Internal Revenue
bulletin

Bulletin No. 2006-2
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2006–1, page 261.

Regulated investment company (RIC). A RIC's income from a derivative contract with respect to a commodity index is not qualifying income for purposes of section 851(b)(2) of the Code if the income from the contract is not derived with respect to the RIC's business of investing in stocks, securities, or currencies. Such a contract is not a security for purposes of section 851(b)(2).

Rev. Rul. 2006–2, page 261.

Section 351. The conclusion in Rev. Rul. 74–503 that a transferor's basis in transferee stock received in exchange for transferor stock is determined under section 362(a) of the Code is incorrect. The other conclusions in the ruling are under study. Rev. Rul. 74–503 revoked.

Rev. Rul. 2006–3, page 276.

Japanese Yugen Kaisha (YK) and Tokurei Yugen Kaisha (TYK). A Yugen Kaisha, a Japanese business entity, which will become a Tokurei Yugen Kaisha under recently enacted Japanese legislation, will continue to be eligible to elect its U.S. entity classification under the check the box regulations.

Rev. Rul. 2006–4, page 264.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for January 2006.

T.D. 9231, page 272.

Final regulations under section 1298 of the Code provide guidance for making certain elections for taxpayers that continue to be subject to the passive foreign investment company (PFIC) excess distribution regime of section 1291 even though the foreign corporation in which they own stock is no longer treated as a PFIC.

T.D. 9232, page 266.
REG–133446–03, page 299.

Temporary and proposed regulations under section 1297 of the Code provide guidance for making certain elections for taxpayers that continue to be subject to the passive foreign investment company (PFIC) excess distribution regime of section 1291 even though the foreign corporation in which they own stock is no longer treated as a PFIC. A public hearing on the proposed regulations is scheduled for March 22, 2006.

Notice 2006–2, page 278.

Extension of transition relief for certain partnerships and other pass-thru entities under section 470. This notice extends the transition relief under section 470 of the Code provided under Notice 2005–29, 2005–13 I.R.B. 796, to partnerships and certain other pass-thru entities that are treated as holding tax-exempt use property because of the application of section 168(h)(6), to taxable years that begin before January 1, 2006. Notice 2005–29 modified and superseded.

Rev. Proc. 2006–9, page 278.

This procedure explains the manner in which taxpayers may request an advance pricing agreement (APA) from the APA Program within the Office of the Associate Chief Counsel (International), the manner in which such a request will be processed by the APA Program, and the effect and administration of APAs. Rev. Proc. 2004–40 superseded.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Rev. Proc. 2006–10, page 293.
This procedure supersedes Rev. Proc. 96–52, 1996–2 C.B. 372. It describes the qualifications necessary to become an acceptance agent and the procedures that an acceptance agent applicant must follow for purposes of entering into an acceptance agent agreement with the IRS. Rev. Proc. 96–52 superseded.

Announcement 2006–2, page 300.
The December 2005 revision of Form 8609, *Low-Income Housing Credit Allocation and Certification*, contains changes from the previous revision. Form 8609–A, *Annual Statement for Low-Income Housing Credit*, is replacing Schedule A (Form 8609).

ADMINISTRATIVE

Rev. Rul. 2006–3, page 276.
Japanese Yugen Kaisha (YK) and Tokurei Yugen Kaisha (TYK). A Yugen Kaisha, a Japanese business entity, which will become a Tokurei Yugen Kaisha under recently enacted Japanese legislation, will continue to be eligible to elect its U.S. entity classification under the check the box regulations.

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 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 168.—Accelerated Cost Recovery System

Transition relief provided to partnerships and other pass-thru entities that are treated as holding tax-exempt use property because of the application of section 168(h)(6), is extended. See Notice 2006-2, page 278.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351–1: Transfer to Corporation Controlled by Transferor.

