Internal Revenue
bulletin

Bulletin No. 2005-9
February 28, 2005

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2005–12, page 628.

LIFO; price indexes; department stores. The December 2004 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, December 31, 2004.

T.D. 9174, page 629.

Final regulations under section 6661 of the Code remove regulations sections 1.6661–1 through 1.6661–6 relating to an addition to tax in the case of a substantial understatement of income tax liability made pursuant to section 6661. In addition, this regulation corrects a reference to section 6661(b)(2)(C)(ii) in regulations section 1.448–1T(b)(1)(iii) to clarify that the definition of "tax shelter" is now found in section 6662(d)(2)(C).

Notice 2005–13, page 630.

Tax-exempt leasing involving defeasance. This notice disallows tax benefits claimed by taxpayers who enter into sale-in, lease-out (SILO) transactions and identifies SILOs as listed transactions.

Notice 2005–20, page 635.

This notice addresses several questions of statutory interpretation arising under section 172(f)(1)(B) of the Code prior to its amendment by section 3004(a) of the Tax and Trade Relief Extension Act of 1998.

EMPLOYEE PLANS

REG–152914–04, page 650.

Proposed regulations under section 417 of the Code would revise final regulations (T.D. 9099, 2004–2 I.R.B. 255) under section 417(a)(3) concerning content requirements applicable to explanations of qualified joint and survivor annuities and qualified preretirement survivor annuities payable under certain retirement plans.

Notice 2005–19, page 634.

Weighted average interest rate update; corporate bond indices; 30-year Treasury securities. The weighted average interest rate for February 2005 and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution are set forth.

EXEMPT ORGANIZATIONS

Announcement 2005–18, page 660.

A Better Way Credit Counseling, Inc., of Greenacres, FL, and Allen's Pre-School and Day Care, Inc., of Murray, UT, no longer qualify as organizations to which contributions are deductible under section 170 of the Code.

(Continued on the next page)

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

REG–148867–03, page 646.

Proposed regulations under section 6103(n) of the Code describe the circumstances under which officers and employees of the Treasury Department, a state tax agency, the Social Security Administration, or the Department of Justice may disclose returns and return information to any person to obtain property or services for tax administration purposes. The proposed regulations clarify the existing regulations with respect to redisclosures of returns or return information by contractors, especially with regard to redisclosures by contractors to agents or subcontractors, and clarify that the civil and criminal penalties for the unauthorized inspection or disclosure of returns or return information apply to the agents or subcontractors.

Notice 2005–18, page 634.

The differential earnings rate for 2004 is tentatively determined for use by mutual life insurance companies to compute their income tax liability for 2004.

Rev. Proc. 2005–15, page 638.

This procedure provides issuers of qualified mortgage bonds and qualified mortgage credit certificates with average area purchase price safe-harbors for statistical areas in the United States and with a nationwide average purchase price for residences in the United States for purposes of the mortgage revenue bond rules under section 143 of the Code (and the mortgage credit certificate rules under section 25). Rev. Proc. 2004–18 obsoleted in part.

Announcement 2005–14, page 653.

This document contains corrections and clarifications to Publication 1220, *Specifications for Filing Forms 1098, 1099, 5498, and W–2G Electronically or Magnetically* (revised 9–2004).

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.

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

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The December 2004 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, December 31, 2004.

Rev. Rul. 2005–12

The following Department Store Inventory Price Indexes for December 2004 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, December 31, 2004.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups — soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

	Groups	Dec. 2003	Dec. 2004	Percent Change from Dec. 2003 to Dec. 2004[1]
1.	Piece Goods	473.7	495.2	4.5
2.	Domestics and Draperies	543.9	527.4	-3.0
3.	Women's and Children's Shoes	629.7	650.7	3.3
4.	Men's Shoes	847.8	841.5	-0.7
5.	Infants' Wear	586.4	577.4	-1.5
6.	Women's Underwear	509.6	517.2	1.5
7.	Women's Hosiery	344.1	339.2	-1.4
8.	Women's and Girls' Accessories	551.3	565.6	2.6
9.	Women's Outerwear and Girls' Wear	362.7	352.5	-2.8
10.	Men's Clothing	535.1	535.8	0.1
11.	Men's Furnishings	583.4	569.9	-2.3
12.	Boys' Clothing and Furnishings	429.0	414.2	-3.4
13.	Jewelry	848.0	866.2	2.1
14.	Notions	799.6	792.2	-0.9
15.	Toilet Articles and Drugs	976.5	992.1	1.6
16.	Furniture and Bedding	612.9	602.0	-1.8
17.	Floor Coverings	595.1	592.5	-0.4
18.	Housewares	710.6	708.0	-0.4
19.	Major Appliances	206.8	199.9	-3.3
20.	Radio and Television	43.8	40.3	-8.0
21.	Recreation and Education[2]	81.5	78.3	-3.9
22.	Home Improvements[2]	125.4	131.7	5.0
23.	Automotive Accessories[2]	112.1	112.9	0.7
	Groups 1–15: Soft Goods	555.8	552.5	-0.6
	Groups 16–20: Durable Goods	386.8	378.5	-2.1
	Groups 21–23: Misc. Goods[2]	93.5	92.2	-1.4
	Store Total[3]	495.1	490.1	-1.0

[1]Absence of a minus sign before the percentage change in this column signifies a price increase.

[2]Indexes on a January 1986 = 100 base.

[3]The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Burkom of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7924 (not a toll-free call).

Section 6661.—Substantial Understatement of Liability

26 CFR 1.448–1T: Limitation on the use of the cash receipts and disbursements method of accounting (temporary).

T.D. 9174

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

Substantial Understatement of Income Tax Liability

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document removes regulations relating to the addition to tax in the case of a substantial understatement of income tax liability and corrects an obsolete cross reference. The Internal Revenue Code (Code) provision imposing the addition to tax and cited in the cross reference was repealed in 1989. The changes made by this document will not affect taxpayers because the addition to tax does not apply to returns with a due date after December 31, 1989 (determined without regard to extensions).

DATES: The changes made by this document are effective January 5, 2005.

FOR FURTHER INFORMATION CONTACT: Audra M. Dineen, (202) 622–4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Section 6661 of the Code, as in effect before its repeal in 1989, imposed an addition to tax equal to 25 percent of the amount of the underpayment of tax attributable to any substantial understatement of income tax liability for a taxable year. Sections 1.6661–1 through 1.6661–6 of the Income Tax Regulations (26 CFR Part 1) provided rules for determining whether an addition to tax should be imposed and for computing the amount of any such addition.

The Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (103 Stat. 2106), repealed section 6661 effective for tax returns due after December 31, 1989 (determined without regard to extensions) and substituted, in section 6662, an accuracy-related penalty applicable to those returns. The repeal of section 6661 has rendered §§1.6661–1 through 1.6661–6 obsolete. This Treasury decision removes those provisions and corrects an obsolete cross reference to section 6661 in the regulations under section 448 (relating to the limitation on the use of the cash method of accounting).

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. In addition, because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this document has been submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of this document is Audra M. Dineen of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division).

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. In §1.448–1T, paragraph (b)(1)(iii) is revised to read as follows:

§1.448–1T Limitation on the use of the cash receipts and disbursements method of accounting (temporary).

* * * * *

(b) * * *

(1) * * *

(iii) Tax shelter within the meaning of section 6662(d)(2)(C).

* * * * *

§§1.6661–1 through 1.6661–6 [Removed]

Par. 3. Sections 1.6661–1 through 1.6661–6 are removed.

Part 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by removing the entries for "1.6661–3" and "1.6661–4" from the table.

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

Approved December 9, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on January 4, 2005, 8:45 a.m., and published in the issue of the Federal Register for January 5, 2005, 70 F.R. 704)

Part III. Administrative, Procedural, and Miscellaneous

Tax-Exempt Leasing Involving Defeasance

Notice 2005–13

The Internal Revenue Service and the Treasury Department are aware of types of transactions, described below, in which a taxpayer enters into a purported sale-leaseback arrangement with a tax-indifferent person in which substantially all of the tax-indifferent person's payment obligations are economically defeased and the taxpayer's risk of loss from a decline, and opportunity for profit from an increase, in the value of the leased property are limited. This notice alerts taxpayers and their representatives that these transactions are tax avoidance transactions and identifies these transactions, and substantially similar transactions, as listed transactions for purposes of § 1.6011–4(b)(2) of the Income Tax Regulations and §§ 6111 and 6112 of the Internal Revenue Code. This notice also alerts parties involved with these transactions of certain responsibilities that may arise from their involvement with these transactions.

FACTS

X is a U.S. taxpayer. FP is a tax-indifferent person that owns and uses certain property.[1] BK1, BK2, BK3, and BK4 are banks. None of these parties is related to any other party, unless otherwise indicated.

Situation 1

On the closing date of January 1, 2003 ("Closing Date"), X and FP enter into a purported sale-leaseback transaction under which FP sells the property to X, and X immediately leases the property back to FP under a lease ("Lease"). The purchase and sale agreement and the Lease are nominally separate legal documents. Both agreements, however, are executed pursuant to a comprehensive participation agreement, which provides that the parties' rights and obligations under any of the agreements are not enforceable before the execution of all transaction documents.

The Lease requires FP to make rental payments over the term of the Lease ("Lease Term"). As described below, the Lease also provides that under certain conditions, X has the option ("Service Contract Option") to require FP to identify a party ("Service Recipient") willing to enter into a contract with X to receive services provided using the leased property ("Service Contract") that commences immediately after the expiration of the Lease Term. The Service Recipient must meet certain financial qualifications, including credit rating and net capital requirements, and provide defeasance or other credit support to satisfy certain of its obligations under the Service Contract. If FP cannot locate a qualified third party to enter into the Service Contract, FP or an affiliate of FP must enter into the Service Contract. The aggregate of the Lease Term plus the term of the Service Contract ("Service Contract Term") is less than 80 percent of the assumed remaining useful life of the property.

On the Closing Date, the property has a fair market value of $105x and X makes a single payment of $105x to FP. To fund the $105x payment, X provides $15x in equity and borrows $81x from BK1 and $9x from BK2. Both loans are nonrecourse and provide for payments during the Lease Term. Accrued but unpaid interest is capitalized as additional principal. As of the Closing Date, the documents reflect that the sum of the outstanding principal on the loans at any given time will be less than the projected fair market value of the property at that time. The amount and timing of the debt service payments closely match the amount and timing of the Lease payments due during the Lease Term.

FP intends to utilize only a small portion of the proceeds of the purported sale-leaseback for operational expenses or to finance or refinance the acquisition of new assets. Upon receiving the $105x purchase price payment, FP sets aside substantially all of the $105x to satisfy its lease obligations. FP deposits $81x with BK3 and $9x with BK4. BK3 may be an affiliate of BK1, and BK4 may be an affiliate of BK2. The deposits with BK3 and BK4 earn interest sufficient to fund FP's rent obligations as described below. BK3 pays annual amounts equal to 90 percent of FP's annual rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK1). Although FP directs BK3 to pay those amounts to BK1, the parties treat these amounts as having been paid from BK3 to FP, then from FP to X as rental payments, and finally from X to BK1 as debt service payments. In addition, FP pledges the deposit with BK3 to X as security for FP's obligations under the Lease, while X, in turn, pledges its interest in FP's pledge to BK1 as security for X's obligations under the loan from BK1. Similarly, BK4 pays annual amounts equal to 10 percent of FP's rent obligation under the Lease (that is, amounts sufficient to satisfy X's debt service obligation to BK2). Although FP directs BK4 to pay these amounts to BK2, the parties treat these amounts as having been paid from BK4 to FP, then from FP to X as rental payments, and finally from X to BK2 as debt service payments. Although FP's deposit with BK4 is not pledged, the parties expect that the amounts deposited with BK4 will remain available to pay the remaining 10 percent of FP's annual rent obligation under the Lease. FP may incur economic costs, such as an early withdrawal penalty, in accessing the BK4 deposit.

FP is not legally released from its rent obligations. X's exposure to the risk that FP will not make the rent payments, however, is substantially limited by the arrangements with BK3 and BK4. In the case of the loan from BK1, X's economic risk is remote due to the deposit arrangement with BK3. In the case of the loan from BK2, X's economic risk is substantially reduced through the deposit arrangement with BK4. X's obligation to make debt service payments on the loans from BK1 and BK2 is completely offset by X's right to receive Lease rentals from FP. As a

[1] In some instances, FP meets the definition of a tax-exempt entity under section 168(h)(2). In other instances, FP does not meet that definition but possesses attributes, such as net operating losses, that render FP tax indifferent.

result, neither bank bears a significant risk of nonpayment.[2]

FP has an option ("Purchase Option") to purchase the property from X on the last day of the Lease Term ("Exercise Date"). Exercise of the Purchase Option allows FP to repurchase the property for a fixed exercise price ("Exercise Price") that, on the Closing Date, exceeds the projected fair market value of the property on the Exercise Date. The Purchase Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus provide X with a predetermined after-tax rate of return on its equity investment.

At the inception of the transaction, X requires FP to invest $9x of the $105x payment in highly rated debt securities ("Equity Collateral"), and to pledge the Equity Collateral to X to satisfy a portion of FP's obligations under the lease.[3] Although the Equity Collateral is pledged to X, it is not among the items of collateral pledged to BK1 or BK2 in support of the nonrecourse loans to X. The Equity Collateral upon maturity, when combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits, fully funds the amount due if FP exercises the Purchase Option. This arrangement ensures that FP is able to make the payment under the Purchase Option without an independent source of funds. Having economically defeased both its rental obligations under the Lease and its payment obligations under the Purchase Option, FP keeps the remaining $6x, subject to its obligation to pay the Termination Value (described below) upon the happening of certain events specified under the Lease.

If FP does not exercise the Purchase Option, X may elect to (1) take back the property, or (2) exercise the Service Contract Option and compel FP either to (a) identify a qualified Service Recipient, or (b) enter (or compel an affiliate of FP to enter) into the Service Contract as the Service Recipient for the Service Contract Term. If X exercises the Service Contract Option, the Service Recipient must pay X predetermined minimum capacity payments sufficient to provide X with a minimum after-tax rate of return on its equity investment. The Service Recipient also must reimburse X for X's operating and maintenance costs for providing the services.

