the purposes of the anti-churning rules if the effect of the book adjustments resulting from the method is such that any portion of the tax deduction for amortization attributable to section 704(c) is allocated, directly or indirectly, to a partner who is subject to the anti-churning rules with respect to such adjustment.

(viii) *Operating rule for transfers upon death*. For purposes of this paragraph (h)(12), if the basis of a partner's interest in a partnership is determined under section 1014(a), such partner is treated as acquiring such interest from a person who is not related to such partner, and such interest is treated as having previously been held by a person who is not related to such partner.

(i) [Reserved]

(j) *General anti-abuse rule*. The Commissioner will interpret and apply the rules in this section as necessary and appropriate to prevent avoidance of the purposes of section 197. If one of the principal purposes of a transaction is to achieve a tax result that is inconsistent with the purposes of section 197, the Commissioner will recast the transaction for Federal tax purposes as appropriate to achieve tax results that are consistent with the purposes of section 197, in light of the applicable statutory and regulatory provisions and the pertinent facts and circumstances.

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

Example 1. Advertising costs. (i) Q manufactures and sells consumer products through a series of wholesalers and distributors. In order to increase sales of its products by encouraging consumer loyalty to its products and to enhance the value of the goodwill, trademarks, and trade names of the business, Q advertises its products to the consuming public. It regularly incurs costs to develop radio, television, and print advertisements. These costs generally consist of employee costs and amounts paid to independent advertising agencies. Q also incurs costs to run these advertisements in the various media for which they were developed.

(ii) The advertising costs are not chargeable to capital account under paragraph (f)(3) of this section (relating to costs incurred for covenants not to compete, rights granted by governmental units, and contracts for the use of section 197 intangibles) and are currently deductible as ordinary and necessary expenses under section 162. Accordingly, under paragraph (a)(3) of this section, section 197 does not apply to these costs.

Example 2. Computer software. (i) X purchases all of the assets of an existing trade or business from Y. One of the assets acquired is all of Y's rights in certain computer software previously used by Y under the terms of a nonexclusive license from the software developer. The software was developed for use by manufacturers to maintain a comprehensive accounting system, including general and subsidiary ledgers, payroll, accounts receivable and payable, cash receipts and disbursements, fixed asset accounting, and inventory cost accounting and controls. The developer modified the software for use by Y at a cost of $1,000 and Y made additional modifications at a cost of $500. The developer does not maintain wholesale or retail outlets but markets the software directly to ultimate users. Y's license of the software is limited to an entity that is actively engaged in business as a manufacturer.

(ii) Notwithstanding these limitations, the software is considered to be readily available to the general public for purposes of paragraph (c)(4)(i) of this section. In addition, the software is not substantially modified because the cost of the modifications by the developer and Y to the version of the software that is readily available to the general public does not exceed $2,000. Accordingly, the software is not a section 197 intangible.

Example 3. Acquisition of software for internal use. (i) B, the owner and operator of a worldwide package-delivery service, purchases from S all rights to software developed by S. The software will be used by B for the sole purpose of improving its package-tracking operations. B does not purchase any other assets in the transaction or any related transaction.

(ii) Because B acquired the software solely for internal use, it is disregarded in determining for purposes of paragraph (c)(4)(ii) of this section whether the assets acquired in the transaction or series of related transactions constitute a trade or business or substantial portion thereof. Since no other assets were acquired, the software is not acquired as part of a purchase of a trade or business and under paragraph (c)(4)(ii) of this section is not a section 197 intangible.

Example 4. Governmental rights of fixed duration. (i) City M operates a municipal water system. In order to induce X to locate a new manufacturing business in the city, M grants X the right to purchase water for 16 years at a specified price.

(ii) The right granted by M is a right to receive tangible property or services described in section 197(e)(4)(B) and paragraph (c)(6) of this section and, thus, is not a section 197 intangible. This exclusion applies even though the right does not qualify for exclusion as a right of fixed duration or amount under section 197(e)(4)(D) and paragraph (c)(13) of this section because the duration exceeds 15 years and the right is not fixed as to amount. It is also immaterial that the right would not qualify for exclusion as a self-created intangible under section 197(c)(2) and paragraph (d)(2) of this section because it is granted by a governmental unit.

Example 5. Separate acquisition of franchise. (i) S is a franchiser of retail outlets for specialty coffees. G enters into a franchise agreement (within the meaning of section 1253(b)(1)) with S pursuant to which G is permitted to acquire and operate a store using the S trademark and trade name at the location specified in the agreement. G agrees to pay S $100,000 upon execution of the agreement and also agrees to pay, throughout the term of the franchise, additional amounts that are deductible under section 1253(d)(1). The agreement contains detailed specifications for the construction and operation of the business, but G is not required to purchase from S any of the materials necessary to construct the improvements at the location specified in the franchise agreement.

(ii) The franchise is a section 197 intangible within the meaning of paragraph (b)(10) of this section. The franchise does not qualify for the exclusion relating to self-created intangibles described in section 197(c)(2) and paragraph (d)(2) of this section because the franchise is described in section 197(d)(1)(F). In addition, because the acquisition of the franchise constitutes the acquisition of an interest in a trade or business or a substantial portion thereof, the franchise may not be excluded under section 197(e)(4). Thus, the franchise is an amortizable section 197 intangible, the basis of which must be recovered over a 15-year period. However, the amounts that are deductible under section 1253(d)(1)are not subject to the provisions of section 197 by reason of section 197(f)(4)(C) and paragraph (b)(10)(ii) of this section.

Example 6. Acquisition and amortization of covenant not to compete. (i) As part of the acquisition of a trade or business from C, B and C enter into an agreement containing a covenant not to compete. Under this agreement, C agrees that it will not compete with the business acquired by B within a prescribed geographical territory for a period of three years after the date on which the business is sold to B.

In exchange for this agreement, B agrees to pay C $90,000 per year for each year in the term of the agreement. The agreement further provides that, in the event of a breach by C of his obligations under the agreement, B may terminate the agreement, cease making any of the payments due thereafter, and pursue any other legal or equitable remedies available under applicable law. The amounts payable to C under the agreement are not contingent payments for purposes of §1.1275–4. The present fair market value of B's rights under the agreement is $225,000. The aggregate consideration paid for all assets acquired in the transaction (including the covenant not to compete) exceeds the sum of the amount of Class I assets and the aggregate fair market value of all Class II, Class III, Class IV, Class V, and Class VI assets by $50,000. See §1.338–6T(b) for rules for determining the assets in each class.

(ii) Because the covenant is acquired in an applicable asset acquisition (within the meaning of section 1060(c)), paragraph (f)(4)(ii) of this section applies and the basis of B in the covenant is determined pursuant to section 1060(a) and the regulations thereunder. Under §§1.1060–1T(c)(2) and 1.338–6T(c)(1), B's basis in the covenant cannot exceed its fair market value. Thus, B's basis in the covenant immediately after the acquisition is $225,000. This basis is amortized ratably over the 15-year period beginning on the first day of the month in which the agreement is entered into. Although the payments under the agreement ($270,000) exceed the amount allocated to the covenant by $45,000, all of the remaining consideration ($50,000) is allocated to Class VII assets (goodwill and going concern value). See §§1.1060–1T(c)(2) and 1.338–6T(b).

Example 7. Stand-alone license of technology. (i) X is a manufacturer of consumer goods that does business throughout the world through subsidiary corporations organized under the laws of each country in which business is conducted. X licenses to Y, its subsidiary organized and conducting business in Country K, all of the patents, formulas, designs, and know-how necessary for Y to manufacture the same products that X manufactures in the United States. Assume that the license is not considered a sale or exchange under the principles of section 1235. The license is for a term of 18 years, and there are no facts to indicate that the license does not have a fixed duration. Y agrees to pay X a royalty equal to a specified, fixed percentage of the revenues obtained from selling products manufactured using the licensed technology. Assume that the royalty is reasonable and is not subject to adjustment under section 482. The license is not entered into in connection with any other transaction. Y incurs capitalized costs in connection with entering into the license.

(ii) The license is a contract for the use of a section 197 intangible within the meaning of paragraph (b)(11) of this section. It does not qualify for the exception in section 197(e)(4)(D) and paragraph (c)(13) of this section (relating to rights of fixed duration or amount) because it does not have a term of less than 15 years, and the other exceptions in section 197(e) and paragraph (c) of this section are also inapplicable. Accordingly, the license is a section 197 intangible.

(iii) The license is not acquired as part of a purchase of a trade or business. Thus, under paragraph (f)(3)(iii) of this section, the license will be closely scrutinized under the principles of section 1235 for purposes of determining whether the transfer is a sale or exchange and, accordingly, whether the payments under the license are chargeable to capital account. Because the license is not a sale or exchange under the principles of section 1235, the royalty payments are not chargeable to capital account for purposes section 197. The capitalized costs of entering into the license are not within the exception under paragraph (d)(2) of this section for self-created intangibles, and thus are amortized under section 197.

Example 8. License of technology and trademarks . (i) The facts are the same as in *Example 7*, except that the license also includes the use of the trademarks and trade names that X uses to manufacture and distribute its products in the United States. Assume that under the principles of section 1253 the transfer is not a sale or exchange of the trademarks and trade names or an undivided interest therein and that the royalty payments are described in section 1253(d)(1)(B).

(ii) As in *Example 7*, the license is a section 197 intangible. Although the license conveys an interest in X's trademarks and trade names to Y, the transfer of the interest is disregarded for purposes of paragraph (e)(2) of this section unless the transfer is considered a sale or exchange of the trademarks and trade names or an undivided interest therein. Accordingly, the licensing of the technology and the trademarks and trade names is not treated as part of a purchase of a trade or business under paragraph (e)(2) of this section.

(iii) Because the technology license is not part of the purchase of a trade or business, it is treated in the manner described in *Example 7*. The royalty payments for the use of the trademarks and trade names are deductible under section 1253(d)(1) and, under section 197(f)(4)(C) and paragraph (b)(10)(ii) of this section, are not chargeable to capital account for purposes of section 197. The capitalized costs of entering into the license are treated in the same manner as in example 7.

Example 9. Disguised sale. (i) The facts are the same as in *Example 7*, except that Y agrees to pay X, in addition to the contingent royalty, a fixed minimum royalty immediately upon entering into the agreement and there are sufficient facts present to characterize the transaction, for federal tax purposes, as a transfer of ownership of the intellectual property from X to Y.

(ii) The purported license of technology is, in fact, an acquisition of an intangible described in section 197(d)(1)(C)(iii) and paragraph (b)(5) of this section (relating to know-how, etc.). As in *Example 7*, the exceptions in section 197(e) and paragraph (c) of this section do not apply to the transfer. Accordingly, the transferred property is a section 197 intangible. Y's basis in the transferred intangible includes the capitalized costs of entering into the agreement and the fixed minimum royalty payment payable at the time of the transfer. In addition, except to the extent that a portion of any payment will be treated as interest or original issue discount under applicable provisions of the Internal Revenue Code, all of the contingent payments under the purported license are properly chargeable to capital account for purposes of section 197 and this section. The extent to which such payments are treated as payments of principal and the time at which any amount treated as a payment of principal is taken into account in determining basis are determined under the rules of §1.1275–4(c)(4) or 1.483–4(a), whichever is applicable. Any contingent amount that is included in basis after the month in which the acquisition occurs is amortized under the rules of paragraph (f)(2)(i) or (ii) of this section.

Example 10. License of technology and customer list as part of sale of a trade or business. (i) X is a computer manufacturer that produces, in separate operating divisions, personal computers, servers, and peripheral equipment. In a transaction that is the purchase of a trade or business for purposes of section 197, Y (who is unrelated to X) purchases from X all assets of the operating division producing personal computers, except for certain patents that are also used in the division manufacturing servers and customer lists that are also used in the division manufacturing peripheral equipment. As part of the transaction, X transfers to Y the right to use the retained patents and customer lists solely in connection with the manufacture and sale of personal computers. The transfer agreement requires annual royalty payments contingent on the use of the patents and also requires a payment for each use of the customer list. In addition, Y incurs capitalized costs in connection with entering into the licenses.

(ii) The rights to use the retained patents and customer lists are contracts for the use of section 197 intangibles within the meaning of paragraph (b)(11) of this section. The rights do not qualify for the exception in 197(e)(4)(D) and paragraph (c)(13) of this section (relating to rights of fixed duration or amount) because they are transferred as part of a purchase of a trade or business and the other exceptions in section 197(e) and paragraph (c) of this section are also inapplicable. Accordingly, the licenses are section 197 intangibles.

(iii) Because the right to use the retained patents is described in paragraph (b)(11) of this section and the right is transferred as part of a purchase of a trade or business, the treatment of the royalty payments is determined under paragraph (f)(3)(ii) of this section. In addition, however, the retained patents are described in paragraph (b)(5) of this section. Thus, the annual royalty payments are chargeable to capital account under the general rule of paragraph (f)(3)(ii)(A) of this section unless Y establishes that the license is not a sale or exchange under the principles of section 1235 and the royalty payments are an arm's length consideration for the rights transferred. If these facts are established, the exception in paragraph (f)(3)(ii)(B) of this section applies and the royalty payments are not chargeable to capital account for purposes of section 197. The capitalized costs of entering into the license are treated in the same manner as in Example 7.

(iv) The right to use the retained customer list is also described in paragraph (b)(11) of this section and is transferred as part of a purchase of a trade or business. Thus, the treatment of the payments for use of the customer list is also determined under paragraph (f)(3)(ii) of this section. The customer list, although described in paragraph (b)(6) of this section, is a customer-related information base. Thus, the exception in paragraph (f)(3)(ii)(B) of this section does not apply. Accordingly, payments for use of the list are chargeable to capital account under the general rule of paragraph (f)(3)(ii)(A) of this section and are amortized under section 197. In addition, the capitalized costs of entering into the contract for use of the customer list are treated in the same manner as in *Example 7*.

Example 11. Loss disallowance rules involving related persons. (i) Assume that X and Y are treated as a single taxpayer for purposes of paragraph (g)(1) of this section. In a single transaction, X and Y acquired from Z all of the assets used by Z in a trade or business. Z had operated this business at two locations, and X and Y each acquired the assets used by Z at one of the locations. Three years after the acquisition, X sold all of the assets it acquired, including amortizable section 197 intangibles, to an unrelated purchaser. The amortizable section intangibles are sold at a loss of $120,000.

(ii) Because X and Y are treated as a single taxpayer for purposes of the loss disallowance rules of section 197(f)(1) and paragraph (g)(1) of this section, X's loss on the sale of the amortizable section 197 intangibles is not recognized. Under paragraph (g)(1)(iv)(B) of this section, X's disallowed loss is allowed ratably, as a deduction under section 197, over the remainder of the 15-year period during which the intangibles would have been amortized, and Y may not increase the basis of the amortizable section 197 intangibles that it acquired from Z by the amount of X's disallowed loss.

Example 12. Disposition of retained intangibles by related person. (i) The facts are the same as in *Example 11*, except that 10 years after the acquisition of the assets by X and Y and 7 years after the sale of the assets by X, Y sells all of the assets acquired from Z, including amortizable section 197 intangibles, to an unrelated purchaser.

(ii) Under paragraph (g)(1)(iv)(B) of this section, X may recognize, on the date of the sale by Y, any loss that has not been allowed as a deduction under section 197. Accordingly, X recognizes a loss of $50,000, the amount obtained by reducing the loss on the sale of the assets at the end of the third year ($120,000) by the amount allowed as a deduction under paragraph (g)(1)(iv)(B) of this section during the 7 years following the sale by X ($70,000).

Example 13. Acquisition of an interest in partnership with no section 754 election. (i) A, B, and C each contribute $1,500 for equal shares in general partnership P. On January 1, 1998, P acquires as its sole asset an amortizable section 197 intangible for $4,500. P still holds the intangible on January 1, 2003, at which time the intangible has an adjusted basis to P of $3,000, and A, B, and C each have an adjusted basis of $1,000 in their partnership interests. D (who is not related to A) acquires A's interest in P for $1,600. No section 754 election is in effect for 2003.

(ii) Because there is no change in the basis of the intangible under section 743(b), D merely steps into the shoes of A with respect to the intangible. D's proportionate share of P's adjusted basis in the intangible is $1,000, which continues to be amortized over the 10 years remaining in the original 15-year amortization period for the intangible.

Example 14. Acquisition of an interest in partnership with a section 754 election. (i) The facts are the same as in *Example 13*, except that a section 754 election is in effect for 2003.

(ii) Pursuant to paragraph (g)(3) of this section, for purposes of section 197, D is treated as if P owns two assets. D's proportionate share of P's adjusted basis in one asset is $1,000, which continues to be amortized over the 10 years remaining in the original 15-year amortization period. For the other asset, D's proportionate share of P's adjusted basis is $600 (the amount of the basis increase under section 743 as a result of the section 754 election), which is amortized over a new 15-year period beginning January 2003. With respect to B and C, P's remaining $2,000 adjusted basis in the intangible continues to be amortized over the 10 years remaining in the original 15-year amortization period.

Example 15. Payment to a retiring partner by partnership with a section 754 election. (i) The facts are the same as in *Example 13*, except that a section 754 election is in effect for 2003 and, instead of D acquiring A's interest in P, A retires from P. A, B, and C are not related to each other within the meaning of paragraph (h)(6) of this section. P borrows $1,600, and A receives a payment under section 736 from P of such amount, all of which is in exchange for A's interest in the intangible asset owned by P. (Assume, for purposes of this example, that the borrowing by P and payment of such funds to A does not give rise to a disguised sale of A's partnership interest under section 707(a)(2)(B).) P makes a positive basis adjustment of $600 with respect to the section 197 intangible under section 734(b).

(ii) Pursuant to paragraph (g)(3) of this section, because of the section 734 adjustment, P is treated as having two amortizable section 197 intangibles, one with a basis of $3,000 and a remaining amortization period of 10 years and the other with a basis of $600 and a new amortization period of 15 years.

