Internal Revenue bulletin

Bulletin No. 2004-51
December 20, 2004

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.

SPECIAL ANNOUNCEMENT

Announcement 2004–102, page 1023.

This document contains a correction to the dates in the Highlight for the public hearings on the Advance Pricing Agreement (APA) Program for Announcement 2004–98, 2004–50 I.R.B. 983. The correct dates are February 1, 2005 and February 22, 2005. The Highlight for Announcement 2004–98 is corrected.

INCOME TAX

Rev. Rul. 2004–111, page 989.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 2005, will be 5 percent for overpayments (4 percent in the case of a corporation), 5 percent for underpayments, and 7 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 2.5 percent.

REG–145535–02, page 1002.

Proposed regulations define the terms predecessor and successor for purposes of section 355(e) of the Code. These regulations provide guidance in determining whether a corporation is a predecessor or successor of a distributing or controlled corporation, as well as rules to assist taxpayers in determining whether an acquisition of an interest in a corporation would cause a distributing corporation to recognize gain under section 355(e). The regulations affect corporations that distribute the stock of controlled corporations in distributions described in section 355.

REG–149519–03, page 1009.

Proposed regulations under section 707 of the Code provide guidance relating to the treatment of transactions between a partnership and its partners as disguised sales of partnership interests between partners. The regulations describe circumstances in which a transfer of consideration (including the assumption of a liability) by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner constitute a sale of a partnership interest. In addition, the proposed rules require disclosure of certain transfers and assumptions of liabilities to the Service. A public hearing is scheduled for March 8, 2005.

EMPLOYEE PLANS

Notice 2004–82, page 998.

Weighted average interest rate update; corporate bond indices; 30–year Treasury securities. The weighted average interest rate for December 2004 and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution are set forth.

(Continued on the next page)

Announcement of Declaratory Judgment Proceedings Under Section 7428 begins on page 1023.
Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

EXEMPT ORGANIZATIONS

Rev. Rul. 2004–112, page 985.

Internet activities. In one situation, the Internet activities conducted by a trade association described in section 501(c)(6) of the Code on a special supplementary section of its Internet website do not constitute unrelated trade or business under section 513(a), because such activities meet the exception for qualified convention and trade show activity under section 513(d)(3)(B). However, in a second situation, the Internet activities of another trade association do not meet the section 513(d)(3)(B) exception.

EMPLOYMENT TAX

T.D. 9162, page 987.

Final regulations under section 6302 of the Code change the accumulated amount of tax liability above which taxpayers must begin depositing federal unemployment taxes. The regulations affect employers that have an accumulated FUTA tax liability of $500 or less.

Notice 2004–81, page 996.

This notice provides tables that show the amount of an individual's income that is exempt from a notice of levy used to collect delinquent tax in 2005.

ADMINISTRATIVE

Rev. Proc. 2004–73, page 999.

This procedure provides guidance concerning when information shown on a return in accordance with the applicable forms and instructions will be adequate disclosure for purposes of reducing an understatement of income tax under sections 6662(d) and 6694(a) of the Code. Rev. Proc. 2003–77 updated.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

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

Section 513.—Unrelated Trade or Business

26 CFR 1.513–3: Qualified convention and trade show activity.

Internet activities. In one situation, the Internet activities conducted by a trade association described in section 501(c)(6) of the Code on a special supplementary section of its Internet website do not constitute unrelated trade or business under section 513(a), because such activities meet the exception for qualified convention and trade show activity under section 513(d)(3)(B). However, in a second situation, the Internet activities of another trade association do not meet the section 513(d)(3)(B) exception.

Rev. Rul. 2004–112

ISSUE

Under the circumstances described below, do Internet activities conducted by trade associations described in § 501(c)(6) of the Internal Revenue Code fall within the specific exception for qualified convention and trade show activity under § 513(d)(3)(B)?

FACTS

Situation 1. *A* is a trade association that is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(6). *A* improves business conditions in a certain industry and serves members that are part of this industry. *A*'s purposes include supporting and enhancing activities within the industry, acting as a spokesperson for the industry, providing members with current information on technical developments, training methods, and economic issues, encouraging and fostering higher safety and technical standards, promoting technological advancements and improvements, and gathering and disseminating information about markets and products.

A conducts, as one of its substantial exempt purposes, semi-annual trade shows to promote and stimulate interest in and demand for the products of *A*'s industry. Each trade show typically occurs at an exhibition facility, during a period of ten consecutive days. *A* undertakes the planning and direction of the show, secures the facility, and charges exhibitors a fee for use of space at the show. At each trade show, *A* sponsors conferences and seminars, and *A*'s members and suppliers to *A*'s industry display their products and services. The conferences, seminars, and exhibits offer a wide variety of information on products and developments in the industry. Sales and order taking are permitted. *A*'s members, nonmembers, and potential customers attend the shows. Revenues from the shows are used by *A* to defray the shows' operating costs, and any excess of revenues over expenditures is used in furtherance of *A*'s exempt purposes.

To serve its members throughout the year, *A* maintains a website with a variety of information, including dates, locations, and advance ticket information about *A*'s trade shows. In addition, in conjunction with each semi-annual trade show, *A* adds a section to its website that augments and enhances the trade show by allowing members and the interested public to access in an alternative medium the same information that is available at the show. The section contains information and visual displays, such as product directories and specific product listings, and links to the websites of exhibitors represented at the trade show, including members of *A* and those who are suppliers of goods and services to *A*'s members. The section also contains order forms, and a function that allows on-line purchases from members and suppliers represented at the trade show. The supplementary section of the website typically is available on-line during the ten-day period in which the semi-annual trade show occurs, and during a three-day period prior to the beginning of the show and a three-day period subsequent to the end of the show. At the end of the final three-day period, the supplementary section is removed from the website. *A* charges a fee to exhibitors who wish to have information listed on the supplementary section of the website. *A* controls all the website's content.

Situation 2. *B* is a trade association that is exempt from federal income tax under § 501(a) as an organization described in § 501(c)(6), and whose purposes are the same as those of *A*. *B* establishes an Internet website that it makes available to the general public 24 hours a day, 7 days a week for a two-week period. At the end of the two-week period, the website is taken down. The two-week period does not overlap or coincide with any international, national, State, regional, or local convention, annual meeting, or show conducted by *B*.

Like the website operated by *A*, *B*'s website permits members and the interested public to access information and visual displays, such as product directories and specific product listings. The website contains links to the websites of members of *B* and those who are suppliers of goods and services to *B*'s members. The website also contains order forms, and a function that allows on-line purchases from members and suppliers appearing on the website. *B* charges a fee to those who wish to have information listed on the website. *B* controls all the website's content.

LAW

Section 501(c)(6), in part, provides for the exemption from federal income tax of business leagues, chambers of commerce or boards of trade not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)–1 of the Income Tax Regulations, in part, provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. The regulation provides that organizations otherwise exempt from tax under § 501(c) are taxable on their unrelated business taxable income.

Section 511(a) provides for the imposition of tax on the unrelated business taxable income (as defined in § 512) of organizations described in § 501(c)(6).

Section 512(a)(1) defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less certain deductions, but with the modifications provided in § 512(b).

Section 513(a) defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under § 501.

Section 513(c) defines the term "trade or business" broadly to include any activity that is carried on for the production of income from the sale of goods or the performance of services. For purposes of § 513(c), an activity, such as advertising, does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors that may, or may not, be related to the exempt purposes of the organization.

Section 513(d)(1) provides, in part, that the term "unrelated trade or business" does not include qualified convention and trade show activities of an organization described in § 513(d)(3)(C). Organizations described in § 513(d)(3)(C) include any organization described in § 501(c)(6) that regularly conducts as one of its substantial exempt purposes a show that stimulates interest in, and demand for, the products of a particular industry or segment of such industry or that educates persons in attendance regarding new developments or products and services related to the exempt activities of the organization.

Section 513(d)(3)(A) defines the term "convention and trade show activity" as any activity of a kind traditionally conducted at conventions, annual meetings, or trade shows. A convention and trade show activity includes, but is not limited to, any activity one of the purposes of which is to attract persons in an industry generally (without regard to membership in the sponsoring organization) as well as members of the public to the show for the purpose of (1) displaying industry products, (2) stimulating interest in, and demand for, industry products or services, or (3) educating persons engaged in the industry in the development of new products and services or new rules and regulations affecting the industry.

Section 513(d)(3)(B) defines the term "qualified convention and trade show activity" as a convention and trade show activity carried out by a qualifying organization in conjunction with an international, national, State, regional, or local convention, annual meeting, or show conducted by a qualifying organization, if one of the purposes of such organization in sponsoring the activity is (1) the promotion and stimulation of interest in, and demand for, the products and services of that industry in general, or (2) to educate persons in attendance regarding new developments or products and services related to the exempt activities of the organization, and the show is designed to achieve such purpose through the character of the exhibits and the extent of the industry products displayed.

Section 1.513–3(b) provides that a convention or trade show activity will not be considered unrelated trade or business if it is conducted by a qualifying organization described in § 513(d)(3)(C), in conjunction with a qualified convention or trade show sponsored by the qualifying organization. Section 1.513–3(c)(1) provides that a qualifying organization includes an organization described in § 501(c)(6) that regularly conducts as one of its substantial exempt purposes a qualified convention or trade show.

Section 1.513–3(c)(2) provides that a qualified convention or trade show is a show that is (i) conducted by a qualifying organization described in § 513(d)(3)(C), (ii) has as at least one of its purposes the education of the qualifying organization's members or the promotion of interest in and demand for the products or services of the industry (or segment thereof) of the members of the qualifying organization, and (iii) is designed to achieve that purpose through the character of a significant portion of the exhibits or the character of conferences and seminars held at a convention or meeting.

Section 1.513–3(d)(1) provides that the rental of display space to exhibitors (including exhibitors who are suppliers) at a qualified trade show or at a qualified convention and trade show will not be considered unrelated trade or business even though the exhibitors who rent the space are permitted to sell or solicit orders.

ANALYSIS

Activities that promote demand for industry products and services, like other advertising activities, generally would constitute a "trade or business" under § 513(c) if carried on for the production of income. Section 513(d) is a narrow exception to what constitutes an "unrelated trade or business" under § 513(a). Section 513(d) was added to the Code by the Tax Reform Act of 1976 (P.L. 94–455 § 1305), in response to a series of revenue rulings (Rev. Ruls. 75–516 through 75–520, 1975–2 C.B. 220–226) holding that income received by a § 501(c)(6) organization at its convention or trade show from renting display space may constitute unrelated business taxable income, if selling by exhibitors is permitted or tolerated at the show. S. Rep. 94–938, at 601–603, 1976–3 C.B. 639–641. The activities described in § 513(d)(3) are specifically excepted from the definition of an unrelated trade or business because they are conducted by a qualifying organization in furtherance of its exempt purposes and in connection with a convention, annual meeting, or trade show. The term "convention, annual meeting, or trade show" as used in § 513(d)(3) refers to a specific event at which individuals representing a particular industry and members of the general public gather in person at one location during a certain period of time. Not only must the activities be conducted at a "convention, annual meeting, or trade show," but the character of the exhibits and the extent of the industry products displayed at the show must be designed to stimulate interest in, and demand for, the products and services of the industry in general or to educate persons in attendance regarding new developments or products and services related to the exempt activities of the organization. It is the nature of the activities and their connection to a specific convention, annual meeting, or trade show that distinguishes "qualified convention and trade show activity" within the meaning of § 513(d)(3) and the regulations from other types of advertising and promotional activities conducted by organizations described in § 501(c)(6).

In ***Situation 1***, *A* is a "qualifying organization" within the meaning of § 513(d)(3)(C), because it is an organization described in § 501(c)(6) and regularly conducts as one of its substantial exempt purposes a trade show to promote public interest in *A*'s industry. *A*'s semi-annual trade shows include conferences, seminars and a wide variety of exhibits sponsored by members and suppliers with information useful to those in *A*'s industry and take place during a limited time, at one physical location, where *A*'s members, suppliers and potential customers meet together in person, and interact face to face. Thus, each of *A*'s semi-annual trade shows is a "show" within the meaning of § 513(d)(3).

The activities conducted on the premises of each of *A*'s semi-annual trade shows and on the special supplementary section of *A*'s Internet website during the 16-day period that coincides with each semi-annual trade show are of a kind traditionally conducted at trade shows, as required by § 513(d)(3)(A), because the activities are designed to attract to the show persons in *A*'s industry and members of the public to view industry products, to stimulate interest in, and demand for such products, and to educate persons in the industry about new products and services. Therefore, these activities are "convention and trade show activity."

Although not conducted on the premises of *A*'s semi-annual trade shows, the activities conducted by *A* on the supplementary section of its Internet website during the 16-day period that coincides with each semi-annual trade show are carried out in conjunction with *A*'s semi-annual trade shows, as required by § 513(d)(3)(B). The supplementary section is no more than ancillary to the trade show. The content of the supplementary section serves to augment and enhance each semi-annual trade show by making available in an alternative medium the same information available at the show. The supplementary section of *A*'s Internet website is available to *A*'s members and the interested public during essentially the same limited time period that each semi-annual trade show is in operation. Although the supplementary section is available for a slightly longer period than the trade show itself, the additional time is reasonably brief and serves to allow for previewing the show before attending, or following up on information gathered at the show. Thus, the supplementary section is merely an extension of each semi-annual trade show.

Accordingly, both the activities conducted on the premises at *A*'s semi-annual trade show and the activities conducted on the supplementary section of *A*'s Internet website during the 16-day period that coincides with *A*'s semi-annual trade show meet the requirements to be a "qualified convention and trade show activity" under § 513(d)(3)(B). These activities, therefore, are not unrelated trade or business under § 513(a) because they meet the requirements for the limited exception under § 513(d)(3).

In ***Situation 2***, *B*'s operation of a website for a two-week period under the circumstances described is not "qualified convention and trade show activity" as defined in § 513(d)(3)(B), because, unlike the activities conducted on the supplementary section of *A*'s Internet website, *B*'s Internet activities are not carried out in conjunction with any international, national, regional, State, or local convention, annual meeting, or show conducted by *B*. *B*'s website is not itself a "convention, annual meeting, or trade show" within the meaning of § 513(d)(3) because the website is not a specific event at which *B*'s members, suppliers and potential customers gather in person at one physical location during a certain period of time and interact face to face. Moreover, *B*'s Internet activities do not coincide with, nor do they augment and enhance, any such specific event conducted by *B* for one of the purposes described in § 513(d)(3)(B). Therefore, because *B*'s website is not qualified convention and trade show activity, the operation of the website, even for a relatively short period of time, is not excepted from the definition of an unrelated trade or business under § 513(d)(1).

As *B* does not meet the specific exception under § 513(d)(3), whether its Internet activities constitute an unrelated trade or business must be determined under the requirements of § 513.

HOLDINGS

In ***Situation 1***, under the circumstances described, the Internet activities conducted by a trade association described in § 501(c)(6) on the special supplementary section of its Internet website do not constitute unrelated trade or business under § 513(a) because such activities meet the specific exception for qualified convention and trade show activity under § 513(d)(3)(B).

In ***Situation 2***, under the circumstances described, the activities conducted by a trade association described in § 501(c)(6) on its Internet website do not meet the specific exception for qualified convention and trade show activity under § 513(d)(3)(B).

DRAFTING INFORMATION

The principal author of this revenue ruling is Charles Barrett of the Tax Exempt and Government Entities Division, Exempt Organizations. For further information regarding this revenue ruling, contact Mr. Barrett at (202) 283–8944 (not a toll-free number).

Section 6302.—Mode or Time of Collection

26 CFR 31.6302(c)–3: Use of government depositaries in connection with tax under the Federal Unemployment Tax Act.

T.D. 9162

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 31

Federal Unemployment Tax Deposits — *De Minimis* Threshold

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the deposit of Federal Unemployment Tax Act (FUTA) taxes. The regulations change the accumulated amount of tax liability above which taxpayers must begin depositing Federal unemployment taxes. The regulations affect employers that have an accumulated FUTA tax liability of $500 or less.

DATES: *Effective Date*: These regulations are effective December 1, 2004.

Applicability Date: For dates of applicability, see §31.6302(c)–3(a)(2) and (3).

FOR FURTHER INFORMATION CONTACT: Heather L. Dostaler, (202) 622–4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Regulations on Employment Taxes and Collection of Income Tax at Source (26 CFR part 31) under section 6302 relating to mode or time of collection. The current rules relating to the deposit of FUTA taxes generally require employers to deposit taxes on a quarterly basis. An exception provides that an employer is not required to make a deposit until accumulated FUTA tax liability exceeds $100.

A notice of proposed rulemaking (REG–144908–02, 2003–2 C.B. 593) providing an additional exception to the FUTA tax deposit requirements was published in the **Federal Register** (68 FR 42329) on July 17, 2003. Under the proposed exception, an employer would not be required to deposit FUTA taxes if the employer's liability for other employment taxes (FICA taxes and withheld income taxes) was below the threshold at which deposits were required for those other taxes.

Three written comments were received in response to the notice of proposed rulemaking, but there was no request for a public hearing and a public hearing was not held. All comments were considered and are available for public inspection upon request. After consideration of the written comments, the proposed regulations under section 6302 are adopted as revised by this Treasury decision. The public comments and the revisions are discussed below.

Summary of Comments

Two commentators expressed concern that the creation of an additional exception linked to the deposit rules for other employment taxes will create complexity and that a single exception based on FUTA tax liability is sufficient. One commentator expressed concern regarding the low threshold amounts under both exceptions, and also expressed concern that the proposed exception could be misinterpreted by those accustomed to referring only to the amount of accumulated FUTA taxes.

One commentator suggested that the regulations should exempt household employers who file Schedule H, "*Household Employment Taxes*," with Form 1040. This comment is outside the scope of these regulations, which are limited to the deposit rules issued under section 6302. Household employment taxes reported on Schedule H are paid with the employer's income taxes.

Explanation of Provisions

After considering the public comments, the IRS and Treasury Department agree that a single exception based on a higher FUTA tax liability threshold is preferable to the exception in the proposed regulations. Accordingly, the final regulations do not include an exception linked to the deposit rules for other employment taxes. Instead, they increase the FUTA tax liability threshold from $100 to $500. Thus, an employer will not be required to make a deposit of FUTA taxes until FUTA tax liability exceeds $500. This change is a simple and straightforward step to reduce the burden on small businesses.