As a practical matter, the Purchase Option and the Service Contract Option collar X's exposure to changes in the value of the property. If the value of the property is at least equal to the Purchase Option Exercise Price, FP likely will exercise the Purchase Option. Likewise, FP likely will exercise the Purchase Option if FP concludes that the costs of the Service Contract Option exceed the costs of the Purchase Option. Moreover, FP may exercise the Purchase Option even if the fair market value of the property is less than the Purchase Option Exercise Price because the Purchase Option is fully funded, and the excess of the Exercise Price over the projected value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. If the Purchase Option is exercised, X will recover its equity investment plus a predetermined after-tax rate of return. Conversely, if the Purchase Option is not exercised, X may compel FP to locate a Service Recipient to enter into the Service Contract in return for payments sufficient to provide X with a minimum after-tax rate of return on its equity investment, regardless of the value of the property.

Throughout the Lease Term, X has several remedies in the event of a default by FP, including a right to (1) take possession of the property or (2) cause FP to pay X specified damages ("Termination Value"). Likewise, throughout the Service Contract Term, X has similar remedies in the event of a default by the Service Recipient. On the Closing Date, the amount of the Termination Value is slightly greater than the purchase price of the property. The Termination Value fluctuates over the Lease Term and Service Contract Term, but at all times is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return. The BK3 deposit, the BK4 deposit and the Equity Collateral are available to satisfy the Termination Value during the Lease Term. If the sum of the deposits plus the Equity Collateral is less than the Termination Value, X may require FP to maintain a letter of credit. During the Service Contract Term, the Service Recipient will be required to provide defeasance or other credit support that would be available to satisfy the Termination Value. As a result, X in almost all events will recover its investment plus a pre-tax rate of return.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X does not include the optional Service Contract Term in the lease term for purposes of calculating the property's recovery period under §§ 168(g)(3)(A) and 168(i)(3). X includes in gross income the rents received on the Lease. If the Purchase Option is exercised, X also includes the Exercise Price in calculating its gain or loss realized on disposition of the property.

The form of the sale from FP to X may be a head lease for a term in excess of the assumed remaining useful life of the property and an option for X to purchase the property for a nominal amount at the conclusion of the head lease term. In some variations of this transaction, the participation agreement provides that if X refinances the nonrecourse loans, FP has a right to participate in the savings attributable to the reduced financing costs by allowing FP to renegotiate certain terms of the transaction, including the Lease rents and the Purchase Option price.

Situation 2

The facts are the same as in Situation 1 except for the following.

The Lease does not provide a Service Contract Option. In lieu of the Purchase Option described in Situation 1, FP has an option ("Early Termination Option") to purchase the property from X on the date ("ETO Exercise Date") that is 30 months before the end of the Lease Term. Exercise of the Early Termination Option allows FP to terminate the Lease and repurchase the property for a fixed exercise price ("ETO Exercise Price") that on the Closing Date, exceeds the projected fair market value of the property on the ETO

[2] The arrangement by which FP sets aside the funds necessary to meet its obligations under the Lease may take a variety of forms other than a deposit arrangement involving BK3 and BK4. These arrangements include a loan by FP to X, BK1 or BK2; a letter of credit collateralized with cash or cash equivalents; a payment undertaking agreement; prepaid rent (regardless of whether X finances a portion of the purchase price by borrowing from BK1 or BK2); a sinking fund arrangement; a guaranteed investment contract; or financial guaranty insurance.

[3] The arrangement by which the return of X's equity investment plus a predetermined after-tax return on such investment is provided may take a variety of forms other than an investment by FP in highly rated debt securities. For example, FP may be required to obtain a payment undertaking agreement from an entity having a specified minimum credit rating.

Exercise Date. The Early Termination Option price is sufficient to repay X's entire loan balances and X's initial equity investment plus a predetermined after-tax rate of return on its equity investment. The balance of the Equity Collateral combined with the balance of the deposits made with BK3 and BK4 and the interest on those deposits fully fund the amount due under the Early Termination Option.

If FP does not exercise the Early Termination Option, FP is required to obtain residual value insurance for the benefit of X, pay rents for the remaining Lease Term, and return the property to X at the end of the Lease Term ("Return Option"). The residual value insurance must be issued by a third party having a specified minimum credit rating and must provide that if the actual residual value of the property is less than a fixed amount ("Residual Value Insurance Amount") at the end of the Lease Term, the insurer will pay X the shortfall. On the Closing Date, the Residual Value Insurance Amount is less than the projected fair market value of the property at the end of the Lease Term. If FP does not maintain the residual value insurance coverage for the entire Lease Term remaining after the ETO Exercise Date, FP will default and be obligated to pay X the Termination Value. If FP does not exercise the Early Termination Option, the rents for the remaining Lease Term plus the Residual Value Insurance Amount are sufficient to provide X with a minimum after-tax rate of return on the property, regardless of the value of the property. As a practical matter, the Early Termination Option and the Return Option collar X's exposure to changes in the value of the property. At the end of the Lease Term, FP also may have the option to purchase the property for the greater of its fair market value or the Residual Value Insurance Amount.

For tax purposes, X claims deductions for interest on the loans and for depreciation on the property. X treats a portion of the property as qualified technological equipment within the meaning of § 168(i)(2). X depreciates that portion of the property over five years under § 168(g)(3)(C). X treats a portion of the property as software. X depreciates that portion of the property over 36 months under § 167(f)(1)(A).

X includes in gross income the rents received on the Lease. If the Early Termination Option is exercised, X also includes the ETO Exercise Price in calculating its gain or loss realized on disposition of the property.

In some variations of this transaction, if the Early Termination Option is not exercised, the Lease rents payable to X may increase for the portion of the Lease Term remaining after the ETO Exercise Date.

ANALYSIS

The substance of a transaction, not its form, governs its tax treatment. *Gregory v. Helvering*, 293 U.S. 465 (1935). In *Frank Lyon Co. v. United States*, 435 U.S. 561, 573 (1978), the Supreme Court stated that "[i]n applying the doctrine of substance over form, the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed." The Court evaluated the substance of the particular transaction in *Frank Lyon* to determine that it should be treated as a sale-leaseback rather than a financing arrangement. The Supreme Court described the transaction in *Frank Lyon* as "a genuine multiple-party transaction with economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached." *Frank Lyon*, 435 U.S. at 584. The Court subsequently relied on its approach in *Frank Lyon* to recharacterize a sale and repurchase of federal securities as a loan, finding that the economic realities of the transaction did not support the form chosen by the taxpayer. *Nebraska Dep't of Revenue v. Loewenstein*, 513 U.S. 123 (1994).

A sale-leaseback will not be respected unless the owner/lessor acquires and retains "significant and genuine attributes" of a traditional owner, including "the benefits and burdens of ownership." *Coleman v. Commissioner*, 16 F.3d 821, 826 (7th Cir. 1994) (citing *Frank Lyon*, 435 U.S. at 582–84). Considering the totality of the facts and circumstances in the transactions described in Situations 1 and 2, X does not acquire the benefits and burdens of ownership and consequently cannot claim tax benefits as the owner of the property. The transactions described above are, in substance, fundamentally different from the sale-leaseback transaction respected by the Court in *Frank Lyon*.

First, in *Frank Lyon*, the sales proceeds were used to construct the lessee's new headquarters. In contrast, in the transactions described above, substantially all of the $105x sales proceeds are immediately set aside by FP to satisfy its obligations under the Lease and to fund FP's exercise of the Purchase Option or the Early Termination Option. As a condition to engaging in the transactions, FP economically defeases substantially all of its rent payment obligations and the amounts due under the Purchase Option or the Early Termination Option by establishing and pledging the deposit with BK3 and the Equity Collateral. Moreover, even though FP may not pledge the deposit with BK4, FP fully funds its remaining rent obligations with the BK4 deposit and may have limited rights to access the funds held in that deposit. Consequently, the only capital retained by FP is the remaining $6x portion of the sales proceeds that represents FP's fee for engaging in the transaction.

Second, in *Frank Lyon*, the taxpayer bore the risk of the lessee's nonpayment of rent, which could have forced the taxpayer to default on its recourse debt. The Court concluded that the taxpayer exposed its business well-being to a real and substantial risk of nonpayment and that the long-term debt affected its financial position. *Frank Lyon*, 435 U.S. at 577. In contrast, in the transactions described above, economic defeasance renders the risk to X of FP's failure to pay rent remote. Moreover, because of the economic defeasance, X's right to receive the Equity Collateral upon the exercise of the Purchase Option, and FP's obligation with respect to the Termination Value, a failure by FP to satisfy its lease obligations does not leave X at risk for repaying the loan balances or forfeiting its equity investment.

Third, in *Frank Lyon*, the taxpayer's return was dependent on the property's value and the taxpayer's equity investment was at risk if the property declined in value. The economic burden of any decline in the value of the property is integral to the determination of tax ownership. *See*, *e.g.*, *Swift Dodge v. Commissioner*, 692 F.2d 651 (9th Cir. 1982). In the transactions described above, X bears insufficient risk of a decline in the value of the property to be treated as its owner for tax purposes. In

Situation 1, regardless of a decline in the value of the property, X can recover its entire investment, repay both loans, and obtain a minimum after-tax rate of return on its equity investment by exercising the Service Contract Option. Similarly, in Situation 2, a decline in the value of the property will not prevent X from recovering its entire investment, repaying both loans and obtaining a minimum after-tax rate of return on its equity investment through the rents for the remaining Lease Term plus the Residual Value Insurance Amount under the Return Option. The failure of FP to satisfy its obligations under the Service Contract Option in Situation 1 or the Return Option in Situation 2 results in default and obligates FP to pay X the Termination Value. In both Situation 1 and Situation 2, the BK3 and BK4 deposits and Equity Collateral are available to fund FP's obligations upon termination of the Lease. Thus, in both situations, X has substantially limited its risk of loss regardless of the value of the property upon termination of the Lease.

Fourth, the combination of FP's Purchase Option and X's Service Contract Option in Situation 1, and FP's Early Termination Option and continued rent and residual value insurance obligations under the Return Option in Situation 2, significantly increase the likelihood that FP will exercise its Purchase Option in Situation 1 and its Early Termination Option in Situation 2 even if the fair market value of the property is less than the Purchase Option Exercise Price or ETO Exercise Price, respectively, because both options are fully funded and the excess of the exercise price over the leased property's fair market value may not fully reflect the costs to FP of modifying, interrupting, or relocating its operations. *See Kwiat v. Commissioner*, T.C. Memo. 1992–433 (ostensible lessor did not possess the benefits and burdens of ownership because reciprocal put and call options limited the risk of economic depreciation and the benefit of possible appreciation); *see also Aderholt Specialty Co. v. Commissioner*, T.C. Memo. 1985–491; Rev. Rul. 72–543, 1972–2 C.B. 87. In contrast, in *Frank Lyon*, the lessee's decision regarding the exercise of its purchase option was not constrained by a lessor's right to exercise a reciprocal option similar to the Service Contract Option or the Return Option described in Situations 1 and 2, respectively. Similarly, X's opportunity to recognize a return through refinancing the BK1 and BK2 loans is also limited in those cases in which FP has a right to participate in any savings attributable to reduced financing costs, such as through renegotiation of the Lease rents and the Purchase Option price. *See Hilton v. Commissioner*, 74 T.C. 305 (1980), *aff'd*, 671 F.2d 316 (9th Cir. 1982) (arrangement whereby lessor and lessee shared the savings from any refinancing of lessor's nonrecourse debt was a factor supporting holding to disregard form of sale-leaseback transaction).

In the transactions described above, X does not have a meaningful interest in the risks and rewards of the property. Thus, X does not acquire the benefits and burdens of ownership of the property and does not become the owner of the property for U.S. federal income tax purposes. In substance, the transactions described above are merely a transfer of tax benefits to X, coupled with X's investment of the Equity Collateral for a predetermined after-tax rate of return.

Furthermore, in appropriate cases, the Service may challenge the purported tax benefits from these transactions on additional grounds, including (1) that the substance over form doctrine requires recharacterization of the arrangement as a financing arrangement, or (2) that the loans from BK1 and BK2, in substance, do not involve the use or forbearance of money, do not constitute valid indebtedness for tax purposes, and that any interest nominally paid or accrued on the loans is not deductible. *Cf.* Rev. Rul. 2002–69, 2002–2 C.B. 760 (disregarded offsetting obligations in a LILO arrangement gave the taxpayer, at most, a future interest in the property).

The American Jobs Creation Act of 2004, P.L. 108–357, 118 Stat. 1418 (the "Act"), was enacted on October 22, 2004. Section 847 of the Act amended §§ 167 and 168 to provide that service contracts that follow a lease must be included in the lease term and to modify the recovery period for qualified technological equipment and computer software subject to a lease with a tax-exempt entity. Section 848 of the Act added new § 470, which suspends losses for certain leases of property to tax-exempt entities. *See* H.R. Rep. No. 755, 108th Cong., 2d Sess., at 660, 662–663 (2004). These amendments generally are effective for leases entered into after March 12, 2004.[4]

Transactions that are the same as, or substantially similar to, the transactions described in this notice are identified as "listed transactions" for purposes of § 1.6011–4(b)(2) and §§ 6111 and 6112 effective February 11, 2005, the date this notice is released to the public. Independent of their classification as "listed transactions," transactions that are the same as, or substantially similar to, the transactions described in this notice may already be subject to the requirements of § 6011, § 6111, or § 6112, or the regulations thereunder. Persons required to disclose these transactions under § 1.6011–4 who fail to do so may be subject to the penalty under § 6707A.[5] Persons required to disclose or register these transactions under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the Service) may be subject to the penalty under § 6708(a). In addition, the Service may impose penalties on parties involved in these transactions or substantially similar transactions, including accuracy-related penalties under § 6662 or § 6662A.

The Service and the Treasury Department recognize that some taxpayers may have filed tax returns taking the position that they were entitled to the purported tax benefits of the types of transactions described in this notice. These taxpayers should consult with a tax advisor to ensure that their transactions are disclosed properly and to take appropriate corrective action.

DRAFTING INFORMATION

For further information regarding this notice, contact John Aramburu at (202) 622–4960 (not a toll-free call).

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[4] Leases or purported leases of Qualified Transportation Property described in section 849(b) of the Act are not identified as listed transactions subject to the terms of this notice.

[5] Section 6707A applies to returns and statements due after October 22, 2004. See Notice 2005–11, 2005–7 I.R.B. 493.

Differential Earnings Rate for Mutual Life Insurance Companies

Notice 2005–18

This notice publishes a tentative determination under § 809 of the Internal Revenue Code of the "differential earnings rate" for 2004. This rate is used by mutual life insurance companies to calculate their federal income tax liability for taxable years beginning in 2004.