Section 351. The conclusion in Rev. Rul. 74–503 that a transferor's basis in transferee stock received in exchange for transferor stock is determined under section 362(a) of the Code is incorrect. The other conclusions in the ruling are under study. Rev. Rul. 74–503 revoked.

Rev. Rul. 2006–2

In Rev. Rul. 74–503, 1974–2 C.B. 117, corporation X transferred shares of its treasury stock to corporation Y in exchange for newly issued shares of Y stock. In the exchange, X obtained 80 percent of the only outstanding class of Y stock. Rev. Rul. 74–503 concludes that the basis of the X treasury stock received by Y is zero and the basis of the newly issued Y stock received by X is zero.

Rev. Rul. 74–503 states that X's basis in the Y stock received in the exchange is determined under § 362(a) of the Internal Revenue Code. This conclusion is incorrect. Accordingly, Rev. Rul. 74–503, 1974–2 C.B.117, is revoked, effective December 20, 2005. The other conclusions in the ruling, including the conclusions that X's basis in the Y stock received in the exchange and Y's basis in the X stock received in the exchange are zero, are under study.

Under the authority of § 7805(b), the Service will not challenge a position taken prior to December 20, 2005, with respect to a transaction occurring prior to such date, by a taxpayer that reasonably relied on the conclusions in Rev. Rul. 74–503. *See* § 601.601(d)(2)(v) of the Statement of Procedural Rules.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 74–503, 1974–2 C.B. 117, is revoked.

DRAFTING INFORMATION

The principal author of this revenue ruling is Mary Goode of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Ms. Goode at (202) 622–7930 (not a toll-free call).

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

The adjusted applicable federal long-term rate is set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 851.—Definition of Regulated Investment Company

26 CFR 1.851–2: Limitations.
(Also Sections 7704, 7805; 301.7805–1.)

Regulated investment company (RIC). A RIC's income from a derivative contract with respect to a commodity

index is not qualifying income for purposes of section 851(b)(2) of the Code if the income from the contract is not derived with respect to the RIC's business of investing in stocks, securities, or currencies. Such a contract is not a security for purposes of section 851(b)(2).

Rev. Rul. 2006–1

ISSUE

If a corporation enters into a derivative contract that provides for a total-return exposure on a commodity index, does income from the derivative contract satisfy the test described in section 851(b)(2) of the Internal Revenue Code?

FACTS

R is a management company registered under the Investment Company Act of 1940 (the "'40 Act"), 15 U.S.C. section 80a–1 *et seq.*, as amended, and has elected under section 851(b)(1) of the Code to be a regulated investment company (RIC) taxable under subchapter M, part I, of the Code. *R* invests substantially all of the funds it receives from shareholders in debt instruments. *R* also enters into contracts ("Derivatives") with various counterparties pursuant to Master Agreements under which it will pay an amount equal to the 3-month U.S. Treasury bill rate plus a spread and pursuant to which it will receive (or pay) an amount based on the total return gain (or loss) on a commodity index. The aggregate amount of the index on which the return on the Derivatives is based is approximately equal to the aggregate amount *R* has invested in its debt instruments. The payment obligation on each Derivative is settled monthly by the receipt (in the event of a gain) or payment (in the event of a loss) of cash, in the net amount due under the contract, and each monthly measuring period constitutes a separate derivative contract under the Master Agreements.

LAW

Section 851(b)(2) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless it meets an income test (the "qualifying income requirement"). Under this test, at least 90 percent of its gross income must be derived from certain enumerated sources.

In addition, section 851(b)(3) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless it meets an asset test (the "asset test"). Under this test, at least 50 percent of its total assets must be represented by cash, cash items, Government securities, securities of other RICs, and "other securities." The "other securities" are generally limited with respect to any one issuer to an amount not greater than 5 percent of the value of the RIC's total assets and to not more than 10 percent of the outstanding voting securities of the issuer.

Prior to the enactment of the Tax Reform Act of 1986 (the "1986 Act"), section 851(b)(2) identified qualifying income as "dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities." Section 851 did not contain its own definition of the term "securities," but section 851(c)(5) provided that, for purposes of the asset test, "all other terms shall have the same meaning as when used" in the '40 Act.