Example 16. Termination of partnership under section 708(b)(1)(B). (i) A and B are partners with equal shares in the capital and profits of general partnership P. P's only asset is an amortizable section 197 intangible, which P had acquired on January 1, 1995. On January 1, 2000, the asset had a fair market value of $100 and a basis to P of $50. On that date, A sells his entire partnership interest in P to C, who is unrelated to A, for $50. At the time of the sale, the basis of each of A and B in their respective partnership interests is $25.

(ii) The sale causes a termination of P under section 708(b)(1)(B). Under section 708, the transaction is treated as if P transfers its sole asset to a new partnership in exchange for the assumption of its liabilities and the receipt of all of the interests in the new partnership. Immediately thereafter, P is treated as if it is liquidated, with B and C each receiving their proportionate share of the interests in the new partnership. The contribution by P of its asset to the new partnership is governed by section 721, and the liquidating distributions by P of the interests in the new partnership are governed by section 731. C does not realize a basis adjustment under section 743 with respect to the amortizable section 197 intangible unless P had a section 754 election in effect for its taxable year in which the transfer of the partnership interest to C occurred or the taxable year in which the deemed liquidation of P occurred.

(iii) Under section 197, if P had a section 754 election in effect, C is treated as if the new partnership had acquired two assets from P immediately preceding its termination. Even though the adjusted basis of the new partnership in the two assets is determined solely under section 723, because the transfer of assets is a transaction described in section 721, the application of sections 743(b) and 754 to P immediately before its termination causes P to be treated as if it held two assets for purposes of section 197. See paragraph (g)(3) of this section. B's and C's proportionate share of the new partnership's adjusted basis is $25 each in one asset, which continues to be amortized over the 10 years remaining in the original 15-year amortization period. For the other asset, C's proportionate share of the new partnership's adjusted basis is $25 (the amount of the basis increase resulting from the application of section 743 to the sale or exchange by A of the interest in P), which is amortized over a new 15-year period beginning in January 2000.

(iv) If P did not have a section 754 election in effect for its taxable year in which the sale of the partnership interest by A to C occurred or the taxable year in which the deemed liquidation of P occurred, the adjusted basis of the new partnership in the amortizable section 197 intangible is determined solely under section 723, because the transfer is a transaction described in section 721, and P does not have a basis increase in the intangible. Under section 197(f)(2) and paragraph (g)(2)(ii) of this section, the new partnership continues to amortize the intangible over the 10 years remaining in the original 15-year amortization period. No additional amortization is allowable with respect to this asset.

Example 17. Disguised sale to partnership. (i) E and F are individuals who are unrelated to each other within the meaning of paragraph (h)(6) of this section. E has been engaged in the active conduct of a trade or business as a sole proprietor since 1990. E and F form EF Partnership. E transfers all of the assets of the business, having a fair market value of $100, to EF, and F transfers $40 of cash to EF. E receives a 60 percent interest in EF and the $40 of cash contributed by F, and F receives a 40 percent interest in EF, under circumstances in which the transfer by E is partially treated as a sale of property to EF under §1.707–3(b).

(ii) Under §1.707–3(a)(1), the transaction is treated as if E had sold to EF a 40 percent interest in each asset for $40 and contributed the remaining 60 percent interest in each asset to EF in exchange solely for an interest in EF. Because E and EF are related persons within the meaning of paragraph (h)(6) of this section, no portion of any transferred section 197(f)(9) intangible that E held during the transition period (as defined in paragraph (h)(4) of this section) is an amortizable section 197 intangible pursuant to paragraph (h)(2) of this section. Section 197(f)(9)(E) and paragraph (g)(3) of this section do not apply to any portion of the section 197 intangible in the hands of EF because the basis of EF in these assets was not increased under any of sections 732, 734, or 743.

Example 18. Acquisition by related person in nonrecognition transaction. (i) A owns a nonamortizable intangible that A acquired in 1990. In 2000, A sells a one-half interest in the intangible to B for cash. Immediately after the sale, A and B, who are unrelated to each other, form partnership P as equal partners. A and B each contribute their one-half interest in the intangible to P.

(ii) P has a transferred basis in the intangible from A and B under section 723. The nonrecognition transfer rule under paragraph (g)(2)(ii) of this section applies to A's transfer of its one-half interest in the intangible to P, and consequently P steps into A's shoes with respect to A's nonamortizable transferred basis. The anti-churning rules of paragraph (h) of this section apply to B's transfer of its one-half interest in the intangible to P, because A, who is related to P under paragraph (h)(6) of this section immediately after the series of transactions in which the intangible was acquired by P, held B's one-half interest in the intangible during the transition period. Pursuant to paragraph (h)(10) of this section, these rules apply to B's transfer of its one-half interest to P even though the nonrecognition transfer rule under paragraph (g)(2)(ii) of this section would have permitted P to step into B's shoes with respect to B's otherwise amortizable basis. Therefore, P's entire basis in the intangible is nonamortizable. However, if A (not B) elects to recognize gain under paragraph (h)(9) of this section on the transfer of each of the one-half interests in the intangible to B and P, then the intangible would be amortizable by P to the extent provided in section 197(f)(9)(B) and paragraph (h)(9) of this section.

Example 19. Acquisition of partnership interest following formation of partnership. (i) The facts are the same as in *Example 18* except that, in 2000, A formed P with an affiliate, S, and contributed the intangible to the partnership and except that in a subsequent year, in a transaction that is properly characterized as a sale of a partnership interest for Federal tax purposes, B purchases a 50 percent interest in P from A. P has a section 754 election in effect and holds no assets other than the intangible and cash.

(ii) For the reasons set forth in *Example 16*(iii), B is treated as if P owns two assets. B's proportionate share of P's adjusted basis in one asset is the same as A's proportionate share of P's adjusted basis in that asset, which is not amortizable under section 197. For the other asset, B's proportionate share of the remaining adjusted basis of P is amortized over a new 15-year period.

Example 20. Acquisition by related corporation in nonrecognition transaction. (i) The facts are the same as *Example 18*, except that A and B form corporation P as equal owners.

(ii) P has a transferred basis in the intangible from A and B under section 362. Pursuant to paragraph (h)(10) of this section, the application of the nonrecognition transfer rule under paragraph (g)(2)(ii) of this section and the anti-churning rules of paragraph (h) of this section to the facts of this *Example 18* is the same as in *Example 16*. Thus, P's entire basis in the intangible is nonamortizable.

Example 21. Acquisition from corporation related to purchaser through remote indirect interest. (i) X, Y, and Z are each corporations that have only one class of issued and outstanding stock. X owns 25 percent of the stock of Y and Y owns 25 percent of the outstanding stock of Z. No other shareholder of any of these corporations is related to any other shareholder or to any of the corporations. On June 30, 2000, X purchases from Z section 197(f)(9) intangibles that Z owned during the transition period (as defined in paragraph (h)(4) of this section).

(ii) Pursuant to paragraph (h)(6)(iv)(B) of this section, the beneficial ownership interest of X in Z is 6.25 percent, determined by treating X as if it owned a proportionate (25 percent) interest in the stock of Z that is actually owned by Y. Thus, even though X is related to Y and Y is related to Z, X and Z are not considered to be related for purposes of the anti-churning rules of section 197.

Example 22. Gain recognition election. (i) B owns 25 percent of the stock of S, a corporation that uses the calendar year as its taxable year. No other shareholder of B or S is related to each other. S is not a member of a controlled group of corporations within the meaning of section 1563(a). S has section 197(f)(9) intangibles that it owned during the transition period. S has a basis of $25,000 in the intangibles. In 2001, S sells these intangibles to B for $75,000. S recognizes a gain of $50,000 on the sale and has no other items of income, deduction, gain, or loss for the year, except that S also has a net operating loss of $20,000 from prior years that it would otherwise be entitled to use in 2001 pursuant to section 172(b). S makes a valid gain recognition election pursuant to section 197(f)(9)(B) and paragraph (h)(9) of this section. In 2001, the highest marginal tax rate applicable to S is 35 percent. But for the election, all of S's taxable income would be taxed at a rate of 15 percent.

(ii) If the gain recognition election had not been made, S would have taxable income of $30,000 for 2001 and a tax liability of $4,500. If the gain were not taken into account, S would have no tax liability for the taxable year. Thus, the amount of tax (other than the tax imposed under paragraph (h)(9) of this section) imposed on the gain is also $4,500. The gain on the disposition multiplied by the highest marginal tax rate is $17,500 ($50,000 x .35). Accordingly, S's tax liability for the year is $4,500 plus an additional tax under paragraph (h)(9) of this section of $13,000 ($17,500 - $4,500).

(iii) Pursuant to paragraph (h)(9)(x)(A) of this section, S determines the amount of its net operating loss deduction in subsequent years without regard to the gain recognized on the sale of the section 197 intangible to B. Accordingly, the entire $20,000 net operating loss deduction that would have been available in 2001 but for the gain recognition election may be used in 2002, subject to the limitations of section 172.

(iv) B has a basis of $75,000 in the section 197(f)(9) intangibles acquired from S. As the result of the gain recognition election by S, B may amortize $50,000 of its basis under section 197. Under paragraph (h)(9)(ii) of this section, the remaining basis does not qualify for the gain-recognition exception and may not be amortized by B.

Example 23. Section 338 election. (i) Corporation P makes a qualified stock purchase of the stock of T corporation from two shareholders in July 2000, and a section 338 election is made by P. No shareholder of either T or P owns stock in both of these corporations, and no other shareholder is related to any other shareholder of either corporation.

(ii) Pursuant to paragraph (h)(8) of this section, in the case of a qualified stock purchase that is treated as a deemed sale and purchase of assets pursuant to section 338, the corporation treated as purchasing assets as a result of an election thereunder (new target) is not considered the person that held or used the assets during any period in which the assets were held or used by the corporation treated as selling the assets (old target). Because there are no relationships described in paragraph (h)(6) of this section among the parties to the transaction, any nonamortizable section 197(f)(9) intangible held by old target is an amortizable section 197 intangible in the hands of new target.

(iii) Assume the same facts as set forth in paragraph (i) of this *Example 23*, except that one of the selling shareholders is an individual who owns 25 percent of the total value of the stock of each of the T and P corporation.

(iv) Old target and new target (as these terms are defined in §1.338–1(c)(13)) are members of a controlled group of corporations under section 267(b)(3), as modified by section 197(f)(9)(C)(i), and any nonamortizable section 197(f)(9) intangible held by old target is not an amortizable section 197 intangible in the hands of new target. However, a gain recognition election under paragraph (h)(9) of this section may be made with respect to this transaction.

Example 24. Relationship created as part of public offering. (i) On January 1, 2001, Corporation X engages in a series of related transactions to discontinue its involvement in one line of business. X forms a new corporation, Y, with a nominal amount of cash. Shortly thereafter, X transfers all the stock of its subsidiary conducting the unwanted business (Target) to Y in exchange for 100 shares of Y common stock and a Y promissory note. Target owns a nonamortizable section 197(f)(9) intangible. Prior to January 1, 2001, X and an underwriter (U) had entered into a binding agreement pursuant to which U would purchase 85 shares of Y common stock from X and then sell those shares in a public offering. On January 6, 2001, the public offering closes. X and Y make a section 338(h)(10) election for Target.

(ii) Pursuant to paragraph (h)(8) of this section, in the case of a qualified stock purchase that is treated as a deemed sale and purchase of assets pursuant to section 338, the corporation treated as purchasing assets as a result of an election thereunder (new target) is not considered the person that held or used the assets during any period in which the assets were held or used by the corporation treated as selling the assets (old target). Further, for purposes of determining whether the nonamortizable section 197(f)(9) intangible is acquired by new target from a related person, because the transactions are a series of related transactions, the relationship between old target and new target must be tested immediately before the first transaction in the series (the formation of Y) and immediately after the last transaction in the series (the sale to U and the public offering). See paragraph (h)(6)(ii)(B) of this section. Because there was no relationship between old target and new target immediately before the formation of Y (because the section 338 election had not been made) and only a 15% relationship between old target and new target immediately after, old target is not related to new target for purposes of applying the anti-churning rules of paragraph (h) of this section. Accordingly, Target may amortize the section 197 intangible.

Example 25. Other transfers to controlled corporations. (i) In 2001, Corporation A transfers a section 197(f)(9) intangible that it held during the transition period to X, a newly formed corporation, in exchange for 15% of X's stock. As part of the same transaction, B transfers property to X in exchange for the remaining 85% of X stock.

(ii) Because the acquisition of the intangible by X is part of a qualifying section 351 exchange, under section 197(f)(2) and paragraph (g)(2)(ii) of this section, X is treated in the same manner as the transferor of the asset. Accordingly, X may not amortize the intangible. If, however, at the time of the exchange, B has a binding commitment to sell 25 percent of the X stock to C, an unrelated third party, the exchange, including A's transfer of the section 197(f)(9) intangible, would fail to qualify as a section 351 exchange. Because the formation of X, the transfers of property to X, and the sale of X stock by B are part of a series of related transactions, the relationship between A and X must be tested immediately before the first transaction in the series (the transfer of property to X) and immediately after the last transaction in the series (the sale of X stock to C). See paragraph (h)(6)(ii)(B) of this section. Because there was no relationship between A and X immediately before and only a 15% relationship immediately after, A is not related to X for purposes of applying the anti-churning rules of paragraph (h) of this section. Accordingly, X may amortize the section 197 intangible.

Example 26. Relationship created as part of stock acquisition followed by liquidation. (i) In 2001, Partnership P purchases 100 percent of the stock of Corporation X. P and X were not related prior to the acquisition. Immediately after acquiring the X stock, and as part of a series of related transactions, P liquidates X under section 331. In the liquidating distribution, P receives a section 197(f)(9) intangible that was held by X during the transition period.

(ii) Because the relationship between P and X was created pursuant to a series of related transactions where P acquires stock (meeting the requirements of section 1504(a)(2)) in a fully taxable transaction followed by a liquidation under section 331, the relationship immediately after the last transaction in the series (the liquidation) is disregarded. See paragraph (h)(6)(iii) of this section. Accordingly, P is entitled to amortize the section 197(f)(9) intangible.

Example 27. Section 743(b) adjustment with no change in user. (i) On January 1, 2001, A forms a partnership (PRS) with B in which A owns a 60-percent, and B owns a 40-percent, interest in profits and capital. A contributes a nonamortizable section 197(f)(9) intangible with a value of $80 and an adjusted basis of $0 to PRS in exchange for its PRS interest and B contributes $120 cash. At the time of the contribution, PRS licenses the section 197(f)(9) intangible to A. On February 1, 2001, A sells its entire interest in PRS to C, an unrelated person, for $80. PRS has a section 754 election in effect.

(ii) The section 197(f)(9) intangible contributed to PRS by A is not amortizable in the hands of PRS. Pursuant to section (g)(2)(ii) of this section, PRS steps into the shoes of A with respect to A's nonamortizable transferred basis in the intangible.

(iii) When A sells the PRS interest to C, C will have a basis adjustment in the PRS assets under section 743(b) equal to $80. The entire basis adjustment will be allocated to the intangible because the only other asset held by PRS is cash. Ordinarily, under paragraph (h)(12)(v) of this section, the anti-churning rules will not apply to an increase in the basis of partnership property under section 743(b) if the person acquiring the partnership interest is not related to the person transferring the partnership interest. However, A is an anti-churning partner under paragraph (h)(12)(vi)(B)(3) of this section. Because A remains a user of the section 197(f)(9) intangible after the transfer to C, paragraph (h)(12)(vi)(A) of this section will cause the anti-churning rules to apply to the entire basis adjustment under section 743(b).

(l) *Effective dates*—(1) *In general*. This section applies to property acquired after January 25, 2000, except that paragraph (c)(13) of this section (exception from section 197 for separately acquired rights of fixed duration or amount) applies to property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T).

(2) *Application to pre-effective date acquisitions*. A taxpayer may choose, on a transaction-by-transaction basis, to apply the provisions of this section and §1.167(a)–14 to property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and on or before January 25, 2000.

(3) *Application of regulation project REG–209709–94 to pre-effective date acquisitions*. A taxpayer may rely on the provisions of regulation project REG–209709– 94 (1997–1 C.B. 731) for property acquired after August 10, 1993 (or July 25, 1991, if a valid retroactive election has been made under §1.197–1T) and on or before January 25, 2000.

(4) *Change in method of accounting*—(i) *In general*. For the first taxable year ending after January 25, 2000, a taxpayer that has acquired property to which the exception in §1.197–2(c)(13) applies is granted consent of the Commissioner to change its method of accounting for such property to comply with the provisions of this section and §1.167(a)–14 unless the proper treatment of such property is an issue under consideration (within the meaning of Rev. Proc. 97–27 (1997–21 IRB 10)(see §601.601(d)(2) of this chapter)) in an examination, before an Appeals office, or before a Federal court.

(ii) *Application to pre-effective date acquisitions*. For the first taxable year ending after January 25, 2000, a taxpayer is granted consent of the Commissioner to change its method of accounting for all property acquired in transactions described in paragraph (l)(2) of this section to comply with the provisions of this section and §1.167(a)–14 unless the proper treatment of any such property is an issue under consideration (within the meaning of Rev. Proc. 97–27 (1997–21 IRB 10)(see §601.601(d)(2) of this chapter)) in an examination, before an Appeals office, or before a Federal court.

(iii) *Automatic change procedures*. A taxpayer changing its method of accounting in accordance with this paragraph (l)(4) must follow the automatic change in accounting method provisions of Rev. Proc. 99–49 (1999–52 IRB 725)(see §601.601(d)(2) of this chapter) except, for purposes of this paragraph (l)(4), the scope limitations in section 4.02 of Rev. Proc. 99–49 (1999–52 IRB 725) are not applicable. However, if the taxpayer is under examination, before an appeals office, or before a federal court, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the application with the National Office. The application must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

Part 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In §602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows.

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.197–2	1545-1671
* * * * *	

David Mader,
Acting Deputy Commissioner of Internal Revenue.

Approved January 14, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 20, 2000, 1:19 p.m., and published in the issue of the Federal Register for January 25, 2000, 65 F.R. 3820)

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274–5: Substantiation requirements.