The Job Creation and Worker Assistance Act of 2002, Pub. L. 107–147, § 611, amended § 809 by adding new paragraph (j). As amended, § 809(j) provides that the differential earnings rate shall be treated as zero for purposes of computing both the differential earnings amount and the recomputed differential earnings amount for a mutual life insurance company's taxable years beginning in 2001, 2002, or 2003. *See* Notice 2002–33, 2002–1 C.B. 989. Because of § 809(j), there is no need to determine a tentative recomputed differential earnings rate for 2003. The final recomputed differential earnings rate for 2003 is already determined to be zero. Subsequently, the Pension Funding Equity Act of 2004, Pub. L. 108–218, § 205, repealed § 809 of the Code for taxable years beginning after December 31, 2004. Therefore, the Internal Revenue Service is required to determine a tentative differential earnings rate for 2004.

The final recomputed differential earnings rate for 2003 is : 0

The tentative determination of the rates is set forth in Table 1.

Notice 2005–18 Table 1

Tentative Determination of Rates To Be Used For Taxable Years Beginning in 2004

Differential earnings rate for 2004	0
Imputed earnings rate for 2004	4.449
Base period stock earnings rate	18.221
Current stock earnings rate for 2004	4.913
Stock earnings rate for 2001	2.354
Stock earnings rate for 2002	-1.876
Stock earnings rate for 2003	14.261
Average mutual earnings rate for 2002	5.570

For additional background concerning the tentative differential earnings rate, see Notice 2002–19, 2002–1 C.B. 619.

DRAFTING INFORMATION

The principal author of this notice is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Ms. Hossofsky at (202) 622–8435 (not a toll-free call).

Weighted Average Interest Rates Update

Notice 2005–19

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 January 2005 is 5.48 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.

Month	For Plan Years Beginning in: Year	Corporate Bond Weighted Average	90% to 100% Permissible Range
February	2005	6.07	5.46 to 6.07

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 January 2005 is 4.73 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.

Month	For Plan Years Beginning in: Year	30-Year Treasury Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
February	2005	5.08	4.57 to 5.33	4.57 to 5.59

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.

Specified Liability Losses

Notice 2005–20

PURPOSE

This notice addresses several questions of statutory interpretation arising under § 172(f)(1)(B) of the Internal Revenue Code prior to its amendment by § 3004(a) of the Tax and Trade Relief Extension Act of 1998 (former § 172(f)(1)(B)). The amendment to former § 172(f)(1)(B) is effective for net operating losses (NOLs) arising in taxable years ending after October 21, 1998.

BACKGROUND

The Statute

Section 172(b)(1)(C) provides that the portion of any NOL that qualifies as a specified liability loss may be carried back to each of the 10 taxable years preceding the taxable year of the loss. For NOLs arising in taxable years ending prior to October 22, 1998, former § 172(f)(1)(B) treats as a specified liability loss the portion of the NOL generated by:

> (B) [a]ny amount [other than product liability expenses and certain expenses related thereto] allowable as a deduction under [chapter 1 of the Internal Revenue Code] with respect to a liability which arises under a Federal or State law or out of any tort of the taxpayer if—
>
> (i) in the case of a liability arising out of a Federal or State law, the act (or failure to act) giving rise to such liability occurs at least 3 years before the beginning of the taxable year, or
>
> (ii) in the case of a liability arising out of a tort, such liability arises out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurs at least 3 years before the beginning of the taxable year.

For this purpose, a liability is not taken into account unless the taxpayer used an accrual method of accounting throughout the period or periods during which the acts or failures to act giving rise to the liability occurred.

The Sealy Decisions

In *Sealy Corp. v. Commissioner*, 107 T. C. 177 (1996), *aff'd*, 171 F.3d 655 (9th Cir. 1999), the Tax Court held that the portion of NOLs generated by deductions for the following liabilities did not result in former § 172(f)(1)(B) specified liability losses:

(1) professional fees incurred to comply with current reporting, filing, and disclosure requirements imposed by the Securities and Exchange Act of 1934;

(2) professional fees incurred to comply with current ERISA reporting requirements; and

(3) professional fees incurred in connection with an income tax audit by the Service for a prior taxable year.

The Tax Court gave three reasons for its conclusion that these liabilities did not arise under a federal or state law within the meaning of former § 172(f)(1)(B). First, the federal laws cited by the taxpayers did not establish their liability to pay the amounts at issue. Instead, the taxpayers' liabilities did not arise until the services were contracted for and received and the taxpayers' choice of the means of compliance, rather than the cited provisions, determined the nature and amount of their costs. *Sealy* at 184. Second, Congress intended former §172(f)(1)(B) to apply only to liabilities for which a deduction is deferred because of the economic performance requirement of § 461(h). The economic performance requirement did not delay the taxpayers' accrual of the deductions at issue. *Sealy* at 185–86. Third, invoking the statutory construction rule of ejusdem generis, the court concluded that Congress intended the 10-year carryback to apply to a relatively narrow class of liabilities similar to other liabilities referred to in former § 172(f). *Sealy* at 186.

In affirming the Tax Court's judgment, the Ninth Circuit stated that the acts giving rise to the liabilities at issue in *Sealy* were contractual acts by which Sealy engaged lawyers or accountants and did not occur at least 3 years before the beginning of the taxable year of the related deductions as required by former § 172(f)(1)(B)(i).

The Host Marriot and Intermet Decisions

In *Host Marriott Corp. v. United States*, 113 F. Supp. 2d 790 (D. Md. 2000), *aff'd*, 267 F.3d 363 (4th Cir. 2001), the district court concluded that interest liabilities on federal tax deficiencies arise under federal law within the meaning of former §172(f)(1)(B). The court pointed out that § 6601(a) imposes interest on due but unpaid federal taxes. The court noted that, in contrast to the situation in *Sealy*, the interest liabilities were set by federal law, not by the taxpayer's choice.

In *Intermet Corp. v. Commissioner*, 117 T.C. 133 (2001), the Tax Court cited *Host Marriot* and concluded that liabilities for state tax deficiencies, interest on state tax deficiencies, and interest on a federal income tax deficiency arise under federal or state law within the meaning of former § 172(f)(1)(B). In distinguishing *Sealy*, the Tax Court only referred to the first reason (*i.e.*, federal law did not establish the liability to pay the amounts at issue) that it gave in *Sealy* for concluding that the professional fee liabilities at issue in that case did not arise under federal or state law.

In addition, in both *Host Marriot* and *Intermet*, the courts concluded that the filing of an erroneous tax return, resulting in the initial failure to timely pay the entire amount of tax due, constitutes the act giving rise to the entire compound interest liability on unpaid tax.

The Major Paint Decision

In *Major Paint Co. v. United States*, 334 F.3d 1042 (Fed. Cir. 2003), *aff'g Standard Brands Liquidating Creditor Trust v. United States*, 53 Fed. Cl. 25 (2002), the Federal Circuit held that liabilities for capitalized legal, accounting, and other professional fees and expenses incurred pursuant to a reorganization bankruptcy under Chapter 11 of Title 11 of the United States Code did not arise under federal law for purposes of former § 172(f)(1)(B). The fees included those incurred by the taxpayer on its own behalf as well as fees incurred on behalf of the unsecured creditors' committee but required to be paid from the bankruptcy estate. The taxpayer capitalized a portion of the fees incurred as a result of the reorganization bankruptcy and later deducted the capitalized fees upon a subsequent voluntary liquidating bankruptcy.

The Bankruptcy Code requires the appointment of an unsecured creditors' committee and allows the committee, with court approval, to employ various professionals to perform services for the committee. The Bankruptcy Code also requires the bankruptcy court to approve the employment of the professionals, the terms of their employment, and the amounts paid to them. In *Major Paint*, a local court rule required the bankrupt taxpayer to employ counsel.

The Federal Circuit analyzed the opinions in *Sealy*, *Host Marriot*, and *Intermet*, from which it concluded two principles could be derived. First, "'arising out of a federal law' means more than just that the liability is incurred with respect to an obligation under a federal law." 334 F.3d at 1046. Second, "the nature and amount of the liability must be traceable to a specific law and cannot be the result of choices made by the taxpayer or others." *Id.* As in *Sealy*, the statutory provisions did not establish a liability to pay the amounts at issue. Rather, the decisions of the taxpayer and the creditors' committee, subject to final approval by the bankruptcy judge, as to the means of compliance determined the nature and amount of the costs. The court concluded that the connection between the Bankruptcy Code and the liabilities for the fees was "too attenuated to meet the level of 'arise under' necessary to qualify as a specified liability loss." *Id.* at 1047.

QUESTIONS AND ANSWERS

The "Arises Under a Federal or State Law" Requirement

Q–1. What tests must a liability satisfy to arise under federal or state law within the meaning of former § 172(f)(1)(B)?

A–1. To arise under federal or state law the liability must be directly imposed by federal or state law and must not be the result of decisions made by the taxpayer or others. *See Sealy* and *Major Paint*.

Q–2. May a tort liability satisfy the requirements of former § 172(f)(1)(B)(i)?

A–2. Yes. A tort liability may be directly imposed under either federal or state law. If the act or failure to act giving rise to the tort liability occurs at least 3 years before the beginning of the taxable year of the liability's deduction, the requirements of former § 172(f)(1)(B)(i) are satisfied.

Multiple Act Torts

Q–3. What is a tort liability that arises out of a series of actions (or failures to act) over an extended period of time?

A–3. A tort liability that arises out of a series of actions (or failures to act) over an extended period of time within the meaning of former § 172(f)(1)(B)(ii) is a liability that arises only from multiple acts or failures to act over an extended period of time. An example is a tort liability for causing someone to develop a disease because of repeated exposures to chemicals or other toxic substances. This liability would be a tort liability within the meaning

of former § 172(f)(1)(B)(ii) if a substantial portion of the exposures occur at least 3 years before the beginning of the taxable year of the liability's deduction.

On the other hand, what may appear to be a tort liability involving multiple acts, such as a tort liability arising from a continuing trespass, is actually a number of separate liabilities, each arising from separate acts or failures to act resulting in separate causes of action. The Internal Revenue Service will not treat this type of liability as a multiple act or failure to act liability that satisfies the requirements of former § 172(f)(1)(B)(ii). Instead, to generate a specified liability loss, the separate liabilities must independently satisfy the 3-year act or failure to act requirement of former § 172(f)(1)(B)(i).

The "Act or Failure to Act" Requirement

Q–4. Which act in the chain of causation leading to the creation of a liability constitutes "the act or failure to act" giving rise to that liability within the meaning of former § 172(f)(1)(B)(i)?

A–4. The act or failure to act resulting in the establishment of a legal liability constitutes the act or failure to act within the meaning of former § 172(f)(1)(B)(i). For example, in the case of a trespass, the act of trespassing constitutes the relevant act for purposes of former § 172(f)(1)(B)(i), not the judgment of a court.

In the case of interest on unpaid federal or state taxes, the Service continues to believe that a taxpayer's use of the government's money over discrete periods, such as days, months or portions of a month, is an essential element that creates the liability. Therefore, the Service believes that the courts in *Host Marriott* and *Intermet* incorrectly concluded that the initial failure to pay the taxes when due constituted the act or failure to act giving rise to any interest that economically accrued during the taxable year such interest was deductible and the 3-year period prior to the beginning of that taxable year. Consequently, the Service will continue to assert that interest that economically accrues on a liability for unpaid taxes in the taxable year such interest is deductible and the 3-year period prior to the beginning of that taxable year does not satisfy the 3-year act or failure to act requirement of former § 172(f)(1)(B)(i).

The "With Respect To" Requirement

Q–5. For purposes of former § 172(f)(1)(B), does a deduction allowable "with respect to" a liability include other items, such as legal and professional fees to contest the liability or court costs incurred to litigate the liability?

A–5. A deduction allowable with respect to a liability includes only a deduction for the liability itself. Therefore, legal fees, court costs, and similar items do not generate a former § 172(f)(1)(B) specified liability loss even if the liabilities are incurred in determining the amount of a liability that does satisfy the requirements of former § 172(f)(1)(B).

In *Sealy*, the Tax Court and Ninth Circuit held that deductions for accounting and legal fees incurred in connection with a federal income tax audit did not generate a specified liability loss under former § 172(f)(1)(B). Federal law directly imposed only the federal income tax liability and did not impose the taxpayer's liability for the accounting and legal fees. The taxpayer's liabilities for the accounting and legal fees arose as a result of decisions made by the taxpayer, and such liabilities were incurred when the services were contracted for and performed. Implicit in the Tax Court's holding is the conclusion that the deduction for the legal and professional fees was not, within the meaning of § 172(f)(1)(B), allowable "with respect to" the federal tax liability that was the subject of the audit.

Depreciation Deductions

Q–6. For purposes of § 172(f)(1)(B), are depreciation deductions allowable with respect to the liability giving rise to the depreciable basis of a depreciable asset?

A–6. Depreciation deductions are not allowable with respect to the liability giving rise to the depreciable basis of a depreciable asset. Depreciation deductions may be allowable with respect to liabilities satisfied through the use of the depreciable asset.

Liabilities arising under federal or state law may be treated as part of the cost basis of property if the liabilities are properly chargeable to a capital account. For example, § 164(a) requires sales taxes imposed on the purchase of equipment used in a taxpayer's trade or business to be capitalized into the cost basis of the equipment. If an NOL is incurred for a taxable year and the sales tax liability was incurred at least 3 years before the beginning of that taxable year, some taxpayers have asserted that any portion of the NOL generated by depreciation deductions for the portion of the property's depreciable basis attributable to the capitalized sales tax constitutes a former § 172(f)(1)(B) specified liability loss irrespective of how the property is used. Likewise, taxpayers may be required to place certain equipment into service to comply with requirements of federal or state law, for example, clean water standards. Some of these taxpayers have asserted that if the equipment was acquired by the taxpayer at least 3 years prior to the beginning of the taxable year, the portion of any NOL generated for the taxable year by depreciation deductions attributable to the equipment qualifies as a former § 172(f)(1)(B) specified liability loss. The Service disagrees with both of these assertions.

Section 167(a) allows a depreciation deduction only for property that is either used in a trade or business or held for the production of income. Whether a depreciation deduction is allowable "with respect to" a liability depends upon the property's actual use. For example, if a taxpayer uses equipment to satisfy an environmental cleanup liability imposed by federal law, the portion of the equipment's depreciation allocable to satisfying the environmental cleanup liability is allowable with respect to the environmental cleanup liability. If the environmental cleanup liability arose as a result of a chemical spill that occurred at least 3 years before the beginning of the taxable year and the environmental cleanup liability is otherwise deductible, the depreciation deductions may generate a specified liability loss. However, if a taxpayer uses equipment to satisfy environmental cleanup liabilities that arise during the same taxable year the depreciation deductions are allowable, for example, by preventing the discharge of pollutants resulting from manufacturing activities during the current taxable year, the act giving rise to the taxpayer's environmental cleanup liability will not satisfy the 3-year act or failure to act requirement of former § 172(f)(1)(B)(i), irrespective of when the taxpayer placed the cleanup equipment in service.