Special Analyses

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

Drafting Information

The principal author of these regulations is Heather L. Dostaler of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

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

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

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

Par. 2. In §31.6302(c)–3, paragraphs (a)(2) and (a)(3) are revised to read as follows:

§31.6302(c)–3 Use of Government depositaries in connection with tax under the Federal Unemployment Tax Act.

(a) * * *

(2) *Special rule where accumulated amount does not exceed $500.* The provisions of paragraph (a)(1) of this section shall not apply with respect to any period described therein if the amount of the tax imposed by section 3301 for such period (as computed under section 6157) plus amounts not deposited for prior periods does not exceed $500 ($100 in the case of periods ending on or before December 31, 2004). Thus, an employer shall not be required to make a deposit for a period unless his tax for such period plus tax not deposited for prior periods exceeds $500.

(3) *Requirement for deposit in lieu of payment with return.* If the amount of tax reportable on a return on Form 940 exceeds by more than $500 ($100 in the case of calendar years before 2005) the sum of the amounts deposited by the employer pursuant to paragraph (a)(1) of this section for such calendar year, the employer shall, on or before the last day of the first calendar month following the calendar year for which the return is required to be filed, deposit the balance of the tax due with an authorized financial institution.

* * * * *

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

Approved November 23, 2004.

Gregory Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 30, 2004, 8:45 a.m., and published in the issue of the Federal Register for December 1, 2004, 69 F.R. 69819)

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 2005, will be 5 percent for overpayments (4 percent in the case of a corporation), 5 percent for underpayments, and 7 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 2.5 percent.

Rev. Rul. 2004–111

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See section 6621(c) and section 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(2)(B) provides that in determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate that applies during the third month following such taxable year also applies during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988–1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of October 2004 is 2 percent. Accordingly, an overpayment rate of 5 percent (4 percent in the case of a corporation) and an underpayment rate of 5 percent are established for the calendar quarter beginning January 1, 2005. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 2005, is 2.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 2005, is 7 percent. These rates apply to amounts bearing interest during that calendar quarter.

The 5 percent rate also applies to estimated tax underpayments for the first calendar quarter in 2005 and for the first 15 days in April 2005.

Interest factors for daily compound interest for annual rates of 2.5 percent, 4 percent, 5 percent, and 7 percent are published in Tables 10, 13, 15, and 19 of Rev. Proc. 95–17, 1995–1 C.B. 556, 564, 567, 569, and 573.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Crystal Foster of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Foster at (202) 622–7326 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 – PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 – PERIODS ENDING DEC. 31, 1986 – Continued

OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995–1 C.B. DAILY RATE TABLE
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 – Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 – Dec. 31, 1998 – Continued

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 – PRESENT

NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	5%	15	569

TABLE OF INTEREST RATES

FROM JANUARY 1, 1999 – PRESENT

CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995–1 C.B. TABLE	PG	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	5%	15	569	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	4%	61	615	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	3%	59	613	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	4%	61	615	5%	63	617
Jan. 1, 2005—Mar. 31, 2005	4%	13	567	5%	15	569

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 – PRESENT

	RATE	1995–1 C.B. TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 – PRESENT – Continued

	RATE	1995–1 C.B. TABLE	PG
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577
Oct. 1, 2001—Dec. 31, 2001	9%	23	577
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575
Jul. 1, 2002—Sep. 30, 2002	8%	21	575
Oct. 1, 2002—Dec. 30, 2002	8%	21	575
Jan. 1, 2003—Mar. 31, 2003	7%	19	573
Apr. 1, 2003—Jun. 30, 2003	7%	19	573
Jul. 1, 2003—Sep. 30, 2003	7%	19	573
Oct. 1, 2003—Dec. 31, 2003	6%	17	571
Jan. 1, 2004—Mar. 31, 2004	6%	65	619
Apr. 1, 2004—Jun. 30, 2004	7%	67	621
Jul. 1, 2004—Sep. 30, 2004	6%	65	619
Oct. 1, 2004—Dec. 31, 2004	7%	67	621
Jan. 1, 2005—Mar. 31, 2005	7%	19	573

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000

FROM JANUARY 1, 1995 – PRESENT

	RATE	1995–1 C.B. TABLE	PAGE
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002—Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002—Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003—Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003—Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003—Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003—Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004—Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004—Jun. 30, 2004	2.5%	58	612
Jul. 1, 2004—Sep. 30, 2004	1.5%	56	610
Oct. 1, 2004—Dec. 31, 2004	2.5%	58	612
Jan. 1, 2005—Mar. 31, 2005	2.5%	10	564

Section 6662.—Imposition of Accuracy-Related Penalty

Guidance is provided concerning when information shown on a return in accordance with the applicable forms and instructions will be adequate disclosure under section 6662(d) for purposes of reducing an understatement of income tax. See Rev. Proc. 2004-73, page 999.

Section 6694.—Understatement of Taxpayer's Liability by Income Tax Return Preparer

Guidance is provided concerning when information shown on a return in accordance with the applicable forms and instructions will be adequate disclosure under section 6694(a) for purposes of reducing an understatement of income tax due to a return preparer's unrealistic position. See Rev. Proc. 2004-73, page 999.

Part III. Administrative, Procedural, and Miscellaneous

Tables for Figuring Amount Exempt From Levy on Wages, Salary, and Other Income

Notice 2004–81

1. Table for Figuring Amount Exempt From Levy on Wages, Salary, and Other Income (Forms 668-W(c), 668-W(c)(DO)) and 668-W(ICS) 2005

Publication 1494, shown below, provides tables that show the amount of an individual's income that is exempt from a notice of levy used to collect delinquent tax in 2005.

(Amounts are for each pay period.)

Filing Status: Single							
	Number of Exemptions Claimed on Statement						
Pay Period	1	2	3	4	5	6	More than 6
Daily	31.54	43.85	56.15	68.46	80.77	93.08	19.23 plus 12.31 for each exemption
Weekly	157.69	219.23	280.77	342.31	403.85	465.38	96.15 plus 61.54 for each exemption
Biweekly	315.38	438.46	561.54	684.62	807.69	930.77	192.31 plus 123.08 for each exemption
Semi-monthly	341.67	475.00	608.33	741.67	875.00	1008.33	208.33 plus 133.33 for each exemption
Monthly	683.33	950.00	1216.67	1483.33	1750.00	2016.67	416.67 plus 266.67 for each exemption

Filing Status: Unmarried Head of Household							
	Number of Exemptions Claimed on Statement						
Pay Period	1	2	3	4	5	6	More than 6
Daily	40.38	52.69	65.00	77.31	89.62	101.92	28.08 plus 12.31 for each exemption
Weekly	201.92	263.46	325.00	386.54	448.08	509.62	140.39 plus 61.54 for each exemption
Biweekly	403.85	526.92	650.00	773.08	896.15	1019.23	280.77 plus 123.08 for each exemption
Semi-monthly	437.50	570.83	704.17	837.50	970.83	1104.17	304.17 plus 133.33 for each exemption
Monthly	875.00	1141.67	1408.33	1675.00	1941.67	2208.33	608.33 plus 266.67 for each exemption

Filing Status: Married Filing Joint Return (and Qualifying Widow(er)s)							
Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6	More than 6
Daily	50.77	63.08	75.38	87.69	100.00	112.31	38.46 plus 12.31 for each exemption
Weekly	253.85	315.38	376.92	438.46	500.00	561.54	192.31 plus 61.54 for each exemption
Biweekly	507.69	630.77	753.85	876.92	1000.00	1123.08	384.62 plus 123.08 for each exemption
Semi-monthly	550.00	683.33	816.67	950.00	1083.33	1216.67	416.67 plus 133.33 for each exemption
Monthly	1100.00	1366.67	1633.33	1900.00	2166.67	2433.33	833.33 plus 266.67 for each exemption

Filing Status: Married Filing Separate Return							
Pay Period	Number of Exemptions Claimed on Statement						
	1	2	3	4	5	6	More than 6
Daily	31.54	43.85	56.15	68.46	80.77	93.08	19.23 plus 12.31 for each exemption
Weekly	157.69	219.23	280.77	342.31	403.85	465.38	96.15 plus 61.54 for each exemption
Biweekly	315.38	438.46	561.54	684.62	807.69	930.77	192.31 plus 123.08 for each exemption
Semi-monthly	341.67	475.00	608.33	741.67	875.00	1008.33	208.33 plus 133.33 for each exemption
Monthly	683.33	950.00	1261.67	1483.33	1750.00	2016.67	416.67 plus 266.67 for each exemption

2. Table for Figuring Additional Exempt Amount for Taxpayers at Least 65 Years Old and/or Blind

Additional Exempt Amount

Filing Status	*	Daily	Wkly	Bi-Wkly	Semi-Mo	Monthly
Single or Head of Household	1	4.81	24.04	48.08	52.08	104.17
	2	9.62	48.08	96.15	104.17	208.33
Any Other Filing Status	1	3.85	19.23	38.46	41.67	83.33
	2	7.69	38.46	76.92	83.33	166.67
	3	11.54	57.69	115.38	125.00	250.00
	4	15.38	76.92	153.85	166.67	333.33

* ADDITIONAL STANDARD DEDUCTION claimed on Parts 3, 4, & 5 of levy.

Examples

These tables show the amount exempt from a levy on wages, salary, and other income. For example:

1. A single taxpayer who is paid weekly and claims three exemptions (including one for the taxpayer) has $280.77 exempt from levy.
2. If the taxpayer in number 1 is over 65 and writes 1 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, & 5 of the levy, $304.81 is exempt from this levy ($280.77 plus $24.04).
3. A taxpayer who is married, files jointly, is paid bi-weekly, and claims two exemptions (including one for the taxpayer) has $630.77 exempt from levy.
4. If the taxpayer in number 3 is over 65 and has a spouse who is blind, this taxpayer should write 2 in the ADDITIONAL STANDARD DEDUCTION space on Parts 3, 4, & 5 of the levy. Then, $707.69 is exempt from this levy ($630.77 plus $76.92).

Weighted Average Interest Rates Update

Notice 2004–82

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. In addition, it provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II), and the weighted average interest rate and permissible ranges of interest rates based on the 30-year Treasury securities rate.

CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004, provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 or 2005 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004–34, 2004–18 I.R.B. 848, provides guidelines for determining the corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices.

The composite corporate bond rate for November 2004 is 5.59 percent. Pursuant to Notice 2004–34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in: Month	Year	Corporate Bond Weighted Average	90% to 110% Permissible Range
December	2004	6.14	5.52 to 6.14

30-YEAR TREASURY SECURITIES WEIGHTED AVERAGE INTEREST RATE

Section 417(e)(3)(A)(ii)(II) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)–1(d)(3) of the Income Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

Section 404(a)(1) of the Code, as amended by the Pension Funding Equity Act of 2004, permits an employer to elect to disregard subclause (II) of § 412(b)(5)(B)(ii) to determine the maximum amount of the deduction allowed under § 404(a)(1).

The rate of interest on 30-year Treasury securities for November 2004 is 4.89 percent. Pursuant to Notice 2002–26, 2002–1 C.B. 743, the Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2031.

The following 30-year Treasury rates were determined for the plan years beginning in the month shown below.

For Plan Years Beginning in: Month	Year	30-Year Treasury Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
December	2004	5.11	4.60 to 5.37	4.60 to 5.62

Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 1–202–283–9703. Mr. Montanaro may be reached at 1–202–283–9714. The telephone numbers in the preceding sentences are not toll-free.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 6662, 6694; 1.6662–4, 1.6694–2.)

Rev. Proc. 2004–73

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2003–77, 2003–2 C.B. 964, and identifies circumstances under which the disclosure on a taxpayer's return with respect to an item or a position is adequate for the purpose of reducing the understatement of income tax under section 6662(d) of the Internal Revenue Code (relating to the substantial understatement aspect of the accuracy-related penalty), and for the purpose of avoiding the preparer penalty under section 6694(a) (relating to understatements due to unrealistic positions). This revenue procedure does not apply with respect to any other penalty provisions (including the negligence or disregard provisions of the section 6662 accuracy-related penalty).

This revenue procedure applies to any return filed on 2004 tax forms for a taxable year beginning in 2004, and to any return filed on 2004 tax forms in 2005 for short taxable years beginning in 2005.

SEC. 2. CHANGES FROM REV. PROC. 2003–77

.01 Section 4.01(1) clarifies that if a taxpayer discloses an item on a line of a form or schedule that does not have a preprinted description identifying that item, then the taxpayer must enter the description on that line.

.02 Section 4.01(3) concerning Form 1120, *Schedule M–1, Reconciliation of Income (Loss) per Books With Income per Return*, is expanded by adding a reference to the new Schedule M–3, *Net Income (Loss) Reconciliation For Corporations With Total Assets of $10 Million or More*, with regard to its Column (b), *Temporary Difference*, and Column (c), *Permanent Differences*, in Parts II and III. The treatment of the Schedule M–1 is also clarified by removing the reference to "netting" and describing the extent of the protection provided by an entry on the schedule. A conforming clarification is made at section 4.01.

.03 Editorial changes have been made in updating Rev. Proc. 2003–77.

SEC. 3. BACKGROUND

.01 Under section 6662(b)(2), section 6662 applies to the portion of an underpayment of tax that is attributable to a substantial understatement of income tax. If section 6662 applies to any portion of an underpayment of tax required to be shown on a return, an amount equal to 20 percent of the portion of the underpayment to which the section applies is added to the tax. (The penalty rate is 40 percent in the case of gross valuation misstatements under section 6662(h).)

.02 Section 6662(d)(1) provides that there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of 10 percent of the amount of tax required to be shown on the return for the taxable year or $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Section 6662(d)(2) defines an understatement as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of the tax that is shown on the return reduced by any rebate (within the meaning of section 6211(b)(2)).

.03 In the case of an item not attributable to a tax shelter, section 6662(d)(2)(B)(ii) provides that the amount of the understatement is reduced by the portion of the understatement attributable to any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return, and there is a reasonable basis for the tax treatment of the item by the taxpayer.

.04 Section 6694 imposes a penalty of $250 on an income tax return preparer for filing a return or claim for refund that results in an understatement of liability due to a position for which the preparer knew or should have known that there was not a realistic possibility of being sustained on the merits and the position was not disclosed in accordance with section 6662(d)(2)(B)(ii).

.05 In general, this revenue procedure provides guidance for determining when disclosure is adequate for purposes of section 6662(d)(2)(B)(ii) and section 6694(a)(3). For purposes of this revenue procedure, the taxpayer must furnish all required information in accordance with the applicable forms and instructions, and the money amounts entered on these forms must be verifiable. Guidance under section 6662(d)(2)(B)(ii) and section 6694(a)(3) for returns filed for 2003, 2002, and 2001 is provided in Rev. Proc. 2003–77; Rev. Proc. 2002–66, 2002–2 C.B. 724; and Rev. Proc. 2001–52, 2001–2 C.B. 491, respectively.

SEC. 4. PROCEDURE

.01 Additional disclosure of facts relevant to, or positions taken with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of income tax under section 6662(d) (except as otherwise provided in section 4.01(3) concerning Schedules M–1 and M–3), provided that the forms and attachments are completed in a clear manner and in accordance with their instructions. The money amounts entered on the forms must be verifiable, and the information on the return must be disclosed in the manner described below. For purposes of this revenue procedure, a number is verifiable if, on audit, the taxpayer can demonstrate the origin of the number (even if that number is not ultimately accepted by the Internal Revenue Service) and the taxpayer can show good faith in entering that number on the applicable form. Where the amount of an item is shown on a line that does not have a preprinted description identifying that item (such as on an unnamed line under an "Other Expense" category) the taxpayer must clearly identify the item by including the description on that line; *e.g.*, to disclose a bad debt for a sole proprietorship, the words "bad debt" must be written or typed on the line of Schedule C that shows the amount of the bad debt.

(1) Form 1040, Schedule A, *Itemized Deductions*:

(a) Medical and Dental Expenses: Complete lines 1 through 4, supplying all required information.

(b) Taxes: Complete lines 5 through 9, supplying all required information. Line 8 must list each type of tax and the amount paid.

(c) Interest Expenses: Complete lines 10 through 14, supplying all required information. This section 4.01(1)(c) does not apply to (i) amounts disallowed under section 163(d) unless Form 4952, *Investment Interest Expense Deduction*, is completed, or (ii) amounts disallowed under section 265.

(d) Contributions: Complete lines 15 through 18, supplying all required information. Enter the amount of the gift reduced by the value of any substantial benefit (goods or services) provided by the donee organization in consideration, in whole or in part. Entering the amount of the gift unreduced by the value of the benefit received will not constitute adequate disclosure. If a contribution of $250 or more is made, this section will not apply unless a contemporaneous written acknowledgment, as required by section 170(f)(8), is obtained from the donee organization. If a contribution of property other than cash is made and the amount claimed as a deduction exceeds $500, attach a properly completed Form 8283, *Noncash Charitable Contributions*, to the return.

(e) Casualty and Theft Losses: Complete Form 4684, *Casualties and Thefts*, and attach to the return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(2) Certain Trade or Business Expenses (including, for purposes of this section, the following six expenses as they relate to the rental of property):

(a) Casualty and Theft Losses: The procedure outlined in section 4.01(1)(e) must be followed.

(b) Legal Expenses: The amount claimed must be stated. This section does not apply, however, to amounts properly characterized as capital expenditures, personal expenses, or non-deductible lobbying or political expenditures, including amounts that are required to be (or that are) amortized over a period of years.

(c) Specific Bad Debt Charge-off: The amount written off must be stated.

(d) Reasonableness of Officers' Compensation: Form 1120, Schedule E, *Compensation of Officers*, must be completed when required by its instructions. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed." This section does not apply to "golden parachute" payments, as defined under section 280G. This section will not apply to the extent that remuneration paid or incurred exceeds the $1 million-employee-remuneration limitation, if applicable.

(e) Repair Expenses: The amount claimed must be stated. This section does not apply, however, to any repair expenses properly characterized as capital expenditures or personal expenses.

(f) Taxes (other than foreign taxes): The amount claimed must be stated.

(3) Differences in book and income tax reporting.

(a) Form 1120, Schedule M–1, *Reconciliation of Income (Loss) per Books With Income per Return*, and

(b) Schedule M–3, *Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More,* Form 1120: Column (b), *Temporary Difference*, and Column (c), *Permanent Difference*, of Part II, (reconciliation of income (loss) items) and Part III (reconciliation of expense/deduction items).