The 1986 Act expanded the definition of RIC qualifying income in a number of ways: by adding a cross-reference to the definition of "securities" in the '40 Act; by adding gains from the sale or other disposition of foreign currencies; and by adding an "other income" provision. As so amended, section 851(b)(2) defines qualifying income, in relevant part, as—

> dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in [the '40 Act]) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to [the RIC's] business of investing in such stock, securities, or currencies . . . .

Section 851(b) further provides that, for this purpose, "the Secretary may by regulation exclude from qualifying income foreign currency gains which are not directly related to the company's principal business of investing in stock or securities (or options and futures with respect to stock or securities)."

The '40 Act defines "security" as—

> any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 80a–2(a)(36) (2000).

ANALYSIS

1. *Definition of "securities."*

The Derivatives that *R* enters into are not stock, debt instruments, or currency (or options, futures, or forward contracts with respect to stock, debt instruments, or currency). Nevertheless, *R*'s income from the Derivatives may be "other income" if the Derivatives are "securities" for purposes of section 851(b)(2). This determination depends on the effect of the 1986 Act amendments to section 851(b)(2), which added the cross-reference to the definition of securities in the '40 Act.

There is no conclusive authority, however, as to whether derivative contracts on commodities are included in the '40 Act's definition of "securities." Accordingly, consideration of Congressional intent in enacting that cross-reference is helpful in determining whether commodity derivative contracts are securities for purposes of section 851(b)(2). Evidence of that intent may be found in the background to amendments to section 851(b)(2) in the 1986 Act. The amendments were added as a Senate floor amendment to the bill that eventually became the 1986 Act. The House

and Senate committee reports, therefore, do not discuss these provisions, and the relevant discussion of the cross-reference in the report of the Conference Committee is extremely brief. *See* H.R. Rep. No. 99–426 (1985) (not discussed); S. Rep. No. 99–313 (1986) (not discussed); 2 H.R. Conf. Rep. No. 99–841, at II–243 (1986) ("The Senate amendment clarifies the definition of 'securities' by reference to the definition of securities in the Investment Company Act of 1940.") Thus the best evidence of Congressional intent is found in the floor statement when the provision was added to the Senate bill and in other floor statements and Administration comments concerning related legislation.

The legislative antecedents to the 1986 Act amendments included H.R. 3397, which was introduced on September 20, 1985, by Representatives Flippo, Kennelly, and McGrath, and S. 2155, which was introduced on March 7, 1986, by Senator Armstrong. These bills proposed the "other income" provision and the cross-reference to the definition of security in the '40 Act. The former change was to codify a series of letter rulings, and the latter was to reflect then-current Treasury Regulations. *See* 131 Cong. Rec. 24,570 (1985) (section-by section analysis of H.R. 3397).

With respect to the definition of qualifying income, Senator Armstrong's floor amendment to the bill that became the 1986 Act was identical to S. 2155. In introducing S. 2155, Senator Armstrong explained that his bill incorporated "minor changes" to H.R. 3397 "to comply with recommendations of the Treasury Department, which has given its support for the Bill." 132 Cong. Rec. 4045 (1986) (remarks of Senator Armstrong). Senator Armstrong concluded his remarks by inserting into the Congressional Record the letter from the Treasury Department that had recommended changes to H.R 3397. *See id.* at 4046, 4047–48 (inserting a letter from Acting Assistant Secretary of the Treasury (Tax Policy) J. Roger Mentz, dated February 5, 1986).

Mr. Mentz's letter explained the fundamental policy served by the qualifying income requirement:

> [I]t is essential that two limits on the activities of RICs be retained. First, income qualifying under section 851(b)(2) should be limited to income from property held for investment, as opposed to property held for sale to customers in the ordinary course of business. Second, income qualifying under section 851(b)(2) should be limited to income from stocks and securities, as opposed to other property. . . . For example, under that second limit, we would generally not treat as qualifying income gains from trading in commodities, even if the purpose of that trading is to hedge a related stock investment.