T.D. 8864

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

Substantiation of Business Expenses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary Income Tax Regulations that provide rules for the substantiation of certain business expenses under sections 62 and 274 of the Internal Revenue Code (Code). Individuals and other taxpayers who claim or reimburse certain business expenses will be affected by these regulations.

DATES: *Effective date*. These regulations are effective January 26, 2000.

Date of Applicability. For date of applicability, see §§1.62–2(m) and 1.274–5(m).

FOR FURTHER INFORMATION CONTACT: Edwin B. Cleverdon, (202) 622-4920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-0771. Responses to this collection of information are required in order to deduct certain business expenses or exclude from income certain reimbursed business expenses of employees.

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

The estimated annual burden per respondent or recordkeeper varies from 10 minutes to 20 hours, depending on individual circumstances, with an estimated average of 1.3 hours.

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

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

Background

On November 6, 1985, the IRS published in the **Federal Register** (50 F.R. 46006) temporary regulations (TD 8061, 1985–2 C.B. 93) adding §1.274–5T regarding substantiation of expenses with documentary evidence under section 274(d) of the Code. A notice of proposed rulemaking (LR–145–84, 1985–2 C.B. 809) cross-referencing the temporary regulations was published in the **Federal Register** (50 F.R. 46087) for the same day. The notice of proposed rulemaking invited comments on only those portions of the temporary regulations under §1.274–5T that amended §1.274–5 (now designated §1.274–5A) to reflect contemporaneous legislation.

On March 25, 1997, the IRS published in the **Federal Register** (62 F.R. 13988) temporary regulations (T.D. 8715, 1997–1 C.B. 79) amending paragraphs (c)(2)(iii)(B) and (f)(4) of §1.274–5T. The amendments raised the receipt threshold from $25 to $75 and authorized the Commissioner to prescribe rules modifying the substantiation requirements for an adequate accounting by an employee to an employer. Under the amendment, the Commissioner could publish rules defining the circumstances (including the use of specified internal controls) under which an employee may make an adequate accounting to his employer by submitting an expense account alone, without the necessity of submitting documentary evidence (such as receipts). A notice of proposed rulemaking (REG–209785–95, 1997–1 C.B. 753) cross-referencing the temporary regulations was published in the **Federal Register** (62 F.R. 14051) for the same day.

On October 1, 1998, the IRS published a notice of proposed rulemaking (REG–122488–97, 1998–42 I.R.B. 19) in the **Federal Register** (63 F.R. 52660), proposing amendments to the Income Tax Regulations (26 CFR part 1) under sections 62(c) and 274(d) of the Code regarding substantiation of expenses using mileage and per diem rates. Specifically, the amendments removed the limitation in §1.274(d)–1(a)(3) that provides that mileage allowances prescribed in rules by the Commissioner are available only to the owner of a vehicle. On that date the IRS also published temporary Income Tax Regulations (T.D. 8784, 1998–42 I.R.B. 4) under section 62(c) and 274(d) of the Code in the **Federal Register** (63 F.R. 52600), relating to the substantiation of expenses under a reimbursement or other expense allowance arrangement.

Comments were received in response to the 1985 proposed regulations, and a public hearing was held on March 3, 1986. Few of the written comments, and none of the comments at the hearing, relate to the provisions in this Treasury Decision. Written comments were also received with respect to the 1997 proposed regulations, but no public hearing was requested or held. No comments were received, and no hearings were requested or held, with respect to the 1998 proposed regulations.

Summary and Discussion of Comments

This Treasury Decision incorporates the suggestions made in the written comments with some exceptions. With respect to the 1985 regulations, one commentator suggested that the definition of an adequate accounting in §1.274–5T(f)(4), in the case of automobile expense reimbursements, should be satisfied by a reimbursement based on data on the type of automobile and local operating and fixed costs. Although this suggestion has not been specifically adopted in the final regulations, the standard mileage rate revenue procedure provides for this type of substantiation. See, e.g., section 8 of Rev. Proc. 98–63, 1998–52 I.R.B. 25.

Another commentator suggested, inter alia, (1) adding exceptions to the documentary evidence requirements under §1.274–5T(c)(2)(iii) and (2) providing that the Commissioner, in establishing a meal allowance under §1.274–5T(j), may allow a specific dollar allowance per meal. These suggestions are not adopted because the intent of the regulations is to give the Commissioner the discretion to make these practical decisions.

Similarly, with respect to the 1997 regulations, commentators made suggestions regarding the specific content of the guidance to be issued under the proposed regulations at §1.274–5(f)(4). We did not incorporate these suggestions because the regulations are designed to describe appropriate published guidance of general applicability, not the specific provisions of such guidance. However, all of the comments will be taken into consideration by the Commissioner in issuing published guidance.

Explanation of Provisions

This Treasury Decision adopts the revision to §1.62–2(e)(2) proposed in REG–122488–97, with minor changes. This Treasury Decision also adopts §§1.274–5(c)(2)(iii), (f)(4), (g), (j), and (m) as proposed by LR–216–84, modified by REG–209785–95, 1997–1 C.B. 753, and REG–122488–97, 1998–42 I.R.B. 19, and removes and reserves the corresponding provisions in §1.274–5T. Finally, this Treasury Decision adopts the proposal in REG–122488–97 to remove §§1.62–2T, 1.274(d)–1, and 1.274(d)–1T.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Sections 1.274–5(c)(2)(iii) and (f) were originally proposed by a notice of proposed rulemaking (LR–145–84) that was issued on November 6, 1985. Therefore, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply with respect to those collections of information. With respect to the collection of information in §1.274–5(c)(iii)(B) as proposed by REG–209785–95 on March 25, 1997, it is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that, by increasing the receipt threshold from $25 to $75, these regulations reduce the existing recordkeeping requirements of taxpayers, including small entities. The regulations do not otherwise significantly alter the reporting or recordkeeping duties of 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 Internal Revenue Code, the IRS submitted the notices of proposed rulemaking preceding these regulations 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 final and temporary regulations is Edwin B. Cleverdon, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, personnel from other offices of the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry to read in part as follows:

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

Section 1.274–5 also issued under 26 U.S.C. 274(d). * * *

Par. 2. Section 1.62–2 is amended by:

1. Revising paragraph (e)(2).

2. Removing the last two sentences of paragraph (m).

3. Adding a sentence to the end of paragraph (m).

The revision and addition read as follows:

§1.62–2 Reimbursement and other expense allowance arrangements.

* * * * *

(e) * * *

(2) *Expenses governed by section 274(d).* An arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by section 274(d) meets the requirements of this paragraph (e)(2) if information sufficient to satisfy the substantiation requirements of section 274(d) and the regulations thereunder is submitted to the payor. See §1.274–5. Under section 274(d), information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, §1.274–5(b)(2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed property, §1.274–5(b)(6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See §1.274–5(g), however, which grants the Commissioner authority to prescribe rules permitting the amount of certain expenses to be deemed substantiated to the payor (in lieu of substantiating the actual amount of such expenses) by means of per diem or mileage rates for travel away from home or transportation expenses. See also §1.274–5(j)(1), which grants the Commissioner the authority to establish a method under which a taxpayer may use a specified amount for meals while traveling away from home in lieu of substantiating the actual cost of meals, and §1.274–5(j)(2), which grants the Commissioner the authority to establish a method under which a taxpayer may use mileage rates to determine 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 in lieu of substantiating the actual costs. Substantiation of the amount of a business expense in accordance with rules prescribed pursuant to the authority granted by §1.274–5(g) or (j) will be treated as substantiation of the amount of such expense for purposes of this section.

* * * * *

(m) * * * Paragraph (e)(2) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee with respect to expenses paid or incurred after December 31, 1997.

§1.62–2T [REMOVED]

Par. 3. Section 1.62–2T is removed.

Par. 4. Section 1.274–5 is added to read as follows:

§1.274–5 Substantiation requirements.

(a) and (b) [Reserved]. For further guidance, see §1.274–5T(a) and (b).

(c) *Rules of substantiation*—(1) [Reserved]. For further guidance, see §1.274–5T(c)(1).

(2) *Substantiation by adequate records*—(i) and (ii) [Reserved]. For further guidance, see §1.274–5T(c)(2)(i) and (ii).

(iii) *Documentary evidence*—(A) Except as provided in paragraph (c)(2)(iii)(B), documentary evidence, such as receipts, paid bills, or similar evidence sufficient to support an expenditure, is required for–

(*1*) Any expenditure for lodging while traveling away from home, and

(*2*) Any other expenditure of $75 or more except, for transportation charges, documentary evidence will not be required if not readily available.

(B) The Commissioner, in his or her discretion, may prescribe rules waiving the documentary evidence requirements in circumstances where it is impracticable for such documentary evidence to be required. Ordinarily, documentary evidence will be considered adequate to support an expenditure if it includes sufficient information to establish the amount, date, place, and the essential character of the expenditure. For example, a hotel receipt is sufficient to support expenditures for business travel if it contains the following: name, location, date, and separate amounts for charges such as for lodging, meals, and telephone. Similarly, a restaurant receipt is sufficient to support an expenditure for a business meal if it contains the following: name and location of the restaurant, the date and amount of the expenditure, the number of people served, and, if a charge is made for an item other than meals and beverages, an indication that such is the case. A document may be indicative of only one (or part of one) element of an expenditure. Thus, a cancelled check, together with a bill from the payee, ordinarily would establish the element of cost. In contrast, a cancelled check drawn payable to a named payee would not by itself support a business expenditure without other evidence showing that the check was used for a certain business purpose.

(iv) and (v) [Reserved]. For further guidance, see §1.274–5T(c)(2)(iv) and (v).

(d) and (e) [Reserved]. For further guidance, see §1.274–5T(d) and (e).

(f) *Reporting and substantiation of expenses of certain employees for travel, entertainment, gifts, and with respect to listed property*—(1) through (3) [Reserved]. For further guidance, see §1.274–5T(f)(1) through (3).

(4) *Definition of an adequate accounting to the employer*–(i) *In general*. For purposes of this paragraph (f) an *adequate accounting* means the submission to the employer of an account book, diary, log, statement of expense, trip sheet, or similar record maintained by the employee in which the information as to each element of an expenditure or use (described in paragraph (b) of this section) is recorded at or near the time of the expenditure or use, together with supporting documentary evidence, in a manner that conforms to all the adequate records requirements of paragraph (c)(2) of this section. An adequate accounting requires that the employee account for all amounts received from the employer during the taxable year as advances, reimbursements, or allowances (including those charged directly or indirectly to the employer through credit cards or otherwise) for travel, entertainment, gifts, and the use of listed property. The methods of substantiation allowed under paragraph (c)(4) or (c)(5) of this section also will be considered to be an adequate accounting if the employer accepts an employee's substantiation and establishes that such substantiation meets the requirements of paragraph (c)(4) or (c)(5). For purposes of an adequate accounting, the method of substantiation allowed under paragraph (c)(3) of this section will not be permitted.

(ii) *Procedures for adequate accounting without documentary evidence.* The Commissioner may, in his or her discretion, prescribe rules under which an employee may make an adequate accounting to an employer by submitting an account book, log, diary, etc., alone, without submitting documentary evidence.

(iii) *Employer*. For purposes of this section, the term *employer* includes an agent of the employer or a third party payor who pays amounts to an employee under a reimbursement or other expense allowance arrangement.

(5) [Reserved]. For further guidance, see §1.274–5T(f)(5).

(g) *Substantiation by reimbursement arrangements or per diem, mileage, and other traveling allowances*—(1) *In general*. The Commissioner may, in his or her discretion, prescribe rules in pronouncements of general applicability under which allowances for expenses described in paragraph (g)(2) of this section will, if in accordance with reasonable business practice, be regarded as equivalent to substantiation by adequate records or other sufficient evidence, for purposes of paragraph (c) of this section, of the amount of the expenses and as satisfying, with respect to the amount of the expenses, the requirements of an adequate accounting to the employer for purposes of paragraph (f)(4) of this section. If the total allowance received exceeds the deductible expenses paid or incurred by the employee, such excess must be reported as income on the employee's return. See paragraph (j)(1) of this section relating to the substantiation of meal expenses while traveling away from home, and paragraph (j)(2) of this section relating to the substantiation of expenses for the business use of a vehicle.

(2) *Allowances for expenses described*. An allowance for expenses is described in this paragraph (g)(2) if it is a—

(i) Reimbursement arrangement covering ordinary and necessary expenses of traveling away from home (exclusive of transportation expenses to and from destination);

(ii) Per diem allowance providing for ordinary and necessary expenses of traveling away from home (exclusive of transportation costs to and from destination); or

(iii) Mileage allowance providing for ordinary and necessary expenses of local transportation and transportation to, from, and at the destination while traveling away from home.

(h) [Reserved]. For further guidance, see §1.274–5T(h).

(i) [Reserved].

(j) *Authority for optional methods of computing certain expenses*—(1) *Meal expenses while traveling away from home*. The Commissioner may establish a method under which a taxpayer may use a specified amount or amounts for meals while traveling away from home in lieu of substantiating the actual cost of meals. The taxpayer will not be relieved of the requirement to substantiate the actual cost of other travel expenses as well as the time, place, and business purpose of the travel. See paragraphs(b)(2) and (c) of this section.

(2) *Use of mileage rates for vehicle expenses*. The Commissioner may establish a method under which a taxpayer may use mileage rates to determine 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 in lieu of substantiating the actual costs. The method may include appropriate limitations and conditions in order to reflect more accurately vehicle expenses over the entire period of usage. The taxpayer will not be relieved of the requirement to substantiate the amount of each business use (i.e., the business mileage), or the time and business purpose of each use. See paragraphs (b)(2) and (c) of this section.

(k) and (l) [Reserved]. For further guidance, see §1.274–5T(k) and (l).

(m) *Effective date*. This section applies to expenses paid or incurred after December 31, 1997.

Par. 5. Section 1.274–5T is amended by:

1. Revising paragraphs (c)(2)(iii), (f)(4), (g) and (j).

2. Adding a sentence at the end of paragraph (m).

The revision and addition read as follows:

§1.274–5T Substantiation requirements.

* * * * *

(c) * * *

(2) * * *

(iii) [Reserved]. For further guidance, see §1.274–5(c)(2)(iii).

* * * * *

(f)* * *

(4) [Reserved]. For further guidance, see §1.274–5(f)(4).

* * * * *

(g) [Reserved]. For further guidance, see §1.274–5(g).

* * * * *

(j) [Reserved]. For further guidance, see §1.274–5(j).

* * * * *

(m) *Effective date*. * * * Paragraphs (c)(2)(iii), (f)(4), (g), and (j) of this section apply to expenses paid or incurred after December 31, 1997.

§1.274(d)–1 [REMOVED]

Par. 6. Section 1.274(d)–1 is removed.

§1.274(d)–1T [REMOVED]

Par. 7. Section 1.274(d)–1T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In §602.101, paragraph (b) is amended by adding the following entry to the table:

§602.101 OMB Control numbers

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
§1.274–5	1545-0771
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 28, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 21, 2000, 3:09 p.m., and published in the issue of the Federal Register for January 26, 2000, 65 F.R. 4121)

Section 401.—Qualified Pension, Profit-Sharing, Stock Bonus Plans, etc.

26 CFR 1.401(k)–1: Certain cash or deferred arrangements.

Cash or deferred arrangements; elective deferrals. This ruling specifies the criteria to be met in order to automatically reduce an employee's compensation by a certain amount and have that amount contributed as an elective deferral to an employer's section 401(k) plan.

Rev. Rul. 2000–8

ISSUE

Will employer contributions to a profit-sharing plan fail to be considered elective contributions, within the meaning of § 1.401(k)–1(g)(3) of the Income Tax Regulations, made under a qualified cash or deferred arrangement, within the meaning of § 401(k) of the Internal Revenue Code, merely because they are made pursuant to an arrangement under which a fixed percentage of an employee's compensation is contributed to the plan unless the employee affirmatively elects to receive the amount in cash?

FACTS

Situation 1

Employer X maintains Plan A, a profit-sharing plan intended to satisfy the requirements of § 401(a), including §§ 401(k) and 401(m), and maintained on a calendar-year basis. Under Plan A, any employee of Employer X, including a newly hired employee, may elect to have Employer X make contributions on the employee's behalf to Plan A in lieu of receiving that amount as cash compensation that would otherwise be payable to the employee. The employee may designate the amount of these compensation reduction contributions as a percentage of the employee's compensation, subject to certain limitations set forth in the plan.

Under Plan A, if a newly hired employee does not affirmatively elect to receive cash or have a specified amount contributed to Plan A, his or her compensation is automatically reduced by 3 percent and this amount is contributed to Plan A. An election by any employee not to make compensation reduction contributions or to contribute a different percentage of compensation can be made at any time. The election is effective for the first pay period and subsequent pay periods (until superseded by a subsequent election) if filed when the employee is hired or if filed within a reasonable period thereafter ending before the compensation for the first pay period is currently available. Thus, if an employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed when the employee is hired or within a reasonable period thereafter ending before the compensation is currently available, then no compensation reduction contributions for the first pay period or subsequent pay periods are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. Elections filed at a later date are effective for payroll periods beginning in the month next following the date the election is filed.

At the time an employee is hired, the employee receives a notice that explains the automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election. Each participant in Plan A is notified annually of his or her compensation reduction percentage and the participant's right to change the percentage, including the procedure for exercising that right and the timing for implementation of any such election.

Plan A provides that compensation reduction contributions are immediately nonforfeitable and, if the employee has not attained age 59 1/2, cannot be distributed prior to the employee's retirement, death, or separation from service, except in the case of hardship (as defined in the plan). Plan A also provides that, for each employee who has at least 1 year of service, Employer X will make matching contributions to Plan A on account of the employee's compensation reduction contributions up to a specified percentage of the employee's compensation. Plan A does not permit after-tax employee contributions.