DRAFTING INFORMATION

The principal author of this notice is Forest Boone of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Boone at 202–622–4960 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters. (Also: Part I, §§ 25, 103, 143.)

Rev. Proc. 2005–15

SECTION 1. PURPOSE

This revenue procedure provides issuers of qualified mortgage bonds, as defined in section 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in section 25(c), with (1) the nationwide average purchase price for residences located in the United States, and (2) average area purchase price safe harbors for residences located in statistical areas in each state, the District of Columbia, Puerto Rico, the Northern Mariana Islands, American Samoa, the Virgin Islands, and Guam.

SECTION 2. BACKGROUND

.01 Section 103(a) provides that, except as provided in section 103(b), gross income does not include interest on any state or local bond. Section 103(b)(1) provides that section 103(a) shall not apply to any private activity bond that is not a "qualified bond" within the meaning of section 141. Section 141(e) provides, in part, that the term "qualified bond" means any private activity bond if such bond (1) is a qualified mortgage bond under section 143, (2) meets the volume cap requirements under section 146, and (3) meets the applicable requirements under section 147.

.02 Section 143(a)(1) provides that the term "qualified mortgage bond" means a bond that is issued as part of a qualified mortgage issue. Section 143(a)(2)(A) provides that the term "qualified mortgage issue" means an issue of one or more bonds by a state or political subdivision thereof, but only if: (i) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences; (ii) the issue meets the requirements of subsections (c), (d), (e), (f), (g), (h), (i), and (m)(7) of section 143; (iii) the issue does not meet the private business tests of paragraphs (1) and (2) of section 141(b); and (iv) with respect to amounts received more than 10 years after the date of issuance, repayments of $250,000 or more of principal on mortgage financing provided by the issue are used by the close of the first semiannual period beginning after the date the prepayment (or complete repayment) is received to redeem bonds that are part of the issue.

Average Area Purchase Price

.03 Section 143(e)(1) provides that an issue of bonds meets the purchase price requirements of section 143(e) if the acquisition cost of each residence financed by the issue does not exceed 90 percent of the average area purchase price applicable to such residence. Section 143(e)(5) provides that, in the case of a targeted area residence (as defined in section 143(j)), section 143(e)(1) shall be applied by substituting 110 percent for 90 percent.

.04 Section 143(e)(2) provides that the term "average area purchase price" means, with respect to any residence, the average purchase price of single-family residences (in the statistical area in which the residence is located) that were purchased during the most recent 12-month period for which sufficient statistical information is available. Under sections 143(e)(3) and (4), respectively, separate determinations are to be made for new and existing residences, and for two-, three-, and four-family residences.

.05 Section 143(e)(2) provides that the determination of the average area purchase price for a statistical area shall be made as of the date on which the commitment to provide the financing is made or, if earlier, the date of the purchase of the residence.

.06 Section 143(k)(2)(A) provides that the term "statistical area" means (i) a metropolitan statistical area (MSA), and (ii) any county (or the portion thereof) that is not within an MSA. Section 143(k)(2)(C) further provides that if sufficient recent statistical information with respect to a county (or portion thereof) is unavailable, the Secretary may substitute another area for which there is sufficient recent statistical information for such county (or portion thereof). In the case of any portion of a State which is not within a county, section 143(k)(2)(D) provides that the Secretary may designate as a county any area that is the equivalent of a county. Section 6a.103A–1(b)(4)(i) of the Temporary Income Tax Regulations (issued under section 103A of the Internal Revenue Code of 1954, the predecessor of section 143) provides that the term "State" includes a possession of the United States and the District of Columbia.

.07 Section 6a.103A–2(f)(5)(i) provides that an issuer may rely upon the average area purchase price safe harbors published by the Department of the Treasury for the statistical area in which a residence is located. Section 6a.103A–2(f)(5)(i) further provides that an issuer may use an average area purchase price limitation different from the published safe harbor if the issuer has more accurate and comprehensive data for the statistical area.

Qualified Mortgage Credit Certificate Program

.08 Section 25(c) permits a state or political subdivision to establish a qualified mortgage credit certificate program. In general, a qualified mortgage credit certificate program is a program under which the issuing authority elects not to issue an amount of private activity bonds that it may otherwise issue during the calendar year under section 146, and in their place, issues mortgage credit certificates to taxpayers in connection with the acquisition of their principal residences. Section 25(a)(1) provides, in general, that the holder of a mortgage credit certificate may claim a federal income tax credit equal to the product of the credit rate specified in the certificate and the interest paid or accrued during the tax year on the remaining principal of the indebtedness incurred to acquire the residence. Section 25(c)(2)(A)(iii)(III) generally provides that residences acquired in connection with the issuance of mortgage credit certificates must meet the purchase price requirements of section 143(e).

Income Limitations for Qualified Mortgage Bonds and Mortgage Credit Certificates

.09 Section 143(f) imposes limitations on the income of mortgagors for whom

financing may be provided by qualified mortgage bonds. In addition, section 25(c)(2)(A)(iii)(IV) provides that holders of mortgage credit certificates must meet the income requirement of section 143(f). Generally, under sections 143(f)(1) and 25(c)(2)(A)(iii)(IV), the income requirement is met only if all owner-financing under a qualified mortgage bond and all mortgage credit certificates issued under a qualified mortgage credit certificate program are provided to mortgagors whose family income is 115 percent or less of the applicable median family income. Section 143(f)(5), however, generally provides for an upward adjustment to the percentage limitation in high housing cost areas. High housing cost areas are defined in section 143(f)(5)(C) as any statistical area for which the housing cost/income ratio is greater than 1.2.

.10 Under section 143(f)(5)(D), the housing cost/income ratio with respect to any statistical area is determined by dividing (a) the applicable housing price ratio for such area by (b) the ratio that the area median gross income for such area bears to the median gross income for the United States. The applicable housing price ratio is the new housing price ratio (new housing average area purchase price divided by the new housing average purchase price for the United States) or the existing housing price ratio (existing housing average area purchase price divided by the existing housing average purchase price for the United States), whichever results in the housing cost/income ratio being closer to 1.

Average Area and Nationwide Purchase Price Limitations

.11 Average area purchase price safe harbors for each state, the District of Columbia, Puerto Rico, the Northern Mariana Islands, American Samoa, the Virgin Islands, and Guam were last published in Rev. Proc. 2004–18, 2004–9 I.R.B. 529.

.12 The nationwide average purchase price limitation was last published in section 5.02 of Rev. Proc. 2004–18. Guidance with respect to the United States and area median gross income figures that are to be used in computing the housing cost/income ratio described in section 143(f)(5) was last published in Rev. Proc. 2004–24, 2004–16 I.R.B. 790.

.13 This revenue procedure uses FHA loan limits for a given statistical area to calculate the average area purchase price safe harbor for that area. FHA sets limits on the dollar value of loans it will insure based on median home prices and conforming loan limits established by the Federal Home Loan Mortgage Corporation. In particular, FHA sets an area's loan limit at 95 percent of the median home sales price for the area, subject to certain floors and caps measured against conforming loan limits.

.14 To calculate the average area purchase price safe harbors in this revenue procedure, the FHA loan limits are adjusted to take into account the differences between average and median purchase prices. Because FHA loan limits do not differentiate between new and existing residences, this revenue procedure contains a single average area purchase price safe harbor for both new and existing residences in a statistical area. The Treasury Department and the Internal Revenue Service have determined that FHA loan limits provide a reasonable basis for determining average area purchase price safe harbors. If the Treasury Department and the Internal Revenue Service become aware of other sources of average purchase price data, including data that differentiate between new and existing residences, consideration will be given as to whether such data provide a more accurate method for calculating average area purchase price safe harbors.

.15 The average area purchase price safe harbors listed in section 4.01 of this revenue procedure are based on FHA loan limits released January 3, 2005. FHA loan limits are available for statistical areas in each state, the District of Columbia, Puerto Rico, the Northern Mariana Islands, American Samoa, the Virgin Islands, and Guam. See section 3.03 of this revenue procedure with respect to FHA loan limits revised after January 3, 2005.

.16 OMB Bulletin No. 03–04, dated and effective June 6, 2003, revised the definitions of the nation's metropolitan areas and recognized 49 new metropolitan statistical areas. The OMB bulletin no longer includes primary metropolitan statistical areas.

SECTION 3. APPLICATION

Average Area Purchase Price Safe Harbors

.01 Average area purchase price safe harbors for statistical areas in each state, the District of Columbia, Puerto Rico, the Northern Mariana Islands, American Samoa, the Virgin Islands, and Guam are set forth in section 4.01 of this revenue procedure. Average area purchase price safe harbors are provided for single-family and two to four-family residences. For each type of residence, section 4.01 of this revenue procedure contains a single safe harbor that may be used for both new and existing residences. Issuers of qualified mortgage bonds and issuers of mortgage credit certificates may rely on these safe harbors to satisfy the requirements of sections 143(e) and (f). Section 4.01 of this revenue procedure provides safe harbors for MSAs and for certain counties and county equivalents. If no purchase price safe harbor is available for a statistical area, the safe harbor for "ALL OTHER AREAS" may be used for that statistical area (except for Alaska, for which a separate safe harbor is provided for statistical areas not listed).

.02 If a residence is in an MSA, the safe harbor applicable to it is the limitation of that MSA. If an MSA falls in more than one state, the MSA is listed in section 4.01 of this revenue procedure under each state.

.03 If the FHA revises the FHA loan limit for any statistical area after January 3, 2005, an issuer of qualified mortgage bonds or mortgage credit certificates may use the revised FHA loan limit for that statistical area to compute (as provided in the next sentence) a revised average area purchase price safe harbor for the statistical area provided that the issuer maintains records evidencing the revised FHA loan limit. The revised average area purchase price safe harbor for that statistical area is computed by dividing the revised FHA loan limit by .76.

.04 If, pursuant to section 6a.103A–2(f)(5)(i), an issuer uses more accurate and comprehensive data to determine the average area purchase price for a statistical area, the issuer must make separate average area purchase price determinations for new and existing residences. Moreover, when computing the

average area purchase price for a statistical area that is an MSA, as defined in OMB Bulletin No. 03–04, the issuer must make the computation for the entire applicable MSA. When computing the average area purchase price for a statistical area that is not an MSA, the issuer must make the computation for the entire statistical area and may not combine statistical areas. Thus, for example, the issuer may not combine two or more counties.

.05 If an issuer receives a ruling permitting it to rely on an average area purchase price limitation that is higher than the applicable safe harbor in this revenue procedure, the issuer may rely on that higher limitation for the purpose of satisfying the requirements of section 143(e) and (f) for bonds sold, and mortgage credit certificates issued, not more than 30 months following the termination date of the 12-month period used by the issuer to compute the limitation.

Nationwide Average Purchase Price

.06 Section 4.02 of this revenue procedure sets forth a single nationwide average purchase price for purposes of computing the housing cost/income ratio under section 143(f)(5).

.07 Issuers must use the nationwide average purchase price set forth in section 4.02 of this revenue procedure when computing the housing cost/income ratio under section 143(f)(5) regardless of whether they are relying on the average area purchase price safe harbors contained in this revenue procedure or using more accurate and comprehensive data to determine average area purchase prices for new and existing residences for a statistical area that are different from the published safe harbors in this revenue procedure.

.08 If, pursuant to section 6.02 of this revenue procedure, an issuer relies on the average area purchase price safe harbors contained in Rev. Proc. 2004–18, the issuer must use the nationwide average purchase price set forth in section 5.02 of Rev. Proc. 2004–18 in computing the housing cost/income ratio under section 143(f)(5). Likewise, if, pursuant to section 6.05 of this revenue procedure, an issuer relies on the nationwide average purchase price published in Rev. Proc. 2004–18, the issuer may not rely on the average area purchase price safe harbors published in this revenue procedure.

SECTION 4. AVERAGE AREA AND NATIONWIDE AVERAGE PURCHASE PRICES

.01 Average area purchase prices for single-family and two to four-family residences in MSAs, and for certain counties and county equivalents are set forth below. The safe harbor for "ALL OTHER AREAS" (found at the end of the table below) may be used for a statistical area that is not listed below (except for Alaska, for which a separate safe harbor is provided for statistical areas not listed).