The information provided reasonably must be expected to apprise the Service of the nature of the potential controversy concerning the tax treatment of the item. If the information provided does not so apprise the Service, a Form 8275, *Disclosure Statement*, or Form 8275–R, *Regulation Disclosure Statement*, must be used to adequately disclose the item (see Part II of the instructions for those forms).

> Note: An item reported on a line with a pre-printed description, shown on an attached schedule, or "itemized" on Schedule M–1 may represent the aggregate amount of several transactions producing that item (*i.e.*, a group of similar items, such as amounts paid or incurred for supplies by a taxpayer engaged in business). In some instances, the potentially controversial item may involve a portion of the amount disclosed on the schedule. The Service will not be reasonably apprised of the potential controversy by the amount disclosed. In these instances, the taxpayer must use Form 8275 or Form 8275-R regarding that portion of the item.

The combining of unlike items will not constitute an adequate disclosure.

(4) Foreign Tax Items:

(a) International Boycott Transactions: Transactions disclosed on Form 5713, *International Boycott Report*. Schedule A, *International Boycott Factor (section 999(c)(1))*; Schedule B, *Specifically Attributable Taxes and Income (Section 999(c)(2))*; and Schedule C, *Tax Effect of the International Boycott Provisions*, must be completed when required by their instructions.

(b) Treaty-Based Return Position: Transactions and amounts under section 6114 or section 7701(b) as disclosed on Form 8833, *Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)*.

(5) Other:

(a) Moving Expenses: Complete Form 3903, *Moving Expenses*, and attach to the return.

(b) Employee Business Expenses: Complete Form 2106, *Employee Business Expenses*, or Form 2106–EZ, *Unreim-*

bursed Employee Business Expenses, and attach to the return. This section does not apply to club dues, or to travel expenses for any non-employee accompanying the taxpayer on the trip.

(c) Fuels Credit: Complete Form 4136, *Credit for Federal Tax Paid on Fuels*, and attach to the return.

(d) Investment Credit: Complete Form 3468, *Investment Credit*, and attach to the return.

SEC. 5. REQUEST FOR COMMENTS

The Service invites comments from the public on issues relating to Schedule M–3 in section 4.01(3). In particular, the Service requests comments addressing whether the adjustments to arrive at line 11, Part I of the schedule, *Net income (loss) per income statement of includible corporations*, may provide an adequate disclosure, and whether the condition that the Internal Revenue Service be apprised of the nature of the potential controversy is necessary for the Schedule M–3. Written comments should be submitted by June 30, 2005, to CC:PA:LPD:RU (Rev. Proc. 2004–73), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday to CC:PA:LPD:RU (Rev. Proc. 2004–73), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, D.C. Alternatively, comments may be submitted electronically via e-mail to the following address: *"Notice.Comments@irscounsel.treas.gov"* using the subject line "Rev. Proc. 2004–73." All comments will be available for public inspection.

SEC. 6. EFFECTIVE DATE

This revenue procedure applies to any return filed on a 2004 tax form for a taxable year beginning in 2004, and to any return filed on a 2004 tax form in 2005 for a short taxable year beginning in 2005.

SEC. 7. DRAFTING INFORMATION

The principal author of this revenue procedure is John Moran of the Office of the Associate Chief Counsel, Procedure & Administration (Administrative Provisions & Judicial Practice Division). For further information regarding this revenue procedure, contact Branch 2 of the Administrative Provisions & Judicial Practice Division at (202) 622–4940 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Guidance Regarding Predecessors and Successors Under Section 355(e); Limitation on Gain Recognition Under Section 355(e)

REG–145535–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that define the terms predecessor and successor for purposes of section 355(e). These proposed regulations provide guidance in determining whether a corporation is a predecessor or successor of a distributing or controlled corporation, as well as rules to assist taxpayers in determining whether an acquisition of an interest in a corporation would cause a distributing corporation to recognize gain under section 355(e). These proposed regulations affect corporations that distribute the stock of controlled corporations in distributions described in section 355.

DATES: Written or electronic comments and requests for a public hearing must be received by February 22, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–145535–02), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–145535–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS — REG–145535–02).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Krishna P. Vallabhaneni at (202) 622–7550; concerning submissions of comments or requests for a hearing, Robin R. Jones, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains proposed regulations under section 355(e) of the Internal Revenue Code of 1986. Section 355(e), enacted as part of the Taxpayer Relief Act of 1997 (Public Law No. 105–34, 111 Stat 788 (1997)), provides that stock of a controlled corporation (Controlled) generally will not be treated as qualified property under section 355(c)(2) or 361(c)(2) if the Controlled stock is distributed as part of a plan (or series of related transactions) pursuant to which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation (Distributing) or Controlled. On April 26, 2002, the Internal Revenue Service (IRS) and the Treasury Department published temporary regulations (T.D. 8988, 2002–1 C.B. 929) in the Federal Register (67 FR 20632) under section 355(e) providing guidance regarding whether a distribution and an acquisition of Distributing or Controlled are part of a "plan (or series of related transactions)." *See* Treas. Reg. §1.355–7T. Section 355(e)(4)(D) provides that, for purposes of section 355(e), "any reference to a controlled corporation or a distributing corporation shall include a reference to any predecessor or successor of such corporation."

Practitioners have commented that guidance regarding the definitions of predecessor and successor is desirable. Therefore, these regulations propose definitions of predecessor and successor, rules for determining whether there has been an acquisition of a predecessor of Distributing, Distributing, or Controlled in certain cases, and rules limiting the amount of gain required to be recognized as a result of acquisitions of stock that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing.

Predecessors of Distributing

The definition of a predecessor of Distributing in these proposed regulations is intended to reflect the fact that section 355(e) generally denies tax-free treatment under sections 355(c)(1) and 361(c)(1) if there is a division of a corporation's assets to which section 355(a) applies that is coupled with planned acquisitions of stock representing in the aggregate a 50-percent or greater interest in Distributing or Controlled. The proposed regulations generally provide that a predecessor of Distributing includes a corporation that, before the distribution, transfers property to Distributing in a transaction to which section 381 applies if Distributing transfers some (but not all) of the acquired property to Controlled (or a predecessor of Controlled, as described below) and the basis of such property immediately after the transfer to Controlled (or a predecessor of Controlled) is determined in whole or in part by reference to the basis of the property in the hands of Distributing immediately before the transfer. For example, if before the distribution P merges into D in a statutory merger under section 368(a)(1)(A) and D transfers some but not all of the acquired P assets to C in exchange for C stock in a reorganization under section 368(a)(1)(D), then P is a predecessor of D.

The proposed regulations also provide that a predecessor of Distributing includes a corporation that, before the distribution, transfers property to Distributing in a transaction to which section 381 applies if some but not all of the property transferred to Distributing includes Controlled stock and, after the combining transaction, Distributing transfers less than all of the property acquired (other than the Controlled stock) to Controlled. In such cases, the distribution of Controlled stock, even without a pre-distribution transfer of acquired assets to Controlled, effects a division of the predecessor's assets.

The definition of a predecessor of Distributing may result in a corporation being treated as a predecessor of Distributing even if the distribution and the combination of the predecessor and Distributing are not part of a plan. Once a predecessor of Distributing is identified, it must be determined whether the distribution and any acquisitions (deemed or actual) of stock of the predecessor are part of a plan.

Predecessors of Controlled

In the course of developing these regulations, the IRS and Treasury Department considered to what extent a corporation's transfer of property to Controlled in a transaction to which section 381 applies implicates the policies underlying section 355(e). Generally, Controlled will not be able to transfer property that it receives in such a transaction to Distributing tax-free. One exception is where Controlled itself distributes the stock of another corporation in a distribution to which section 355 applies. In these cases, however, Controlled will functionally be a distributing corporation, and the transferor of property to Controlled may be a predecessor of the distributing corporation. Therefore, as a general matter, it appears that property transferred to Controlled cannot be divided tax-free between Distributing and Controlled in the same way that property transferred to Distributing can be divided tax-free. Accordingly, the policy underlying the definition of a predecessor of Distributing does not appear to necessitate a definition of a predecessor of Controlled.

Nonetheless, solely for purposes of determining whether a corporation is a predecessor of Distributing, calculating certain limitations on gain recognition described below, and applying a special affiliated group rule described below, these proposed regulations define a predecessor of Controlled as a corporation that before the distribution transfers property to Controlled in a transaction to which section 381 applies. Under these proposed regulations, for no other purpose can a corporation be a predecessor of Controlled. Thus, acquisitions of stock that are part of a plan that includes the distribution and that in the aggregate represent a 50-percent or greater interest in a predecessor of Controlled will not cause Distributing to recognize gain. However, the IRS and Treasury Department continue to study whether there may be other situations in which a corporation should be treated as a predecessor of Controlled.

The definition of a predecessor of Controlled ensures that a corporation is treated as a predecessor of Distributing in the following situation and similar ones. Suppose Distributing acquires all the assets of X (including all the outstanding stock of Y) in a transaction to which section 381 applies. After the acquisition, Distributing causes Y to merge into Controlled, a wholly owned subsidiary of Distributing, in a reorganization under section 368(a)(1)(D). Distributing then distributes the stock of Controlled to its shareholders *pro rata* in a distribution to which section 355(a) applies. In this case, there is a separation of the X assets in a distribution to which section 355(a) applies. Under the definition of a predecessor of Controlled described above, Y will be treated as a predecessor of Controlled, and because Distributing acquires in a transaction to which section 381 applies stock of a predecessor of Controlled from X, X will be treated as a predecessor of Distributing.

Multiple Predecessors

Under the proposed regulations, more than one corporation may be a predecessor of Distributing or Controlled. For example, if more than one corporation transfers property to Distributing in transactions to which section 381 applies, each of the transferring corporations may be a predecessor of Distributing. However, a corporation that transfers its assets in a transaction to which section 381 applies to a predecessor of Distributing is not also treated as a predecessor of Distributing. The IRS and Treasury Department recognize that such transfers of assets to a predecessor of Distributing could be part of the plan that includes the distribution, but are concerned that treating such transferring corporations as predecessors of Distributing would add substantial complexity. Nonetheless, the IRS and Treasury Department continue to consider whether such corporations should be treated as a predecessor of Distributing.

Successors

The definition of a successor of Distributing or Controlled proposed in these regulations is intended to identify corporations that are properly viewed as a continuation of Distributing or Controlled for purposes of section 355(e). Therefore, the proposed regulations define a successor of Distributing as any corporation to which Distributing transfers property after the distribution in a transaction to which section 381 applies and a successor of Controlled as any corporation to which Controlled transfers property after the distribution in a transaction to which section 381 applies. More than one corporation may be a successor of Distributing or Controlled. For example, if after a distribution Distributing transfers property to another corporation (X) in a transaction to which section 381 applies, and X transfers property to another corporation (Y) in a transaction to which section 381 applies, then each of X and Y may be a successor of Distributing. In this case, the determination of whether Y is a successor of Distributing is made after the determination of whether X is a successor of Distributing.

Special Rules for Measuring Certain Acquisitions

Whether there have been acquisitions of stock that are part of a plan that includes a distribution that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing is counted separately from whether there have been acquisitions of stock that are part of a plan that includes a distribution that in the aggregate represent a 50-percent or greater interest in Distributing. Therefore, Distributing may be required to recognize gain by reason of section 355(e) with respect to a predecessor of Distributing, but not Distributing, and vice versa.

Because a predecessor of Distributing may no longer exist after it combines with Distributing, special rules are necessary to determine whether there has been an acquisition of the predecessor in connection with and after the combination transaction. These proposed regulations provide that each person that owned an interest in Distributing immediately before the transaction in which the predecessor of Distributing transfers its property to Distributing is treated as acquiring stock in the predecessor of Distributing in the combination transaction. For example, suppose D acquires the assets of a predecessor in a statutory merger under section 368(a)(1)(A) and A, an individual, owned stock of D immediately before the merger. A would be treated as acquiring stock of the predecessor.

In addition, an acquisition of Distributing (or a successor of Distributing) that occurs after Distributing's combination with a predecessor will count not only as an acquisition of Distributing, but also as an acquisition of the predecessor. The stock of Distributing (or a successor of Distributing) is treated as the stock of all predecessors of Distributing. Therefore, if D acquires the assets of a predecessor in a statutory merger under section 368(a)(1)(A) and, after the merger, A, an individual, acquires 5 percent of the stock of D, A is treated as acquiring not only stock of D, but also stock of the predecessor of D.

The proposed regulations provide similar rules for determining whether there has been an acquisition of stock of Distributing or Controlled if there is an acquisition of stock of a successor of Distributing or Controlled. Therefore, acquisitions of a successor of Distributing or Controlled and acquisitions of Distributing or Controlled (before or after the distribution) pursuant to a plan are combined to determine whether there have been acquisitions of stock that in the aggregate represent a 50-percent or greater interest in Distributing or Controlled that cause section 355(e) to apply.

Special Rules for Gain Recognition

Generally, if a distribution and acquisitions that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing or Distributing are part of a plan, section 355(e) requires Distributing to recognize the full amount of the gain inherent in the Controlled stock on the date of the distribution under section 355(c)(2) or section 361(c)(2), as applicable. However, if a distribution and acquisitions of stock that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing are part of a plan but there are not acquisitions of stock that in the aggregate represent a 50-percent or greater interest in Distributing that are part of that plan, and if the gain inherent in the assets of the predecessor of Distributing that are contributed to Controlled is small relative to the gain inherent in the Controlled stock on the date of the distribution, it may seem inappropriate to require that Distributing recognize the full amount of gain inherent in the Controlled stock. Similarly, if a distribution and acquisitions of stock that in the aggregate represent a 50-percent or greater interest in Distributing are part of a plan but there are not acquisitions of stock that in the aggregate represent a 50-percent or greater interest in the predecessor of Distributing that are part of a plan, and if the excess of the gain inherent in the Controlled stock on the date of the distribution over the gain attributable to the assets of the predecessor is small relative to the full amount of gain inherent in the Controlled stock, it may seem inappropriate to require that Distributing recognize the full amount of gain inherent in the Controlled stock. Therefore, the proposed regulations provide two rules limiting the amount of gain that Distributing must recognize in these cases.

The first rule provides that if a distribution and acquisitions of stock that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing are part of a plan, then the amount of gain that Distributing recognizes by reason of such acquisitions will not exceed the amount of gain, if any, that the predecessor of Distributing would have recognized if, immediately before the distribution, the predecessor had transferred the property that was transferred to Controlled and the stock of Controlled that it transferred to Distributing to a newly formed, wholly owned corporation solely for stock of such corporation in an exchange to which section 351 applied (even if section 351 would not have actually applied) and then sold the stock of that corporation to an unrelated person in exchange for cash equal to its fair market value.

The second rule applies if a distribution and acquisitions of stock that in the aggregate represent a 50-percent or greater interest in Distributing are part of a plan and the acquisitions occur in the section 381 transaction in which a predecessor of Distributing transfers its assets to Distributing. In these cases, the proposed regulations effectively provide that the amount of gain that Distributing recognizes will not exceed the amount of gain that Distributing would have recognized had it not transferred assets of the predecessor to Controlled and had it not acquired any Controlled stock from the predecessor. In particular, the amount of gain that Distributing recognizes will not exceed the excess, if any, of the amount described in section 355(c)(2) or section 361(c)(2), as applicable, over the amount of gain, if any, that Distributing would have been required to recognize if there had been acquisitions of stock that in the aggregate represent a 50-percent or greater interest in the predecessor of Distributing (but not Distributing) involved in the combining transfer that were part of a plan that includes the distribution, taking into account the limitation in the first rule. For example, assume that X, a corporation, merges into Distributing in a statutory merger that qualifies as a reorganization under section 368(a)(1)(A). In the merger, Distributing issues 75 percent of its stock to the former shareholders of X. Distributing then forms Controlled solely with assets acquired from X in the merger and distributes the stock of Controlled *pro rata* to its shareholders. At the time of the distribution, the basis of the Controlled stock is $30 and the fair market value of that stock is $70. Assume that the distribution and the former X shareholders' acquisition of stock of Distributing are part of a plan. Furthermore, assume that, other than the deemed acquisition of stock of X by the pre-merger shareholders of Distributing, there are no other acquisitions of the stock of X that are part of a plan that includes the distribution. By reason of the second limitation, Distributing's gain recognized under section 361(c)(2) would be zero because all of the gain inherent in the Controlled stock at the time of the distribution is attributable to assets acquired from X in the merger.

In order to ensure that in appropriate cases these limitations do not ultimately prevent recognition of gain in the full amount described in section 355(c)(2) or 361(c)(2), as applicable, these proposed regulations provide that if there are acquisitions of stock that in the aggregate represent a 50-percent or greater interest in more than one corporation (for example, two predecessors of Distributing) that are pursuant to a plan that includes the distribution, Distributing must recognize gain in the amount described in section 355(c)(2) or 361(c)(2), as applicable, subject to the limitations described above, with respect to each such corporation. However, because this rule could cause Distributing to recognize a total amount of gain in excess of that amount described in section 355(c)(2) or 361(c)(2), as applicable, these regulations include an overall limitation on gain recognition. That rule provides that the sum of the amounts required to be recognized by Distributing under section 355(e) and the regulations promulgated thereunder will not exceed the amount described in section 355(c)(2) or section 361(c)(2), as applicable.

As described above, the rule for determining whether a corporation is a predecessor of Distributing references the assets of the predecessor at the time it combines with Distributing while the rule for calculating the limitation on gain recognition references the basis and value of the predecessor's assets at the time of the distribution. The IRS and Treasury Department believe that determining whether a corporation is a predecessor of Distributing by reference to its assets at the time it combines with Distributing (and not later) is appropriate because, in that transaction, the predecessor will likely cease to exist. However, the division of the predecessor's assets does not occur until the distribution. In addition, the gain required to be recognized by reason of section 355(e) is measured as of the date of the distribution. Therefore, the IRS and Treasury Department believe that it is appropriate to measure the basis and value of the predecessor's assets on the date of the distribution for purposes of determining the amount of gain required to be recognized when there have been acquisitions of a 50-percent or greater interest in the predecessor that are part of a plan that includes the distribution.