Id. at 4048.

The letter pointed out that the Service had "often gone beyond the literal terms of the statute in order to give a reasonable interpretation to [then-current] section 851(b)(2)," for example by granting letter rulings that certain investment products were securities, gains on the sale or disposition of which resulted in qualifying income. (The products explicitly mentioned were options on securities, futures contracts on securities, stock index futures, options on stock indices, and options on stock index futures.) The letter noted that, despite this flexibility, each RIC could be certain of the treatment of various income items only by obtaining its own letter ruling. *See id.* at 4047–48. Thus, one justification for the amendments in H.R. 3397 appeared to be providing the needed certainty.

With respect to foreign currency gains, the Treasury letter stated:

> We believe that investments in foreign-currency denominated securities are the type of passive investments that should be permissible for RICs. Moreover, foreign currency investments that are made to hedge investments in foreign-currency denominated securities also appear to be an appropriate[] part of the passive investment activity of RICs. Accordingly, we believe that foreign currency gains from investments in foreign-currency denominated securities and from hedging activities with respect to such securities should be treated as qualifying income under section 851(b)(2).

Id. at 4048.

The Treasury Department, however, was not prepared at that time to propose statutory rules that would distinguish between currency gains relating to investments in stocks or securities denominated in a foreign currency and other currency gains that Treasury believed should not be qualifying income under section 851(b)(2). The letter, therefore, suggested that foreign currency gains be added to the list of qualifying income but that Treasury be provided with "regulatory authority to exclude from qualifying income any foreign currency gains that are not derived with respect to investment in a foreign-currency denominated security or from hedging activity with respect to such a security." *Id.*

When Senator Armstrong offered the relevant provision as an amendment on the Senate floor, he asserted that it "enjoys the support of the Treasury Department" and that its purpose was "to permit the mutual fund industry to make better use of income from stock options, futures contracts and options on stock ind[ic]es, options and futures o[n] foreign currencies, and foreign currency transactions." 132 Cong. Rec. 14,991–92 (1986).

This discussion demonstrates that the amendments to section 851(b)(2) made by the 1986 Act had a very specific purpose, which was to provide certainty by expanding the statutory description of qualifying income to include income that the Service, in specific cases, had already treated administratively as qualifying income. This included income from derivative contracts on stocks and securities (as the term "security" is generally understood in the U.S. tax law), such as futures and options on stock indices, which create an economic exposure to stock or securities even though the property underlying the derivative may be a collection of stocks and securities, rather than a specific stock or security.

The new rule regarding gains from foreign currencies (and options, futures or forward contracts on foreign currencies) was distinct from both the "other income" provision and the cross-reference to the definition of "security" in the '40 Act. Thus a separate provision both established the general rule that foreign currency gain is qualifying income and created specific regulatory authority to exclude any foreign currency gains that are not "directly related" to a RIC's "principal business of investing in stock or securities (or options and futures with respect to stock or securities)." The reason was that these gains were income from property other than stock or securities.

The foregoing indicates that Congress did not intend for the cross-reference to the '40 Act to incorporate into section 851(b)(2) an expansive construction of the term "securities." Particularly important was the specific inclusion in the 1986 amendment of foreign-currency-related gains. If the '40 Act were read expansively, there would be no need for special mention of these gains, because they would be included in the provision for "other income . . . derived with respect to [the RIC's] business of investing in securities." Moreover, the authority given to Treasury to exclude from qualifying income "foreign currency gains which are not directly related to the company's principal business of investing in stock or securities" indicates that the reason for the special treatment for foreign currency was to facilitate a RIC's principal activity, namely investing in qualifying stock or securities, when the stock or securities are denominated in a foreign currency.