Area Name	1 Family	2 Family	3 Family	4 Family
ALASKA				
ANCHORAGE, AK (MSA)	301,250	339,303	412,237	475,658
DENALI BOROUGH, AK	316,137	404,668	489,126	607,879
JUNEAU CITY and BOROUGH, AK	289,342	325,921	395,987	456,908
YAKUTAT CITY AND BOROUGH, AK	316,137	404,668	489,126	607,879
All other areas in Alaska	250,000	290,779	351,474	436,800
ARIZONA				
FLAGSTAFF, AZ (MSA)	268,750	302,697	367,763	436,800
MOHAVE COUNTY, AZ	321,842	362,500	440,461	508,224
CALIFORNIA				
AMADOR COUNTY, CA	320,000	360,421	437,895	505,263
BAKERSFIELD, CA (MSA)	237,375	290,779	351,474	436,800
INYO COUNTY, CA	381,999	436,447	530,263	611,842
CALVERAS COUNTY, CA	350,000	394,211	478,947	552,632
CHICO, CA (MSA)	310,000	349,158	424,211	489,474
HUMBOLDT COUNTY, CA	294,342	331,521	402,829	464,803
FRESNO, CA (MSA)	295,000	332,263	403,684	465,789
LOS ANGELES-LONG BEACH-SANTA ANA, CA (MSA)	411,704	527,037	637,046	791,700
MADERA, CA (MSA)	268,750	302,697	367,763	436,800
MARIPOSA COUNTY, CA	246,842	290,779	351,474	436,800
MERCED, CA (MSA)	312,500	351,974	427,632	493,421
MODESTO, CA (MSA)	362,500	408,289	496,053	572,368
MONO COUNTY, CA	381,999	488,975	591,028	734,521
NAPA, CA (MSA)	411,704	527,037	637,046	791,700
OXNARD-THOUSAND OAKS-VENTURA, CA (MSA)	411,704	527,037	637,046	791,700
TUOLUMNE COUNTY, CA	326,842	368,158	447,303	516,118
REDDING, CA (MSA)	293,750	330,855	401,974	463,816
RIVERSIDE-SAN BERNARDINO-ONTARIO, CA (MSA)	389,605	438,818	533,143	615,166
SACRAMENTO-ARDEN-ARCADE-ROSEVILLE, CA (MSA)	411,704	488,580	591,028	700,658
SALINAS, CA (MSA)	411,704	527,037	637,046	791,700
SAN DIEGO-CARLSBAD-SAN MARCOS, CA (MSA)	411,704	527,037	637,046	791,700

Area Name	1 Family	2 Family	3 Family	4 Family
SAN FRANCISCO-OAKLAND-FREMONT, CA (MSA)	411,704	527,037	637,046	791,700
SAN JOSE-SUNNYVALE-SANTA CLARA, CA (MSA)	411,704	527,037	637,046	791,700
SAN LUIS OBISPO-PASO ROBLES, CA (MSA)	411,704	527,037	637,046	791,700
SANTA BARBARA-SANTA MARIA-GOLETA, CA (MSA)	411,704	527,037	637,046	791,700
SANTA CRUZ-WATSONVILLE, CA (MSA)	411,704	527,037	637,046	791,700
SANTA ROSA-PETALUMA, CA (MSA)	411,704	527,037	637,046	791,700
STOCKTON, CA (MSA)	399,938	450,457	547,283	631,480
NEVADA COUNTY, CA	381,999	475,868	578,158	667,105
MENDOCINO COUNTY, CA	373,750	420,961	511,447	590,132
VALLEJO-FAIRFIELD, CA (MSA)	411,704	520,921	632,895	730,263
VISALIA-PORTERVILLE, CA (MSA)	233,125	290,779	351,474	436,800
YUBA CITY, CA (MSA)	330,000	371,684	451,579	521,053
COLORADO				
ARCHULETA COUNTY, CO	263,487	296,768	360,561	436,800
BOULDER, CO (MSA)	381,999	471,645	573,026	661,184
COLORADO SPRINGS, CO (MSA)	272,103	306,472	372,350	436,800
DENVER-AURORA, CO (MSA)	344,222	440,609	532,532	631,579
LA PLATA COUNTY, CO	303,750	342,118	415,658	479,605
EAGLE COUNTY, CO	344,222	440,609	532,532	661,829
LAKE COUNTY, CO	344,222	440,609	532,532	661,829
FORT COLLINS-LOVELAND, CO (MSA)	280,000	315,368	383,158	442,105
GARFIELD COUNTY, CO	292,293	329,214	399,980	461,517
GRAND COUNTY, CO	293,750	330,855	401,974	463,816
GREELEY, CO (MSA)	286,875	323,112	392,566	452,961
GUNNISON COUNTY, CO	259,938	292,772	355,704	436,800
OURAY COUNTY, CO	262,500	295,658	359,211	436,800
PITKIN COUNTY, CO	381,999	488,975	591,028	734,521
ROUTT COUNTY, CO	270,000	304,105	369,474	436,800
SAN MIGUEL COUNTY, CO	344,222	401,250	487,500	562,500
SUMMIT COUNTY, CO	380,000	428,000	520,000	600,000
CONNECTICUT				
BRIDGEPORT-STAMFORD-NORWALK, CT (MSA)	411,704	527,037	637,046	791,700
HARTFORD-WEST HARTFORD-EAST HARTFORD, CT (MSA)	335,000	377,316	458,421	528,947
NEW HAVEN-MILFORD, CT (MSA)	381,999	435,039	528,553	609,868
NORWICH-NEW LONDON, CT (MSA)	293,750	330,855	401,974	463,816
LITCHFIELD COUNTY, CT	255,000	290,779	351,474	436,800
DISTRICT OF COLUMBIA				
WASHINGTON-ARLINGTON-ALEXANDRIA, DC-VA-MD-WV (MSA)	411,704	516,697	627,763	724,342
DELAWARE				
DOVER, DE (MSA)	246,875	290,779	351,474	436,800
PHILADELPHIA-CAMDEN-WILMINGTON, PA-NJ-DE-MD (MSA)	312,500	351,974	427,632	493,421
FLORIDA				
CAPE CORAL-FORT MYERS, FL (MSA)	248,750	290,779	351,474	436,800
JACKSONVILLE, FL (MSA)	275,000	309,737	376,316	436,800
MONROE COUNTY, FL	381,999	488,975	591,028	734,521
MIAMI-FORT LAUDERDALE-MIAMI BEACH, FL (MSA)	368,421	414,958	504,154	581,717
NAPLES-MARCO ISLAND, FL (MSA)	393,750	443,487	538,816	621,711
ORLANDO, FL (MSA)	235,000	290,779	351,474	436,800
PORT ST. LUCIE-FORT PIERCE, FL (MSA)	311,842	351,250	426,776	492,434
SARASOTA-BRADENTON-VENICE, FL (MSA)	338,026	380,724	462,562	533,725
GEORGIA				
ATHENS-CLARKE COUNTY, GA (MSA)	232,375	290,779	351,474	436,800
ATLANTA-SANDY SPRINGS-MARIETTA, GA (MSA)	299,875	337,754	410,355	473,487
BRUNSWICK, GA (MSA)	232,375	290,779	351,474	436,800

Area Name	1 Family	2 Family	3 Family	4 Family
HAWAII				
HAWAII COUNTY, HI	278,750	313,961	381,447	440,132
HONOLULU, HI (MSA)	617,558	695,564	845,079	975,091
MAUI COUNTY, HI	381,250	429,408	521,711	601,974
KALAWAO COUNTY, HI	239,400	306,379	370,326	460,232
KAUAI COUNTY, HI	531,250	598,355	726,974	838,816
IDAHO				
BLAIN COUNTY, ID	336,250	378,724	460,132	530,921
TETON COUNTY, ID	369,407	438,453	532,699	614,653
ILLINOIS				
CHICAGO-NAPERVILLE-JOLIET, IL-IN-WI (MSA)	362,105	407,845	495,512	571,745
ST. LOUIS, MO-IL (MSA)	281,250	316,776	384,868	444,079
INDIANA				
CINCINNATI-MIDDLETOWN, OH-KY-IN (MSA)	235,646	290,779	351,474	436,800
CHICAGO-NAPERVILLE-JOLIET, IL-IN-WI (MSA)	362,105	407,845	495,512	571,745
INDIANAPOLIS, IN (MSA)	231,250	290,779	351,474	436,800
LOUISVILLE, KY-IN (MSA)	237,375	290,779	351,474	436,800
SCOTT COUNTY, IN	237,375	290,779	351,474	436,800
KANSAS				
KANSAS CITY, MO-KS (MSA)	265,313	298,826	363,059	436,800
KENTUCKY				
CINCINNATI-MIDDLETOWN, OH-KY-IN (MSA)	235,646	290,779	351,474	436,800
LOUISVILLE, KY-IN (MSA)	237,375	290,779	351,474	436,800
MARYLAND				
BALTIMORE-TOWSON, MD (MSA)	344,222	389,557	473,292	546,107
HAGERSTOWN-MARTINSBURG, MD-WV (MSA)	355,000	399,842	485,789	560,526
WASHINGTON COUNTY, MD	268,750	302,697	367,763	436,800
WASHINGTON-ARLINGTON-ALEXANDRIA, DC-VA-MD-WV (MSA)	411,704	516,697	627,763	724,342
PHILADELPHIA-CAMDEN-WILMINGTON, PA-NJ-DE-MD (MSA)	312,500	351,974	427,632	493,421
MAINE				
PORTLAND-SOUTH PORTLAND-BIDDEFORD, ME (MSA)	327,500	368,868	448,158	517,105
MASSACHUSETTS				
BARNSTABLE TOWN, MA (MSA)	411,704	527,037	637,046	761,842
BOSTON-CAMBRIDGE-QUINCY, MA-NH (MSA)	411,704	527,037	637,046	787,396
DUKES COUNTY, MA	344,222	440,609	532,532	661,829
NANTUCKET COUNTY, MA	344,222	440,609	532,532	661,829
PITTSFIELD, MA (MSA)	237,500	290,779	351,474	436,800
PROVIDENCE-NEW BEDFORD-FALL RIVER, RI-MA (MSA)	369,407	472,891	571,567	710,309
SPRINGFIELD, MA (MSA)	237,500	290,779	351,474	436,800
WORCESTER, MA (MSA)	381,999	488,975	591,028	734,521
MICHIGAN				
LENAWEE COUNTY, MI	297,500	335,079	407,105	469,737
ANN ARBOR, MI (MSA)	297,500	335,079	407,105	469,737
DETROIT-WARREN-LIVONIA, MI (MSA)	297,500	335,079	407,105	469,737
HOLLAND-GRAND HAVEN, MI (MSA)	236,250	290,779	351,474	436,800
LANSING-EAST LANSING, MI (MSA)	250,000	290,779	351,474	436,800
MONROE, MI (MSA)	297,500	335,079	407,105	469,737
MINNESOTA				
MINNEAPOLIS-ST. PAUL-BLOOMINGTON, MN-WI (MSA)	306,250	344,934	419,079	483,553
ROCHESTER, MN (MSA)	238,125	290,779	351,474	436,800
MISSOURI				
KANSAS CITY, MO-KS (MSA)	265,313	298,826	363,059	436,800
ST. LOUIS, MO-IL (MSA)	281,250	316,776	384,868	444,079
MONTANA				
MISSOULA, MT (MSA)	243,750	290,779	351,474	436,800

Area Name	1 Family	2 Family	3 Family	4 Family
NEW HAMPSHIRE				
MANCHESTER-NASHUA, NH (MSA)	381,999	488,975	591,028	734,521
BOSTON-CAMBRIDGE-QUINCY, MA-NH (MSA)	411,704	527,037	637,046	787,396
NEW JERSEY				
ALLENTOWN-BETHLEHEM-EASTON, PA-NJ (MSA)	369,407	459,255	557,974	643,816
ATLANTIC CITY, NJ (MSA)	306,250	344,934	419,079	483,553
PHILADELPHIA-CAMDEN-WILMINGTON, PA-NJ-DE-MD (MSA)	312,500	351,974	427,632	493,421
NEW YORK-NEWARK-EDISON, NY-NJ-PA (MSA)	411,704	527,037	637,046	791,700
OCEAN CITY, NJ (MSA)	411,704	483,574	587,520	677,908
TRENTON-EWING, NJ (MSA)	381,250	429,408	521,711	601,974
NEW MEXICO				
LOS ALAMOS COUNTY, NM	318,750	359,013	436,184	503,289
SANTA FE, NM (MSA)	381,999	449,471	546,086	630,099
NEVADA				
CARSON CITY, NV (MSA)	333,750	375,908	456,711	526,974
DOUGLAS COUNTY, NV	381,999	446,250	542,237	625,658
LAS VEGAS-PARADISE, NV (MSA)	353,947	398,655	484,349	558,863
LYON COUNTY, NV	237,368	290,779	351,474	436,800
NYE COUNTY, NV	321,842	362,500	440,461	508,224
RENO-SPARKS, NV (MSA)	373,947	421,182	511,717	590,442
NEW YORK				
BUFFALO-NIAGARA FALLS, NY (MSA)	237,500	290,779	351,474	436,800
KINGSTON, NY (MSA)	293,750	330,855	401,974	463,816
NEW YORK-NEWARK-EDISON, NY-NJ-PA (MSA)	411,704	527,037	637,046	791,700
POUGHKEEPSIE-NEWBURGH-MIDDLETOWN, NY (MSA)	356,250	401,250	487,500	562,500
ROCHESTER, NY (MSA)	243,750	290,779	351,474	436,800
NORTH CAROLINA				
CHARLOTTE-GASTONIA-CONCORD, NC-SC (MSA)	233,125	290,779	351,474	436,800
DURHAM, NC (MSA)	230,000	290,779	351,474	436,800
JACKSONVILLE, NC (MSA)	306,250	344,934	419,079	483,553
RALEIGH-CARY, NC (MSA)	231,053	290,779	351,474	436,800
VIRGINIA BEACH-NORFOLK-NEWPORT NEWS, VA-NC (MSA)	375,122	422,507	513,325	592,299
OHIO				
AKRON, OH (MSA)	250,054	290,779	351,474	436,800
ASHTABULA COUNTY, OH	290,797	327,530	397,933	459,154
CINCINNATI-MIDDLETOWN, OH-KY-IN (MSA)	235,646	290,779	351,474	436,800
CLEVELAND-ELYRIA-MENTOR, OH (MSA)	290,797	327,530	397,933	459,154
COLUMBUS, OH (MSA)	274,738	309,441	375,957	436,800
DAYTON, OH (MSA)	239,072	290,779	351,474	436,800
OREGON				
BEND, OR (MSA)	285,875	321,986	391,197	451,382
CORVALLIS, OR (MSA)	292,375	329,307	400,092	461,645
EUGENE-SPRINGFIELD, OR (MSA)	227,500	290,779	351,474	436,800
JOSEPHINE COUNTY, OR	268,750	302,697	367,763	436,800
MEDFORD, OR (MSA)	312,500	351,974	427,632	493,421
PORTLAND-VANCOUVER-BEAVERTON, OR-WA (MSA)	281,250	316,776	384,868	444,079
PENNSYLVANIA				
ALLENTOWN-BETHLEHEM-EASTON, PA-NJ (MSA)	369,407	459,255	557,974	643,816
NEW YORK-NEWARK-EDISON, NY-NJ-PA (MSA)	411,704	527,037	637,046	791,700
PHILADELPHIA-CAMDEN-WILMINGTON, PA-NJ-DE-MD (MSA)	312,500	351,974	427,632	493,421
PITTSBURGH, PA (MSA)	240,000	290,779	351,474	436,800
YORK-HANOVER, PA (MSA)	240,000	290,779	351,474	436,800
RHODE ISLAND				
PROVIDENCE-NEW BEDFORD-FALL RIVER, RI-MA (MSA)	369,407	472,891	571,567	710,309