Special Rule for Affiliated Groups

The proposed regulations include a special rule that relates to the application of section 355(e)(2)(C). Section 355(e)(2)(C) provides that a plan (or series of related transactions) will not result in stock or securities in the controlled corporation not being treated as qualified property for purposes of section 355(c)(2) or section 361(c)(2) if, immediately after the completion of such plan or transactions, the distributing corporation and all controlled corporations are members of a single affiliated group (as defined in section 1504 without regard to subsection (b) thereof). These proposed regulations provide that, for purposes of section 355(e)(2)(C), a predecessor of Distributing or Controlled is treated as continuing in existence following its transfer of property to Distributing or Controlled, and Distributing or Controlled is treated as continuing in existence following a transfer of property to a successor.

Request for Comments

The IRS and Treasury Department are concerned that certain transfers of assets to a partnership or a corporation by Distributing or Controlled may facilitate an acquisition of an interest in Distributing's or Controlled's assets that is functionally equivalent to an acquisition of Distributing or Controlled. The IRS and Treasury Department are also concerned that certain acquisitions by persons unrelated to Distributing or Controlled of an interest in a corporation or partnership in which Distributing or Controlled directly or indirectly owns an interest may also be an acquisition that is functionally equivalent to an acquisition of Distributing or Controlled. If such transfers and acquisitions are part of a plan that includes the distribution, they could be used to circumvent the purposes of section 355(e). Accordingly, the IRS and Treasury Department are studying how section 355(e) might apply to such transfers and acquisitions. Comments are requested in this regard.

Special Analyses

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

Comments and Requests for a Public Hearing

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

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Krishna P. Vallabhaneni of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.355–8 also issued under 26 U.S.C. 355(e)(5). * * *

Par. 2. Section 1.355–8 is added to read as follows:

§1.355–8 Definition of predecessors and successors and limitations on gain recognition.

(a) *References to a distributing or controlled corporation*. For purposes of section 355(e) and the regulations promulgated thereunder, except as otherwise provided, any reference to a distributing corporation (Distributing) or a controlled corporation (Controlled) shall include a reference to any predecessor or successor of such corporation, as such terms are defined in this section.

(b) *Definition of predecessor*—(1) *Predecessor of a distributing corporation*. A predecessor of Distributing is a corporation (the first corporation) that before the distribution transfers property to Distributing in a transaction to which section 381 applies (the combining transfer), but only if either—

(i) Distributing transfers some but not all of the property acquired from the first corporation to Controlled (the separating transfer) and the basis of such property immediately after the separating transfer is determined in whole or in part by reference to the basis of the property in the hands of Distributing immediately before the separating transfer; or

(ii) In the combining transfer, some but not all of the property transferred to Distributing includes Controlled stock and, after the combining transfer, Distributing does not transfer all of the property acquired from the first corporation (other than the Controlled stock) to Controlled.

(2) *Predecessor of a controlled corporation*. Solely for purposes of paragraphs (b)(1), (e)(2), and (f) of this section, a corporation is a predecessor of Controlled if, before the distribution, it transfers property to Controlled in a transaction to which section 381 applies. Other than for the purposes described in the preceding sentence, no corporation can be a predecessor of Controlled.

(3) *References to a distributing or controlled corporation*. For purposes of paragraph (b)(1) of this section, a reference to Distributing shall not include a reference to a predecessor of Distributing. Therefore, a corporation that transfers property to a predecessor of Distributing in a transaction to which section 381 applies is not also a predecessor of Distributing. For purposes of paragraph (b)(2) of this section, a reference to Controlled shall not include a reference to a predecessor of Controlled. Therefore, a corporation that transfers property to a predecessor of Controlled in a transaction to which section 381 applies is not also a predecessor of Controlled.

(4) *Determination of predecessor status*—(i) *Substitute assets*. For purposes of determining whether a corporation is a predecessor of Distributing, if after the combining transfer Distributing transfers any property it received in the combining transfer in a transaction in which gain or loss is not recognized in whole, the property received by Distributing in exchange for such property shall be treated as transferred to Distributing in the combining transfer.

(ii) *Reorganizations under section 368(a)(1)(F)*. For purposes of determining whether a corporation is a predecessor of Distributing or Controlled, if a corporation engages in a reorganization under section 368(a)(1)(F), then the resulting corporation shall be treated as the same corporation that engaged in the reorganization. Therefore, if a corporation (X) transfers property to another corporation (Y) in a reorganization under section 368(a)(1)(A), and then Y transfers property to Distributing in a reorganization under section 368(a)(1)(F), Y and Distributing will be treated as the same corporation and X may be a predecessor of Distributing.

(iii) *Multiple predecessors*. More than one corporation may be a predecessor of Distributing or Controlled. Therefore, if more than one corporation transfers property to Distributing or Controlled in transactions to which section 381 applies, each of the transferring corporations may be a predecessor of Distributing or Controlled, respectively.

(c) *Definition of successor*—(1) *In general*. A successor of Distributing or Controlled, respectively, is a corporation to which Distributing or Controlled transfers property after the distribution in a transaction to which section 381 applies (a successor transaction).

(2) *Determination of successor status*. More than one corporation may be a successor of Distributing or Controlled. Therefore, if Distributing transfers property to another corporation (X) in a transaction to which section 381 applies, and X transfers property to another corporation (Y) in a transaction to which section 381 applies, then each of X and Y may be a successor of Distributing. In this case, the determination of whether Y is a successor of Distributing is made after the determination of whether X is a successor of Distributing.

(d) *Special acquisition rules*—(1) *Deemed acquisitions of a predecessor of a distributing corporation*. If there is a predecessor of Distributing, the following rules shall apply.

(i) Each person that owned an interest in Distributing immediately before the combining transfer involving the predecessor of Distributing shall be treated as acquiring in the combining transfer stock representing an interest in the predecessor of Distributing.

(ii) If stock of Distributing is acquired after the combining transfer involving the predecessor of Distributing, the stock of Distributing shall be treated as the stock of the predecessor of Distributing. Therefore, an acquisition of the stock of Distributing that occurs after the combining transfer shall be treated as not only an acquisition of the stock of Distributing, but also an acquisition of the stock of the predecessor of Distributing.

(2) *Deemed acquisitions of a distributing corporation*. If there is a successor of Distributing, the following rules shall apply.

(i) Each person that owned an interest in the successor of Distributing immediately before the successor transaction involving the successor of Distributing shall be treated as acquiring in the successor transaction stock representing an interest in Distributing.

(ii) If stock of the successor of Distributing is acquired after the successor transaction, the stock of the successor of Distributing shall be treated as stock of Distributing. Therefore, acquisitions of the stock of a successor of Distributing that occur after the successor transaction shall be treated as acquisitions of the stock of Distributing.

(3) *Deemed acquisitions of a controlled corporation*. If there is a successor of Controlled, the following rules shall apply.

(i) Each person that owned an interest in the successor of Controlled immediately before the successor transaction involving the successor of Controlled shall be treated as acquiring in the successor transaction stock representing an interest in Controlled.

(ii) If stock of the successor of Controlled is acquired after the successor transaction, the stock of the successor of Controlled shall be treated as stock of Controlled. Therefore, acquisitions of the stock of a successor of Controlled that occur after the successor transaction shall be treated as acquisitions of stock of Controlled.

(4) *Separate counting for distributing corporations and their predecessors*. The measurement of whether one or more persons have acquired stock that in the aggregate represents a 50-percent or greater in-

terest in either a predecessor of Distributing or Distributing that is part of the plan that includes the distribution shall be made separately. Therefore, there may be acquisitions of stock that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing that are part of a plan that includes a distribution where there are not acquisitions of stock that in the aggregate represent a 50-percent or greater interest in Distributing that are part of a plan that includes a distribution. In addition, there may be acquisitions of stock that in the aggregate represent a 50-percent or greater interest in Distributing that are part of a plan that includes a distribution where there are not acquisitions of stock that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing that are part of a plan that includes a distribution.

(e) *Special rules for gain recognition*—(1) *In general*. If there are acquisitions of stock that in the aggregate represent a 50-percent or greater interest in more than one corporation (for example, two predecessors of Distributing) that are pursuant to a plan that includes the distribution, Distributing must recognize gain in the amount described in section 355(c)(2) or 361(c)(2), as applicable, with respect to each such corporation, subject to the limitations in paragraphs (e)(2) and (3) of this section if applicable. The limitations in paragraphs (e)(2) and (3) of this section are applied separately to each such corporation to determine the amount of gain required to be recognized. Paragraph (e)(4) of this section sets forth an overall limitation that is computed taking into account all of the gain recognized by Distributing by reason of section 355(e).

(2) *Acquisition of a predecessor of a distributing corporation*—(i) *In general*. If a distribution and acquisitions of stock that in the aggregate represent a 50-percent or greater interest in a predecessor of Distributing are part of a plan, the amount of gain recognized by Distributing by reason of section 355(e) as a result of the acquisitions shall not exceed the amount of gain, if any, that the predecessor of Distributing would have recognized if, immediately before the distribution, the predecessor of Distributing had transferred the property that was transferred to Controlled in the separating transfer and stock of Controlled that the predecessor of Distributing transferred to Distributing in the combining transfer to a newly formed, wholly owned corporation in exchange solely for stock of such corporation in an exchange to which section 351 applied and then sold the stock of that corporation to an unrelated person in exchange for cash equal to its fair market value.

(ii) *Operating rules*. For purposes of applying paragraph (e)(2)(i) of this section, the following rules shall apply.

(A) If before the distribution Distributing transfers any property it received from the predecessor of Distributing in the combining transfer in a transaction in which gain or loss is not recognized in whole, the property received by Distributing in exchange for such property shall be treated as transferred to Distributing in the combining transfer.

(B) The basis of the property other than stock of Controlled treated as transferred to the newly formed, wholly owned corporation by the predecessor of Distributing shall equal the basis of such property in the hands of Controlled immediately before the distribution.

(C) Only property (other than stock of Controlled) owned by Controlled at the time of the distribution shall be taken into account in computing the amount pursuant to paragraph (e)(2)(i) of this section. However, if before the distribution Controlled transfers any property it received in the separating transfer in a transaction in which gain or loss is not recognized in whole, the property received by Controlled in exchange for such property shall be treated as transferred to Controlled in the separating transfer.

(D) The basis and fair market value of the stock of Controlled treated as transferred to the newly formed, wholly owned corporation shall equal the basis and fair market value, respectively, of such stock immediately before the combining transfer in which the predecessor of Distributing transferred such stock to Distributing.

(3) *Acquisitions of a distributing corporation*. If a distribution and acquisitions of stock that in the aggregate represent a 50-percent or greater interest in Distributing are part of a plan and the acquisitions occur in a combining transfer, the amount of gain recognized by Distributing by reason of section 355(e) as a result of the acquisitions shall not exceed the excess, if any, of the amount described in section 355(c)(2) or section 361(c)(2), as applicable, over the amount of gain, if any, that Distributing would have been required to recognize if there had been acquisitions of stock that in the aggregate represent a 50-percent or greater interest in the predecessor of Distributing (but not Distributing) involved in the combining transfer that were part of a plan that includes the distribution, taking into account the limitation in paragraph (e)(2) of this section. For purposes of this paragraph (e)(3), references to Distributing shall not include a reference to a predecessor of Distributing.

(4) *Overall limitation on gain recognition*. The sum of the amounts required to be recognized by Distributing under section 355(e) and the regulations promulgated thereunder (taking into account paragraphs (e)(2) and (3) of this section) shall not exceed the amount described in section 355(c)(2) or section 361(c)(2), as applicable.

(f) *Predecessor or successor as a member of the affiliated group*. For purposes of section 355(e)(2)(C), a predecessor of Distributing shall be treated as continuing in existence following the combining transfer to which section 381 applies described in paragraph (b)(1) of this section, a predecessor of Controlled shall be treated as continuing in existence following the transaction to which section 381 applies described in paragraph (b)(2) of this section, and Distributing or Controlled shall be treated as continuing in existence following a successor transaction.

(g) *Examples*. The following examples illustrate the principles of this section. Unless otherwise stated, assume throughout these examples that Distributing (D) owns all the stock of Controlled (C) and that D distributes the stock of C in a distribution to which section 355 applies, but to which section 355(d) does not apply. In addition, assume that X, Y, and Z are individuals, and that D, C, P, Q, and R are corporations and none of them is a member of a consolidated group. No inference should be drawn from any example concerning whether any requirements of section 355 other than those of section 355(e) are satisfied. The examples are as follows:

Example 1. Predecessor of distributing—(i) *Facts*. X owns 100 percent of the stock of P and Y owns 100 percent of the stock of D. P merges into D in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and Y own 10 percent and 90 percent, respectively, of the stock of D. D then contributes to C one of the assets acquired from P in the merger. At the time of the contribution, the asset has a basis of $40x and a fair market value of $110x. In exchange for the asset, D receives additional C stock and $10x. D distributes the stock of C (but not the cash) to X and Y *pro rata*. The contribution is described in section 368(a)(1)(D) and D recognizes $10x of gain under section 361(b) in the contribution. Immediately before the distribution, the asset contributed to C has a basis of $50x and a fair market value of $110x, and the stock of C held by D has a basis of $100x and a fair market value of $200x.

(ii) *Analysis*. Under paragraph (b)(1) of this section, P is a predecessor of D because before the distribution P transferred property to D in a transaction to which section 381 applies, D transferred some but not all of the acquired property to C, and immediately after its transfer to C, the property has a basis determined in whole or in part by reference to the basis of the property in the hands of D immediately before the transfer to C.

(iii) Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90 percent of the voting power and value of P.

(iv) If the distribution and Y's deemed acquisition of a 90-percent interest in P were part of a plan, D would recognize gain in the amount described in section 361(c)(2). Without regard to the limitations in paragraph (e) of this section, D would be required to recognize $100x of gain. Under paragraph (e)(2) of this section, however, D's gain recognized by reason of the acquisition of P would not exceed $60x, the gain P would have recognized if, immediately before the distribution, it had transferred the former P property transferred by D to C to a newly formed, wholly owned corporation solely for stock of such corporation in an exchange to which section 351 applied and then sold that stock to an unrelated person for cash equal to its fair market value. Therefore, D would recognize $60x of gain.

Example 2. Distributing's predecessor owns controlled stock—(i) *Facts*. X owns 100 percent of the stock of P, and Y owns 100 percent of the stock of D. P owns 35 percent of the stock of C with a basis of $40x and a fair market value of $35x. D owns the remaining 65 percent of the C stock with a basis of $10x and a fair market value of $65x. P merges into D in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and Y own 10 percent and 90 percent, respectively, of the D stock, and D owns 100 percent of the C stock with a basis of $50x and a fair market value of $100x. D then contributes to C one of the assets it acquired from P in the merger in exchange for additional shares of C. The contribution qualifies as a reorganization under section 368(a)(1)(D). After the contribution, D distributes all of the C stock to X and Y *pro rata*. Immediately before the distribution, the asset contributed to C has a basis of $40x and a fair market value of $100x, and the C stock held by D has a basis of $90x and a fair market value of $200x.

(ii) *Analysis*. Under paragraph (b)(1) of this section, P is a predecessor of D because before the distribution P transferred property to D in a transaction to which section 381 applies, D transferred some but not all of the acquired property to C, and immediately after its transfer to C, the property has a basis determined in whole or in part by reference to the basis of the property in the hands of D immediately before the transfer to C. P is also a predecessor of D under paragraph (b)(1) of this section because some but not all of the property transferred to D includes C stock and, after the merger, D does not transfer all of the property acquired from P to C.

(iii) Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90 percent of the voting power and value of P.

(iv) If the distribution and Y's deemed acquisition of a 90-percent interest in P were part of a plan, D would recognize gain in the amount described in section 361(c)(2). Without regard to the limitations in paragraph (e) of this section, D would be required to recognize $110x of gain. Under paragraph (e)(2) of this section, however, D's gain recognized by reason of the acquisition of P would not exceed $55x, the gain P would have recognized if, immediately before the distribution, it had transferred the former P property that was transferred by D to C and the stock of C acquired from P to a newly formed, wholly owned corporation solely for stock of such corporation in an exchange to which section 351 applies and then sold that stock to an unrelated person for cash equal to its fair market value. For this purpose, the basis and fair market value of the C stock is treated as its basis and fair market value, respectively, immediately before the merger. Therefore, D would recognize $55x of gain.

Example 3. Predecessor of controlled—(i) *Facts*. X owns 100 percent of the stock of P and P owns various assets including 100 percent of the stock of R. Y owns 100 percent of the stock of D and D owns 100 percent of the stock of C. P merges into D in a reorganization under section 368(a)(1)(A). Immediately after the merger, X and Y own 10 percent and 90 percent, respectively, of the stock of D. D then causes R to merge into C in a reorganization under section 368(a)(1)(D). At the time of the P-D merger, the R stock has a basis of $40x and a fair market value of $110x. D distributes the stock of C to X and Y *pro rata*. Immediately before the distribution, the stock of C held by D has a basis of $100x and a fair market value of $200x.

(ii) *Analysis*. Under paragraph (b)(2) of this section, R is a predecessor of C because before the distribution R transferred property to C in a transaction to which section 381 applies. Under paragraph (b)(1) of this section, P is a predecessor of D because some but not all of the property transferred to D includes stock of R, a predecessor of C and, after the merger, D does not transfer all of the property acquired from P to C.

(iii) Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 90 percent of the voting power and value of P.

(iv) If the distribution and Y's deemed acquisition of a 90-percent interest in P were part of a plan, D would recognize gain in the amount described in section 361(c)(2). Without regard to the limitations in paragraph (e) of this section, D would be required to recognize $100x of gain. Under paragraph (e)(2) of this section, however, D's gain recognized by reason of the acquisition of P would not exceed $70x, the gain P would have recognized if, immediately before the distribution, it had transferred the stock of R to a newly formed, wholly owned corporation solely for stock of such corporation in an exchange to which section 351 applied and then sold that stock to an unrelated person for cash equal to its fair market value. For this purpose, the basis and fair market value of the R stock is treated as its basis and fair market value, respectively, immediately before the P-D merger. Therefore, D would recognize $70x of gain.

Example 4. Acquisition of a distributing corporation. (i) *Facts*. X owns 100 percent of the stock of P and Y owns 100 percent of the stock of D. P merges into D in a reorganization under section 368(a)(1)(A). In the merger, X acquires 60 percent of the D stock. After the merger, therefore, X and Y own 60 percent and 40 percent, respectively, of the stock of D. D then contributes to C, a newly formed corporation, some of the assets acquired from P in the merger and one asset that it owned prior to the merger, in exchange for C stock in a transfer that qualifies as a reorganization under section 368(a)(1)(D). After the contribution, D distributes the C stock to its shareholders *pro rata*. Immediately before the distribution, the contributed asset that D had owned prior to the merger has a basis of $3x and a fair market value of $10x and the contributed assets acquired from P have an aggregate basis of $1x and an aggregate value of $30x. Finally, immediately before the distribution, D's C stock has a basis of $4x and a fair market value of $40x.