Plan A provides that both matching contributions and compensation reduction contributions will be invested in accordance with the participant's election among a broad range of investment funds held by the trustee or, if no investment election is made by the participant, in the trust's balanced fund which includes both diversified equity and fixed income investments.[1]

Situation 2

The facts are the same as in *Situation 1*, except Plan A is amended, effective the next January 1, to apply the same rule to both current and newly hired employees. Thus, under Plan A as amended, if an employee hired before January 1 who has not elected compensation reduction contributions of at least 3 percent of compensation does not affirmatively elect during a specified reasonable period ending on the January 1 effective date to receive cash or have a specified amount contributed to Plan A, his or her compensation is automatically reduced by 3 percent and this amount is contributed to Plan A beginning the first pay period that begins after the January 1 effective date.

Under the terms of Plan A as amended, if a current employee files an election to receive cash in lieu of compensation reduction contributions and the election is filed during the reasonable period ending on the January 1 effective date, then no compensation reduction contributions for the first pay period beginning on or after the January 1 effective date or for subsequent pay periods are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. In the case of a current employee who has a compensation reduction contribution election in effect for less than 3 percent, who does not make a new compensation reduction contribution election during the reasonable period ending on the January 1 effective date, and whose compensation is therefore automatically reduced by 3 percent beginning on that January 1, if that employee thereafter makes an affirmative election to reduce his or her compensation by another amount (or no amount), then that affirmative election will continue in effect until the employee makes a subsequent affirmative election for a different amount.

At the beginning of the reasonable period ending on the January 1 effective date, each current employee receives a notice that explains the new automatic compensation reduction election and the employee's right to elect to have no such compensation reduction contributions made to the plan or to alter the amount of those contributions, including the procedure for exercising that right and the timing for implementation of any such election. Thereafter, each employee receives the annual notice described above in *Situation 1*.

LAW AND ANALYSIS

Section 401(k) provides that a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan can meet the requirements of § 401(a) even if it includes a qualified cash or deferred arrangement. Section 401(k) also sets forth the requirements that a cash or deferred arrangement must satisfy in order to be a qualified cash or deferred arrangement.

Section 1.401(k)–1(a)(2)(i) defines a

[1]The Department of Labor has advised Treasury and the Service that, under Title I of the Employee Retirement Income Security Act of 1974 (ERISA), fiduciaries of a plan must ensure that the plan is administered prudently and solely in the interest of plan participants and beneficiaries. While ERISA § 404(c) may serve to relieve certain fiduciaries from liability when participants or beneficiaries exercise control over the assets in their individual accounts, the Department of Labor has taken the position that a participant or beneficiary will not be considered to have exercised control when the participant or beneficiary is merely apprised of investments that will be made on his or her behalf in the absence of instructions to the contrary. See 29 CFR § 2550.404c-1 and 57 F.R. 46924.

cash or deferred arrangement as an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of § 401(a). Section 1.401(k)–1(a)(2)(ii) provides that a cash or deferred arrangement does not include an arrangement under which amounts contributed under a plan at an employee's election are designated or treated at the time of contribution as after-tax employee contributions.

Section 1.401(k)–1(a)(3)(i) defines a cash or deferred election as any election (or modification of an earlier election) by an employee to have the employer either provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available or contribute an amount to a trust (or provide an accrual or other benefit) under a plan deferring the receipt of compensation. Section 1.401(k)1(a)(3)(iv) provides that a cash or deferred election does not include a one-time irrevocable election, made at the time an employee commences employment with the employer or upon the employee's first becoming eligible under any plan of the employer, to have contributions made by the employer on the employee's behalf to the plan (or to any other plan of the employer) equal to a specified amount or percentage of the employee's compensation.

Section 1.401(k)–1(e)(2) provides generally that a qualified cash or deferred arrangement must provide that the amount that each eligible employee may defer as an elective contribution is available to the employee in cash.

Section 1.401(k)–1(g)(3) defines elective contributions as employer contributions made to a plan that were subject to a cash or deferred election under a cash or deferred arrangement. Such contributions are elective contributions without regard to whether the cash or deferred arrangement is a qualified cash or deferred arrangement.

The definition of a cash or deferred election in § 1.401(k)–1(a)(3)(i) requires that the employee have an election between the employer paying cash (or some other taxable benefit) to the employee or making a contribution to a trust on behalf of the employee. The regulation does not require that the employee receive an amount in cash in any case in which the employee does not make an affirmative election to have that amount contributed to the trust. Thus, a cash or deferred election will not fail to be made under a qualified cash or deferred arrangement merely because, when an employee fails to make an affirmative election with respect to an amount of compensation, that amount is contributed on the employee's behalf to a trust, provided that the employee had an effective opportunity to elect to receive that amount in cash. The employee has an effective opportunity to elect to receive an amount in cash as required under § 1.401(k)–1(a)(3)(i) if the employee receives notice of the availability of the election and the employee has a reasonable period before the cash is currently available to make the election.

If Plan A were to permit after-tax employee contributions, then the amounts contributed to the plan would have to be designated or treated, at the time of the contribution, as pre-tax compensation reduction contributions or after-tax employee contributions.

In *Situation 1*, compensation reduction contributions made by Employer X to Plan A, including those made on behalf of a newly hired employee who has not filed an election to the contrary, are amounts contributed pursuant to a procedure under which the employee receives a notice explaining his or her rights to have no compensation reduction contributions made and, after receiving the notice, the employee has a reasonable period before the cash is currently available to elect to receive the cash in lieu of having it contributed to the plan. Similarly, in *Situation 2*, compensation reduction contributions made by Employer X to Plan A, including those made on behalf of a newly hired employee who has not filed an election to the contrary and those made on behalf of a current employee who has elected less than 3 percent compensation reduction contributions, are amounts contributed pursuant to a procedure under which the employee receives a notice explaining his or her rights to have no compensation reduction contributions made and, after receiving the notice, the employee has a reasonable period before the cash is currently available to elect to receive the cash in lieu of having it contributed to the plan. Thus, in *Situation 1* and *Situation 2*, an eligible employee has an effective opportunity to elect to receive cash or have a contribution made to the plan on the employee's behalf. In addition, compensation reduction contributions made under the plan are not contributions made pursuant to a one-time irrevocable election because the employee can change the election in the future. Consequently, the compensation reduction contributions described in *Situation 1* and *Situation 2* are made pursuant to cash or deferred elections and satisfy the requirement in § 1.401(k)–1(a)(3)(i) that the amount that each eligible employee may defer as an elective contribution be available to the employee in cash. The result would be the same if the plan required a period of service (permitted under § 401(k)(2)(D)) before an employee became eligible for elective contributions.

HOLDING

Where, as in *Situation 1* and *Situation 2*, a newly hired or a current employee has an effective opportunity to elect to receive an amount in cash or have that amount contributed by the employer to a profit-sharing plan, those employer contributions made on the employee's behalf to the plan in lieu of receipt of cash compensation will not fail to be considered elective contributions within the meaning of § 1.401(k)–1(g)(3) made under a qualified cash or deferred arrangement within the meaning of § 401(k) merely because they are made pursuant to an arrangement under which, in any case in which an employee does not affirmatively elect to receive cash, the employee's compensation is reduced by a fixed percentage and that amount is contributed on the employee's behalf to the plan.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 98–30, 1998–25 I.R.B. 8, is amplified and superseded.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling has been reviewed and approved by the Office of

Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1605.

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

The collections of information in this revenue ruling are in the third, sixth, and last paragraphs in the section headed "FACTS" and in the sixth paragraph in the section headed "LAW AND ANALYSIS." The collections of information are required to enable personnel in the Tax Exempt and Government Entities Division of the Internal Revenue Service to determine if an employer's retirement plan satisfies the requirements to obtain favorable tax treatment and to enable certain employee elections to meet the requirements of § 401(k). The collections of information are required to obtain a benefit. The likely respondents are businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting burden is 1,750 hours. The estimated average annual burden per respondent is 1 hour and 10 minutes. The estimated number of respondents is 1,500. The estimated annual frequency of responses is on occasion.

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

DRAFTING INFORMATION

The principal author of this revenue ruling is Roger Kuehnle of the Tax Exempt and Government Entities Division. For further information regarding this revenue ruling, call the Employee Plans' taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers) between 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.

Section 1296.—Election of Mark to Market For Marketable Stock

26 CFR 1.1296(e)–1: Definition of marketable stock.

T.D. 8867

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Passive Foreign Investment Companies; Definition of Marketable Stock

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations under section 1296 relating to the new mark-to-market election for stock of a passive foreign investment company (PFIC). The final regulations interpret changes made by the Taxpayer Relief Act of 1997. The final regulations affect persons holding PFIC stock that is regularly traded on certain U.S. or foreign exchanges or markets or holding stock in certain PFICs comparable to U.S. regulated investment companies (RICs).

DATES: *Effective Date*: January 25, 2000.

Applicability Dates: For dates of applicability see section 1.1296(e)–1(g) of these regulations.

FOR FURTHER INFORMATION CONTACT: Robert Laudeman, (202) 622-3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On February 2, 1999, the IRS published in the **Federal Register** proposed regulations (REG-113744-98, 1999–10 I.R.B. 59, [64 F.R. 5014]) regarding the taxation of U.S. holders of PFIC stock. Three written comments regarding the proposed regulations were received. Because no one requested to speak at a public hearing, no hearing was held. After consideration of all of the comments received, the proposed regulations under section 1296 are adopted as final regulations with some changes. The changes are discussed below.

The preamble to the proposed regulations (64 F.R. 5014) provides a detailed discussion of the mark-to-market election for shareholders of PFIC stock and the proposed regulations.

Summary of Public Comments and Changes

Exchange or Other Market

The proposed regulations require that a foreign exchange or market be regulated or supervised by a governmental authority of the country in which the market is located. The proposed regulations also list additional characteristics that the foreign exchange or market must have for stock that is regularly traded on the exchange or market to be marketable stock for purposes of section 1296. Specifically, the proposed regulations require that the exchange have trading volume, listing, financial disclosure and other requirements designed to prevent fraud, perfect the mechanism of a free and open market, and protect investors.

The final regulations add a surveillance requirement and add the concept of perfecting a fair and orderly market to the requirements for exchanges. These changes are intended to clarify the characteristics that an exchange or other market must have in order to be a qualified exchange or market for purposes of section 1296 and to more closely represent common characteristics of foreign markets. See International Federation of Stock Exchanges (FIBV), *1998 Market Principles*, available by request from secretariat@fibv.com, and International Organization of Securities Commissions (IOSCO), *Supervisory Framework for Markets, Report by the Technical Committee*, May 1999 (visited Oct. 5, 1999) <http://www.iosco.org/iosco.html>.

Stock in Certain PFICs

The proposed regulations provide that stock in certain PFICs is *marketable stock* if the PFIC both is a corporation described in section 1296(e)(1)(B) (foreign corporations comparable to RICs) and offers for sale or has outstanding stock of which it is the issuer and which is redeemable at its net asset value. The proposed regulations further provide that a PFIC is a corporation described in section 1296(e)(1)(B) only if the PFIC satisfies eight conditions listed in the proposed regulations with respect to the class of shares held by the electing taxpayer. The conditions are intended to describe PFICs that are comparable to RICs in relevant respects and to implement the intent of the statute by ensuring that the net asset valuations of such companies represent legitimate and sound fair market values for the companies' stock.

Two commentators asserted that the statute and legislative history indicate that Congress was only concerned that PFICs redeem stock at net asset values and that such values represent sound and legitimate fair market values and, therefore, it is not necessary that the PFIC resemble a RIC. The commentators suggest that the regulations be modified to include PFICs that redeem their stock at its net asset value but do not otherwise resemble RICs. Because the plain language of the statute clearly requires that the stock in any foreign corporation be comparable to a RIC, the final regulations retain the approach of requiring PFICs to be comparable to RICs in order for their stock to be marketable stock for purposes of section 1296(e)(1)(B).

The proposed regulations provide that a foreign corporation must have one hundred or more unrelated shareholders. One commentator recommended that the number be reduced to ten unrelated shareholders, arguing that a corporation with ten unrelated shareholders as opposed to one hundred unrelated shareholders has the same susceptibility to legal liabilities if valuations are inaccurate. Requiring that a PFIC have one hundred or more unrelated shareholders is comparable to the requirement imposed on RICs by section 851(a). In addition, the IRS and the Treasury Department believe that there will be less likelihood of share price manipulation with corporations that have one hundred or more unrelated shareholders. Consequently, the above described rule in the proposed regulations is not changed except that "one hundred or more" is corrected to read "more than one hundred" unrelated shareholders.

The proposed regulations require that the class of shares of the foreign corporation be readily available for purchase by the general public at its net asset value by new investors in initial amounts not greater than $10,000 (U.S.). One commentator recommended that this condition not be included in the final regulations because an investment ceiling will not make the valuation easier or less likely to be manipulated.

The condition in the proposed regulations regarding initial investments is not an investment ceiling. Rather, the condition specifies that the foreign corporation not require a minimum initial investment of greater than $10,000 (U.S.) and that shares of the foreign corporation be readily available for purchase by the general public at net asset values. For example, a foreign corporation that requires new investors to purchase shares for a minimum initial investment of $5,000 (U.S.) satisfies the condition. However, a foreign corporation that requires new investors to purchase shares for a minimum initial investment of $20,000 (U.S.) does not satisfy the condition. There is not any limit, however, on the total amount that a shareholder can invest. The final regulations clarify that this condition is not an investment ceiling.

Two additional requirements in the proposed regulations are that shares be available for purchase by the general public and that, no less frequently than annually, financial statements prepared by independent auditors be available to the public. One commentator asserted that availability to the general public of the shares of the foreign corporation and of the financial statements is not necessary and should not be required because it will not necessarily ensure a legitimate and sound fair market value for the foreign corporation's stock.

Availability of shares for purchase by the general public is comparable to the requirement of availability of shares of RICs for purchase by the general public. In addition, availability of shares for purchase by the the general public for net asset value (in addition to current investors being able to redeem shares for the same net asset value), will ensure that the net asset values are legitimate and sound. However, shares will not be considered available for purchase by the general public if the shares are only available to individuals with high annual incomes or high net worth. For example, limiting investors to individuals with annual incomes in excess of $200,000 or net worth in excess of $1 million will not be considered available for purchase by the general public.

Similarly, availability to the general public of audited financial statements is comparable to conditions imposed on RICs and will help to ensure that the foreign corporation's financial information is readily available to potential and current investors, which, in turn, will help ensure that the net asset values are legitimate and sound. Availability of financial statements to the general public requires no more than that the statements be available upon request to potential and current investors.

The proposed regulations require that quotations for the shares of the foreign corporation be determined and published on a daily basis in a widely-available medium, such as a newspaper of general circulation. One commentator asserted that the condition is not necessary because the mark-to-market election is made on an annual basis at the close of the taxpayer's taxable year. The commentator recommended that the condition be changed to require that values be communicated to shareholders, on at least an annual basis, in written form that serves as support for such valuation.

The final regulations do not adopt the commentator's recommendation. The publication of quotations for the shares is not intended to serve solely as a means for a current shareholder of the PFIC to determine the value of the PFIC on the mark date. The publication of quotations for the shares is comparable to the practice of RICs and helps to ensure that asset valuations are legitimate and sound by allowing potential investors as well as current shareholders to have ready access to price information.

Because quotations for the shares of some PFICs may not be published on a daily basis, the daily publication requirement in the proposed regulations is changed to require that quotations for the shares of the foreign corporation be determined and published no less frequently than weekly. In addition, the publication requirement is changed to clarify that the quotations must be published in a permanent medium not controlled by the issuer of the shares, such as an independent trade publication. The requirement that the medium be permanent does not require the medium to be saved in a printed form; archived electronic data not susceptible to subsequent alteration are permanent. This change is intended to assist shareholders and the IRS in verifying valuations.

The proposed regulations require that the foreign corporation be supervised or regulated as an investment company by a foreign government or instrumentality thereof. One commentator suggested that the condition be clarified with respect to the meaning of governmental supervision. In particular, the commentator asks whether a foreign jurisdiction that requires a local corporation to file information upon incorporation with the local government or agency would qualify as supervision or regulation.

The condition in the proposed regulations is intended to require that the PFIC be supervised or regulated as an investment company in a manner comparable, but not identical, to RICs. Consequently, the final regulations clarify the type of supervision or regulation required. The final regulations provide that sufficient supervision or regulation requires that the government or agency have broad inspection and enforcement authority and effective oversight over investment companies to ensure that such companies provide complete and accurate disclosure of relevant financial information to shareholders and potential investors and to provide adequate sanctions for false or inadequate disclosure. The mere filing of information upon incorporation does not qualify as supervision or regulation.

Finally, the proposed regulations require that the foreign corporation have no senior securities authorized or outstanding, including any debt other than de minimis amounts. In addition, the proposed regulations require that the foreign corporation meet the PFIC income and asset tests in sections 1297(a)(1) and (2) with the requisite percentages increased from 75 percent to 90 percent and from 50 percent to 90 percent respectively. One commentator asserted that these conditions not be included in the final regulations because there is no basis for requiring a PFIC to have the same borrowing restrictions, asset composition, and characteristics of RICs in order for the PFIC's stock to be marketable stock under section 1296.

Conditions regarding debt and asset composition are essential characteristics of RICs. The IRS and the Treasury Department believe that Congress intended to provide mark-to-market treatment to shares of PFICs that are, in fact, comparable to RICs.

Special Rules for RICs

The proposed regulations provide that if shares in a PFIC are owned directly or indirectly by a RIC, that is offering for sale, or has outstanding any stock of which it is the issuer, and which is redeemable at net asset value, the PFIC shares shall be treated as marketable stock for purposes of section 1296. Section 1296(e)(2) further provides that except as provided in regulations, similar treatment as marketable stock shall apply in the case of any other RIC which publishes net asset valuations at least annually. The IRS and Treasury Department invited comments regarding situations where PFIC stock held by other RICs that publish asset valuations at least annually should not be treated as marketable stock for purposes of section 1296.

One commentator explained why PFIC stock held by any closed-end RIC that publishes net asset values at least annually should be treated as marketable stock. In particular, that commentator pointed out that closed-end RICs are subject to many of the same regulatory requirements as open-end RICs. In addition, that commentator explained that an industry practice has developed under which closed-end RICs typically determine and publish current share prices, together with net asset values, on a weekly basis in print and other media.