A construction of the term "securities" that excludes derivative contracts providing for a total return exposure to a commodity index is consistent with Congress' intent in amending section 851(b)(2) in 1986. Accordingly, because the underlying property is a commodity (or commodity index), the Derivatives that *R* enters into are not securities for purposes of section 851(b)(2).

2. *Application of the "other income" provision.*

R invests substantially all of the funds it receives from shareholders in debt instruments, which are securities for purposes of section 851(b)(2). Even though *R*'s Derivatives are not themselves securities for purposes of section 851(b)(2), income from the Derivatives counts toward the 90-percent test if it is "other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to [*R*'s] business of investing in" stock, securities, or currencies.

R, however, does not enter into the Derivatives in connection with a business of investing in stock, securities, or currencies. Nor does *R* enter into the Derivatives in order to reduce or hedge the level of risk in a business of investing in stock, securities, or currencies. *R*'s business is to create investment exposure to changes in *commodity* prices, and the Derivatives are the primary vehicle for doing so. *R* owns the debt instruments to facilitate its business of providing this commodity-derivative exposure. Because *R*'s Derivatives are not themselves securities and because *R* does not enter into those contracts with respect to a business of investing in stock, securities, or currencies, income from the Derivatives is not qualifying income for purposes of section 851(b)(2).

HOLDING

A derivative contract with respect to a commodity index is not a security for purposes of section 851(b)(2). Under the facts above, *R*'s income from such a contract is not qualifying income for purposes of section 851(b)(2) because the income from the contract is not derived with respect to *R*'s business of investing in stocks, securities or currencies.

PROSPECTIVE APPLICATION

Under the authority of section 7805(b)(8), the holding of this revenue ruling will not be applied adversely with respect to amounts of income that a taxpayer recognizes on or before June 30, 2006.

DRAFTING INFORMATION

The principal author of this revenue ruling is Dale S. Collinson of the Office of the Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue ruling, contact him at (202) 622–3900 or Susan Thompson Baker at (202) 622–3930 (not toll-free calls).

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for January 2006.

Rev. Rul. 2006–4

This revenue ruling provides various prescribed rates for federal income tax purposes for January 2006 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the deemed rate of return for transfers made during calendar year 2006 to pooled income funds described in § 642(c)(5) that have been in existence for less than 3 taxable years immediately preceding the taxable year in which the transfer was made.

REV. RUL. 2006–4 TABLE 1

Applicable Federal Rates (AFR) for January 2006

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.38%	4.33%	4.31%	4.29%
110% AFR	4.82%	4.76%	4.73%	4.71%
120% AFR	5.27%	5.20%	5.17%	5.14%
130% AFR	5.71%	5.63%	5.59%	5.57%
Mid-term				
AFR	4.48%	4.43%	4.41%	4.39%
110% AFR	4.93%	4.87%	4.84%	4.82%
120% AFR	5.39%	5.32%	5.29%	5.26%
130% AFR	5.84%	5.76%	5.72%	5.69%
150% AFR	6.76%	6.65%	6.60%	6.56%
175% AFR	7.90%	7.75%	7.68%	7.63%
Long-term				
AFR	4.73%	4.68%	4.65%	4.64%
110% AFR	5.22%	5.15%	5.12%	5.10%
120% AFR	5.70%	5.62%	5.58%	5.56%
130% AFR	6.17%	6.08%	6.03%	6.00%

REV. RUL. 2006–4 TABLE 2

Adjusted AFR for January 2006

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.17%	3.15%	3.14%	3.13%
Mid-term adjusted AFR	3.56%	3.53%	3.51%	3.50%
Long-term adjusted AFR	4.36%	4.31%	4.29%	4.27%

REV. RUL. 2006–4 TABLE 3

Rates Under Section 382 for January 2006

Adjusted federal long-term rate for the current month	4.36%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.40%

REV. RUL. 2006–4 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for January 2006

Appropriate percentage for the 70% present value low-income housing credit	8.07%
Appropriate percentage for the 30% present value low-income housing credit	3.46%