(ii) *Analysis*. Under paragraph (b)(1) of this section, P is a predecessor of D because before the distribution P transferred property to D in a transaction to which section 381 applies, D transferred some but not all of the acquired property to C, and immediately after its transfer to C, the property has a basis determined in whole or in part by reference to the basis of the property in the hands of D immediately before the transfer to C.

(iii) Under paragraph (d)(1)(i) of this section, Y is treated as acquiring stock representing 40 percent of the voting power and value of P. There are not acquisitions that in the aggregate represent a 50-percent or greater interest in P in the merger that is pursuant to a plan that includes a distribution. However, there is an acquisition by X of a 60-percent interest in D in the merger. If that acquisition were pursuant to a plan that includes the distribution, D would be required to recognize gain in the amount described in section 361(c)(2). Without regard to the limitations in paragraph (e) of this section, D would be required to recognize $36x of gain. Under paragraph (e)(3) of this section, however, because that acquisition occurred in connection with P's merger into D, the amount of gain recognized by D would not exceed $7x, the excess of the gain described in section 361(c)(2) ($36x) over the gain that D would have been required to recognize if there had been an acquisition of stock representing a 50-percent or greater interest in P (but not D) that was part of a plan involving the distribution ($29x). Therefore, D would recognize $7x of gain.

Example 5. Successor of a controlled corporation—(i) *Facts*. X owns 100 percent of the stock of each of D and R. D owns 100 percent of the C stock. D's C stock has a basis of $10x and a fair market value of $30x. D distributes all of its C stock to X. Immediately after the distribution, C merges into R in a reorganization under section 368(a)(1)(D). Immediately after the merger, X owns all of the R stock. Subsequently, Z purchases 60 percent of the stock of R from X.

(ii) *Analysis*. Under paragraph (c) of this section, R is a successor of C because after the distribution C transfers property to R in a transaction to which section 381 applies. Accordingly, Z acquired an interest in a successor of C. In addition, under paragraph (d)(3)(ii) of this section, the stock of R is treated as stock of C such that Z is treated as acquiring 60 percent of the voting power and value of C.

(iii) If the distribution and Z's acquisition of a 60-percent interest in R were part of a plan, D would be required to recognize gain in the amount of $20x, the amount described in section 355(c)(2).

(h) *Effective date*. This section applies to distributions occurring after the date these regulations are published as final regulations in the **Federal Register**.

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

(Filed by the Office of the Federal Register on November 19, 2004, 8:45 a.m., and published in the issue of the Federal Register for November 22, 2004, 69 F.R. 67873)

Notice of Proposed Rulemaking and Notice of Public Hearing

Section 707 Regarding Disguised Sales, Generally

REG–149519–03

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the treatment of transactions between a partnership and its partners as disguised sales of partnership interests between the partners under section 707(a)(2)(B) of the Internal Revenue Code (Code). The proposed regulations affect partnerships and their partners, and are necessary to provide guidance needed to comply with the applicable tax law. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by February 24, 2005. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for March 8, 2005, at 10:00 a.m. must be received by February 15, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–149519–03), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–149519–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS internet site *http://www.irs.gov/regs* or via the Federal eRulemaking Portal site at *http://www.regulations.gov* (indicate IRS and REG–149519–03). The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Deane M. Burke or Christopher L. Trump, (202) 622–3070; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Treena V. Garrett, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 25, 2005. Comments are specifically requested concerning:

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

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

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

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

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

The collection of information in the proposed regulations is in §§1.707–3(c)(2), 1.707–5(a)(8), 1.707–6(c), and 1.707–7(k). This information is required by the IRS to ensure that section 707(a)(2)(B) of the Code and the regulations thereunder are properly applied to transfers between partners in a partnership. The information collected will be used to determine whether partners are complying with section 707(a)(2)(B) and the regulations thereunder. The respondents will be partners and partnerships.

Estimated total annual reporting burden: 7,500 hours.

Estimated average burden per respondent varies from 15 minutes to 25 minutes, depending on individual circumstances, with an estimated average of 20 minutes.

Estimated number of respondents: 22,500.

Estimated annual frequency of responses: annually.

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 proposes to amend section 707 of the Income Tax Regulations (26 CFR part 1) regarding disguised sales of partnership property, including partnership interests.

Section 707(a)(2)(B) of the Code provides that, under regulations prescribed by the Secretary, transfers to and by a partnership that are more properly characterized as transactions between the partnership and one who is not a partner or between two or more partners acting other than in their capacity as partners shall be treated as such transactions. The legislative history of section 707(a)(2)(B) indicates the provision was adopted as a result of Congressional concern that taxpayers were deferring or avoiding tax on sales of partnership property, including sales of partnership interests, by characterizing sales as contributions of property, including money, followed or preceded by related partnership distributions. See H.R. Rep. No. 861, 98th Cong. 2nd Sess. 861 (1984), 1984–3 (Vol. 2) C.B. 115. Specifically, Congress was concerned about court decisions that allowed tax-free treatment in cases that were economically indistinguishable from sales of property to a partnership or another partner, and believed that these transactions should be treated for tax purposes in a manner consistent with their underlying economic substance. See H.R. Rep. No. 432, 98th Cong. 2nd Sess. 1218 (1984) (H.R. Rep.), and S. Prt. No. 169 (Vol. I), 98th Cong. 2nd Sess. 225 (1984) (S. Prt.) (discussing *Communications Satellite Corp. v. United States*, 625 F.2d 997 (Ct. Cl. 1980), and *Jupiter Corp. v. United States*, 2 Cl. Ct. 58 (1983), both of which involved disguised sales of a partnership interest).

On September 30, 1992, final regulations under section 707(a)(2) (T.D. 8439, 1992–2 C.B. 126) relating to disguised sales of property to and by partnerships were published in the **Federal Register** (57 FR 44974 as corrected on November 30, 1992, by 57 FR 56443) (existing regulations). Section 1.707–7 of the existing regulations was reserved for rules on disguised sales of partnership interests. On October 9, 2001, the IRS and the Treasury Department issued Notice 2001–64, 2001–2 C.B. 316, announcing that the IRS and the Treasury Department were considering issuing proposed regulations under section 707(a)(2)(B), relating to disguised sales of partnership interests. The IRS and the Treasury Department requested comments on the scope and substance of guidance concerning disguised sales of partnership interests, including any applicable safe harbors or exceptions. Written comments in response to Notice 2001–64 were received and considered in drafting these proposed regulations.

In February 2003, the Joint Committee on Taxation released its Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues and Policy Recommendations (Enron Report), and the Written Testimony of the Staff of the Joint Committee on the Enron Report (Written Testimony). In the Enron Report and the Written Testimony, the Joint Committee recommended changes to rules in the existing regulations that require disclosure of certain transactions. These proposed regulations include those changes and provide disclosure rules for disguised sales of partnership interests consistent with the disclosure rules in the existing regulations, as amended.

Explanation of Provisions

1. *Framework of Rules*

Commentators responding to Notice 2001–64 generally recommended that the proposed regulations relating to disguised sales of partnership interests include a framework similar to that in the existing regulations, with a general rule that applies based on all of the facts and circumstances, and a variety of safe harbors and presumptions. In addition, the commentators specifically recommended that certain of the presumptions and safe harbors in the existing regulations be incorporated into the proposed regulations and that the treatment of liabilities under the proposed regulations largely follow the treatment of liabilities under the existing regulations. The IRS and the Treasury Department agree with those recommendations and, accordingly, the proposed regulations follow the form of the existing regulations and include rules similar to many of the rules in the existing regulations, with appropriate modifications.

2. *General Rule*

The commentators also recommended that the proposed regulations provide a narrower rule than the existing regulations for determining that a purported contribution and distribution are related, and therefore, are treated as a disguised sale of a partnership interest. One commentator noted that, unlike the existing regulations, the proposed regulations would potentially apply whenever there are cash contributions and distributions, which are common events for most partnerships. In addition, unlike in a disguised sale of partnership property, no person, other than the partnership, participates in both of the transactions that constitute the disguised sale (transfers to and by a partnership) and a party engaged in one of those transactions may not even be aware of the other transaction. Another commentator expressed concern that without a narrower rule, the proposed regulations could apply to many common, legitimate partnership transactions, such as the routine admission to and redemption from professional and securities partnerships.

Under the existing regulations, a transfer of property by a partner to a partnership and a simultaneous transfer of money or other consideration by the partnership to the partner are treated as a disguised sale of property only if, based on all the facts and circumstances, the transfer by the partnership would not have been made but for the transfer to the partnership, and, in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations. Section 1.707–3(b)(1). One of the commentators suggested that in addition to the "but for" test in the existing regulations, the proposed regulations provide that transfers to and by a partnership will constitute a disguised sale of a partnership interest only if the two transfers are "directly related." Another commentator suggested that the proposed regulations find a disguised sale of a partnership interest only where both the transfer to and the transfer by the partnership would not have been made but for the other transfer, a so-called "double but for test." The commentators also recommended narrowing the scope of the proposed regulations by providing additional favorable presumptions or safe harbors for certain transactions, such as transfers to and from professional partnerships.

The IRS and the Treasury Department agree that because many more transactions may potentially be subject to the proposed regulations, it is appropriate that the proposed regulations be narrower than the existing regulations. However, the IRS and the Treasury Department have concerns about the alternate tests of relatedness suggested by the commentators. Specifically, the IRS and the Treasury Department are not certain how a "directly related" test would be interpreted or applied, or whether it would be effective in narrowing the scope of the proposed rules. In addition, the IRS and the Treasury Department are concerned that certain transactions that should be treated as a disguised sale of a partnership interest would not be covered under a "double but for test." For example, assume that a prospective investor in a partnership and an existing partner who wishes to sell its partnership interest agree that upon the prospective investor's transfer to the partnership, the partnership will make a corresponding transfer to the existing partner. If the prospective investor is indifferent as to whether the existing partner retains its partnership interest, the transaction would not satisfy a "double but for test" since the transfer to the partnership was not made but for the transfer from the partnership. Nonetheless, the IRS and the Treasury Department believe that the transaction is economically indistinguishable from a sale of a partnership interest and should be treated as such. In contrast, the IRS and the Treasury Department believe that the "but for" test of the existing regulations provides a relatively bright line rule that is easier to interpret and administer and that, in most cases, covers those transactions that should be treated as disguised sales of partnership interests. The IRS and the Treasury Department thus believe that the appropriate way to narrow the scope of those rules is to provide additional safe harbors but adopt the same "but for" test included in the existing regulations.

Accordingly, the proposed regulations provide that a transfer of money, property or other consideration (including the assumption of a liability) (consideration) by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner constitute a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner only if, based on all the facts and circumstances, the transfer by the partnership would not have been made but for the transfer to the partnership, and, in cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

3. *Facts and Circumstances*

As under the existing regulations, the proposed regulations provide that whether two transfers constitute a disguised sale is determined based on all the facts and circumstances. The proposed regulations list a series of factors that, among others, tend to indicate the existence of a disguised sale of a partnership interest. The weight given each of the factors will depend on the circumstances of each case. Generally, the facts and circumstances existing on the date of the earliest of the transfers are the ones considered in determining if a sale exists.

Many of the factors listed in the proposed regulations are similar to those under the existing regulations. However, the proposed regulations include additional facts and circumstances that are relevant in the context of a disguised sale of a partnership interest. For example, included in the facts and circumstances in the proposed regulations are (1) that the same property (other than money, including marketable securities that are treated as money under section 731(c)(1)) (non-cash property) that is transferred to the partnership by the purchasing partner is transferred to the selling partner, and (2) that the partnership holds transferred non-cash property for a limited period of time, or during the period of time the partnership holds transferred non-cash property, the risk of gain or loss associated with the property is not significant.

4. *Presumptions and Safe Harbors*

a. *In General*

The commentators generally suggested that the proposed regulations provide presumptions and safe harbors that model those contained in the existing regulations. Those rules generally focus on the timing, risk, and source of partnership distributions. The IRS and the Treasury Department believe that rules similar to those rules in the existing regulations should apply in the context of disguised sales of partnership interests. Therefore, the proposed regulations include presumptions and safe harbors similar to those in the existing regulations, along with an additional favorable presumption and an additional exception that address concerns specifically relevant in the context of disguised sales of partnership interests. As under the existing regulations, each of the presumptions in the proposed regulations may be rebutted only by facts and circumstances that clearly establish the contrary.

b. *Timing of Transfers, Liquidations, and Service Partnerships*

The proposed regulations adopt an approach similar to that in the existing regulations regarding transfers made within two years and transfers made more than two years apart. Thus, the proposed regulations provide that a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner that are made within two years of each other are presumed to be a sale, and that such transfers made more than two years apart are presumed not to be a sale. One commentator suggested that the timing presumptions in the proposed regulations should only apply to "extraordinary" contributions and distributions because the proposed regulations, unlike the existing regulations, may apply whenever there is a cash contribution to and cash distribution from a partnership, which are routine transactions for many partnerships. The IRS and the Treasury Department believe that this concern is adequately addressed by the inclusion in the proposed regulations of (1) presumptions, discussed below, against sale treatment for transfers of money (including marketable securities) to a selling partner in liquidation of the selling partner's interest in the partnership as well as for guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures, and (2) an exception for contributions and distributions of money (including marketable securities) to and from service partnerships (defined as described below).

Another commentator argued that the proposed regulations should not include presumptions based upon the amount of time that elapses between transfers. The commentator submitted that the timing presumptions in the existing regulations have done little to promote certainty for taxpayers. The IRS and the Treasury

Department did not follow the commentator's recommendation. Even though timing presumptions do not eliminate the need to analyze the relevant facts and circumstances, the IRS and the Treasury Department believe that timing presumptions help the IRS and taxpayers identify transactions where closer scrutiny is required. See S. Prt. No. 169 (Vol. I), 98th Cong. 2nd Sess. 231 (1984) (suggesting that regulations provide a presumption of "relatedness" for transfers within three years).

The IRS and the Treasury Department believe that the abuse that section 707(a)(2)(B) was intended to address typically is not present in situations involving complete liquidations of partners' partnership interests for money. Accordingly, the proposed regulations provide that, notwithstanding the presumption relating to transfers within two years, a transfer of money, including marketable securities that are treated as money under section 731(c)(1), to a selling partner in liquidation of that partner's entire interest in the partnership is presumed not to be part of a disguised sale of that interest. However, the IRS and the Treasury Department recognize that there are instances in which a liquidating distribution may properly be characterized as part of a disguised sale of a partnership interest, particularly when the tax consequences of a liquidating distribution are significantly different from those of a sale of a partnership interest. Accordingly, the presumption against sale treatment may be rebutted in those cases.

As recommended by the commentators, the proposed regulations provide that transfers of money, including marketable securities that are treated as money under section 731(c)(1), to and by a partnership that would be described in section 448(d)(2) if the partnership were a corporation (service partnership) are not a sale and need not be disclosed. This exception takes into account that partners frequently enter and exit service partnerships and, in most cases, those transactions are factually unrelated to each other and should not be treated as a disguised sale of a partnership interest. One commentator also suggested that the proposed regulations provide favorable presumptions or safe harbors for other types of partnerships, including securities partnerships and partnerships involved in staged closings. The IRS and the Treasury Department specifically request additional comments on whether the proposed regulations should include safe harbors for partnerships other than service partnerships, and if so, how to appropriately define those categories of partnerships.

c. *Guaranteed Payments, Preferred Returns, Operating Cash Flow Distributions, and Qualified Reimbursements*

As recommended by the commentators, the proposed regulations provide that rules similar to those provided in §1.707–4 of the existing regulations concerning guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures apply (notwithstanding the presumption relating to transfers made within two years of each other) to determine the extent to which a transfer to a selling partner is treated as part of a sale of the selling partner's interest in the partnership to the purchasing partner. The IRS and the Treasury Department agree that inclusion of those rules in the proposed regulations is appropriate in order to distinguish between transfers to partners that occur in the ordinary course of business and transfers to partners that are part of a disguised sale.

d. *Certain Presumptions Not Included*

Commentators expressed concern that a transfer of property by one partner to a partnership and a transfer of different property by the partnership to another partner should not form the basis of a disguised sale of a partnership interest. One commentator argued that to recharacterize those transfers as a sale of a partnership interest would require the reordering of steps or the creation of additional steps, which is impermissible under the step transaction and related doctrines. Nonetheless, the commentator acknowledged that there are situations in which the recharacterization more properly reflects the substance of the transaction.

The proposed regulations do not adopt a specific favorable presumption or safe harbor for transactions involving transfers of different property. The IRS and the Treasury Department are concerned that if such a favorable presumption or safe harbor were available, a purchasing partner and selling partner could easily structure a transaction to fit within the favorable presumption or safe harbor, for example, by the purchasing partner transferring an asset that it wishes to sell to the partnership and the partnership selling the asset and transferring the sales proceeds to the selling partner. The IRS and the Treasury Department specifically request additional comments on whether a favorable presumption or safe harbor for transactions involving transfers of different property is appropriate and, if so, how any favorable presumption or safe harbor could be narrowly tailored to cover only those transactions that clearly should not be characterized as a sale of a partnership interest.

The commentators also suggested that the proposed regulations provide a safe harbor for situations in which one partner funds a defaulting partner's obligation to make a capital contribution. According to one commentator, the subsequent transfer by the defaulting partner to the partnership and the related transfer by the partnership to the non-defaulting partner merely restore the original economic deal intended, and should not be characterized as a sale. The IRS and the Treasury Department believe, however, that this type of transaction can be difficult to distinguish from an actual sale of a partnership interest. Therefore, the proposed regulations do not include a safe harbor for these transactions.

5. *Liabilities*

The proposed regulations generally follow the approach of the existing regulations with respect to the treatment of liabilities. Thus, if a partnership assumes a liability of a partner, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of that liability immediately after the partnership assumes the liability. Similarly, if a partner assumes a liability of a partnership, the partner is treated as transferring consideration to the partnership to the extent that the amount of the liability assumed exceeds the partner's share of that liability immediately before the assumption. However, the proposed regulations specifically provide, as suggested by the commentators, that deemed contributions to and distributions from a partnership under section 752 resulting from reallocations of partnership liabilities among partners are not treated as transfers of consideration. The rules in the proposed regulations relating to a partner's share of a partnership liability, including the effect of a subsequent reduction in a partner's share of a partnership liability, follow those rules in the existing regulations. The proposed regulations also include rules with respect to debt-financed transfers of consideration by partnerships that follow the rules in the existing regulations.