Area Name	1 Family	2 Family	3 Family	4 Family
SOUTH CAROLINA				
CHARLESTON-NORTH CHARLESTON, SC (MSA)	287,875	324,238	393,934	454,539
CHARLOTTE-GASTONIA-CONCORD, NC-SC (MSA)	233,125	290,779	351,474	436,800
GEORGETOWN COUNTY, SC	228,750	290,779	351,474	436,800
BEAUFORT COUNTY, SC	262,500	295,658	359,211	436,800
TENNESSEE				
NASHVILLE-DAVIDSON-MURFREESBORO, TN (MSA)	297,500	335,079	407,105	469,737
TEXAS				
AUSTIN-ROUND ROCK, TX (MSA)	233,750	290,779	351,474	436,800
UTAH				
WASATCH COUNTY, UT	231,250	290,779	351,474	436,800
KANE COUNTY, UT	268,750	302,697	367,763	436,800
PROVO-OREM, UT (MSA)	231,250	290,779	351,474	436,800
SALT LAKE CITY, UT (MSA)	306,250	344,934	419,079	483,553
ST. GEORGE, UT (MSA)	237,375	290,779	351,474	436,800
VERMONT				
BURLINGTON-SOUTH BURLINGTON, VT (MSA)	281,125	316,636	384,697	443,882
VIRGINIA				
CHARLOTTESVILLE, VA (MSA)	278,625	313,820	381,276	439,934
HARRISONBURG, VA (MSA)	232,500	290,779	351,474	436,800
CULPEPER COUNTY, VA	381,999	448,442	544,837	628,658
KING GEORGE COUNTY, VA	381,999	448,442	544,837	628,658
RICHMOND, VA (MSA)	281,250	316,776	384,868	444,079
VIRGINIA BEACH-NORFOLK-NEWPORT NEWS, VA-NC (MSA)	375,122	422,507	513,325	592,299
WASHINGTON-ARLINGTON-ALEXANDRIA, DC-VA-MD-WV (MSA)	411,704	516,697	627,763	724,342
WINCHESTER, VA-WV (MSA)	312,500	351,974	427,632	493,421
WASHINGTON				
BELLINGHAM, WA (MSA)	265,938	299,530	363,914	436,800
BREMERTON-SILVERDALE, WA (MSA)	278,750	313,961	381,447	440,132
MOUNT VERNON-ANACORTES, WA (MSA)	256,250	290,779	351,474	436,800
JEFFERSON COUNTY, WA	236,250	290,779	351,474	436,800
SAN JUAN COUNTY, WA	381,999	479,934	583,092	672,829
ISLAND COUNTY, WA	366,842	413,179	502,039	579,276
OLYMPIA, WA (MSA)	243,625	290,779	351,474	436,800
PORTLAND-VANCOUVER-BEAVERTON, OR-WA (MSA)	281,250	316,776	384,868	444,079
SEATTLE-TACOMA-BELLEVUE, WA (MSA)	379,868	427,851	519,820	599,792
WISCONSIN				
CHICAGO-NAPERVILLE-JOLIET, IL-IN-WI (MSA)	362,105	407,845	495,512	571,745
MADISON, WI (MSA)	267,368	301,141	365,872	436,800
MILWAUKEE-WAUKESHA-WEST ALLIS, WI (MSA)	256,316	290,779	351,474	436,800
MINNEAPOLIS-ST. PAUL-BLOOMINGTON, MN-WI (MSA)	306,250	344,934	419,079	483,553
RACINE, WI (MSA)	242,500	290,779	351,474	436,800
WEST VIRGINIA				
HAGERSTOWN-MARTINSBURG, MD-WV (MSA)	355,000	399,842	485,789	560,526
MORGANTOWN, WV (MSA)	228,125	290,779	351,474	436,800
WASHINGTON-ARLINGTON-ALEXANDRIA, DC-VA-MD-WV (MSA)	411,704	516,697	627,763	724,342
WINCHESTER, VA-WV (MSA)	312,500	351,974	427,632	493,421
WYOMING				
TETON COUNTY, WY	369,407	438,453	532,699	614,653
GUAM	237,500	290,779	351,474	436,800
PUERTO RICO				
FAJARDO, PR (MSA)	325,000	366,053	444,737	513,158
SAN JUAN-CAGUAS-GUAYNABO, PR (MSA)	325,000	366,053	444,737	513,158

Area Name	1 Family	2 Family	3 Family	4 Family
VIRGIN ISLANDS				
ST. CROIX	287,500	323,816	393,421	453,947
ST. JOHN	246,447	290,779	351,474	436,800
ST. THOMAS	318,750	359,013	436,184	503,289
ALL OTHER AREAS	$227,147	$290,779	$351,474	$436,800

.02 The nationwide average purchase price (for use in the housing cost/income ratio for new and existing residences) is $238,200.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2004–18 is obsolete except as provided in section 6 of this revenue procedure.

SECTION 6. EFFECTIVE DATES

.01 Issuers may rely on this revenue procedure to determine average area purchase price safe harbors for commitments to provide financing or issue mortgage credit certificates that are made, or (if the purchase precedes the commitment) for residences that are purchased, in the period that begins on February 10, 2005, and ends on the date as of which the safe harbors contained in section 4.01 of this revenue procedure are rendered obsolete by a new revenue procedure.

.02 Notwithstanding section 5 of this revenue procedure, issuers may continue to rely on the average area purchase price safe harbors contained in Rev. Proc. 2004–18, with respect to bonds sold, or for mortgage credit certificates issued with respect to bond authority exchanged, before March 12, 2005, if the commitments to provide financing or issue mortgage credit certificates are made on or before April 11, 2005.

.03 Except as provided in section 6.04, issuers must use the nationwide average purchase price limitation contained in this revenue procedure for commitments to provide financing or issue mortgage credit certificates that are made, or (if the purchase precedes the commitment) for residences that are purchased, in the period that begins on February 10, 2005, and ends on the date when the nationwide average purchase price limitation is rendered obsolete by a new revenue procedure.

.04 Notwithstanding sections 5 and 6.03 of this revenue procedure, issuers may continue to rely on the nationwide average purchase price set forth in Rev. Proc. 2004–18 with respect to bonds sold, or for mortgage credit certificates issued with respect to bond authority exchanged, before March 12, 2005, if the commitments to provide financing or issue mortgage credit certificates are made on or before April 11, 2005.

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1877.

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

This revenue procedure contains a collection of information requirement in section 3.03. The purpose of the collection of information is to verify the applicable FHA loan limit that issuers of qualified mortgage bonds and qualified mortgage certificates have used to calculate the average area purchase price for a given metropolitan statistical area for purposes of section 143(e) and 25(c). The collection of information is required to obtain the benefit of using revisions to FHA loan limits to determine average area purchase prices. The likely respondents are state and local governments.

The estimated total annual reporting and/or recordkeeping burden is: 15 hours.

The estimated annual burden per respondent and/or recordkeeper: 15 minutes.

The estimated number of respondents and/or recordkeepers: 60.

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

SECTION 8. DRAFTING INFORMATION

The principal authors of this revenue procedure are David E. White and Timothy L. Jones of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue procedure, contact David E. White at (202) 622–3980 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Disclosure of Returns and Return Information in Connection With Written Contracts or Agreements for the Acquisition of Property and Services for Tax Administration Purposes

REG–148867–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the disclosure of returns and return information pursuant to section 6103(n) of the Internal Revenue Code (Code). The proposed regulations describe the circumstances under which officers or employees of the Treasury Department, a State tax agency, the Social Security Administration, or the Department of Justice may disclose returns and return information to obtain property or services for tax administration purposes, pursuant to a written contract or agreement. The proposed regulations clarify the existing regulations with respect to redisclosures of returns or return information by contractors, especially with regard to redisclosures by contractors to agents or subcontractors, and clarify that the civil and criminal penalties of sections 7431, 7213, and 7213A apply to the agents or subcontractors. The proposed regulations also clarify that section 6103(n) applies to written contracts or agreements that are entered into to obtain property or services for purposes of tax administration, including contracts that are not awarded under the Federal Acquisition Regulations (FAR), 48 CFR pts. 1–53.

The proposed regulations will affect officers and employees of the Treasury Department, a State tax agency, the Social Security Administration, or the Department of Justice who disclose returns or return information in connection with a written contract or agreement for the acquisition of property or services for tax administration purposes. The proposed regulations will also affect any person, or officer, employee, agent, or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information in connection with a written contract or agreement for the acquisition of property or services.

DATES: Written or electronic comments and requests for a public hearing must be received by April 12, 2005.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–148867–03), 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–148867–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–148867–03). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Helene R. Newsome, 202–622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by March 14, 2005. Comments are specifically requested concerning:

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

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

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

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

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

The collections of information in this proposed regulation are in §§301.6103(n)–1(d) and 301.6103(n)–1(e)(3). This information is required and will be used to ensure compliance with the internal revenue laws and regulations, and to protect the privacy of American taxpayers. The collections of information are required to obtain a benefit. The likely respondents are state or local governments, business or other for-profit institutions, federal agencies, and/or small businesses or organizations.

Estimated total annual reporting burden: 250 hours. Estimated average annual burden per respondent: 6 minutes.

Estimated number of respondents: 2500.

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 return information are confidential, as required by 26 U.S.C. 6103.

Background

Under section 6103(a), returns and return information are confidential unless the Code authorizes disclosure. Section 6103(n) authorizes, pursuant to regulations prescribed by the Secretary, returns and return information to be disclosed to any person, including any person described in section 7513(a), for purposes of tax administration, to the extent necessary in connection with: (1) the processing, storage, transmission, and reproduction of returns and return information; (2) the programming, maintenance, repair, testing, and procurement of equipment; and (3) the providing of other services.

Clarification is needed with respect to whether the existing regulations permit redisclosures by persons authorized to receive the returns and return information to their agents or subcontractors, and if so, whether certain penalty provisions, written notification requirements, and safeguard requirements are applicable to these agents and subcontractors. The proposed regulations make these clarifications. The existing regulations provide that any person, or officer or employee of the person, who receives returns or return information under the existing regulations, may redisclose the returns or return information when authorized in writing by the IRS. The proposed regulations clarify that redisclosures to agents or subcontractors are permissible provided that the IRS authorizes the redisclosures in writing. The proposed regulations clarify that agents and subcontractors are persons described in section 6103(n) and, accordingly, are subject to the civil and criminal penalty provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of returns or return information. The proposed regulations clarify that agents and subcontractors are required to comply with any written notification requirements and safeguard restrictions that may be imposed by the IRS.

Finally, the proposed regulations clarify that section 6103(n) applies to written contracts or agreements that are entered into to obtain property or services for tax administration purposes, including contracts that are not awarded under the FAR.

Explanation of Provisions

The structure of the proposed regulations is very similar to that of the existing regulations, with the exception of modifications to clarify: the redisclosure authority of contractors, especially to agents or subcontractors; the applicability to agents and subcontractors of written notification requirements, safeguard requirements, and the civil and criminal penalty provisions of sections 7431, 7213, and 7213A; and the applicability of section 6103(n) to written contracts or agreements for tax administration purposes, including contracts that are not awarded under the FAR. The proposed regulations also elaborate on the safeguard protections that the IRS may require. Finally, the proposed regulations contain other minor changes for organizational and clarity purposes.

Redisclosures to Agents or Subcontractors

The proposed regulations, at §301.6103(n)–1(a)(2)(ii), provide that any person, or officer or employee of the person, who receives returns or return information under the proposed regulations, may further disclose the returns or return information, when authorized in writing by the IRS, to the extent necessary to carry out the purposes of the written contract or agreement. To eliminate any ambiguity as to whether this provision applies to agents and subcontractors, the proposed regulation states that disclosures may include redisclosures to a person's agent or subcontractor, or officer or employee of the agent or subcontractor. The proposed regulations, at §301.6103(n)–1(a)(3), provide guidance applicable if agents or subcontractors, or officers or employees of the agents or subcontractors, who receive returns or return information under §301.6103(n)–1(a)(2)(ii), are to exercise the authority to redisclose the returns or return information to another officer or employee of the agent or subcontractor whose duties or responsibilities require the returns or return information for a purpose described in the proposed regulations. The proposed regulations, at §301.6103(n)–1(c), set forth the civil and criminal penalties to which agents, subcontractors, and their officers or employees, are subject for unauthorized inspection or disclosure of returns or return information. The proposed regulations, at §301.6103(n)–1(d), extend the written notification requirements to agents and subcontractors. In particular, agents or subcontractors who receive returns or return information under the proposed regulations must provide written notice to their officers and employees of the purposes for which returns or return information may be used and of the potential civil and criminal penalties for unauthorized inspections or disclosures. The proposed regulations, at §301.6103(n)–1(e), clarify that agents or subcontractors who receive returns or return information under the proposed regulations are subject to all safeguard requirements described in the proposed regulations.

Section 6103(n) Applies to Written Tax Administration Contracts or Agreements, Including Contracts Not Awarded Under the FAR

The proposed regulations clarify that section 6103(n) applies to written contracts or agreements that are entered into to obtain property or services for purposes of tax administration, including contracts that are not awarded under the FAR. The existing regulations use the term *contractual procurement* to describe the acquisition of property or services. Clarification is needed as to whether this term is limited to the acquisition of property or services under the FAR or whether the term refers more broadly to any written contract or agreement to acquire property or services relating to tax administration. The FAR applies only to contracts involving acquisitions with appropriated funds. FAR 1.104 and 2.101, 48 CFR 1.104 and 2.101. The existing and proposed regulations under section 6103(n), however, are intended to apply to any written contract or agreement for tax administration that creates obligations that are enforceable or otherwise recognizable at law, regardless of the form of the contract (*e.g.*, interagency agreement, memorandum of understanding, purchase order), the statutory or regulatory authority for the contract, if any (*e.g.*, the FAR, the Contract Disputes Act, 41 U.S.C. 601 through 613, the Economy Act, 31 U.S.C. § 1535), or the nature of the consideration exchanged (monetary or non-monetary). Accordingly, the proposed regulations replace

the term *contractual procurement* with the phrase "written contract or agreement" in all instances where the term appeared.

Other Changes to the Existing Regulations

The proposed regulations, at §301.6103(n)–1(a)(4), clarify that any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under the proposed regulations, may redisclose the returns or return information pursuant to §301.6103(p)(2)(B)–1 (concerning disclosures by a Federal, State, or local agency, or its agents or contractors, for a purpose authorized, and subject to all applicable conditions imposed, by section 6103). The proposed regulations, at §301.6103(n)–1(e), add the requirement that any person, or agent or subcontractor of the person, who may receive returns or return information under the proposed regulations, must agree, before the disclosure of any returns or return information to the person, agent, or subcontractor, to an IRS inspection of his, her, or its site or facilities. Finally, the proposed regulations, at §301.6103(n)–1(e)(3), set forth the condition that before the execution of a contract or subcontract for the acquisition of property or services under which returns or return information will be disclosed in accordance with the proposed regulations, the contract must be made available to the IRS.

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 collections 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 any burden on taxpayers is minimal in that the estimated average burden per respondent for complying with the collections of information imposed by these regulations is 6 minutes. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel of the Small Business Administration for comment on its impact on small businesses.