At this time, the IRS and Treasury Department know of no reason not to treat PFIC stock held by closed-end funds that publish net asset values at least annually as marketable stock. Consequently, as provided by section 1296(e)(2), PFIC stock held by any closed-end RIC that publishes net asset values at least annually shall be treated as marketable stock. The final regulations, however, continue to reserve this issue in the event that it is determined that situations exist where PFIC stock held by closed-end RICs that publish net asset valuations at least annually should not be treated as marketable stock for purposes of section 1296. If such a situation is found to exist, the reservation will be replaced at that time by a new regulatory exception.

Special Analyses

It has been determined that these regulations are not significant regulatory actions as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a requirement for the 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 preceeding 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 Robert Laudeman of the Office of the 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 an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.1296(e)–1 also issued under 26 U.S.C. 1296(e). * * *

Par. 2. Section 1.1296(e)–1 is added to read as follows:

§1.1296(e)–1 Definition of marketable stock.

(a) *General rule*. For purposes of section 1296, the term *marketable stock* means—

(1) Passive foreign investment company (PFIC) stock that is regularly traded, as defined in paragraph (b) of this section, on a qualified exchange or other market, as defined in paragraph (c) of this section;

(2) Stock in certain PFICs, as described in paragraph (d) of this section; and

(3) Options on stock that is described in paragraph (a)(1) or (2) of this section, to the extent provided in paragraph (e) of this section.

(b) *Regularly traded*—(1) *General rule*. For purposes of paragraph (a)(1) of this section, a class of stock that is traded on one or more qualified exchanges or other markets, as defined in paragraph (c) of this section, is regularly traded on such exchanges or markets for any calendar year during which such class of stock is traded, other than in de minimis quantities, on at least 15 days during each calendar quarter.

(2) *Anti-abuse rule*. Trades that have as one of their principal purposes the meeting of the trading requirement of paragraph (b)(1) of this section shall be disregarded. Further, a class of stock shall not be treated as meeting the trading requirement of paragraph (b)(1) of this section if there is a pattern of trades conducted to meet the requirement of paragraph (b)(1) of this section.

(c) *Qualified exchange or other market*—(1) *General rule*. For purposes of paragraph (a)(1) of this section, the term *qualified exchange or other market* means, for any calendar year—

(i) A national securities exchange that is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(ii) A foreign securities exchange that is regulated or supervised by a governmental authority of the country in which the market is located and which has the following characteristics—

(A) The exchange has trading volume, listing, financial disclosure, surveillance, and other requirements designed to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free and open, fair and orderly, market, and to protect investors; and the laws of the country in which the exchange is located and the rules of the exchange ensure that such requirements are actually enforced; and

(B) The rules of the exchange effectively promote active trading of listed stocks.

(2) *Exchange with multiple tiers*. If an exchange in a foreign country has more than one tier or market level on which stock may be separately listed or traded, each such tier shall be treated as a separate exchange.

(d) *Stock in certain PFICs*—(1) *General rule*. Except as provided in paragraph (d)(2) of this section, a foreign corporation is a corporation described in section 1296(e)(1)(B), and paragraph (a)(2) of this section, if the foreign corporation offers for sale or has outstanding stock of which it is the issuer and which is redeemable at its net asset value and if the foreign corporation satisfies the following conditions with respect to the class of shares held by the electing taxpayer—

(i) At all times during the calendar year, the foreign corporation has more than one hundred shareholders with respect to the class, other than shareholders who are related under section 267(b);

(ii) At all times during the calendar year, the class of shares of the foreign corporation is readily available for purchase by the general public at its net asset value and the foreign corporation does not require a minimum initial investment of greater than $10,000 (U.S.);

(iii) At all times during the calendar year, quotations for the class of shares of the foreign corporation are determined and published no less frequently than on a weekly basis in a widely-available permanent medium not controlled by the issuer of the shares, such as a newspaper of general circulation or a trade publication;

(iv) No less frequently than annually, independent auditors prepare financial statements of the foreign corporation that include balance sheets (statements of assets, liabilities, and net assets) and statements of income and expenses, and those statements are made available to the public;

(v) The foreign corporation is supervised or regulated as an investment company by a foreign government or an agency or instrumentality thereof that has broad inspection and enforcement authority and effective oversight over investment companies;

(vi) At all times during the calendar year, the foreign corporation has no senior securities authorized or outstanding, including any debt other than in de minimis amounts;

(vii) Ninety percent or more of the gross income of the foreign corporation for its taxable year is passive income, as defined in section 1297(a)(1) and the regulations thereunder; and (viii) The average percentage of assets held by the foreign corporation during its taxable year which produce passive income or which are held for the production of passive income, as defined in section 1297(a)(2) and the regulations thereunder, is at least 90 percent.

(2) *Anti-abuse rule*. If a foreign corporation undertakes any actions that have as one of their principal purposes the manipulation of the net asset value of a class of its shares, for the calendar year in which the manipulation occurs, the shares are not marketable stock for purposes of paragraph (d)(1) of this section.

(e) [Reserved]

(f) *Special rules for regulated investment companies (RICs)*—(1) *General rule*. In the case of any RIC that is offering for sale, or has outstanding, any stock of which it is the issuer and which is redeemable at net asset value, if the RIC owns directly or indirectly, as defined in sections 958(a)(1) and (2), stock in any passive foreign investment company, that stock will be treated as marketable stock owned by that RIC for purposes of section 1296. Except as provided in paragraph (f)(2) of this section, in the case of any other RIC that publishes net asset valuations at least annually, if the RIC owns directly or indirectly, as defined in sections 958(a)(1) and (2), stock in any passive foreign investment company, that stock will be treated as marketable stock owned by that RIC for purposes of section 1296.

(2) [Reserved]

(g) *Effective date*. This section applies to shareholders whose taxable year ends on or after January 25, 2000 for stock in a foreign corporation whose taxable year ends with or within the shareholder's taxable year. In addition, shareholdersmay elect to apply these regulations to any taxable year beginning after December 31, 1997, for stock in a foreign corporation whose taxable year ends with or within the shareholder's taxable year.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved January 12, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 21, 2000, 8:45 a.m., and published in the issue of the Federal Register for January 25, 2000, 65 F.R. 3817)

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Transportation Fringe Benefits

REG–113572–99

AGENCY: Internal Revenue Service

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

SUMMARY: This document contains proposed regulations relating to qualified transportation fringe benefits. These proposed regulations reflect changes to the law made by the Energy Policy Act of 1992, the Taxpayer Relief Act of 1997, and the Transportation Equity Act for the 21st Century. These proposed regulations affect employers that offer qualified transportation fringes and employees who receive these benefits. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by April 26, 2000. Outlines of topics to be discussed at the public hearing scheduled for June 1, 2000 at 10 a.m. must be received by May 10, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–113572–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–113572–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/reglist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, John Richards of the Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations), (202) 622-6040; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

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 Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by March 27, 2000. 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 service to provide information.

The collections of information in this proposed regulation are in 26 CFR 1.132–9(b). This information is required by the Internal Revenue Service to implement section 132(f). This information will be used to verify compliance with section 132(f). Section 132(f)(3) provides that qualified transportation fringes can include cash reimbursement for qualified transportation fringes. The proposed regulations require that employers keep records of substantiation provided by employees in order to receive cash reimbursement for qualified transportation fringes. Section 132(f)(4) provides that an employee may choose between cash compensation and any qualified transportation fringe. The proposed regulations require that employers keep records, in a verifiable form, such as written or electronic, of employee elections to reduce compensation. The value of qualified transportation fringes provided for a month exceeding the applicable statutory monthly limit must be reported on the employee's Form W-2. The burden for this requirement is reflected in the burden for Form W-2. The likely recordkeepers are employers. The likely respondents are employees.

Estimated total annual recordkeeping burden: 7,020,000 hours.

Estimated average annual recordkeeping burden per recordkeeper : The average annual recordkeeping burden will vary depending on the size of the employer. The estimated average annual recordkeeping burden per recordkeeper is 26.5 hours.

Estimated number of recordkeepers: 265,343

Estimated total annual reporting burden: 5,948,728 hours

Estimated average annual reporting burden per respondent: .8 hours.

Estimated number of respondents: 7,264,970

Estimated annual frequency of responses: Monthly.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains a proposed amendment to the Income Tax Regulations (26 CFR part 1) under section

132(f). Congress amended section 132 as part of the Energy Policy Act of 1992, Public Law No. 102-486, section 1911 (106 Stat. 3012), effective after December 31, 1992. This provision excludes from gross income the value of any qualified transportation fringe provided by an employer to an employee to the extent it does not exceed the applicable statutory monthly limit.

This 1992 amendment to section 132 resulted in three changes to the tax treatment of employer-provided transportation benefits. First, Congress added an exclusion for transportation provided by an employer to an employee in a commuter highway vehicle. Second, mass transit passes provided by an employer to an employee became excludable as a qualified transportation fringe and not as a de minimis fringe. The exclusions for transportation provided by an employer to an employee in a commuter highway vehicle and mass transit passes were made subject to an aggregate $60 per month limit (adjusted for cost of living). Third, Congress eliminated the working condition fringe for commuter parking, imposed a $150 per month limit (adjusted for cost of living) for the exclusion for qualified parking, and provided that employer-provided parking is excludable from gross income only as a qualified transportation fringe. The 1992 amendment provided that qualified transportation fringes could not be provided in lieu of salary.

Section 1072 of the Taxpayer Relief Act of 1997 (TRA '97), Pub. L. No. 105-34 (111 Stat. 948), amended section 132(f), effective for tax years beginning after December 31, 1997, to permit qualified parking to be provided to employees in lieu of salary. Section 9010 of the Transportation Equity Act for the 21st Century (TEA 21), Pub. L. No. 105-178 (112 Stat. 507), amended section 132(f) to increase the monthly dollar limits to $65 for transportation in a commuter highway vehicle and mass transit passes[1] and $175 for qualified parking and to provide that, effective after December 31, 1997, any qualified transportation fringe may be provided to employees in lieu of salary.

[1] The dollar limit for transportation in a commuter highway vehicle and transit passes was further increased to $100 effective January 1, 2002.

Explanation of Provisions

This document contains proposed regulations under section 132. The proposed regulations provide guidance, in question and answer form, to employers that provide qualified transportation fringes to employees. Qualified transportation fringes consist of transportation in a commuter highway vehicle, any transit pass, and qualified parking provided by an employer to an employee.

Notice 94–3, 1994–1 C.B. 327, provided guidance on qualified transportation fringes in the form of questions and answers. The proposed regulations reflect statutory changes in section 132(f) since 1994, including the revised monthly dollar limits and the use of bona fide salary reduction arrangements, as permitted under TRA '97 and TEA 21, and generally conform with the guidance in Notice 94–3. In response to public comments, the proposed regulations also provided additional guidance concerning the standards for determining when the section 132(f) exclusion applies to cash reimbursement of transit pass expenses.

Section 132(f) limits the value of qualified transportation fringes that may be excluded from an employee's gross income. The proposed regulations explain that there are two categories of qualified transportation fringes for purposes of determining the amount that is excludable from gross income. The first category is transportation in a commuter highway vehicle and transit passes. The second category is qualified parking. There is a statutory monthly limit on the value of the benefits from each category that is excludable from gross income. For 1999 and 2000, the statutory monthly limit is $65 for transportation in a commuter highway vehicle and mass transit passes and $175 for qualified parking. An employee may receive benefits from each category provided the applicable statutory monthly limit for that category is not exceeded. The amount by which the value of qualified transportation fringes provided by an employer to an employee exceeds the applicable statutory monthly limit is included in the employee's wages for income and employment tax purposes.

The proposed regulations provide that, for purposes of valuing qualified parking, the valuation rules under section 1.61–21(b) generally apply. With respect to employer-provided van pool benefits, the regulations provide that an employer may use the special valuation rules provided under section 1.61–21(c), (d), (e), and (f) in valuing these benefits. An example in the proposed regulations illustrates that in determining the value of a transit pass sold at a discount for purposes of section 132(f), the purchase price rather than the face amount of the transit pass controls.

The proposed regulations reflect that qualified transportation fringes include cash reimbursement by an employer to an employee for expenses incurred by the employee for transportation in a commuter highway vehicle and qualified parking. Section 132(f)(3) provides that qualified transportation fringes include cash reimbursement for a transit pass only if a voucher or similar item that is exchangeable for a transit pass is not readily available for direct distribution by the employer to the employee. In defining "readily available," the regulations reflect the general standards set forth in Notice 94–3, under which an amount is readily available if an employer can obtain it on terms no less favorable than those available to an individual employee and without incurring a significant administrative cost.

In addition, the proposed regulations clarify the meaning of "significant administrative costs." The proposed regulations provide that the determination of whether obtaining a voucher would result in a significant administrative cost is made with respect to each transit system voucher. A transit system voucher is a voucher that is accepted by one or more mass transit operators (e.g., train, subway, and bus) in an area as fare media (or in exchange for fare media). The proposed regulations provide a safe harbor under which administrative costs are treated as significant if the average monthly administrative costs incurred by the employer for a voucher (disregarding delivery charges imposed by the fare media provider to the extent not in excess of $15 per order) are more than 1 percent of the average monthly value of the vouchers for a system. These standards are intended to provide clear guidance so that employers can determine when qualified transportation fringes include cash reimbursement for transit passes.

The proposed regulations provide that

reimbursements may be made only pursuant to a bona fide reimbursement arrangement. Thus, an employee must provide substantiation that an expense has been incurred for qualified transportation fringes in order to receive a reimbursement. The regulations recognize that the substantiation requirements vary depending upon the payment method used to purchase transportation in a commuter highway vehicle, mass transit passes, and qualified parking. The regulations provide examples of what constitutes reasonable reimbursement procedures in certain circumstances. For example, if an employee uses metered parking, the substantiation requirement may be satisfied if the employee certifies that the expense was incurred and the employer has no reason to believe the employee did not actually incur the expense.

The proposed regulations provide that there are no substantiation requirements

with respect to mass transit passes provided directly by an employer to its employees. Of course, an employer may impose its own substantiation requirements in addition to those required under the regulations.

The proposed regulations follow the approach taken in Notice 94–3 with respect to taxing the value of employer-provided parking benefits provided to members of car and van pools. The regulations provide that the "prime member" bears the tax consequences with respect to the parking space.[2] The prime member is the employee to whom the parking space is assigned.

The proposed regulations reflect that qualified transportation fringes may be provided under a compensation reduction arrangement which permits an employee to make a compensation reduction election. A compensation reduction election is an election in which the employee chooses between a fixed amount of compensation to be received at a specified future date and a fixed amount of qualified transportation fringes to be provided with respect to a specified future period (such as a calendar month). The proposed regulations provide that the compensation reduction election for any month in a year may not exceed the aggregate statutory monthly maximum for that year (e.g., $240 for 1999 and 2000 ($65 plus $175)). The election must be made before the employee is able currently to receive the taxable compensation. Under the proposed regulations, the determination of whether the employee is able currently to receive the taxable compensation does not depend on whether the compensation has been constructively received for purposes of section 451.

The proposed regulations require that an election be irrevocable after the beginning of the period for which the qualified transportation fringes will be provided. However, unused amounts can be carried over to any subsequent months, including months in subsequent years, but cannot be used for any purpose other than qualified transportation fringes under section 132(f).

The proposed regulations provide that the exclusion for qualified transportation fringes applies only to employees. Partners, 2-percent S-corporation shareholders, and independent contractors are not considered to be employees for purposes of qualified transportation fringes. However, amounts may be excludable pursuant to the working condition fringe rules and the de minimis fringe rules that apply to partners, 2-percent S- corporation shareholders, and independent contractors under section 132(d) and (e).

The proposed regulations provide that qualified transportation fringes not exceeding the applicable statutory monthly limit are not subject to employment taxes. However, qualified transportation fringes exceeding the applicable statutory monthly limit are includible in the employee's wages for income and employment tax purposes. If the value of noncash qualified transportation fringes provided to an employee exceeds the applicable statutory monthly limit, the employer may follow the reporting and withholding guidelines provided in Announcement 85–113, 1985–31 I.R.B. 31. Announcement 85–113 provides that employers may elect, for purposes of the FICA, the FUTA, and federal income tax withholding, to treat noncash fringe benefits as paid on a pay period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually. Announcement 85–113 also provides a special accounting rule for noncash fringes provided during the last two months of a calendar year.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

An Initial Regulatory Flexibility Analysis has been prepared as required for the collection of information in this notice of proposed rulemaking under 5 U.S.C. § 603. The analysis follows:

Initial Regulatory Flexibility Analysis

This proposed rule may have an impact on small organizations that provide qualified transportation fringes in the form of cash reimbursement or that offer qualified transportation fringes in lieu of salary. Section 132(f)(3) provides that qualified transportation fringes may be provided in the form of cash reimbursement. The legislative history indicates that cash reimbursements must be made pursuant to a bona fide reimbursement arrangement. Thus, this proposed rule provides that employers must receive substantiation from employees as a condition to providing cash reimbursement for qualified transportation fringes. Section 132(f)(4) provides that an employee may choose between cash compensation and qualified transportation fringes. This proposed rule provides that employers must keep records with respect to employee compensation reduction elections. Thus, the requirements under this proposed rule create a collection of information requirement for employers.

The objectives of this proposed rule with respect to employee substantiation of qualified transportation fringes is to carry out the legislative intent that cash reimbursement be provided by an employer only under a bona fide reimbursement arrangement. The objective of the recordkeeping requirement with respect to employee compensation reduction elections is to ensure against recharacterization of taxable compensation after it has been paid to an employee. The legal basis for this proposed rule is section 132(f)(3) and (4).

All classes of employers will likely

[2] Other pool members may chose to reimburse the costs of the prime member, in which event, under Rev. Rul. 55-555, 1955-2 C.B. 20, the reimbursements will not be includible in the prime member's gross income. See also Rev. Rul. 80-99, 1980-1 C.B. 10.

offer qualified transportation fringes and therefore will be affected by this proposed rule. Approximately 265,000 small entities may be affected by this proposed rule. There are no professional skills necessary for the recordkeeping required under this proposed rule.