Unlike the existing regulations, the proposed regulations do not include any special rules for qualified liabilities. The IRS and the Treasury Department believe that the inclusion of those special rules in the existing regulations is appropriate because, otherwise, any transfer of property to a partnership subject to a liability could be recharacterized as a disguised sale of property. In contrast, under the proposed regulations, a transfer to a partnership of encumbered property alone would not be subject to recharacterization as a disguised sale of a partnership interest. Rather, a transfer to a partnership of encumbered property would have to be related to a transfer of consideration by another partner in order for disguised sale treatment to apply. Nonetheless, the IRS and the Treasury Department specifically request comments on whether the proposed regulations should include rules similar to those in the existing regulations for qualified liabilities, and if so, whether and how those rules should be modified to address issues particular to disguised sales of partnership interests.

The proposed regulations also include an anti-abuse rule to address cases in which the rules of the proposed regulations do not adequately capture the substance of an integrated set of transactions. The anti-abuse rule in the proposed regulations provides that an increase in a partner's share of a partnership liability may be treated as a transfer of consideration in a sale of a partnership interest if, within a short period of time after the partnership incurs or assumes the liability or another liability, one or more partners (or related parties) in substance bear an economic risk for the liability that is disproportionate to the partners' interests in partnership profits or capital, and the transactions are undertaken pursuant to a plan that has as one of its principal purposes minimizing the extent to which the partners are treated as making a transfer of consideration to a partnership that may be treated as part of a sale. Comments are requested on this proposed anti-abuse rule, including examples of particular situations where application of this rule would be appropriate.

6. *Treatment of Transfers as a Sale*

If a transfer of consideration by a purchasing partner to the partnership and a transfer of consideration by the partnership to a selling partner are treated as part of a sale of a partnership interest, the proposed regulations provide several rules relating to the tax consequences of sale treatment. First, the proposed regulations provide that transfers that are treated as a sale of a partnership interest are treated as a sale for all purposes of the Code. In addition, the proposed regulations include rules relating to the timing of the sale that are similar to those in the existing regulations. Specifically, the proposed regulations provide that the sale is considered to take place on the date of the earliest of the transfers. If the transfer by the partnership occurs before the transfer to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred to the partnership an obligation to deliver that partner's consideration in exchange for the consideration transferred by the partnership to the selling partner (selling partner's consideration), and the purchasing partner transferred the selling partner's consideration to the selling partner in exchange for the selling partner's partnership interest. If the transfer by the partnership occurs after the transfer to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred that partner's consideration to the partnership (purchasing partner's consideration) in exchange for an obligation of the partnership to deliver the selling partner's consideration, and the purchasing partner transferred that obligation to the selling partner in exchange for the selling partner's partnership interest.

The IRS and the Treasury Department intend that the deemed transactions that are treated as occurring as described in the immediately preceding paragraph result in actual tax consequences to the partnership, the purchasing partner(s), and the selling partner(s) for all purposes of the Code. Thus, for instance, where the consideration actually transferred by the purchasing partner to a partnership is different than the actual consideration later transferred from the partnership to the purchasing partner, there may be tax consequences for the partnership and the partners resulting from deemed exchanges of consideration, *e.g.*, gain or loss recognition to the partnership or partners (including the potential application of section 267 or 707).

The proposed regulations also provide rules relating to the amount of the sale and the inclusion of liability relief in the amount realized on the sale. Specifically, with respect to the amount of the sale, the proposed regulations provide that the selling partner is treated as selling to the purchasing partner a partnership interest with a value equal to the lesser of the selling partner's consideration or the purchasing partner's consideration. For this purpose, simultaneous transfers of consideration by more than one purchasing partner to a partnership, or by a partnership to more than one selling partner, are aggregated. In those cases, each purchasing partner is presumed to have purchased a fractional share of the partnership interest(s) sold, and each selling partner is presumed to have sold its fractional share of the total partnership interest(s) sold. In addition, although the proposed regulations provide that deemed contributions to and distributions from a partnership under section 752 resulting from reallocations of partnership liabilities among partners are not treated as transfers of consideration, the proposed regulations clarify that the amount realized by a selling partner on the sale of the partner's interest in the partnership includes any reduction in the selling partner's share of partnership liabilities that is treated as occurring as a result of the sale, if the reduction in liability has not otherwise been treated as a transfer of consideration to the selling partner.

The proposed regulations also address issues relating to the application of certain rules that may overlap. First, the proposed regulations provide that if a portion of a transfer of consideration by a partnership to a selling partner is not treated as part of a sale of the partner's interest in the partnership, but as a distribution to the selling partner under section 731, and the sale is treated as occurring on the same date as the distribution, then the distribution is treated as occurring immediately following the sale. Thus, the portion of the transfer that is treated as a distribution is not taken into account for purposes of computing the selling partner's basis in its partnership interest prior to the disguised sale of the interest. In addition, the proposed regulations provide that the rules for disguised sales of property apply before the rules of the proposed regulations, and to the extent a transfer of consideration is treated as part of a sale of property under the rules for disguised sales of property, the transfer is not taken into account for purposes of the rules in the proposed regulations. This ordering rule is appropriate because, in some cases, the tax consequences of a disguised sale of property may be simpler than a disguised sale of a partnership interest because, for example, a disguised sale of property will not result in a technical termination of the partnership under section 708(b)(1)(B) or basis adjustments under section 743(b).

Finally, the proposed regulations clarify whether the rules apply to certain transfers that occur upon the formation or termination of a partnership. The proposed regulations do not apply to transfers incident to the formation of a partnership, although these transfers may be subject to recharacterization as a disguised sale of property under the existing regulations. The proposed regulations also do not apply to deemed transfers resulting from a termination of a partnership under section 708(b)(1)(B). The IRS and the Treasury Department specifically request comments on whether the proposed regulations should include special rules or exceptions for some or all of the transfers occurring in a partnership merger or division under §1.708–1(c) or (d).

7. *Disclosure*

In the Enron Report and the Written Testimony, the Joint Committee recommended that the period for which disclosure of a transaction is required under the disguised sale rules should be extended beyond two years. The Committee further suggested that expanding the disclosure period to seven years might make it more likely that taxpayers would undertake the facts and circumstances determination for transfers occurring more than two years apart and would make that facts and circumstances determination easier for the IRS to administer. To effect this recommendation, the proposed regulations would amend §§1.707–3(c)(2) and 1.707–6(c) of the existing regulations to extend the disclosure requirement to the specified events occurring within seven years instead of two years. The IRS and the Treasury Department request comments regarding whether the disclosure requirement should be extended to a period that is more than two years, but less than seven years.

The proposed regulations also would add a new requirement to both §§1.707–5 and –6 of the existing regulations, relating to the disclosure of the assumption of or taking subject to liabilities. Specifically, §1.707–5(a)(8) of the proposed regulations would require disclosure if a partner transfers property to a partnership, and the partnership assumes or takes subject to a liability of the partner (whether or not the liability is qualified) within a seven-year period (without regard to the order of the transactions), and the partner treats the transactions as other than as a sale for tax purposes. Similarly, §1.707–6(c)(3) of the proposed regulations would require disclosure if a partnership transfers property to a partner, and the partner assumes or takes subject to a liability of the partnership (whether or not the liability is qualified) within a seven-year period (without regard to the order of the transactions), and the partnership treats the transactions as other than as a sale for tax purposes. These disclosure requirements were added because of a concern that taxpayers are taking unwarranted positions regarding a partner's share of partnership liabilities before or after an assumption of or taking subject to a liability.

Finally, the proposed regulations would amend the provision in §1.707–8(c) to clarify who is required to disclose under the disguised sale rules. The amended paragraph provides that the required disclosure must be made by any person who makes a transfer that is required to be disclosed, and that the persons who are required to disclose may designate by written agreement a single person to make the disclosure. However, the designation of one person to make the disclosure does not relieve the other persons required to disclose from their obligation to make the disclosure, if the designated person fails to make the appropriate disclosure.

The proposed regulations provide disclosure rules for transactions that may be treated as disguised sales of partnership interests consistent with the disclosure rules in the existing regulations, as amended. Disclosure to the IRS is required when a partner transfers consideration to a partnership and the partnership transfers consideration to another partner within a seven-year period (without regard to the order of the transfers), the partners treat the transfers other than as a sale for tax purposes, and the transfer of consideration by the partnership is not presumed to be a guaranteed payment for capital, is not a reasonable preferred return, and is not an operating cash flow distribution. However, disclosure is not required if the exception described earlier for service partnerships applies.

8. *Review of Existing Regulations*

The IRS and the Treasury Department have become aware of certain deficiencies and technical ambiguities in the existing regulations under §§1.707–3, 1.707–4 and 1.707–5. Among the deficiencies and technical ambiguities identified are the rules for capital expenditure reimbursements, the liability sharing rules, and the interaction of the capital expenditure reimbursement rules with the qualified liability rules. In order to address these deficiencies and technical ambiguities, the IRS and the Treasury Department intend to issue proposed regulations amending the existing regulations. In addition, the IRS and the Treasury Department intend to revise these proposed regulations to reflect those proposed amendments to the existing regulations. The IRS and Treasury Department request comments on the scope and content of the revisions to the existing regulations (and these proposed regulations).

Proposed Effective Date

The regulations are proposed to apply to transactions with respect to which all transfers considered part of a sale occur on and after the date these regulations are published as final regulations in the **Federal Register**. A determination of disguised sale treatment for a partnership interest for the period between the effective date of section 707(a)(2)(B) and the effective date of these regulations is to be made based on the statutory language and the guidance provided in the legislative history of section 707(a)(2)(B).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time necessary to prepare the required disclosure is not lengthy and few small businesses are likely to be partners or parties required to make the disclosures required by the rule, and particularly, because the disclosure requirement does not apply to certain service partnerships. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

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

A public hearing has been scheduled for March 8, 2005, at 10:00 a.m. in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name 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 or electronic comments by February 24, 2005, and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by February 15, 2005. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Deane M. Burke of the Office of the Associate Chief Counsel (Passthroughs & Special Industries), IRS. However, other personnel from the IRS and the 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 TAX

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

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

Section 1.707–2 through 1.707–9 also issued under 26 U.S.C. 707(a)(2)(B).

Par. 2. Section 1.707–0 is amended as follows:

1. Adding an entry for §1.707–5(a)(8).

2. Revising the entry for §1.707–7.

3. Adding entries for §§1.707–7(a) through 1.707–7(l).

4. Revising the entry for §1.707–8(c).

5. Revising the entries for §§1.707–9(a) and (a)(2).

The revisions and additions read as follows:

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§1.707–0 Table of contents.

* * * * *

§1.707–5 Disguised sales of property to partnerships; special rules relating to liabilities.

* * * * *

(a) * * *

(8) Disclosure of liabilities assumed or taken subject to within seven years of transfer.

* * * * *

§1.707–7 Disguised sales of partnership interests.

distributions, and reimbursements of preformation expenditures).

(g) Exception for certain transfers to and by service partnerships.

(h) Other exceptions.

(i) [Reserved.]

(j) Special rules relating to liabilities.

(1) In general.

(2) Partner liability assumed by partnership.

(3) Partnership liability assumed by partner.

(4) Partner's share of liability.

(i) Recourse liability.

(ii) Nonrecourse liability.

(5) Reduction of partner's share of liability.

(6) Treatment of debt-financed transfers of consideration by partnerships.

(i) In general.

(ii) Partner's allocable share of liability.

(A) In general.

(B) Debt-financed transfers made pursuant to a plan.

(*1*) In general.

(*2*) Special rule.

(C) Reduction of partner's share of liability.

(7) Share of liability where assumption accompanied by transfer of money.

(8) Anti-abuse rule.

(k) Disclosure rules.

(l) Examples.

* * * * *

§1.707–8 Disclosure of certain information.

* * * * *

(c) Parties required to disclose.

* * * * *

§1.707–9 Effective dates and transitional rules.

(a) Sections 1.707–3 through 1.707–7.

(1) * * *

(2) Transfers occurring before effective dates.

* * * * *

Par. 3. In §1.707–3, the heading for paragraph (c)(2) and the text in paragraph (c)(2)(i) are amended by removing the language "two" and adding "seven" in its place.

Par. 4. In §1.707–5, new paragraph (a)(8) is added.

The addition reads as follows:

§1.707–5 Disguised sales of property to partnership; special rules relating to liabilities.

(a) * * *

(8) *Disclosure of liabilities assumed or taken subject to within seven years of transfer*. Disclosure to the Internal Revenue Service in accordance with §1.707–8 is required if—

(i) A partner transfers property to a partnership and the partnership assumes or takes subject to a liability of the partner (whether or not the liability is qualified, as described in §1.707–5(a)(6)) within a seven-year period (without regard to the order of the transactions);

(ii) The partner treats the transactions as other than as a sale for tax purposes; and

(iii) The transactions are not disclosed under paragraph (a)(7)(ii) of this section.

* * * * *

Par. 5. In §1.707–6 is amended as follows:

1. Revising paragraph (c) introductory text.

2. Amending paragraph (c)(1) by removing the language "two" and adding "seven" in its place.

3. Adding new paragraph (c)(3).

The revisions and addition read as follows:

§1.707–6 Disguised sales of property by partnership to partners; general rule.

* * * * *

(c) * * * Similar to the rules provided in §§1.707–3(c)(2), 1.707–5(a)(7)(ii), and 1.707–5(a)(8), a partnership is to disclose to the Internal Revenue Service, in accordance with §1.707–8, the facts in the following circumstances:

* * * * *

(3) When a partnership transfers property to a partner and the partner assumes or takes subject to a liability of the partnership (whether or not the liability is qualified, as described in §1.707–5(a)(6)) within a seven-year period (without regard to the order of the transactions), the partnership treats the transactions as other than as a sale for tax purposes, and the transactions are not disclosed under paragraph (c)(2) of this section.

* * * * *

Par. 6. Section 1.707–7 is revised to read as follows:

§1.707–7 Disguised sales of partnership interests.

(a) *Treatment of transfers as a sale*—(1) *In general*. Except as otherwise provided in this section, if a transfer of money, property or other consideration (including the assumption of a liability) (consideration) by a partner (purchasing partner) to a partnership and a transfer of consideration by the partnership to another partner (selling partner) are described in paragraph (b)(1) of this section, the transfers are treated as a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner. For purposes of this section, the term *transfer* refers to a portion of a single transfer or to one or more transfers.

(2) *Definition, timing and consequences of sale*—(i) *Definition of sale*. For purposes of this section, the use of the term *sale* (or any variation of that word) to refer to a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner means a sale or exchange, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner, rather than a contribution and distribution to which sections 721 and 731, respectively, apply. Transfers that are treated as a sale under paragraph (a)(1) of this section are treated as a sale for all purposes of the Internal Revenue Code (*e.g.*, sections 453, 483, 704, 708, 743, 751, 1001, 1012 and 1274).

(ii) *Timing and consequences of sale*—(A) *In general*. For purposes of this section, a transfer is treated as occurring on the date of the actual transfer, or if earlier, on the date that the transferor agrees in writing to make the transfer. The sale of the selling partner's partnership interest is considered to take place on the date of the earliest of the transfers described in paragraph (a)(1) of this section. On this date, the purchasing partner is treated as acquiring the partnership interest sold for all purposes of the Internal Revenue Code.

(B) *Simultaneous transfers*. If the transfer of consideration by the purchasing partner and the transfer of consideration to the selling partner are simultaneous and the consideration transferred is the same, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred that partner's consideration (purchasing partner's consideration) directly to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership. If the transfer of consideration by the purchasing partner to the partnership and the transfer of consideration by the partnership to the selling partner are simultaneous and the consideration transferred is not the same, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred that partner's consideration to the partnership in exchange for the consideration to be transferred to the selling partner (selling partner's consideration) and then the purchasing partner transferred the selling partner's consideration to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership.

(C) *Transfer to selling partner first*. If the transfer of consideration by the partnership to the selling partner occurs before the transfer of consideration by the purchasing partner to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred an obligation to deliver the purchasing partner's consideration to the partnership in exchange for the selling partner's consideration and then the purchasing partner transferred the selling partner's consideration to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership. On the date of the actual transfer of the purchasing partner's consideration, the purchasing partner and the partnership are treated as if the purchasing partner satisfied its obligation to deliver the purchasing partner's consideration to the partnership.

(D) *Transfer by purchasing partner first*. If the transfer of consideration by the partnership to the selling partner occurs after the transfer of consideration by the purchasing partner to the partnership, the partners and the partnership are treated as if, on the date of the sale, the purchasing partner transferred the purchasing partner's consideration to the partnership in exchange for an obligation of the partnership to deliver the selling partner's consideration and then the purchasing partner transferred that obligation to the selling partner in exchange for all or a portion of the selling partner's interest in the partnership. On the date of the actual transfer of the selling partner's consideration, the selling partner and the partnership are treated as if the partnership satisfied its obligation to deliver the selling partner's consideration to the selling partner.

(E) *Consequences of deemed transactions*. Transfers and exchanges that are deemed to occur under paragraphs (a)(2)(ii)(B), (a)(2)(ii)(C), and (a)(2)(ii)(D) of this section are treated as actual transfers or exchanges for all purposes of the Internal Revenue Code (*e.g.*, sections 453, 483, 704, 708, 743, 751, 1001, 1012 and 1274).

(3) *Amount of sale*—(i) *In general*. If a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner are treated as a sale under paragraph (b)(1) of this section, the selling partner is treated as selling to the purchasing partner a partnership interest with a value equal to the lesser of the selling partner's consideration or the purchasing partner's consideration.

(ii) *Aggregation of consideration*. For purposes of paragraph (a)(3)(i) of this section, simultaneous transfers of consideration by more than one purchasing partner to a partnership or by a partnership to more than one selling partner are aggregated. In those cases—

(A) Each purchasing partner is presumed to have purchased that fraction of each partnership interest(s) sold equal to—

(*1*) The amount of consideration transferred by that partner to the partnership, divided; by

(*2*) The aggregate consideration transferred by all purchasing partners to the partnership; and

(B) Each selling partner is presumed to have sold that fraction of the total partnership interest(s) sold equal to—

(*1*) The amount of consideration transferred by the partnership to that partner, divided; by

(*2*) The aggregate consideration transferred by the partnership to all selling partners.