Comments and Request for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic and written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Helene R. Newsome, Office of the Associate Chief Counsel (Procedure & Administration), Disclosure & Privacy Law Division.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINSTRATION

Paragraph 1. The authority citation for part 301 continues to read, in part, as follows:

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

Par. 2. Section 301.6103(n)–1 is revised to read as follows:

§301.6103(n)–1 Disclosure of returns and return information in connection with written contracts or agreements for the acquisition of property and services for tax administration purposes.

(a) *General rule*. (1) Pursuant to the provisions of section 6103(n) of the Internal Revenue Code and subject to the conditions of this section, officers and employees of the Treasury Department, a State tax agency, the Social Security Administration, or the Department of Justice, are authorized to disclose returns and return information (as defined in section 6103(b)) to any person (including, in the case of the Treasury Department, any person described in section 7513(a)), or to an officer or employee of the person, for purposes of tax administration (as defined in section 6103(b)(4)), to the extent necessary in connection with a written contract or agreement for the acquisition of—

(i) Equipment or other property; or

(ii) Services relating to the processing, storage, transmission, or reproduction of returns or return information, the programming, maintenance, repair, or testing of equipment or other property, or the providing of other services.

(2) Any person, or officer or employee of the person, who receives returns or return information under paragraph (a)(1) of this section, may—

(i) Further disclose the returns or return information to another officer or employee of the person whose duties or responsibilities require the returns or return information for a purpose described in this paragraph; or

(ii) Further disclose the returns or return information, when authorized in writing by the Internal Revenue Service (IRS), to the extent necessary to carry out the purposes described in this paragraph. Disclosures may include disclosures to an agent or subcontractor of the person, or officer or employee of the agent or subcontractor.

(3) An agent or subcontractor, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a)(2)(ii) of this section, may further disclose the returns or return information to another officer or employee of the agent or subcontractor whose duties or responsibilities require the returns or return information for a purpose described in this paragraph (a).

(4) Any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under this paragraph, may, subject to the provisions of §301.6103(p)(2)(B)–1 (concerning disclosures by a Federal, State, or local agency,

or its agents or contractors), further disclose the returns or return information for a purpose authorized, and subject to all applicable conditions imposed, by section 6103.

(b) *Limitations*. (1) Disclosure of returns or return information in connection with a written contract or agreement for the acquisition of property or services described in paragraph (a) of this section will be treated as necessary only if the performance of the contract or agreement cannot otherwise be reasonably, properly, or economically carried out without the disclosure.

(2) Disclosure of returns or return information in connection with a written contract or agreement for the acquisition of property or services described in paragraph (a) of this section shall be made only to the extent necessary to reasonably, properly, or economically perform the contract. For example, disclosure of returns or return information to employees of a contractor for purposes of programming, maintaining, repairing, or testing computer equipment used by the IRS or a State tax agency shall be made only if the services cannot be reasonably, properly, or economically performed without the disclosure. If it is determined that disclosure of returns or return information is necessary, and if the services can be reasonably, properly, and economically performed by disclosure of only parts or portions of a return or if deletion of taxpayer identity information (as defined in section 6103(b)(6)) reflected on a return would not seriously impair the ability of the employees to perform the services, then only the parts or portions of the return, or only the return with taxpayer identity information deleted, may be disclosed.

(c) *Penalties*. Any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, is subject to the civil and criminal provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of the returns or return information.

(d) *Notification requirements*. Any person, or agent or subcontractor of the person, who receives returns or return information under paragraph (a) of this section shall provide written notice to his, her, or its officers and employees receiving the returns or return information that—

(1) Returns or return information disclosed to the officer or employee may be used only for a purpose and to the extent authorized by paragraph (a) of this section;

(2) Further inspection of any returns or return information for a purpose or to an extent not authorized by paragraph (a) of this section constitutes a misdemeanor, punishable upon conviction by a fine of as much as $1,000, or imprisonment for as long as 1 year, or both, together with costs of prosecution;

(3) Further disclosure of any returns or return information for a purpose or to an extent not authorized by paragraph (a) of this section constitutes a felony, punishable upon conviction by a fine of as much as $5,000, or imprisonment for as long as 5 years, or both, together with the costs of prosecution;

(4) Further inspection or disclosure of returns or return information by any person who is not an officer or employee of the United States for a purpose or to an extent not authorized by paragraph (a) of this section may also result in an award of civil damages against that person in an amount not less than $1,000 for each act of unauthorized inspection or disclosure, or the sum of actual damages sustained by the plaintiff as a result of the unauthorized inspection or disclosure plus, in the case of a willful inspection or disclosure or an inspection or disclosure that is the result of gross negligence, punitive damages. In addition, costs and reasonable attorneys fees may be awarded; and

(5) A conviction for an offense referenced in paragraph (c)(2) or (3) of this section shall, in addition to any other punishment, result in dismissal from office or discharge from employment if the person convicted is an officer or employee of the United States.

(e) *Safeguards*. (1) Any person, or agent or subcontractor of the person, who may receive returns or return information under paragraph (a) of this section, shall agree, before disclosure of any returns or return information to the person, agent, or subcontractor, to permit an inspection by the IRS of his, her, or its site or facilities.

(2) Any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, shall comply with all applicable conditions and requirements as the IRS may prescribe from time to time (prescribed requirements) for the purposes of protecting the confidentiality of returns and return information and preventing disclosures or inspections of returns or return information in a manner not authorized by this section.

(3) The terms of any written contract or agreement for the acquisition of property or services as described in paragraph (a) of this section shall provide, or shall be amended to provide, that any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, shall comply with the prescribed requirements. Any contract or agreement shall be made available to the IRS before execution of the contract or agreement. For purposes of this paragraph (e)(3), a written contract or agreement shall include any contract or agreement between a person and an agent or subcontractor of the person to provide the property or services described in paragraph (a) of this section.

(4) If the IRS determines that any person, or officer, employee, agent or subcontractor of the person, or officer or employee of the agent or subcontractor, who receives returns or return information under paragraph (a) of this section, has failed to, or does not, satisfy the prescribed requirements, the IRS may take any actions it deems necessary to ensure that the prescribed requirements are or will be satisfied, including—

(i) Suspension of further disclosures of returns or return information by the IRS to the State tax agency, the Social Security Administration, or the Department of Justice, until the IRS determines that the conditions and requirements have been or will be satisfied;

(ii) Suspension of further disclosures by the Treasury Department otherwise authorized by paragraph (a) of this section; and

(iii) Suspension or termination of any duty or obligation arising under a contract or agreement with the Treasury Department.

(f) *Definitions*. For purposes of this section—

(1) The term *Treasury Department* includes the IRS, the Office of the Chief Counsel for the IRS, and the Office of the Treasury Inspector General for Tax Administration;

(2) The term *State tax agency* means an agency, body, or commission described in section 6103(d); and

(3) The term *Department of Justice* includes offices of the United States Attorneys.

(g) *Effective date*. This section is applicable on or after the date final regulations are published in the **Federal Register**.

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

(Filed by the Office of the Federal Register on January 11, 2005, 8:45 a.m., and published in the issue of the Federal Register for January 12, 2005, 70 F.R. 2076)

Notice of Proposed Rulemaking

Revised Regulations Concerning Disclosure of Relative Values of Optional Forms of Benefit

REG–152914–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would revise final regulations that were issued on December 17, 2003, under section 417(a)(3) of the Internal Revenue Code concerning content requirements applicable to explanations of qualified joint and survivor annuities and qualified preretirement survivor annuities payable under certain retirement plans. These regulations affect plan sponsors and administrators, and participants in and beneficiaries of, certain retirement plans.

DATES: Written and electronic comments and requests for a public hearing must be received by April 28, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–152914–04), 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–152914–04), 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* (indicate IRS and REG–152914–04).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Bruce Perlin at (202) 622–6090 (not a toll-free number); concerning submissions or hearing requests, LaNita Van Dyke, (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–0928.

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

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

Background

Section 417(a) provides rules under which a participant (with spousal consent) may waive payment of the participant's benefit in the form of qualified joint and survivor annuity (QJSA). Specifically, section 417(a)(3) provides that a plan must provide to each participant, within a reasonable period before the annuity starting date, a written explanation that includes the following information: (1) the terms and conditions of the QJSA; (2) the participant's right to make an election to waive the QJSA form of benefit; (3) the effect of such an election; (4) the rights of the participant's spouse; and (5) the right to revoke an election to waive the QJSA form of benefit.

Section 205 of the Employee Retirement Income Security Act of 1974 (ERISA), Public Law 93–406 (88 Stat. 829) as subsequently amended, provides rules that are parallel to the rules of sections 401(a)(11) and 417 of the Internal Revenue Code. In particular, section 205(c)(3) of ERISA provides a rule parallel to the rule of section 417(a)(3) of the Code.

Section 1.401(a)–20, which provides rules governing the requirements for a waiver of the QJSA, was published in the **Federal Register** on August 19, 1988 (T.D. 8219, 1988–2 C.B. 48 [53 FR 31837]). Section 1.401(a)–20, Q&A–36, as published in 1988, set forth requirements for the explanation that must be provided under section 417(a)(3) as a prerequisite to waiver of a QJSA. Under those requirements, such a written explanation must contain a general description of the eligibility conditions and other material features of the optional forms of benefit and sufficient additional information to explain the relative values of the optional forms of benefit available under the plan (*e.g.*, the extent to which optional forms are subsidized relative to the normal form of benefit or the interest rates used to calculate the optional forms). In addition, §1.401(a)–20, Q&A–36, as published in 1988, provided that the written explanation must comply with the requirements set forth in §1.401(a)–11(c)(3). Section 1.401(a)–11(c)(3) was issued prior to the enactment of section 417, and provides rules relating to written explanations that were required prior to a participant's election of a preretirement survivor annuity or election to waive a joint and survivor annuity. Section 1.401(a)–11(c)(3)(i)(C) provides that such a written explanation must contain a general explanation of the relative financial effect of these elections on a participant's annuity.

For a married participant, the QJSA must be at least as valuable as any other optional form of benefit payable under the plan at the same time. See §1.401(a)–20, Q&A–16. Further, the anti-forfeiture rules

of section 411(a) prohibit a participant's benefit under a defined benefit plan from being satisfied through payment of a form of benefit that is actuarially less valuable than the value of the participant's accrued benefit expressed in the form of an annual benefit commencing at normal retirement age. These determinations must be made using reasonable actuarial assumptions. However, see section 417(e)(3) and §1.417(e)–1(d) for actuarial assumptions required for use in certain present value calculations.

Final regulations under section 417(a)(3) regarding disclosure of the relative value and financial effect of optional forms of benefit as part of QJSA explanations provided to participants receiving qualified retirement plan distributions were published in the **Federal Register** on December 17, 2003. See §1.417(a)(3)–1 (T.D. 9099, 2004–2 I.R.B. 255 [68 FR 70141]). The 2003 regulations are generally effective for QJSA explanations provided with respect to annuity starting dates beginning on or after October 1, 2004.

The 2003 regulations were issued in response to concerns that, in certain cases, the information provided to participants under section 417(a)(3) regarding available distribution forms pursuant to §1.401(a)–20, Q&A–36, does not adequately enable them to compare those distribution forms without professional advice. In particular, participants who are eligible for early retirement benefits in the form of both subsidized annuity distributions and unsubsidized single-sum distributions may be receiving explanations that do not adequately disclose the value of the subsidy that is foregone if the single-sum distribution is elected. In such a case, merely disclosing the amount of the single-sum distribution and the amount of the annuity payments would not adequately enable a participant to make an informed comparison of the relative values of those distribution forms. The 2003 regulations address this problem, as well as the problem of disclosure in other cases where there are significant differences in value among optional forms, and also clarify the rules regarding the disclosure of the financial effect of benefit payments.

A number of commentators requested that the effective date of the 2003 regulations be postponed. Among the reasons cited is the need in some plans for sponsors to complete an extensive review and analysis of optional forms of benefit in order to prepare proper comparisons of the relative values of those optional forms to the QJSA. They noted that recently proposed regulations under section 411(d)(6) would permit elimination of certain optional forms of benefit and that many plan sponsors can be expected to engage in a thorough review of all of the optional forms of benefit under their plans following publication of those regulations in final form. See §1.411(d)–3, 69 FR 13769 (March 24, 2004) (REG–128309–03, 2004–16 I.R.B. 800). These commentators argued that it would be inefficient for plans to be required to incur the costs of two such extensive analyses in succession, rather than a single analysis of optional forms that might serve to some extent for purposes of both the relative value regulations and the section 411(d)(6) regulations. After consideration of these comments, Treasury and the IRS issued Announcement 2004–58, 2004–29 I.R.B. 66, which postponed the effective date of the 2003 regulations under §1.417(a)(3)–1 for certain QJSA explanations.

Under section 101 of Reorganization Plan No. 4 of 1978 (43 FR 47713), the Secretary of the Treasury has interpretive jurisdiction over ERISA provisions that are parallel to the Code provisions addressed in these regulations. Therefore, these proposed regulations would apply for purposes of the parallel rules in section 205(c)(3) of ERISA, as well as for section 417(a)(3) of the Code.

Explanation of Provisions

Consistent with Announcement 2004–58, these proposed regulations would modify the 2003 regulations to provide that the 2003 regulations are generally effective for QJSA explanations provided with respect to annuity starting dates beginning on or after February 1, 2006. In the interim, plans that do not comply with §1.417(a)(3)–1 would be required to comply with the 1988 regulations regarding disclosure of relative value and financial effect.

However, the existing effective date under §1.417(a)(3)–1 of the 2003 regulations is retained for explanations with respect to any optional form of benefit that is subject to the requirements of section 417(e)(3) (*e.g.*, single sums, social security level income options, distributions in the form of partial single sums in combination with annuities, or installment payment options) if the actuarial present value of that optional form is less than the actuarial present value (as determined under section 417(e)(3)) of the QJSA. Thus, for example, a QJSA explanation provided with respect to an annuity starting date beginning on or after October 1, 2004, must comply with §1.417(a)(3)–1 to the extent that the plan provides for payment to that participant in the form of a single sum that does not reflect an early retirement subsidy available under the QJSA. Where the existing effective date is retained, the plan must disclose the relative value of the QJSA for the participant even if the plan provides a disclosure of relative values that is not tailored to the participant's marital status. Accordingly, if a plan provides a relative value disclosure based on the single life annuity (the QJSA for a single participant) to a married participant, the plan must also include a comparison of the value of the QJSA to the value of the single life annuity.