The IRS is not aware of any other relevant federal rules which may duplicate, overlap, or conflict with this proposed rule.

A less burdensome alternative for small organizations would be to exempt those entities from the recordkeeping requirements under this proposed rule. However, it would be inconsistent with the statutory provisions and the legislative history to exempt those entities from the recordkeeping requirements imposed under this rule. This proposed rule provides several options which avoid more burdensome recordkeeping requirements for small entities. This proposed rule provides that (1) there are no substantiation requirements if the employer distributes transit passes in kind; (2) a compensation reduction election can be made electronically; (3) an election to reduce compensation can be automatically renewed; and (4) an employer can provide for deemed compensation reduction elections under its qualified transportation fringe benefit plan.

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 regulations and how they can be made easier to understand, and on the administrability of the rules in the proposed regulations. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 1, 2000, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601 (a) (3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit 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 May 10, 2000. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is John Richards, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). 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 to read in part as follows:

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

Par. 2. Section 1.132–0 is amended by adding entries for §1.132–9 to read as follows:

§1.132–0 Outline of regulations under section 132.

* * * * *

§1.132–9(a) Table of Contents.

§1.132–9(b) Questions and Answers.

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Par. 3 Section 1.132–9 is added to read as follows:

§1.132–9 Qualified Transportation Fringes.

(a) *Table of Contents*. This section contains a list of the questions and answers in §1.132–9.

Q-1. What is a qualified transportation fringe?

Q-2. What is transportation in a commuter highway vehicle?

Q-3. What are transit passes?

Q-4. What is qualified parking?

Q-5. To which workers may qualified transportation fringes be provided?

Q-6. Must a qualified transportation fringe benefit plan be in writing?

Q-7. Is there a limit on the value of qualified transportation fringes that may be excluded from an employee's gross income?

Q-8. What amount is includible in an employee's wages for income and employment tax purposes if the value of the qualified transportation fringe exceeds the applicable statutory monthly limit?

Q-9. Are excludable qualified transportation fringes calculated on a monthly basis?

Q-10. May an employee receive qualified transportation fringes from more than one employer?

Q-11. May qualified transportation fringes be provided to employees pursuant to a compensation reduction agreement?

Q-12. What is a compensation reduction election for purposes of section 132(f)?

Q–13. Is there a limit to the amount of the compensation reduction?

Q–14. When must the employee have made a compensation reduction election and under what circumstances can the amount be paid in cash to the employee?

Q–15. May an employee whose qualified transportation fringe costs are less than the employee's compensation reduction carry over this excess amount to subsequent periods?

Q–16. How does section 132(f) apply to expense reimbursements?

Q-17. May an employer provide nontaxable cash reimbursement under section 132(f) for periods longer than one month?

Q-18. What are the substantiation requirements if an employer distributes transit passes?

Q-19. May an employer choose to impose substantiation requirements in addition to those described in this regulation?

Q-20. How is the value of parking determined?

Q-21. How do the qualified transportation fringe rules apply to van pools?

Q-22. What are the reporting and employment tax requirements for qualified transportation fringes?

Q-23. How does section 132(f) interact with other fringe benefit rules?

Q-24. May qualified transportation fringes be provided to individuals who are partners, 2-percent shareholders of S-corporations, or independent contractors?

(b) Questions and Answers.

Q-1. What is a qualified transportation fringe?

A-1. (a) The following benefits are "qualified transportation fringe" benefits:

(1) Transportation in a commuter highway vehicle.

(2) Transit passes.

(3) Qualified parking.

(b) An employer may simultaneously provide an employee with any one or more of these three benefits.

Q-2. What is transportation in a commuter highway vehicle?

A-2. Transportation in a commuter highway vehicle is transportation provided by an employer to an employee in connection with travel between the employee's residence and place of employment. A "commuter highway vehicle" is a highway vehicle with a seating capacity of at least 6 adults (excluding the driver) and with respect to which at least 80 percent of the vehicle's mileage is reasonably expected to be–

(a) For transporting employees in connection with travel between their residences and their place of employment; and

(b) On trips during which the number of employees transported for commuting is at least one-half of the adult seating capacity of the vehicle (excluding the driver).

Q-3. What are transit passes?

A-3. A "transit pass" is any pass, token, farecard, voucher, or similar item (including an item exchangeable for fare media) that entitles a person to transportation—

(a) On mass transit facilities (whether or not publicly owned); or

(b) Provided by any person in the business of transporting persons for compensation or hire in a highway vehicle with a seating capacity of at least six adults (excluding the driver).

Q-4. What is qualified parking?

A-4. (a) "Qualified parking" is parking provided to an employee by an employer—

(1) On or near the employer's business premises; or

(2) At a location from which the employee commutes to work by carpool, commuter highway vehicle, mass transit facilities, transportation provided by any person in the business of transporting persons for compensation or hire or by any other means.

(b) However, parking on or near property used by the employee for residential purposes is not qualified parking.

(c) Parking is provided by an employer if—

(1) The employer pays for the parking;

(2) The employer reimburses the employee for parking expenses; or

(3) The parking is on property that the employer owns or leases. See Q/A-16 of this section for rules relating to cash reimbursements.

Q-5. To which workers may qualified transportation fringes be provided?

A-5. Qualified transportation fringes may be provided only by employers to employees. The term "employee" for purposes of qualified transportation fringes is defined in §1.132–1(b)(2)(i). This term includes only common law employees and other statutory employees, such as officers of corporations. See Q/A-24 of this section for rules regarding partners, 2-percent shareholders, and independent contractors.

Q-6. Must a qualified transportation fringe benefit plan be in writing?

A-6. No. Section 132(f) does not require that a qualified transportation fringe benefit plan be in writing.

Q-7. Is there a limit on the value of qualified transportation fringes that may be excluded from an employee's gross income?

A-7. (a) *Transportation in a commuter highway vehicle and transit passes.* Before January 1, 2002, up to $65 is excludable from the gross income of an employee for transportation in a commuter highway vehicle and transit passes provided by an employer for a month. On January 1, 2002, this amount is increased to $100 per month.

(b) *Parking.* Up to $175 is excludable from the gross income of an employee for qualified parking in a month.

(c) *Combination.* An employer may provide qualified parking benefits in addition to transportation in a commuter highway vehicle and transit passes.

(d) *Cost-of-living adjustments.* The amounts in paragraphs (a) and (b) of this Q/A–7 are adjusted annually, beginning with 2000, to reflect cost-of-living. The adjusted figures are announced by the Service before the beginning of the year.

Q-8. What amount is includible in an employee's wages for income and employment tax purposes if the value of the qualified transportation fringe exceeds the applicable statutory monthly limit?

A-8. Generally, an employee must include in gross income the amount by which the fair market value of the benefit exceeds the sum of the amount, if any, paid by the employee and any amount excluded from gross income under section 132(a)(5). Thus, assuming no other statutory exclusion applies, if an employer provides an employee with a qualified transportation fringe that exceeds the applicable statutory monthly limit and the employee does not make any payment, the value of the benefits provided in excess of the applicable statutory monthly limit is included in the employee's wages for income and employment tax purposes. See § 1.61–21(b)(1). The following examples illustrate the principles of this Q/A-8:

Example 1. (i) For each month in 2000, Employer M provides a transit pass valued at $75 to Employee D, who does not pay any amount to Employer M for the transit pass.

(ii) In this example, because the value of the monthly transit pass exceeds the statutory monthly limit by $10, $120 ($75 - $65, times 12 months) must be included in D's wages for income and employment tax purposes for 2000 with respect to the transit passes.

Example 2. (i) For each month in 2000, Employer M provides qualified parking valued at $195 to Employee E, who does not pay any amount to M for the parking.

(ii) In this example, because the fair market value of the qualified parking exceeds the statutory monthly limit by $20, $240 ($195 - $175, times 12 months) must be included in Employee E's wages for income and employment tax purposes for 2000 with respect to the qualified parking.

Example 3. (i) For each month in 2000, Employer P provides qualified parking with a fair market value of $220 per month to its employees, but charges each employee $45 per month.

(ii) In this example, because the sum of the amount paid by an employee ($45) plus the amount excludable for qualified parking ($175) is not less than the fair market value of the monthly benefit, no amount is includible in the employee's wages for income and employment tax purposes with respect to the qualified parking.

Q-9. Are excludable qualified transportation fringes calculated on a monthly basis?

A-9. Yes. The value of transportation in a commuter highway vehicle, transit passes, and qualified parking is calculated on a monthly basis to determine whether the value of the benefit has exceeded the applicable statutory monthly limit on qualified transportation fringes. Except in the case of a transit pass, the applicable statutory monthly limit applies to qualified transportation fringes used by the employee in a month. In the case of a transit pass, the applicable statutory monthly limit applies to the transit passes provided by the employer to the employee in a month for that month or for any previous month in the calendar year. Monthly exclusion amounts are not combined to provide a qualified transportation fringe in any month exceeding the statutory limit. A "month" is a calendar month or a substantially equivalent period applied consistently. The following examples illustrate the principles of this Q/A-9:

Example 1. (i) Employee E incurs $150 for qualified parking used during the month of June, 2000, for which E is reimbursed $150 by Employer R. E incurs $180 in expenses for qualified parking used during the month of July, 2000, for which E is reimbursed $180 by R.

(ii) In this example, because monthly exclusion amounts may not be combined to provide a benefit in any month greater than the applicable statutory limit, the amount by which the amount reimbursed for July exceeds the applicable statutory monthly limit ($180 minus $175 equals $5) is includible in E's wages for income and employment tax purposes.

Example 2. (i). Employee F receives transit passes from Employer G with a value of $195 in the month of March (when the applicable statutory monthly limit is $65). F was hired during January and has not received any transit passes from G.

(ii). In this example, the value of the transit passes (three months times $65 equals $195) is excludable from F's wages for income and employment tax purposes. However, if F was not hired until March, only $65 would be excludable from F's wages for income and employment tax purposes.

Example 3. (i). Each month during 2000, Employer R distributes transit passes with a face amount of $70 to each of its employees. Transit passes with a face amount of $70 can be purchased from the transit system by any individual for $65.

(ii). In this example, because the value of the transit passes distributed by R does not exceed the applicable statutory monthly limit ($65), no portion of the transit passes is included as wages for income and employment tax purposes.

Q-10. May an employee receive qualified transportation fringes from more than one employer?

A-10. Yes. The statutory monthly limits described in Q/A-7 of this section apply to benefits provided by an employer to its employees. For this purpose, all employees treated as employed by a single employer under section 414(b), (c), (m), or (o) are treated as employed by a single employer. See § 1.132–1(c). Thus, qualified transportation fringes paid by entities under common control under section 414(b), (c), (m), or (o) are combined for purposes of applying the applicable statutory limit. In addition, an individual who is treated as an employee of the employer under section 414(n) is treated as an employee of the employer for purposes of section 132. See § 414(t). The following examples illustrate the principles of this Q/A-10:

Example 1. (i) During 2000, Employee E works for Employers M and N, who are unrelated and not treated as a single employer under section 414(b), (c), (m), or (o). Each month, M and N each provide qualified parking benefits to E with a value of $100.

(ii) In this example, because M and N are unrelated employers, and the value of the monthly parking benefit provided by each is not more than the applicable statutory monthly limit, the parking benefits provided by each employer are excludable as qualified transportation fringes assuming that the other requirements of this section are satisfied.

Example 2. (i) Same facts as in Example 1, except that M and N are treated as a single employer under section 414(b).

(ii) In this example, because M and N are treated as a single employer, the value of the monthly parking benefit provided by M and N must be combined for purposes of determining whether the applicable statutory monthly limit has been exceeded. Thus, the amount by which the value of the parking benefit exceeds the monthly limit ($200 minus $175 equals $25) for each month in 2000 is includible in E's wages for income and employment tax purposes.

Q-11. May qualified transportation fringes be provided to employees pursuant to a compensation reduction agreement?

A-11. Yes. An employer may offer employees a choice between cash compensation and any qualified transportation fringe. An employee who is offered this choice and who elects qualified transportation fringes is not required to include the cash compensation in income if—

(a) The election is pursuant to an arrangement described in Q/A-12 of this section; (b) The amount of the reduction in cash compensation does not exceed the limitation in Q/A-13 of this section;

(c) The arrangement satisfies the timing and reimbursement rules in Q/A-14 and 16 of this section; and

(d) The related fringe benefit arrangement otherwise satisfies the requirements set forth elsewhere in this section.

Q-12. What is a compensation reduction election for purposes of section 132(f)?

A-12. (a) *Election requirements generally.* A compensation reduction arrangement is an arrangement under which the employer provides the employee with the right to elect whether the employee will receive either a fixed amount of cash compensation at a specified future date or a fixed amount of qualified transportation fringes to be provided for a specified future period (such as qualified parking to be used during a future calendar month). The employee's election must be in writing or another form, such as electronic, that includes, in a permanent and verifiable form, the information required to be in the election. The election must contain the date of the election, the amount of the compensation to be reduced, and the period for which the benefit will be provided. The election must relate to a fixed dollar amount or fixed percentage of compensation reduction. An election to reduce compensation for a period by a set amount for such period may be automatically renewed for subsequent periods.

(b) *Negative election permitted.* An employer may provide under its qualified transportation fringe benefit plan that a compensation reduction election will be deemed to have been made if the employee does not elect to receive cash compensation in lieu of the qualified transportation fringe provided that the employee receives adequate notice that a compensation reduction will be made and is given adequate opportunity to choose to receive the cash compensation instead of the qualified transportation fringe.

Q–13. Is there a limit to the amount of the compensation reduction?

A–13. Yes. Each month, the amount of the compensation reduction may not exceed the combined applicable statutory monthly limits for transportation in a commuter highway vehicle, transit passes, and qualified parking. For example, for 2000, an employee could elect to reduce compensation for any month by no more than $240 ($65 for transportation in a commuter highway vehicle and transit passes, plus $175 for qualified parking) with respect to qualified transportation fringes. If an employee were to elect to reduce compensation by $250 for a month, the excess $10 ($250 minus $240) would be includible in the employee's wages for income and employment tax purposes.

Q–14. When must the employee have made a compensation reduction election and under what circumstances can the amount be paid in cash to the employee?

A–14. The compensation reduction election must satisfy the following requirements.

(a) *Timing of election*. The compensation reduction election must be made before the employee is able currently to receive the cash or other taxable amount at the employee's discretion. The determination of whether the employee is able currently to receive the cash does not depend on whether it has been constructively received for purposes of section 451. The election must specify that the period (such as a calendar month) for which the qualified transportation fringe will be provided must not begin before the election is made. For this purpose, the date a qualified transportation fringe is provided is—

(1) The date the employee receives a voucher or similar item; or

(2) In any other case, the date the employee uses the qualified transportation fringe.

(b) Thus, a compensation reduction election must relate to qualified transportation fringes to be provided after the election.

(c) *Revocability of elections*. The employee may not revoke a compensation reduction election after the employee is able currently to receive the cash or other taxable amount at the employee's discretion. In addition, the election may not be revoked after the beginning of the period for which the qualified transportation fringe will be provided.

(d) *Compensation reduction amounts not refundable*. Unless an election is revoked in a manner consistent with paragraph (c) of this Q/A-14, an employee may not subsequently receive the compensation (in cash or any form other than by payment of a qualified transportation fringe under the employer's plan). Thus, an employer's qualified transportation fringe benefit plan may not provide that an employee who ceases to participate in the employer's qualified transportation fringe benefit plan is entitled to receive a refund of the amounts by which the employee's compensation reduction exceeds the actual qualified transportation fringes provided to the employee by the employer.

(e) *Examples*. The following examples illustrate the principles of this Q/A-14:

Example 1. (i) Employer P maintains a qualified transportation fringe benefit arrangement. Employees of P are paid twice per month, with the payroll dates being the first and the fifteenth day of the month. Under P's arrangement, an employee is permitted to elect at any time before the first day of a month to reduce his or her compensation payable during that month in an amount up to the applicable statutory monthly limit (i.e., for 2000, $65 if the employee elects coverage for transportation in a commuter highway vehicle or a mass transit pass, or $175 if the employee chooses qualified parking) in return for the right to receive qualified transportation fringes up to the amount of the election. If such an election is made, P will provide a mass transit pass for that month with a value not exceeding the compensation reduction amount elected by the employee or will reimburse the cost of other qualified transportation fringes used by the employee on or after the first day of that month up to the compensation reduction amount elected by the employee. Any compensation reduction amount elected by the employee for the month that is not used for qualified transportation fringes is not refunded to the employee at any future date.

(ii) In this example, the arrangement satisfies the requirements of this Q/A-14 because the election is made before the employee is able currently to receive the cash and the election specifies the future period for which the qualified transportation fringes will be provided. The arrangement would also satisfy the requirements of this Q/A-14 and Q/A-13 of this section if employees were allowed to elect to reduce compensation up to $240 (for 2000) per month.

(iii) The arrangement would also satisfy the requirements of this Q/A-14 (and Q/A-13 of this section) if employees were allowed to make an election at any time before the first or the fifteenth day of the month to reduce their compensation payable on that payroll date by an amount not in excess of one-half of the applicable statutory monthly limit (depending on the type of qualified transportation fringe elected by the employee) and P provides a mass transit pass on or after the applicable payroll date for the compensation reduction amount elected by the employee for the payroll date or reimburses the cost of other qualified transportation fringes used by the employee on or after the payroll date up to the compensation reduction amount elected by the employee for that payroll date.

Example 2. (i) Employee Q elects to reduce his compensation payable on March 1 of a year (when the statutory monthly limit for transportation in a commuter highway vehicle and transit passes is $65) by $195 in exchange for a mass transit voucher to be provided in March. The election is made on the preceding February 27. Employee Q was hired in January of the year. On March 10 of the year, the employer of Employee Q delivers to Employee Q a mass transit voucher worth $195.