(4) *Liability relief included in amount realized on sale*. The amount realized by a selling partner on the sale of the selling partner's interest in the partnership includes any reduction in the selling partner's share of partnership liabilities that is treated as occurring as a result of the sale. If a sale of a partnership interest and either a distribution by the partnership to the selling partner under section 731 or a contribution by the purchasing partner to the partnership under section 721 occur on the same date, the reduction in the selling partner's share of partnership liabilities is computed immediately after the sale and before the distribution or the contribution, as the case may be. To the extent a reduction in a selling partner's share of partnership liabilities is included in the amount realized by the selling partner on the sale of an interest in a partnership because the amount is treated as consideration received by the selling partner in exchange for the selling partner's interest under paragraph (j)(2) of this section, the amount of the reduction shall not also be included in the amount realized by operation of this paragraph.

(5) *Sale precedes excess distribution to selling partner*. If a portion of a transfer of consideration by a partnership to a selling partner is not treated as part of a sale of the selling partner's interest in the partnership, but as a distribution to the selling partner under section 731, and the sale is treated as occurring on the same date as the distribution, then the distribution is treated as occurring immediately following the sale.

(6) *Transfers first treated as a sale of property*. To the extent that a transfer of consideration by a purchasing partner to a partnership or a transfer of consideration by a partnership to a selling partner may be treated as part of a sale of property under §1.707–3(a), §1.707–3(a) applies before this section, and to the extent the transfer is treated as part of a sale of property under §1.707–3(a), such transfer is not taken into account in applying the rules of this section.

(7) *Application of disguised sale rules*. Except as otherwise provided in paragraph (a)(8) of this section, the rules of this section apply to transfers to and from a partnership even if, after the application of the rules of this section, it is determined that the partnership has terminated under section 708(b)(1)(A).

(8) *Certain transfers disregarded*. Section 707(a)(2)(B) and the rules of this section do not apply to deemed transfers resulting from a termination of a partnership under section 708(b)(1)(B) and transfers

incident to the formation of a partnership. However, transfers incident to the formation of a partnership may be transfers to which §1.707–3(a) applies.

(b) *Transfers treated as sale*—(1) *In general*. A transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner constitute a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner only if, based on all the facts and circumstances—

(i) The transfer of consideration by the partnership to the selling partner would not have been made but for the transfer of consideration to the partnership by the purchasing partner; and

(ii) In cases in which the transfers are not made simultaneously, the subsequent transfer is not dependent on the entrepreneurial risks of partnership operations.

(2) *Facts and circumstances*. The determination of whether a transfer of consideration by a purchasing partner to a partnership and a transfer of consideration by the partnership to a selling partner constitute a sale under paragraph (b)(1) of this section is made based on all the facts and circumstances in each case. The weight to be given each of the facts and circumstances will depend on the particular case. Generally, the facts and circumstances existing on the date of the earliest of the transfers are the ones considered in determining if a sale exists under paragraph (b)(1) of this section. Among the facts and circumstances that may tend to prove the existence of a sale under paragraph (b)(1) of this section are the following:

(i) That the timing and amount of all or any portion of a subsequent transfer are determinable with reasonable certainty at the time of an earlier transfer;

(ii) That the person receiving the subsequent transfer has a legally enforceable right to the transfer or that the right to receive the transfer is secured in any manner, taking into account the period for which it is secured;

(iii) That the same property (other than money, including marketable securities that are treated as money under section 731(c)(1)) that is transferred to the partnership by the purchasing partner is transferred to the selling partner;

(iv) That partnership distributions, allocations or control of operations are designed to effect an exchange of the benefits and burdens of ownership of transferred property (other than money, including marketable securities that are treated as money under section 731(c)(1)), including a partnership interest;

(v) That the partnership holds transferred property (other than money, including marketable securities that are treated as money under section 731(c)(1)) for a limited period of time, or during the period of time the partnership holds transferred property (other than money, including marketable securities that are treated as money under section 731(c)(1)), the risk of gain or loss associated with the property is not significant;

(vi) That the transfer of consideration by the partnership to the selling partner is disproportionately large in relationship to the selling partner's general and continuing interest in partnership profits;

(vii) That the selling partner has no obligation to return or repay the consideration to the partnership, or has an obligation to return or repay the consideration due at such a distant point in the future that the present value of that obligation is small in relation to the amount of consideration transferred by the partnership to the selling partner;

(viii) That the transfer of consideration by the purchasing partner or the transfer of consideration to the selling partner is not made *pro rata*;

(ix) That there were negotiations between the purchasing partner and the selling partner (or between the partnership and each of the purchasing and selling partners with each partner being aware of the negotiations with the other partner) concerning any transfer of consideration; and

(x) That the selling partner and purchasing partner enter into one or more agreements, including an amendment to the partnership agreement (other than for admitting the purchasing partner) relating to the transfers.

(c) *Transfers made within two years presumed to be a sale*. For purposes of this section, if within a two-year period a purchasing partner transfers consideration to a partnership and the partnership transfers consideration to a selling partner (without regard to the order of the transfers), the transfers are presumed to be a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

(d) *Transfers made more than two years apart presumed not to be a sale*. For purposes of this section, if a transfer of consideration by a purchasing partner to a partnership and the transfer of consideration by the partnership to a selling partner (without regard to the order of the transfers) occur more than two years apart, the transfers are presumed not to be a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner unless the facts and circumstances clearly establish that the transfers constitute a sale.

(e) *Transfers of money in liquidation of a partner's interest presumed not to be a sale*. Notwithstanding the presumption set forth in paragraph (c) of this section, for purposes of this section, if a partnership transfers money, including marketable securities that are treated as money under section 731(c)(1), to a selling partner, or is treated as transferring consideration to the selling partner under paragraph (j)(2) of this section, in liquidation of the selling partner's interest in the partnership, the transfer is presumed not to be a sale, in whole or in part, of the selling partner's interest in the partnership to the purchasing partner unless the facts and circumstances clearly establish that the transfer is part of a sale. See §1.761–1(d) for the definition of the term *liquidation of a partner's interest*.

(f) *Application of §1.707–4 (special rules applicable to guaranteed payments, preferred returns, operating cash flow distributions, and reimbursements of preformation expenditures)*. Notwithstanding the presumption set forth in paragraph (c) of this section, rules similar to those provided in §1.707–4 apply to determine the extent to which a transfer to a selling partner is treated as part of a sale of the selling partner's interest in the partnership to the purchasing partner.

(g) *Exception for certain transfers to and by service partnerships*. Section 707(a)(2)(B) and the rules of this section do not apply to transfers of money, including marketable securities that are treated as money under section 731(c)(1), to and by a partnership that would be described in section 448(d)(2) if the partnership were a corporation. Solely for purposes of applying section 448(d)(2) to partnerships under this paragraph (g), partners are treated as employees of the partnership and "partnership interest" is substituted for "stock" in testing for ownership by the employees performing services.

(h) *Other exceptions*. The Commissioner may provide by guidance published in the Internal Revenue Bulletin that section 707(a)(2)(B) and the rules of this section do not apply to other transfers to and by a partnership.

(i) [Reserved.]

(j) *Special rules relating to liabilities*—(1) *In general*. For purposes of this section, deemed contributions to and distributions from a partnership under section 752 resulting from reallocations of partnership liabilities among partners are not treated as transfers of consideration. Under paragraph (a)(4) of this section, the preceding sentence does not apply if the transaction is otherwise treated as a sale of a partnership interest under the rules of this section.

(2) *Partner liability assumed by partnership*. For purposes of this section, if a partnership assumes a liability of a partner, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of that liability (determined under the rules of paragraphs (j)(4) and (5) of this section) immediately after the partnership assumes the liability. For purposes of this section, a partnership is treated as assuming a liability of a partner to the extent provided in §§1.752–1(d) and (e). For purposes of this paragraph (j)(2), if the partnership assumes the liabilities of more than one partner pursuant to a plan, a partner's share of the liabilities assumed by the partnership pursuant to that plan immediately after the assumptions equals the sum of that partner's shares of the liabilities assumed by the partnership pursuant to the plan. The preceding sentence does not apply to any liability assumed by the partnership with a principal purpose of reducing the extent to which any other liability assumed by the partnership is treated as a transfer of consideration to a partner under this paragraph (j)(2).

(3) *Partnership liability assumed by partner*. For purposes of this section, if a partner assumes a liability of a partnership, the partner is treated as transferring consideration to the partnership to the extent that the amount of the liability exceeds the partner's share of that liability (determined under the rules of paragraph (j)(4) of this section) immediately before the partner assumes the liability. For purposes of this section, a partner assumes a partnership liability to the extent provided in §§1.752–1(e) and 1.704–1(b)(2)(iv)(c). For purposes of this paragraph (j)(3), if more than one partner assumes a liability of the partnership pursuant to a plan, the amount that is treated as a transfer of consideration by each partner is the amount by which all of the liabilities assumed by the partner pursuant to the plan exceed the partner's share of all of those liabilities immediately before the assumption. The preceding sentence does not apply to any liability assumed by a partner with a principal purpose of reducing the extent to which any other liability assumed by a partner is treated as a transfer of consideration to a partnership under this paragraph (j)(3).

(4) *Partner's share of liability*. A partner's share of any liability of the partnership is determined under the following rules:

(i) *Recourse liability*. A partner's share of a recourse liability of the partnership equals the partner's share of the liability under the rules of section 752 and the regulations thereunder. A partnership liability is a recourse liability to the extent that the obligation is a recourse liability under §1.752–1(a)(1) or would be treated as a recourse liability under that section if it were treated as a partnership liability for purposes of that section.

(ii) *Nonrecourse liability*. A partner's share of a nonrecourse liability of the partnership is determined by applying the same percentage used to determine the partner's share of the excess nonrecourse liability under §1.752–3(a)(3). A partnership liability is a nonrecourse liability of the partnership to the extent that the obligation is a nonrecourse liability under §1.752–1(a)(2) or would be treated as a nonrecourse liability under that section if it were treated as a partnership liability for purposes of that section.

(5) *Reduction of partner's share of liability*. For purposes of this section, a partner's share of a liability, immediately after a partnership assumes the liability, is determined by taking into account a subsequent reduction in the partner's share if—

(i) At the time that the partnership assumes a liability, it is anticipated that the transferring partner's share of the liability will be subsequently reduced; and

(ii) The reduction of the partner's share of the liability is part of a plan that has as one of its principal purposes minimizing the extent to which the assumption of the liability is treated as part of a sale under this section.

(6) *Treatment of debt-financed transfers of consideration by partnerships*—(i) *In general*. For purposes of this section, if a partnership incurs a liability and all or a portion of the proceeds of that liability are allocable under §1.163–8T to a transfer of consideration to a partner made within 90 days of incurring the liability, the transfer of consideration to the partner is taken into account only to the extent that the amount of consideration transferred exceeds that partner's allocable share of the partnership liability.

(ii) *Partner's allocable share of liability*—(A) *In general*. A partner's allocable share of a partnership liability for purposes of paragraph (j)(6)(i) of this section equals the amount obtained by multiplying the partner's share of the liability (as defined in paragraph (j)(4) of this section) by a fraction determined by dividing—

(*1*) The portion of the liability that is allocable under §1.163–8T to the consideration transferred to the partner; by

(*2*) The total amount of the liability.

(B) *Debt-financed transfers made pursuant to a plan*—(*1*) *In general*. Except as provided in paragraph (j)(6)(ii)(C) of this section, if a partnership transfers to more than one partner pursuant to a plan all or a portion of the proceeds of one or more partnership liabilities, paragraph (j)(6)(i) of this section is applied by treating all of the liabilities incurred pursuant to the plan as one liability, and each partner's allocable share of those liabilities equals the amount obtained by multiplying the sum of the partner's shares of each of the respective liabilities (as defined in paragraph (j)(4) of this section) by the fraction obtained by dividing—

(*i*) The portion of those liabilities that is allocable under §1.163–8T to the consideration transferred to the partners pursuant to the plan; by

(*ii*) The total amount of those liabilities.

(*2*) *Special rule*. Paragraph (j)(6)(ii)(B)(*1*) of this section does not apply to any transfer of consideration to a partner that is made with a principal purpose of reducing the extent to which any transfer is taken into account under paragraph (j)(6)(i) of this section.

(C) *Reduction of partner's share of liability*. For purposes of paragraph (j)(6)(ii) of this section, a partner's share of a liability is determined by taking into account a subsequent reduction in the partner's share if—

(*1*) It is anticipated that the partner's share of the liability that is allocable to a transfer of consideration to the partner will be reduced subsequent to the transfer; and

(*2*) The reduction of the partner's share of the liability is part of a plan that has as one of its principal purposes minimizing the extent to which the partnership's distribution of the proceeds of the borrowing is treated as part of a sale.

(7) *Share of liability where assumption accompanied by transfer of money*. For purposes of paragraph (j)(2) of this section, if pursuant to a plan a partner pays or contributes money to the partnership and the partnership assumes one or more liabilities of the partner, the amount of those liabilities that the partnership is treated as assuming is reduced (but not below zero) by the money transferred. Similarly, for purposes of paragraph (j)(3) of this section, if pursuant to a plan a partnership pays or distributes money to a partner and the partner assumes one or more liabilities of the partnership, the amount of those liabilities that the partner is treated as assuming is reduced (but not below zero) by the money transferred.

(8) *Anti-abuse rule*. For purposes of this section, an increase in a partner's share of a partnership liability may be treated as a transfer of consideration by the partner to the partnership, notwithstanding any other rule in this section, if—

(i) Within a short period of time after the partnership incurs or assumes the liability or another liability, one or more partners of the partnership, or related parties to a partner (within the meaning of section 267(b) or 707(b)), in substance bears an economic risk for the liability that is disproportionate to the partner's interest in partnership profits or capital; and

(ii) The transactions are undertaken pursuant to a plan that has as one of its principal purposes minimizing the extent to which the partner is treated as making a transfer of consideration to the partnership that may be treated as part of a sale under this section.

(k) *Disclosure rules*. Disclosure to the Internal Revenue Service in accordance with §1.707–8 is required when a partner transfers consideration to a partnership and the partnership transfers consideration to another partner within a seven-year period (without regard to the order of the transfers), the partners treat the transfers other than as a sale for tax purposes, and the transfer of consideration by the partnership is not presumed to be a guaranteed payment for capital under §1.707–4(a)(1)(ii), is not a reasonable preferred return within the meaning of §1.707–4(a)(3), and is not an operating cash flow distribution within the meaning of §1.707–4(b)(2). However, disclosure is not required under this paragraph if an exception provided in either paragraph (a)(8) (relating to transfers resulting from a termination of a partnership under section 708(b)(1)(B) and transfers incident to the formation of a partnership) or paragraph (g) (relating to transfers to and by service partnerships) applies to either of the transfers.

(l) *Examples*. The following examples illustrate the application of this section. For purposes of these examples, assume that the transfers would otherwise be respected as contributions and distributions and that, except as otherwise provided, sections 721(b), 751(b), 704(c)(1)(B), 737, and §1.707–3 do not apply. All amounts and percentages in these examples are rounded to the nearest whole number.

Example 1. Treatment of simultaneous transfers as a sale by a selling partner to a purchasing partner. (i) A and B each owns a 50% interest in partnership AB. AB holds Blackacre, real property with a fair market value of $400x. AB has no liabilities. On May 25, 2008, C transfers $100x in cash to AB in exchange for an interest in AB. Simultaneously, AB transfers $100x in cash to A.

(ii) Because C's transfer of $100x to AB and AB's transfer of $100x to A occurred within two years, the transfers are presumed to be a sale of a portion of A's interest in AB to C under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's interest in AB to C. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A or the consideration transferred by C to AB. C transferred $100x to AB, and A received $100x from AB. Thus, A is treated as having sold an interest in AB with a value of $100x to C.

Example 2. Treatment of non-simultaneous transfers as a sale by a selling partner to a purchasing partner. (i) The facts are the same as in *Example 1*, except that AB transfers $100x in cash to A on March 25, 2008, and C transfers $50x in cash to AB on May 25, 2008, in exchange for an interest in AB.

(ii) Because AB's transfer of $100x to A and C's transfer of $50x to AB occurred within two years, the transfers are presumed to be a sale of a portion of A's interest in AB to C under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's interest in AB to C. Under paragraph (a)(2)(ii)(A) of this section, the sale takes place on the date of the earliest of the transfers, March 25, 2008, upon AB's transfer of $100x to A. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A or the consideration transferred by C to AB. C transferred $50x to AB, and A received $100x from AB. Thus, A is treated as having sold an interest in AB with a value of $50x to C. Under paragraph (a)(2)(ii)(C), because the transfer to A precedes the transfer by C, each of A, C, and AB is treated as if, on March 25, 2008, C transferred an obligation to deliver $50x to AB in exchange for $50x, and then C transferred $50x to A in exchange for a portion of A's interest in AB with a value of $50x. On May 25, 2008, when C actually transfers $50x to AB, C is treated as satisfying the obligation to deliver $50x to AB. A also is treated as receiving, in its capacity as a partner, a distribution from AB to which section 731 applies of $50x ($100x transfer - $50x amount of sale). Under paragraph (a)(5) of this section, the distribution is treated as occurring immediately following the sale.

Example 3. Treatment of deemed transfers and exchanges. (i) A and B each owns a 50% interest in partnership AB. AB holds Whiteacre, real property with a fair market value of $1,000x and a tax basis of $700x, along with other assets. AB has no liabilities. On January 1, 2008, C transfers Investment Property, with a fair market value of $1,500x and a tax basis of $300x, to AB. Simultaneously with that transfer, AB transfers Whiteacre to B.

(ii) Because C's transfer of Investment Property to AB and AB's transfer of Whiteacre to B occurred within two years, the transfers are presumed to be a sale of a portion of B's interest in AB to C under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of B's interest in AB to C. Under paragraph (a)(2)(ii)(A) of this section, the sale takes place on the date of the earliest of the transfers, January 1, 2008. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that B is treated as selling to C equals the lesser of the consideration transferred by C to AB or the consideration transferred by AB to B. C transferred the Investment Property with a fair market value of $1,500x to AB, and B received Whiteacre with a fair market value of $1,000x from AB. Thus, B is treated as having sold an interest in AB with a value of $1,000x to C.