The proposed regulations include a special rule that would enable a plan to use the delayed effective date rule even if there are minor differences between the value of an optional form and the value of the QJSA for a married participant that are caused by the calculation of the amount of the optional form of benefit based on the life annuity rather than on the QJSA. Under this special rule, solely for purposes of the effective date provisions, the actuarial present value of an optional form is treated as not being less than the actuarial present value of the QJSA if the following two conditions are met. First, using the applicable interest rate and applicable mortality table under §§1.417(e)–1(d)(2) and (3), the actuarial present value of that optional form is not less than the actuarial present value of the QJSA for an unmarried participant. Second, using reasonable actuarial assumptions, the actuarial present value of the QJSA for an unmarried participant is not less than the actuarial present value of the QJSA for a married participant.

These proposed regulations would also modify the 2003 regulations in several other respects. First, for purposes of disclosing the normal form of benefit as

part of a disclosure made in the form of generally applicable information, reasonable estimates of the type permitted to be used to disclose participant-specific information may be used to determine the normal form of benefit, but only if the plan follows the requirements applicable to reasonable estimates used in disclosing participant-specific information (such as offering a more precise calculation upon request and revising previously offered information consistent with the more precise information). Second, a QJSA explanation does not fail to satisfy the requirements for QJSA explanations made in the form of disclosures of generally applicable information merely because the QJSA explanation contains an item of participant-specific information in place of the corresponding generally applicable information.

In addition, the proposed regulations would modify §1.401(a)–20, Q&A–16, to clarify the interaction of the rule prohibiting a plan from providing an option to a married individual that is worth more than the QJSA with the requirement that certain optional forms of benefit be calculated using specified actuarial assumptions. Under that clarification, a plan would not fail to satisfy the requirements of §1.401(a)–20, Q&A–16, merely because the amount payable under an optional form of benefit that is subject to the minimum present value requirement of section 417(e)(3) is calculated using the applicable interest rate (and, for periods when required, the applicable mortality table) under section 417(e)(3).

Dates of Applicability

The changes to §1.401(a)–20, A–36, and §1.417(a)(3)–1 are proposed to apply as if they had been included in T.D. 9099 (68 FR 70141). The change to §1.401(a)–20, Q&A–16, is proposed to apply as if it had been included in T.D. 8219 (53 FR 31837). Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, 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 electronic or written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. In addition to the other requests for comments set forth in this document, the IRS and Treasury also request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if one is requested.

Drafting Information

The principal authors of these regulations are Bruce Perlin and Linda S.F. Marshall of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1986

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

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

Par. 2. Section 1.401(a)–20 is amended by:

1. Adding a sentence to the end of Q&A–16.

2. Adding a sentence to the end of Q&A–36.

The additions read as follows:

§1.401(a)–20 Requirements of qualified joint and survivor annuity and qualified preretirement survivor annuity.

* * * * *

A–16 * * * A plan does not fail to satisfy the requirements of this Q&A–16 merely because the amount payable under an optional form of benefit that is subject to the minimum present value requirement of section 417(e)(3) is calculated using the applicable interest rate (and, for periods when required, the applicable mortality table) under section 417(e)(3).

* * * * *

A–36 * * * However, the rules of §1.401(a)–20, Q&A–36, as it appeared in 26 CFR Part 1 revised April 1, 2003, apply to the explanation of a QJSA under section 417(a)(3) for an annuity starting date prior to February 1, 2006.

* * * * *

Par. 3. Section 1.417(a)(3)–1 is amended by:

1. Removing the language "paragraph (c)(3)(iii) of" from paragraph (c)(2)(ii)(A).

2. Adding a sentence to the end of paragraph (d)(2)(ii).

3. Adding paragraph (d)(5).

4. Revising paragraph (f).

The additions and revision read as follows:

§1.417(a)(3)–1 Required explanation of qualified joint and survivor annuity and qualified preretirement survivor annuity.

* * * * *

(d) * * * * *

(2) * * * * *

(ii) *Actual benefit must be disclosed.* * * * Reasonable estimates of the type described in paragraph (c)(3)(i) may be used to determine the normal form of benefit for purposes of this paragraph (d)(2)(ii) if the requirements of paragraphs (c)(3)(ii) and (iii) of this section are satisfied with respect to those estimates.

* * * * *

(5) *Use of participant-specific information in generalized notice.* A QJSA explanation does not fail to satisfy the requirements of this paragraph (d) merely because

it contains an item of participant-specific information in place of the corresponding generally applicable information.

* * * * *

(f) *Effective date*—(1) *General effective date for QJSA explanations*. Except as provided in paragraph (f)(2) of this section, this section applies to a QJSA explanation with respect to any distribution with an annuity starting date that is on or after February 1, 2006.

(2) *Special effective date for certain QJSA explanations*—(i) *Application to QJSA explanations with respect to certain optional forms that are less valuable than the QJSA*. This section also applies to a QJSA explanation with respect to any distribution with an annuity starting date that is on or after October 1, 2004, and before February 1, 2006, if the actuarial present value of any optional form of benefit that is subject to the requirements of section 417(e)(3) (*e.g.*, single sums, distributions in the form of partial single sums in combination with annuities, social security level income options, and installment payment options) is less than the actuarial present value (as determined under §1.417(e)–1(d)) of the QJSA. For purposes of this paragraph (f)(2)(i), the actuarial present value of an optional form is treated as not less than the actuarial present value of the QJSA if—

(A) Using the applicable interest rate and applicable mortality table under §§1.417(e)–1(d)(2) and (3), the actuarial present value of that optional form is not less than the actuarial present value of the QJSA for an unmarried participant; and

(B) Using reasonable actuarial assumptions, the actuarial present value of the QJSA for an unmarried participant is not less than the actuarial present value of the QJSA for a married participant.

(ii) *Requirement to disclose differences in value for certain optional forms*. A QJSA explanation with respect to any distribution with an annuity starting date that is on or after October 1, 2004, and before February 1, 2006, is only required to be provided under this section with respect to—

(A) An optional form of benefit that is subject to the requirements of section 417(e)(3) and that has an actuarial present value that is less than the actuarial present value of the QJSA (as described in paragraph (f)(2)(i) of this section); and

(B) The QJSA (determined without application of paragraph (c)(2)(ii) of this section).

(3) *Annuity starting date*. For purposes of paragraphs (f)(1) and (2) of this section, in the case of a retroactive annuity starting date under section 417(a)(7), as described in §1.417(e)–1(b)(3)(vi), the date of commencement of the actual payments based on the retroactive annuity starting date is substituted for the annuity starting date.

(4) *Effective date for QPSA explanations*. This section applies to any QPSA explanation provided on or after July 1, 2004.

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

(Filed by the Office of the Federal Register on January 27, 2005, 8:45 a.m., and published in the issue of the Federal Register for January 28, 2005, 70 F.R. 4058)

Corrected Information for Publication 1220, *Specifications for Filing Forms 1098, 1099, 5498 and W–2G, Electronically or Magnetically*; Revised September 2004

Announcement 2005–14

The following announcement provides corrected information for Publication 1220, *Specifications for Filing Forms 1098, 1099, 5498 and W–2G, Electronically or Magnetically*, revised September 2004.

- Part A, Sec. 2. Nature of Changes, .02, (c), (3) should read "The title of Amount Code ***2*** was changed to Aggregate Amount Received." This statement refers to the Form 1099-CAP and is correctly recorded in the Payer "A" Record, Amount Codes in positions 28–41.

- Part A, Sec. 9. Due Dates, .03 and .05 references to postmarked dates should read March 1, ***2005*** and December 1, ***2005***, respectively.

- In Part D, Standard Payee "B" Record Format For All Types of Returns, Positions 1–543, Payment Amount 3, the positions should be 79 – ***90***.

- In Part D, Record Format Specifications and Record Layouts for Form 1099-B, Field Position 627–662, the length of this field should be ***36*** positions.

- When making a correction for a payee name only, use the one step correction process found in Part A, Sec. 11.

Please make note of these changes when submitting information returns for Tax Year 2004 filing. If you have any questions, call toll-free 1–866–455–7438.

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

Announcement 2005-15

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Consent Disbarments From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to disbarment from such practice. The Director, Office of Professional Responsibility, in his discretion, may disbar an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent disbarment from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
O'Connell, Anthony G.	Revere, MA	CPA	Indefinite from January 5, 2005

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
McCarthy III, William P.	Sacramento, CA	Enrolled Agent	September 12, 2004 to March 10, 2006
Deen, Mae T.	Salinas, CA	Enrolled Agent	October 18, 2004 to April 16, 2006
Adams Jr., Joseph T.	Philadelphia, PA	Enrolled Agent	December 1, 2004 to May 29, 2006

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Cornelius, Gerald K.	Ventura, CA	Enrolled Agent	Indefinite from September 15, 2004
Janus, Stephen E.	Michigan City, IN	CPA	Indefinite from October 25, 2004
Arotsky, Marvin A.	New Haven, CT	CPA	Indefinite from December 1, 2004
Penta, Richard	Hamilton, MA	CPA	Indefinite from January 1, 2005

Name	Address	Designation	Date of Suspension
Bedell, Michael F.	Ridge, NY	CPA	Indefinite from January 7, 2005
Nussbaum, Jerrold	Annapolis, MD	Attorney	Indefinite from April 15, 2005

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Whitworth, Douglas D.	Houston, TX	CPA	Indefinite from October 28, 2004
Lindberg, William D.	Costa Mesa, CA	CPA	Indefinite from November 4, 2004
Tompkins, Thomas M.	Chickasaw, AL	Attorney	Indefinite from November 4, 2004
Peterson Jr., Theodore E	Charlotte, NC	CPA	Indefinite from November 4, 2004
Gassiott, William E.	Cypress, TX	CPA	Indefinite from November 4, 2004
Wagar Jr., John E.	Lafayette, LA	Attorney	Indefinite from November 9, 2004
Fiore, Owen G.	Kooskia, ID	Attorney	Indefinite from November 30, 2004
O'Keefe, Michael H.	Beaumont, TX	Attorney	Indefinite from November 30, 2004
Ivker, Richard N.	Waltham, MA	Attorney	Indefinite from November 30, 2004

Name	Address	Designation	Date of Suspension
Jones, Edwin A.	Robards, KY	Attorney	Indefinite from November 30, 2004
Landis, John C.	Drexel Hill, PA	Attorney	Indefinite from November 30, 2004
Cushman, Christopher A.	Kansas City, MO	Attorney	Indefinite from November 30, 2004
Weiner, Alan S.	Rockville, MD	Attorney	Indefinite from November 30, 2004
Virdone, Peter P.	Kailua, HI	CPA	Indefinite from November 30, 2004
Doherty, Paul M.	N. Billerica, MA	Attorney	Indefinite from December 3, 2004
Carney, Kevin F.	Woburn, MA	Attorney	Indefinite from December 3, 2004
Greiner, Thomas	Cleveland, OH	Attorney	Indefinite from December 8, 2004
Wertis, Richard L.	Garden City, NY	Attorney	Indefinite from December 10, 2004
Southerland, Harry L.	Raeford, NC	Attorney	Indefinite from December 10, 2004
Chestnutt, A. Johnson	Fayetteville, NC	CPA	Indefinite from December 13, 2004
Heald, Arthur A.	Saint Albans, VT	Attorney	Indefinite from December 10, 2004
Culliton, James M.	Santa Clarita, CA	Attorney	Indefinite from December 15, 2004
Juarez, Michael G.	Douglas, AZ	Attorney	Indefinite from December 15, 2004
Clark, Carroll A.	Mesa, AZ	Attorney	Indefinite from December 15, 2004

Name	Address	Designation	Date of Suspension
Creque, George A	Willow Springs, CA	Attorney	Indefinite from December 15, 2004
Younts, Roger W.	Lexington, NC	CPA	Indefinite from December 15, 2004
Kluge, David R.	Sheridan, OR	Attorney	Indefinite from December 15, 2004
Fanaras, Andrew R.	Haverhill, MA	Attorney	Indefinite from December 15, 2004
Murphy, Patrick B.	Alhambra, CA	Attorney	Indefinite from December 20, 2004
Mills, Stuart B.	Pender, NE	Attorney	Indefinite from December 20, 2004
North, Gerald D.W.	Chicago, IL	Attorney	Indefinite from December 20, 2004
Nickel, Warren J.	Tinley Park, IL	Attorney	Indefinite from December 20, 2004
Gray, Douglas C.	Dover, NH	Attorney	Indefinite from December 20, 2004
Emmons, Kyle D.	Columbia, MO	Attorney	Indefinite from December 20, 2004
Velella, Guy J.	Bronx, NY	Attorney	Indefinite from December 30, 2004
Ginn, Jeffrey S.	Lexington, KY	CPA	Indefinite from January 25, 2005
Grenrood Jr., Bernard	West Monroe, LA	Attorney	Indefinite from January 25, 2005
Tehin Jr., Nikolai	San Francisco, CA	Attorney	Indefinite from January 25, 2005
Kemper, Morris B.	Alameda, CA	Attorney	Indefinite from January 25, 2005
Harrison, John S.	Oakland, CA	Attorney	Indefinite from January 25, 2005

Name	Address	Designation	Date of Suspension
Mangurten, Irvin B.	Buffalo Grove, IL	CPA	Indefinite from January 27, 2005
Zivin, Mitchell W.	Long Grove, IL	Attorney	Indefinite from February 7, 2005
Zdon, John N.	Chicago, IL	Attorney	Indefinite from February 7, 2005
Lokietz, David S.	Mount Dora, FL	CPA	Indefinite from February 7, 2005
Heldrich Jr., Gerard C.	Lincolnshire, IL	Attorney	Indefinite from February 7, 2005
Whitaker, Paul M.	Albany, NY	Attorney	Indefinite from February 18, 2005
Blake, Linda D.	Bellvale, NY	Attorney	Indefinite from February 18, 2005
Smith, H. Paul	San Antonio, TX	Attorney	Indefinite from February 18, 2005
Atwood, Adina A.	Ardmore, OK	Attorney	Indefinite from February 18, 2005
Sablone Jr., Francis R.	Old Lyme, CT	Attorney	Indefinite from February 18, 2005
Phelps, S. Don	Olympia, WA	Attorney	Indefinite from February 18, 2005
Davidson, Frazier	Bronx, NY	Attorney	Indefinite from February 18, 2005

Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Dorris, Virginia A.	Bradenton, FL	Enrolled Agent	December 14, 2004
Mackey, Glen N.	Roanoke, VA	Attorney	December 21, 2004

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2005–18

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on March 18, 2002, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

A Better Way Credit Counseling, Inc.
Greenacres, FL

Allen's Pre-School and Day Care, Inc.
Murray, UT

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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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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