(ii) In this example, $130 is included in Employee Q's wages for income and employment tax purposes because the compensation reduction election fails to satisfy the requirement in this Q/A-14 and Q/A-12 of this section that the election relate to qualified transportation fringes to be provided for a future period to the extent the election relates to $65 worth of transit passes for each of January and February of the year. No amount would be included in Employee Q's wages as a result of the election if $195 worth of mass transit passes were instead delivered to Employee Q in May of the year (because the compensation reduction would relate solely to fringes to be provided for a future period and the amount provided does not exceed the aggregate limit for the period, i.e., the sum of $65 for each of March, April, and May)

Q–15. May an employee whose qualified transportation fringe costs are less than the employee's compensation reduction carry over this excess amount to subsequent periods?

A–15. Yes. An employee may carry over unused compensation reduction amounts to subsequent periods under the plan of the employee's employer. The following example illustrates the principles of this Q/A-15:

Example. (i) By an election made before November 1, 1999, Employee E elects to reduce compensation in the amount of $65 for the month of November, 1999. E incurs $50 in employee-operated commuter highway vehicle expenses during November for which E is reimbursed $50 by Employer R. By an election made before December 1, 1999, E elects to reduce compensation by $65 for the month of December. E incurs $65 in employee-operated commuter highway vehicle expenses during December for which E is reimbursed $65 by R. Before January 1, 2000, E elects to reduce compensation by $50 for the month of January. E incurs $65 in employee-operated commuter highway vehicle expenses during January for which E is reimbursed $65 by R because R allows E to carry over to January, 2000, the $15 amount by which the compensation reductions for November and December exceeded the employee-operated commuter highway vehicle expenses incurred during those months.

(ii) In this example, because E is reimbursed in an amount not exceeding the applicable statutory monthly limit, and the reimbursement does not exceed the amount of employee-operated commuter highway vehicle expenses incurred during the month of January, the amount reimbursed ($65) is excludable from E's wages for income and employment tax purposes.

Q–16. How does section 132(f) apply to expense reimbursements?

A-16. (a) *In general*. The term "qualified transportation fringe" includes cash reimbursement by an employer to an employee for expenses incurred or paid by an employee for transportation in a commuter highway vehicle or qualified parking. The reimbursement must be made under a bona fide reimbursement arrangement which meets the rules of paragraph (d) of this Q/A-16. The term "cash reimbursement" does not include cash advances.

(b) *Special rule for transit passes*. The term "qualified transportation fringe" includes cash reimbursement for transit passes made under a bona fide reimbursement arrangement, but, in accordance with section 132(f)(3), only if no voucher or similar item that may be exchanged only for a transit pass is readily available for direct distribution by the employer to employees. For this purpose, a voucher or similar item is "readily available" if an employer can obtain it—

(1) On terms no less favorable than those available to an individual employee; and

(2) Without incurring a significant administrative cost.

(c) *Significant administrative cost.* Administrative costs relate only to fees paid to fare media providers. The determination of whether obtaining a voucher would result in a significant administrative cost is made with respect to each transit system voucher. A transit system voucher is a voucher that is accepted by one or more mass transit operators (e.g., train, subway, and bus) in an area as fare media (or in exchange for fare media). Administrative costs are treated as significant if the average monthly administrative costs incurred by the employer for a voucher (disregarding delivery charges imposed by the fare media provider to the extent not in excess of $15 per order) are more than 1 percent of the average monthly value of the vouchers for a system. Thus, whether a voucher is readily available without incurring a significant administrative cost is determined with respect to the transit system in each area for which the voucher may be used. The following example illustrates the principles of this Q/A-16:

Example. (i) Company C in City X sells mass transit vouchers to employers in the metropolitan area of X worth $65 each. Several different bus, rail, van pool, and ferry operators service X, and a number of the operators accept the vouchers either as fare media or in exchange for fare media. Employers can readily obtain vouchers for distribution to their employees. To cover its operating expenses, C imposes on each voucher a 50 cents charge, plus a $15 charge for delivery. Employer M disburses vouchers purchased from C to its employees who use operators that accept the vouchers.

(ii) In this example, because the cost of a voucher disbursed to M's employees is not more than 1 percent of the value of the voucher (50 cents divided by $65 equals 0.77 percent) and the delivery charges are disregarded because they are not more than $15, vouchers for X are readily available. Thus, the vouchers disbursed to M's employees are qualified transportation fringes and any reimbursement of mass transportation costs in X would not be a qualified transportation fringe.

(d) *Substantiation requirements*. Employers that make cash reimbursements must establish a bona fide reimbursement arrangement to establish that their employees have, in fact, incurred expenses for transportation in a commuter highway vehicle, transit passes, or qualified parking. For purposes of section 132(f), what constitutes a bona fide reimbursement arrangement may vary depending on the facts and circumstances, including the method or methods of payment utilized within the mass transit system. The employer must implement reasonable procedures to ensure that an amount equal to the reimbursement was incurred for transportation in a commuter highway vehicle, transit passes, or qualified parking. The following are examples of reasonable reimbursement procedures for purposes of this Q/A-16:

(1) An employee presents to the employer a parking expense receipt for parking on or near the employer's business premises and certifies that the parking was used by the employee and the employer has no reason to doubt the employee's certification.

(2) An employee submits a used transit pass to the employer at the end of the month and certifies both that he or she purchased it, and that he or she used it during the month, or presents a transit pass to the employer at the beginning of the month and certifies that it will be used it during the month. In both cases, the employer has no reason to doubt the employee's certification.

(3) If a receipt is not provided in the ordinary course of business (e.g., if the employee uses metered parking or if used transit passes cannot be returned to the user), the employee certifies to the employer the type and the amount of expenses incurred and the employer has no reason to doubt the employee's certification.

Q-17. May an employer provide nontaxable cash reimbursement under section 132(f) for periods longer than one month?

A-17. Yes. Qualified transportation fringes include reimbursement to employees for costs incurred for transportation in more than one month, provided the reimbursement for each month is calculated separately and does not exceed the applicable statutory monthly limit for any month. See Q/A-8 and 9 of this section if the limit for a month is exceeded. The following example illustrates the principles of this Q/A-17:

Example. (i) Employee R pays $100 per month for qualified parking used during the period from April 1, 2000 through June 30, 2000. After receiving adequate substantiation from R, R's employer reimburses R $300 in cash on June 30, 2000.

(ii) In this example, because the value of the reimbursed expenses for each month did not exceed the applicable statutory monthly limit, the $300 reimbursement is excludable from R's wages for income and employment tax purposes as a qualified transportation fringe.

Q-18. What are the substantiation requirements if an employer distributes transit passes?

A-18. There are no substantiation requirements if the employer distributes transit passes. Thus, an employer may distribute a transit pass for each month with a value not more than the statutory monthly limit without requiring any certification from the employee regarding the use of the transit pass.

Q-19. May an employer choose to impose substantiation requirements in addition to those described in this regulation?

A-19. Yes.

Q-20. How is the value of parking determined?

A-20. Section 1.61–21(b)(2) applies for purposes of determining the value of parking.

Q-21. How do the qualified transportation fringe rules apply to van pools?

A-21. (a) *Van pools generally*. Employer- and employee-operated van pools, as well as private or public transit-operated van pools, may qualify as qualified transportation fringes. The value of van pool benefits which are qualified transportation fringes may be excluded up to the applicable statutory monthly limit for transportation in a commuter highway vehicle and transit passes, less the value of any transit passes provided by the employer for the month.

(b) *Employer-operated van pools*. The value of van pool transportation provided by or for an employer to its employees is excludable as a qualified transportation fringe, provided the van qualifies as a "commuter highway vehicle" as defined in section 132(f)(5)(B) and Q/A–2 of this section. A van pool is operated by or for the employer if the employer purchases or leases vans to enable employees to commute together or the employer contracts with and pays a third party to provide the vans and some or all of the costs of operating the vans, including maintenance, liability insurance and other operating expenses.

(c) *Employee-operated van pools*. Cash reimbursement by an employer to employees for expenses incurred for transportation in a van pool operated by employees independent of their employer are excludable as qualified transportation fringes provided that the van qualifies as a "commuter highway vehicle" as defined in section 132(f)(5)(B) and Q/A-2 of this section. See Q/A-16 of this section for the rules governing cash reimbursements.

(d) *Private or public transit-operated van pool transit passes*. The qualified transportation fringe exclusion for transit passes is available for travel in van pools owned and operated either by public transit authorities or by any person in the business of transporting persons for compensation or hire. In accordance with paragraph (b) of Q/A-3 of this section, the van must seat at least six adults (excluding the driver). See Q/A-16(b) and (c) of this section for a special rule for cash reimbursement for transit passes.

(e) *Value of van pool transportation benefits*. *Section* 1.61–21(b)(2) provides that the fair market value of a fringe benefit is based on all the facts and circumstances. Alternatively, transportation in an employer-provided commuter highway vehicle may be valued under the automobile lease valuation rule in § 1.61–21(d), the vehicle cents-per-mile rule in § 1.61–21(e), or the commuting valuation rule in § 1.61–21(f). If one of these special valuation rules is used, the employer must use the same valuation rule to value the use of the commuter highway vehicle by each employee who share the use. See § 1.61–21(c).

(f) *Qualified parking prime member*. If an employee obtains a qualified parking space as a result of membership in a car or van pool, the applicable statutory monthly limit for qualified parking applies to the individual to whom the parking space is assigned. This individual is the "prime member." In determining the tax consequences to the prime member, the statutory monthly limit amounts of each car pool member may not be combined. If the employer provides access to the space and the space is not assigned to a particular individual, then the employer must designate one of its employees as the prime member who will bear the tax consequences. The employer may not designate more than one prime member for a car or van pool during a month. The employer of the prime member is responsible for including the value of the qualified parking in excess of the statutory monthly limit in the prime member's wages for income and employment tax purposes.

Q-22. What are the reporting and employment tax requirements for qualified transportation fringes?

A-22. (a) *Employment tax treatment generally*. Qualified transportation fringes not exceeding the applicable statutory monthly limit described in Q/A-7 of this section are not wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding. Any amount by which an employee elects to reduce compensation as provided in Q/A-11 of this section is not subject to the FICA, the FUTA, and federal income tax withholding. Qualified transportation fringes exceeding the applicable statutory monthly limit described in Q/A-7 of this section are wages for purposes of the FICA, the FUTA, and federal income tax withholding and are reported on the employee's Form W-2, Wage and Tax Statement.

(b) *Employment tax treatment of cash reimbursement exceeding monthly limits*. Cash reimbursement to employees (for example, cash reimbursement for qualified parking) in excess of the applicable statutory monthly limit under section 132(f) are treated as paid for employment tax purposes when actually or constructively paid. See §§ 31.3121(a)–2(a), 31.3301–4, 31.3402(a)–1(b) of this chapter. Employers must report and deposit the amounts withheld in addition to reporting and depositing other employment taxes. See Q/A-16 of this section for rules governing cash reimbursements.

(c) *Noncash fringe benefits exceeding monthly limits*. If the value of noncash qualified transportation fringes exceeds the applicable statutory monthly limit, the employer may elect, for purposes of the FICA, the FUTA, and federal income tax withholding, to treat the noncash taxable fringe benefits as paid on a pay period, quarterly, semi-annual, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually.

Q–23. How does section 132(f) interact with other fringe benefit rules?

A-23. For purposes of section 132, the terms "working condition fringe" and "de minimis fringe" do not include any qualified transportation fringe under section 132(f). If, however, an employer provides local transportation other than transit passes, the value of the benefit may be excludable, either totally or partially, under fringe benefit rules other than the qualified transportation fringe rules under section 132(f). See §§ 1.132–6(d)(2)(i) (occasional local transportation fare), 1.132–6(d)(2)(iii) (transportation provided under unusual circumstances), and 1.61–21(k) (valuation of local transportation provided to qualified employees).

Q-24. May qualified transportation fringes be provided to individuals who are partners, 2-percent shareholders of S-corporations, or independent contractors?

A-24. (a) *General rule*. Section 132(f)(5)(E) states that self-employed individuals who are employees within the meaning of section 401(c)(1) are not employees for purposes of section 132(f). Therefore, individuals who are partners, sole proprietors, or other independent contractors are not employees for purposes of section 132(f). In addition, under section 1372(a), 2-percent shareholders of S corporations are treated as partners for fringe benefit purposes. Thus, an individual who is both a 2-percent shareholder of an S corporation and a common law employee of that S corporation is not considered an employee for purposes of section 132(f). However, while section 132(f) does not apply to individuals who are partners, 2-percent shareholders of S corporations, or independent contractors, other exclusions for working condition and de minimis fringes may be available as described in paragraphs (b) and (c) of this Q/A-24. See §§ 1.132–1(b)(2) and 1.132–1(b)(4).

(b) *Transit passes*. The working condition and de minimis fringe exclusions under section 132(a)(3) and (4) are available for transit passes provided to individuals who are partners, 2-percent shareholders, and independent contractors. For example, tokens or farecards provided by a partnership to an individual who is a partner that enable the partner to commute on a public transit system (not including privately-operated van pools) are excludable from the partner's gross income if the value of the tokens and farecards in any month does not exceed the dollar amount specified in § 1.132–6(d)(1). However, if the value of a pass provided in a month exceeds the dollar amount specified in § 1.132–6(d)(1), the full value of the benefit provided (not merely the amount in excess of the dollar amount specified in § 1.132–6(d)(1)) is includible in gross income.

(c) *Parking*. The working condition fringe rules under section 132(d) do not apply to commuter parking. See § 1.132–5(a)(1). However, the de minimis fringe rules under section 132(e) are available for parking provided to individuals who are partners, 2-percent shareholders, or independent contractors that qualifies under the de minimis rules. See § 1.132–6(a) and (b). The following example illustrates the principles of this Q/A-24:

Example. (i) Individual G is a partner in partnership P. Individual G commutes to and from G's office every day and parks free of charge in P's lot.

(ii) In this example, the value of the parking is not excluded under section 132(f), but may be excluded under section 132(e) if the parking is a de minimis fringe under § 1.132–6.

Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

(Filed by the Office of the Federal Register on January 24, 2000, 1:36 p.m., and published in the issue of the Federal Register for January 27, 2000, 65 F.R. 4388)

Notice of Proposed Rulemaking and Notice of Public Hearing

Applying Section 197 to Partnerships

REG–100163–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the amortization of certain intangible property to partnership transactions involving sections 732(b) and 734(b). The proposed regulations interpret the provisions of section 197(f)(9), reflecting changes to the law made by the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) and affect taxpayers who acquired intangible property after August 10, 1993, or made a retroactive election to apply OBRA '93 to intangibles acquired after July 25, 1991. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by April 24, 2000. Outlines of topics to be discussed at the public hearing scheduled for May 24, 2000, at 10 a.m. must be received by May 3, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–100163–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–100163–00), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/regslist.html. The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Robert G. Honigman, (202) 622-3050; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing Guy Traynor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

This document proposes to amend section 197 of the Income Tax Regulations (26 CFR Part 1) to provide additional rules regarding the application of section 197(f)(9) to partnership transactions under sections 732(b) and 734(b).

Background

On January 16, 1997, the IRS published proposed regulations REG–209709–94, 1997–1 C.B. 731, in the **Federal Register** (62 F.R. 2336) inviting comments under sections 167(f) and 197, including the anti-churning rules in section 197(f)(9). Commentators requested that the final regulations provide additional guidance on how the special anti-churning rule of section 197(f)(9)(E) applies to increases in the basis of partnership property under sections 732, 734, and 743. In accordance with these comments, these proposed regulations provide rules for determining the amount of a basis adjustment under sections 732(b) and 734(b) that will be subject to the anti-churning rules. Final regulations being issued in T.D. 8865 at the same time as these proposed regulations provide rules for determining the amount of a basis adjustment under sections 732(d) and 743(b) that will be subject to the anti-churning rules.

Explanation of Provisions

A. *In General*

Section 197(f)(9)(E) provides that, in applying the anti-churning rules for basis adjustments under sections 732, 734, and 743, determinations are made at the partner level, and each partner is treated as having owned and used such partner's proportionate share of the partnership's assets. With respect to basis adjustments under sections 732(b) and 734(b), this rule requires taxpayers and the IRS to analyze transactions that actually involve a distribution of property from the partnership to a partner as deemed transactions involving transfers of property directly among the partners.

B. *Two-Step Analysis*

The proposed regulations embody a two-step analysis in determining whether the anti-churning rules apply to the deemed transfer of intangibles in transactions giving rise to basis adjustments under sections 732(b) and 734(b). First, it is necessary to determine whether the portion of an intangible that a partner is deemed to transfer is treated, immediately prior to the deemed transfer, as being subject to the anti-churning rules for purposes of applying these provisions. Second, if the partner's share of the intangible is treated, immediately prior to the deemed transfer, as being subject to the anti-churning rules for purposes of applying these provisions, it is necessary to determine whether the deemed transferor and transferee are related so that the anti-churning rules will continue to apply to the intangible after the deemed transfer.

For purposes of applying the first prong of the analysis, when a partner acquires an interest in a partnership, the proposed regulations treat the partner as acquiring an undivided interest in all section 197(f)(9) intangibles held by a partnership at the time that the partner acquires an interest in the partnership. If a partner acquires an interest in a partnership from an unrelated person after August 10, 1993 (or, in certain cases, after July 25, 1991), the partner's share of any intangible held by the partnership as of August 10, 1993 (or, in certain cases, after July 25, 1991) is treated as no longer subject to the anti-churning rules for purposes of analyzing subsequent deemed transfers of intangibles in transactions that give rise to the basis adjustments under sections 732(b) and 734(b). With respect to intangibles acquired by the partnership after August 10, 1993, that are subject to the anti-churning rules in the hands of the partnership, a partner's share of the intangible is treated as not subject to the anti-churning rules for purposes of analyzing these basis adjustments if the partner acquired the interest in the partnership from an unrelated person after the partnership acquired the tainted intangible. Once a partner's share of an intangible is treated as no longer subject to the anti-churning rules for purposes of analyzing subsequent deemed transfers, that share of the intangible will remain untainted even if the partner transfers the interest to the original transferor or a person who is related to the original transferor, so long as the transfers are not part of the same transaction or series of related transactions. Special rules are provided where a partner acquires a partnership interest in exchange for property contributed to a partnership.