(iii) Under paragraph (a)(2)(ii)(B), because the transfers are simultaneous and the consideration transferred is not the same, each of B, C, and AB is treated as if, on January 1, 2008, C transferred $1,000x of the Investment Property to AB in exchange for Whiteacre and then C transferred Whiteacre to B in exchange for a portion of B's interest in AB with a value of $1,000x. In the deemed exchange of $1,000x worth of the Investment Property for Whiteacre, AB realizes and recognizes gain of $300x ($1,000x - $700x basis), and C realizes and recognizes gain of $800x ($1,000x - $200x allocable basis). In the deemed exchange of Whiteacre for B's interest in AB, B realizes and recognizes gain or loss under section 741 (and section 751(a), if applicable) based on an amount realized of $1,000x. C also is considered to have contributed to AB, in C's capacity as a partner, $500x of the Investment Property ($1,500x total value of transferred Investment Property - $1,000x amount treated as C's consideration) with an allocable basis of $100x in a transaction to which section 721 applies. Thus, the basis of the Investment Property in the hands of AB is $1,100x, C's basis in the partnership interest is $1,100x, and the basis of Whiteacre in the hands of B is $1,000x.

Example 4. Treatment of simultaneous transfers as a sale by a selling partner to more than one purchasing partner. (i) E and F each owns a 50% interest in partnership EF. EF holds a building with a fair market value of $500x. EF has no liabilities. On May 25, 2008, G and H each transfer $50x in cash to EF in exchange for an interest in EF. Simultaneously, EF distributes $100x in cash to E.

(ii) Because each of G's and H's transfers of $50x to EF and EF's transfer of $100x to E occurred within two years, G's transfer to EF and EF's transfer to E, and H's transfer to EF and EF's transfer to E, are presumed to be a sale of a portion of E's interest in EF to G and H, respectively, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of E's partnership interest to G and H, respectively. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that E is treated as selling to each of G and H equals the lesser of the consideration transferred by EF to E or the consideration transferred by G and H to EF. Because G and H made simultaneous transfers of consideration to EF, the transfers are aggregated under paragraph (a)(3)(ii) of this section. G and H together transferred $100x to EF, and E received $100x from EF. Thus, E is treated as having sold a partnership interest with a value of $100x to G and H. Under paragraph (a)(3)(ii) of this section, when transfers of multiple purchasing partners are aggregated, each purchasing partner is presumed to have purchased a *pro rata* portion of the selling partner's partnership interest. That is, G is presumed to have purchased the fraction of E's partnership interest sold that is equal to G's amount transferred ($50x) divided by the aggregate amount transferred by G and H ($100x), or one-half of the partnership interest that was sold. H also is presumed to have purchased the fraction of E's partnership interest equal to H's amount transferred ($50x) divided by the aggregate amount transferred by both of G and H ($100x), or one-half of the partnership interest that was sold. Thus, each of G and H is treated as having purchased a fraction of E's partnership interest that is equal to $50x.

Example 5. Treatment of non-simultaneous transfers as a sale by a selling partner to more than one purchasing partner. (i) The facts are the same as in *Example 4*, except that partnership EF distributes $75x in cash to E on May 1, 2007. In addition, G transfers $50x in cash to EF on March 25, 2008, and H transfers $50x in cash to EF on May 25, 2008, each in exchange for a partnership interest in EF.

(ii) Because each of G's and H's transfers of $50x to EF and EF's transfer of $75x to E occurred within two years, G's transfer to EF and EF's transfer to E, and H's transfer to EF and EF's transfer to E, are presumed to be a sale of a portion of E's partnership interest to G and H, respectively, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of E's interest in EF to each of G and H, respectively. Under paragraph (a)(2)(ii)(A) of this section, the sale takes place on the date of the earliest of the transfers, May 1, 2007, the date that EF transferred $75x to E. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that E is treated as selling to each of G and H equals the lesser of the consideration transferred by G and H to EF, or the consideration transferred by EF to E. Because the transfers made by G and H were not simultaneous, the transfers are not aggregated. Rather, in accordance with paragraph (a)(2)(ii)(A) of this section, the transfers are considered in the order in which they were made. The value of the partnership interest that E is treated as selling to G equals $50x, the lesser of G's $50x transfer to EF and the $75x that E received from EF. The value of the partnership interest that E is treated as selling to H equals $25x, the lesser of the remaining amount of the transfer to E, $25x ($75x - $50x = $25x), and H's $50x transfer to EF. H also is considered to have contributed to EF, in H's capacity as a partner, $25x ($50x transfer - $25x amount of sale), to which section 721 applies.

(iii) Under paragraph (a)(2)(ii)(C), each of E, G, and EF are treated as if, on May 1, 2007, G transferred an obligation to deliver $50x to EF in exchange for $50x, and, on that same date, G transferred $50x to E in exchange for a portion of E's interest in EF with a value of $50x. On March 25, 2008, when G actually transfers $50x to EF, G is treated as satisfying its obligation to deliver $50x to EF. Also, under paragraph (a)(2)(ii)(C), each of E, H, and EF are treated as if, on May 1, 2007, H transferred an obligation to deliver $25x to EF in exchange for $25x, and, on that same date, H transferred $25x to E in exchange for a portion of E's interest in EF with a value of $25x. On May 25, 2008, when H actually transfers $25x to EF, H is treated as satisfying its obligation to deliver $25x to EF.

Example 6. Operation of presumption for liquidation of a partner for money. (i) A and B each owns a 50% interest in partnership AB. AB holds marketable securities with a fair market value of $200x. AB has no liabilities. On April 1, 2008, C transfers $100x in cash to AB in exchange for an interest in AB. Simultaneously, AB distributes $100x of the marketable securities to A in liquidation of A's partnership interest in AB. Assume that the marketable securities transferred to A are treated, under section 731(c)(1), as money for purposes of section 731(a)(1).

(ii) Because C's transfer of $100x to AB and AB's transfer of $100x of marketable securities to A occurred within two years, the transfers are presumed to be a sale of a portion of A's interest in AB to C under paragraph (c) of this section. However, under paragraph (e) of this section, notwithstanding the presumption set forth in paragraph (c) of this section, AB's transfer of marketable securities to A in liquidation of A's interest in AB is presumed not to be a sale of A's partnership interest to C, unless the facts and circumstances clearly establish otherwise. If, however, one of the exceptions under section 731(c)(3) applies to the $100x of marketable securities distributed to A, the securities would not be treated as money for purposes of section 731(a)(1), and the presumption against sale treatment under paragraph (e) of this section would not apply.

Example 7. Transfers that would otherwise be treated as both a sale of property and a sale of a partnership interest. (i) C and D each owns a 50% interest in partnership CD. CD holds Greenacre, real property with a fair market value of $2,000x. CD has no liabilities. On June 1, 2008, E transfers $500x in cash to CD in exchange for a partnership interest in CD. Immediately after E's transfer, C transfers Redacre to CD, and CD distributes $500x in cash to C. At the time of the transfers, Redacre has a fair market value of $250x.

(ii) Because E's transfer of $500x to CD and CD's transfer of $500x to C occurred within two years, the transfers are presumed to be a sale of a portion of C's partnership interest in CD to E under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of C's partnership interest in CD to E. However, because C's transfer of Redacre to CD and CD's transfer of $500x to C occurred within two years, under §1.707–3(c), the transfers are presumed to be a sale of Redacre by C to CD. There are no facts that rebut the presumption that the transfers are a sale of Redacre by C to CD. Under paragraph (a)(6) of this section, transfers that are in part a sale of a partnership interest and in part a sale of property are treated, first, as part of a sale of property. Thus, C's transfer of Redacre to CD and $250x of CD's $500x transfer to C are treated, first, as a sale of Redacre by C to CD for $250x. Although the $250x distributed to C that is treated as part of a sale of Redacre is not treated as part of a sale of C's partnership interest in CD to E, the remaining

$250x that is distributed to C is treated as part of a sale of C's partnership interest in CD to E. The value of the partnership interest that C is treated as selling to E equals $250x, the lesser of E's $500x transfer to CD, and the remaining $250x that C received from CD. E also is considered to have contributed to CD, in E's capacity as a partner, $250x ($500x contribution - $250x amount of sale), to which section 721 applies.

Example 8. Treatment of simultaneous transfers as a sale where partnership has nonrecourse liabilities. (i) A and B each owns a 50% interest in partnership AB. The partnership agreement states that the partners agree to share profits in proportion to the partners' booked-up capital accounts. AB holds $100x cash and Orangeacre, a parcel of raw land with a fair market value of $860x. Orangeacre is encumbered by a $360x nonrecourse liability incurred by AB in 1998 in connection with the purchase of Orangeacre. The liability, which has an issue price of $360x, has a term of 10 years and all principal is payable at maturity. The liability provides for adequate stated interest, all of which is qualified stated interest. On January 1, 2007, C contributes $100x to AB in exchange for an interest in AB. On the same date, A receives a transfer of $200x from AB.

(ii) For purposes of determining whether the transfers constitute a disguised sale of A's or B's interest in AB, the $360x liability is ignored because no partner assumes the liability. Because C's transfer of $100x to AB and AB's transfer of $200x to A occurred within two years, the transfers are presumed to be a sale of a portion of A's partnership interest in AB to C, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's partnership interest in AB to C. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A, or the consideration transferred by C to AB. C transferred $100x to AB, and A received $200x from AB. Thus, A is treated as having sold an interest in AB with a value of $100x to C. Under paragraph (a)(4) of this section, the amount realized by A on the sale of its partnership interest includes any reduction in A's share of the $360x partnership liability that is treated as occurring as a result of the sale. Before the sale, A's share of the nonrecourse liability under §1.752–3(a)(3) was $180x (50% of the $360x liability). As a result of A's sale of its $100x partnership interest in AB to C, A's share of the nonrecourse liability under §1.752–3(a)(3) was reduced to $120x (because A's partnership interest was 33% after the sale but immediately before the $100x distribution from AB that reduced A's interest in AB to 20%). Thus, A's amount realized on the sale of its partnership interest equals $100x plus the reduction in A's share of the $360x partnership liability of $60x ($180x - $120x), or $160x. A also is treated as receiving, in its capacity as a partner, and without regard to any deemed distributions under section 752(b), a distribution from AB to which section 731 applies of $100x ($200x transfer - $100x amount of sale). Under paragraph (a)(5) of this section, the distribution is treated as occurring immediately following the sale.

Example 9. Treatment of simultaneous transfers as a sale where selling partner has recourse liabilities that are assumed by the partnership. (i) The facts are the same as those in *Example 8*, except that AB does not make a transfer to A but AB does assume a personal $80x recourse liability of A's, on January 1, 2007. Immediately after AB's assumption of A's personal $80x recourse liability, A is completely released from liability, and only B and C are ultimately liable on the $80x recourse debt.

(ii) As in *Example 8*, the $360x liability is ignored for purposes of determining whether the transfers constitute a sale of A's or B's interest in AB because no partner assumes the $360x liability. However, AB's assumption of A's $80x recourse liability is treated as a transfer of consideration to A to the extent that the amount of the liability exceeds A's share of that liability immediately after AB assumes the liability, determined as provided in paragraph (j)(4)(i) of this section. Under paragraph (j)(4)(i) of this section, A's share of the recourse liability immediately following the assumption is zero. Thus, the assumption is treated as a transfer of $80x to A by AB on January 1, 2007. Because C's transfer of $100x to AB, and AB's transfer of $80x to A, occurred within two years, the transfers are presumed to be a sale of a portion of A's partnership interest in AB to C, under paragraph (c) of this section, unless the facts and circumstances clearly establish otherwise. There are no facts that rebut the presumption of sale treatment or that support the application of either of the presumptions against sale treatment provided in paragraphs (e) or (f) or the exception provided in paragraph (g) of this section. Thus, the transfers are treated as a sale of a portion of A's partnership interest in AB to C. Under paragraph (a)(3)(i) of this section, the value of the partnership interest that A is treated as selling to C equals the lesser of the consideration transferred by AB to A, or the consideration transferred by C to AB. C transferred $100x to AB, and A received $80x from AB. Thus, A is treated as having sold a partnership interest in AB with a value of $80x to C. Under paragraph (a)(4) of this section, the amount realized by A on the sale of its partnership interest includes any reduction in A's share of the $360x partnership liability that is treated as occurring as a result of the sale. Before the sale, A's share of the nonrecourse liability under §1.752–3(a)(3) was $180x (50% of the $360x liability). As a result of A's sale of its $80x partnership interest in AB to C, A's share of the nonrecourse liability under §1.752–3(a)(3) was reduced to $133x (because A's partnership interest was 37% after the sale). Thus, A's amount realized on the sale of its partnership interest equals $80x plus the reduction in A's share of the $360x partnership liability of $47x ($180x - $133x), or $127x. C also is treated as making, in its capacity as a partner, and without regard to any deemed contributions under section 752(a), a contribution to AB to which section 721 applies of $20x ($100x contribution - $80x amount of sale).

Par. 7. Section 1.707–8 is amended as follows:

1. Revising paragraph (a).

2. Revising paragraph (c).

The revisions read as follows:

§1.707–8 Disclosure of certain information.

(a) *In general*. The disclosure referred to in §1.707–3(c)(2) (regarding certain transfers made within seven years of each other), §1.707–5(a)(7)(ii) (regarding a liability incurred within two years prior to a transfer of property), §1.707–5(a)(8) (relating to liabilities assumed within seven years of the transfer), §1.707–6(c) (relating to transfers of property from a partnership to a partner in situations analogous to those listed above), and §1.707–7(k) (relating to certain transfers made within seven years of each other) is to be made in accordance with paragraphs (b) and (c) of this section.

* * * * *

(c) *Parties required to disclose*. The disclosure required by this section must be made by any person who makes a transfer that is required to be disclosed. The persons who are required to disclose may designate by written agreement a single person to make the disclosure. The designation of one person to make the disclosure does not relieve the other persons required to disclose from their obligation to make the disclosure if the designated person fails to make the disclosure in accordance with paragraph (b) of this section.

Par. 8. Section 1.707–9 is amended as follows:

1. Revising the heading for paragraph (a).

2. Revising paragraph (a)(1).

3. Revising the heading for paragraph (a)(2), and adding a sentence at the end of the paragraph.

4. Amending paragraph (a)(3) by removing the language "1.707–6" and adding "1.707–7" in its place.

5. Revising paragraph (b).

The revisions and addition read as follows:

§1.707–9 Effective dates and transitional rules.

(a) *Sections 1.707–3 through 1.707–7*—(1) *In general*. Except as provided in paragraph (a)(3) of this section, §§1.707–3 through 1.707–7 apply to any transaction with respect to which all transfers that are part of a sale of an item of property or of a partnership interest occur on or after the date these regulations are published as final regulations in the **Federal Register**. For any transaction with respect to which all transfers that are part of a sale of an item of property occur after April 24, 1991, but before the date these regulations are published as final regulations in the **Federal Register**, §§1.707–3 through 1.707–6 as contained in 26 CFR edition revised April 1, 2004, (T.D. 8439) apply, except as provided in paragraph (a)(3) of this section.

(2) *Transfers occurring before effective dates*. * * * In addition, except as provided in paragraph (a)(3) of this section, in the case of any transaction with respect to which one or more of the transfers occurs after April 24, 1991, but before the date these regulations are published as final regulations in the **Federal Register**, the determination of whether the transaction is a disguised sale of a partnership interest under section 707(a)(2)(B) is to be made on the same basis.

* * * * *

(b)* * * The disclosure provisions described in §1.707–8 apply to transactions with respect to which all transfers that are part of a sale of property occur on and after the date these regulations are published as final regulations in the **Federal Register**. For transactions with respect to which all transfers that are part of a sale of property occur after September 30, 1992, but before the date these regulations are published as final regulations in the **Federal Register**, the disclosure provisions as described in §1.707–8 as contained in the 26 CFR edition revised April 1, 2004, (T.D. 8439) apply.

* * * * *

Par. 9. Section 1.752–3 is amended in the sixth sentence of paragraph (a)(3) by revising the sentence "This additional method does not apply for purposes of §1.707–5(a)(2)(ii)" to read "This additional method does not apply for purposes of §§1.707–5(a)(2)(ii) and 1.707–7(j)(4)(ii)."

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

(Filed by the Office of the Federal Register on November 24, 2004, 8:45 a.m., and published in the issue of the Federal Register for November 26, 2004, 69 F.R. 68838)

Notice of Disposition of Declaratory Judgment Proceedings Under Section 7428

Announcement 2004–100

This announcement serves notice to donors that on October 27, 2004, the United States Tax Court entered a decision accepting the agreement of the parties regarding the organization described below. Pursuant to the decision, the organization listed below is not recognized as an organization described in section 501(c)(3) and is not exempt from tax under section 501(a) and is not an organization described in section 170(c)(2) effective January 1, 1996.

Del Oro Conservatory for the Classical Arts of Music and Dance, Inc.
Chandler, AZ

Notice of Disposition of Declaratory Judgment Proceedings Under Section 7428

Announcement 2004–101

This announcement serves notice to donors that on October 27, 2004, the United States Tax Court entered a decision accepting the agreement of the parties regarding the organization described below. Pursuant to the decision, the organization listed below is not recognized as an organization described in section 501(c)(3) and is not exempt from tax under section 501(a), and is not an organization described in section 170(c)(2) effective October 1, 1998.

Open Classrooms Chartered
Baltimore, MD

Public Hearing on the Advance Pricing Agreement Program; Correction

Announcement 2004–102

PURPOSE

This document contains a correction to a scheduled public hearing date in the Highlight for Announcement 2004–98, 2004–50 I.R.B. 983. As published, the Highlight contains an error that may prove to be misleading and is in need of correction.

CORRECTION

In the Highlight under SPECIAL ANNOUNCEMENT, the text reads: "Public hearings with Chief Counsel Donald L. Korb and Associate Chief Counsel (International) Hal Hicks will be held on January 5, 2005, and February 1, 2005, to solicit…". The text should read: "Public hearings with Chief Counsel Donald L. Korb and Associate Chief Counsel (International) Hal Hicks will be held on February 1, 2005, and February 22, 2005, to solicit…".

FOR FURTHER INFORMATON CONTACT:

Matthew Frank at (202) 435–5222 (not a toll-free number).

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2004–1 through 2004–26 is in Internal Revenue Bulletin 2004–26, dated June 28, 2004.

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

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