For purposes of applying the anti-churning rules to basis adjustments under section 732(b), the distributee partner is deemed to acquire the distributed intangible directly from the continuing partners of the distributing partnership. The proposed regulations contain a favorable stacking rule that treats the distributee partner as acquiring the intangible first from the continuing partners for whom transfers would not be subject to the anti-churning rules (either because the continuing partner's share of the intangible is treated, for purposes of this rule, as not being subject to the anti-churning rules or the distributee partner is not related to the continuing partner) to the extent of such partners' share of appreciation in the intangible.

The proposed regulations contain a special rule to ensure that, in analyzing subsequent transfers, a partner cannot treat the entire intangible as no longer subject to the anti-churning rules simply because the full basis of the intangible (which may be significantly less than the intangible's fair market value) becomes amortizable as a result of the favorable stacking rule that applies to section 732(b) basis adjustments.

For purposes of applying the anti-churning rules to basis adjustments under section 734(b), the continuing partners are deemed to acquire interests in the intangible that remains in the partnership from the partner who received a distribution (giving rise to the section 734(b) basis adjustment) of property other than the intangible. To the extent that the distributee partner could transfer the intangible directly to a continuing partner (who may be the distributee partner) and the transfer would not be subject to the anti-churning rules (either because the distributee partner's share of the intangible is treated (for purposes of this rule) as not being subject to the anti-churning rules or the continuing partner is not related to the distributee (except in certain circumstances)), the basis adjustment will be amortizable with respect to the continuing partner.

The proposed regulations contain a special rule which provides that if a distribution that gives rise to an increase in the basis under section 734(b) of a section 197(f)(9) intangible held by the partnership is undertaken as part of a series of related transactions that include a contribution of the intangible to the partnership by a continuing partner, the continuing partner is treated as related to the distributee partner to the extent that the continuing partner's partnership interest was received in exchange for the intangible.

In addition to issues relating to determining the amount of a basis adjustment that is subject to the anti-churning rules, the Treasury Department and the IRS also recognize that certain problems may arise in maintaining capital accounts where a portion of a section 734(b) adjustment is allocated to an intangible that is subject to the anti-churning rules with respect to one or more partners. In some situations, the failure to allocate deductions for amortization to any partner whose allocable share of a section 734(b) adjustment is subject to the anti-churning rules will distort the partners' economic agreement. For example, where partners agree to share depreciation and amortization deductions equally, if one partner's share of a section 734(b) adjustment allocable to an intangible asset is subject to the anti-churning rules, the capital accounts of the partners will not reflect an equivalent sharing of the economic amortization from the asset absent special adjustments to account for the disparity between the allocation of tax amortization and the intended allocation of economic amortization. Furthermore, divergence of book and tax accounts with respect to an intangible that may result from such special adjustments can cause problems in allocating the correct amount of taxable gain or loss to the appropriate parties upon disposition of the intangible. Similar problems may arise as a result of allowing remedial allocations for intangibles that otherwise are subject to the anti-churning rules and are addressed in §1.197–2(h)(12)(vii)(B). These regulations are not intended to create such distortions. Nevertheless, a general rule that resolves these distortions in all situations (including different allocations of gain and depreciation or amortization) would be extremely complicated and, perhaps, unduly narrow. Therefore, the proposed regulations provide that taxpayers may use any reasonable method to determine amortization for book purposes in these situations, provided that the method used does not contravene the purposes of the anti-churning rules under section 197 (i.e., the effect of the book adjustments will not be such that a partner who is subject to the anti-churning rules will receive, directly or indirectly, deductions for amortization, for Federal income tax purposes, attributable to the section 734(b) adjustment). The Treasury Department and IRS may consider providing guidance with respect to this issue in the future and request comments relating thereto.

C. *Effective Date*

These regulations are proposed to apply to distributions occurring on or after the date final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

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

A public hearing has been scheduled for May 24, 2000, at 10 a.m. in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

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

Persons that wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time devoted to each topic (signed original and eight (8) copies) by April 24, 2000.

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

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

Drafting Information

The principal author of these proposed regulations is Robert G. Honigman, Office of the Assistant Chief Counsel (Passthroughs & Special Industries). However, other personnel from the Treasury Department and IRS 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 1.197–2 is amended by:

1. Revising paragraphs (h)(12)(ii), (h)(12)(iv), and (h)(12)(vi).

2. Adding *Examples 28*, *29*, and *30* to paragraph (k).

3. Adding a sentence at the end of paragraph (l)(1).

The additions and revisions read as follows:

§1.197–2 Amortization of goodwill and other intangibles.

* * * * *

(h) * * *

(12) * * *

(ii) *Section 732(b) adjustments* — (A) *In general*. The anti-churning rules of this paragraph (h) apply to any increase in the adjusted basis of a section 197(f)(9) intangible under section 732(b) to the extent that the basis increase exceeds the total unrealized appreciation from the intangible allocable to –

(*1*) Partners other than the distributee partner or persons related to the distributee partner;

(*2*) If the distributed intangible is a section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, the distributee partner and persons related to the distributee partner to the extent that –

(*i*) They acquired an interest or interests in the partnership after August 10, 1993; and

(*ii*) Such interest or interests were held after August 10, 1993, by a person or persons other than the distributee partner or persons who were related to the distributee partner, and the acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest or interests; and

(*3*) If the distributed intangible is a section 197(f)(9) intangible that is acquired by the partnership after August 10, 1993, and that is not amortizable with respect to the partnership, the distributee partner and persons related to the distributee partner to the extent that –

(*i*) They acquired an interest or interests in the partnership after the partnership acquired the distributed intangible; and

(*ii*) Such interest or interests were held after the partnership acquired the distributed intangible, by a person or persons other than the distributee partner or persons who were related to the distributee partner, and the acquisition of such interest or interests by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest or interests.

(B) *Effect of retroactive elections*. For purposes of paragraph (h)(12)(ii)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the relevant party made a valid retroactive election under §1.197–1T.

(C) *Intangible still subject to anti-churning rules*. Notwithstanding paragraph (h)(12)(ii) of this section, in applying the provisions of this paragraph (h) with respect to subsequent transfers, the distributed intangible remains subject to the provisions of this paragraph (h) in a percentage (determined at the time of the distribution) equal to –

(*1*) The sum of –

(*i*) The amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section; and

(*ii*) The total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply; over –

(*2*) The fair market value of such intangible.

(D) *Partner's allocable share of unrealized appreciation from the intangible*. The amount of unrealized appreciation from an intangible that is allocable to a partner is the amount of taxable gain that would have been allocated to that partner if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction.

(E) *Acquisition of partnership interest by contribution*. Solely for purposes of paragraphs (h)(12)(ii)(A)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership. However, if the partner contributed the distributed section 197(f)(9) intangible to the partnership, the interest acquired by such partner in exchange for the intangible is treated as not being described in paragraphs (h)(12)(ii)(A)(*2*) or (*3*) of this section.

* * * * *

(iv) *Section 734(b) adjustments* — (A) *In general*. The anti-churning rules of this paragraph (h) do not apply to a continuing partner's share of an increase in the basis of a section 197(f)(9) intangible held by a partnership under section 734(b) to the extent that the continuing partner is an eligible partner.

(B) *Eligible partner*. For purposes of this paragraph (h)(12)(iv), eligible partner means –

(*1*) A continuing partner that is not the distributee partner or a person related to the distributee partner;

(*2*) With respect to any section 197(f)(9) intangible acquired by the partnership on or before August 10, 1993, a continuing partner that is the distributee partner or a person related to the distributee partner to the extent that –

(*i*) The distributee partner's interest in the partnership was acquired after August 10, 1993; and

(*ii*) Such interest was held after August 10, 1993 by a person or persons who were not related to the distributee partner, and the acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest; or

(*3*) With respect to any section 197(f)(9) intangible acquired by the partnership after August 10, 1993, that is not amortizable with respect to the partnership, a continuing partner that is the distributee partner or a person related to the distributee partner to the extent that –

(*i*) The distributee partner's interest in the partnership was acquired after the partnership acquired the relevant intangible; and

(*ii*) Such interest was held after the partnership acquired the relevant intangible by a person or persons who were not related to the distributee partner, and the acquisition of such interest by such person or persons was not part of a transaction or series of related transactions in which the distributee partner or persons related to the distributee partner subsequently acquired such interest.

(C) *Effect of retroactive elections*. For purposes of paragraph (h)(12)(iv)(A) of this section, references to August 10, 1993, are treated as references to July 25, 1991, if the distributee partner made a valid retroactive election under §1.197–1T.

(D) *Partner's share of basis increase*. For purposes of this paragraph (h)(12)(iv), a continuing partner's share of a basis increase is equal to –

(*1*) The total basis increase allocable to the intangible; multiplied by

(*2*) A fraction equal to –

(*i*) The unrealized appreciation from the intangible that would have been allocated to the continuing partner if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction; over

(*ii*) The total unrealized appreciation from the intangible that would have been realized by the partnership if the partnership had sold the intangible immediately before the distribution for its fair market value in a fully taxable transaction.

(E) *Interests acquired by contribution*— (*1*) *Application of paragraphs (h)(12)(iv)(B)(2) and (3) of this section*. Solely for purposes of paragraphs (h)(12)(iv)(B)(*2*) and (*3*) of this section, a partner who acquires an interest in a partnership in exchange for a contribution of property to the partnership is deemed to acquire a pro rata portion of that interest in the partnership from each person who is a partner in the partnership at the time of the contribution based on each such partner's proportionate interest in the partnership. However, if the partner contributed the distributed section 197(f)(9) intangible to the partnership, the interest acquired by such partner in exchange for the intangible is treated as not being described in paragraphs (h)(12)(iv)(B)(*2*) or (*3*) of this section.

(*2*) *Special rule with respect to paragraph (h)(12)(iv)(B)(1) of this section*. Solely for purposes of paragraph (h)(12)(iv)(B)(*1*) of this section, if a distribution that gives rise to an increase in the basis under section 734(b) of a section 197(f)(9) intangible held by the partnership is undertaken as part of a series of related transactions that include a contribution of the intangible to the partnership by a continuing partner, the continuing partner is treated as related to the distributee partner to the extent that the continuing partner's partnership interest was received in exchange for the intangible.

(F) *Effect of section 734(b) adjustment on partners' capital accounts*. If one or more partners are subject to the anti-churning rules under this paragraph (h) with respect to a section 734(b) adjustment allocable to an intangible asset, taxpayers may use any reasonable method to determine amortization of the asset for book purposes, provided that the method used does not contravene the purposes of the anti-churning rules under section 197 and this paragraph (h). A method will be considered to contravene the purposes of the anti-churning rules if the effect of the book adjustments resulting from the method is such that any portion of the tax deduction for amortization attributable to the section 734 adjustment is allocated, directly or indirectly, to a partner who is subject to the anti-churning rules with respect to such adjustment.

* * * * *

(vi) *Partner is or becomes a user of partnership intangible* — (A) *General rule.* If, as part of a series of related transactions that includes a transaction described in paragraph (h)(12)(ii), (iii), (iv), or (v) of this section, an anti-churning partner becomes (or remains) a user of an intangible that is treated as transferred in the transaction (as a result of the partners being treated as having owned their proportionate share of partnership assets), the anti-churning rules shall apply to the proportionate share of such intangible that is treated as transferred by the anti-churning partner, notwithstanding the application of paragraph (h)(12)(ii), (iii), (iv), or (v) of this section.

* * * * *

(k) * * *

Example 28. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest prior to the effective date. (i) In 1990, A, B, and C each contribute $150 cash to form general partnership ABC for the purpose of engaging in a consulting business and a software manufacturing business. The partners agree to share partnership profits and losses equally. In 2000, the partnership distributes the consulting business to A in liquidation of A's entire interest in ABC. The only asset of the consulting business is a nonamortizable intangible, which has a fair market value of $180 and a basis of $0. At the time of the distribution, the adjusted basis of A's interest in ABC is $150. A is not related to B or C.

(ii) Under section 732(b), A's adjusted basis in the intangible distributed by ABC is $150, a $150 increase over the basis of the intangible in ABC's hands. In determining whether the anti-churning rules apply to any portion of the basis increase, A is treated as having owned and used A's proportionate share of partnership property. Thus, A is treated as holding an interest in the intangible during the transition period. Because the intangible was not amortizable prior to the enactment of section 197, the section 732(b) increase in the basis of the intangible may be subject to the anti-churning provisions. Paragraph (h)(12)(ii) of this section provides that the anti-churning provisions apply to the extent that the section 732(b) adjustment exceeds the total unrealized appreciation from the intangible allocable to partners other than A or persons related to A, as well as certain other partners whose purchase of their interests meet certain criteria. Because B and C are not related to A, and A's acquisition of its partnership interest does not satisfy the necessary criteria, the section 732(b) basis increase is subject to the anti-churning provisions to the extent that it exceeds B and C's proportionate share of the unrealized appreciation from the intangible. B and C's proportionate shares of the unrealized appreciation from the intangible is $120 (2/3 of $180). This is the amount of gain that would be allocated to B and C if the partnership sold the intangible immediately before the distribution for its fair market value of $180. Therefore, $120 of the section 732(b) basis increase is not subject to the anti-churning rules. The remaining $30 of the section 732(b) basis increase is subject to the anti-churning rules. Accordingly, A is treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $120 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $30.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-third of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 - $120 = $60), over the fair market value of the distributed intangible ($180).

Example 29. Distribution of section 197(f)(9) intangible to partner who acquired partnership interest after the effective date. (i) The facts are the same as in example 28, except that B and C form ABC in 1990. A does not acquire an interest in ABC until 1995. In 1995, A contributes $150 to ABC in exchange for a one-third interest in ABC. At the time of the distribution, the adjusted basis of A's interest in ABC is $150.

(ii) As in *Example 28*, the anti-churning rules do not apply to the increase in the basis of the intangible distributed to A under section 732(b) to the extent that it does not exceed the unrealized appreciation from the intangible allocable to B and C. Under paragraph (h)(12)(ii) of this section, the anti-churning provisions also do not apply to the section 732(b) basis increase to the extent of A's allocable share of the unrealized appreciation from the intangible because A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by the partnership before A acquired the ABC interest. Under paragraph (h)(12)(ii)(E) of this section, A is deemed to acquire the ABC partnership interest from an unrelated person because A acquired the ABC partnership interest in exchange for a contribution to the partnership of property other than the distributed intangible and, at the time of the contribution, no partner in the partnership was related to A. Consequently, the increase in the basis of the intangible under section 732(b) is not subject to the anti-churning rules to the extent of the total unrealized appreciation from the intangible allocable to A, B, and C. The total unrealized appreciation from the intangible allocable to A, B, and C is $180 (the gain the partnership would have recognized if it had sold the intangible for its fair market value immediately before the distribution). Because this amount exceeds the section 732(b) basis increase of $150, the entire section 732(b) basis increase is amortizable.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-sixth of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($0) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($180 - $150 = $30), over the fair market value of the distributed intangible ($180).

Example 30. Distribution of section 197(f)(9) intangible contributed to the partnership by a partner. (i) The facts are the same as in *Example 29*, except that C purchased the intangible used in the consulting business in 1988 for $60 and contributed the intangible to ABC in 1990. At that time, the intangible had a fair market value of $150 and an adjusted tax basis of $60. When ABC distributes the intangible to A in 2000, the intangible has a fair market value of $180 and a basis of $60.

(ii) As in *Examples 28* and *29*, the adjusted basis of the intangible in A's hands is $150 under section 732(b). However, the increase in the adjusted basis of the intangible under section 732(b) is only $90 ($150 adjusted basis after the distribution compared to $60 basis before the distribution). Pursuant to paragraph (g)(2)(ii)(B) of this section, A steps into the shoes of ABC with respect to the $60 of A's adjusted basis in the intangible that corresponds to ABC's basis in the intangible and this portion of the basis is nonamortizable. B and C are not related to A, A acquired the ABC interest from an unrelated person after August 10, 1993, and the intangible was acquired by ABC before A acquired the ABC interest. Therefore, under paragraph (h)(12)(ii) of this section, the section 732(b) basis increase is amortizable to the extent of A, B, and C's allocable share of the unrealized appreciation from the intangible. The total unrealized appreciation from the intangible that is allocable to A, B, and C is $120. If ABC had sold the intangible immediately before the distribution to A for its fair market value of $180, it would have recognized gain of $120, which would have been allocated $10 to A, $10 to B, and $100 to C under section 704(c). Because A, B, and C's allocable share of the unrealized appreciation from the intangible exceeds the section 732(b) basis increase in the intangible, the entire $90 of basis increase is amortizable by A. Accordingly, after the distribution, A will be treated as having two intangibles, an amortizable section 197 intangible with an adjusted basis of $90 and a new amortization period of 15 years and a nonamortizable intangible with an adjusted basis of $60.

(iii) In applying the anti-churning rules to future transfers of the distributed intangible, under paragraph (h)(12)(ii)(C) of this section, one-half of the intangible will continue to be subject to the anti-churning rules, determined as follows: The sum of the amount of the distributed intangible's basis that is nonamortizable under paragraph (g)(2)(ii)(B) of this section ($60) and the total unrealized appreciation inherent in the intangible reduced by the amount of the increase in the adjusted basis of the distributed intangible under section 732(b) to which the anti-churning rules do not apply ($120 - $90 = $30), over the fair market value of the distributed intangible ($180).

* * * * *

(l) * * *

(1) *In general*. * * * Paragraphs (h)(12)(ii), (iv), and (vi) of this section apply to partnership distributions occurring on or after the date final regulations are published in the **Federal Register**.

* * * * *

David Mader,

Acting Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 20, 2000, 1:19 p.m., and published in the issue of the Federal Register for January 25, 2000, 65 F.R. 3903)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

Bulletins 2000–1 through 2000–6

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1999–27 through 1999–52 is in Internal Revenue Bulletin 2000–1, dated January 3, 2000.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 1999–27 through 1999–52 is in Internal Revenue Bulletin 2000–1, dated January 3, 2000.

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