REV. RUL. 2006–4 TABLE 5	
Rate Under Section 7520 for January 2006	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.4%

REV. RUL. 2006–4 TABLE 6	
Deemed Rate for Transfers to New Pooled Income Funds During 2006	
Deemed rate of return for transfers during 2006 to pooled income funds that have been in existence for less than 3 taxable years	3.8%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 1297.—Passive Foreign Investment Company

26 CFR 1.1297–3T: Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC (temporary).

T.D. 9232

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

Guidance on Passive Foreign Investment Company (PFIC) Purging Elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulation.

SUMMARY: This document contains temporary regulations that provide certain elections for taxpayers that continue to be subject to the PFIC excess distribution regime of section 1291 even though the foreign corporation in which they own stock is no longer treated as a PFIC under section 1297(a) or (e). The regulations are necessary to provide guidance about purging the PFIC taint for such foreign corporations. The regulations will affect U.S. persons that hold stock in a PFIC. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking (REG–133446–03) on this subject in this issue of the Bulletin.

DATES: *Effective Date*: These regulations are effective December 8, 2005.

Applicability Date: For dates of applicability, see §§1.1291–9T(k), 1.1297–3T(f), and 1.1298–3T(f).

FOR FURTHER INFORMATION CONTACT: Ethan Atticks at (202) 622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1965. Responses to this collection of information are required to obtain a tax benefit.

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

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble of the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

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

Background

This document contains amendments to regulations under sections 1291(d)(2), 1297(e) and 1298(b)(1). The temporary regulations provide rules for a shareholder of a foreign corporation to make a deemed sale or a deemed dividend election under section 1298(b)(1) when section 1297(e) applies to a portion of the holding period. The temporary regulations also provide rules for such shareholders, or shareholders of foreign corporations that no longer meet the income or asset tests of section 1297(a), to make late deemed sale or deemed dividend elections.

Section 1297(e), added by the Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 708), provides that a foreign corporation generally is not treated as a PFIC with respect to a shareholder during the qualified portion of the shareholder's holding period in the stock of the foreign corporation. The "qualified portion" is the portion of the shareholder's holding period which is after December 31, 1997, and during which the shareholder is a U.S. shareholder (as defined in section 951(b)) and the foreign corporation is a controlled foreign corporation. If the qualified portion of the U.S. shareholder's holding period in the stock of the foreign corporation is less than the shareholder's entire hold-

ing period, then, notwithstanding section 1297(e), section 1298(b)(1) will apply to treat the foreign corporation as a PFIC with respect to the shareholder if at any time during the shareholder's holding period of the stock, the corporation was a PFIC that was not a QEF, and the shareholder has not made an election under section 1298(b)(1) to purge the PFIC taint under rules similar to the rules of section 1291(d)(2).

Section 1298(b)(1) provides that if a shareholder owns stock in a foreign corporation that, at any time during the shareholder's holding period with respect to such stock, was a PFIC that was not a QEF, the stock will retain its character as PFIC stock, even if the corporation later ceases to qualify as a PFIC under section 1297(a), unless the shareholder elects to purge the PFIC taint under rules similar to the rules of section 1291(d)(2).

On March 2, 1988, the IRS and Treasury Department published temporary regulations (T.D. 8178, 1988–1 C.B. 313 [53 FR 6770]), and proposed regulations that cross-referenced the temporary regulations (INTL 941–86, 1988–1 C.B. 916 [53 FR 6781]), concerning the election under section 1298(b)(1) (then section 1297(b)(1)) (1988 temporary regulations). The 1988 temporary regulations permitted a shareholder of a former PFIC, as defined in §1.1291–9(j)(2)(iv), to purge the PFIC taint by making a deemed sale election. On January 2, 1998, the IRS and Treasury Department published temporary regulations (T.D. 8750, 1998–1 C.B. 562 [63 FR 6]) and proposed regulations that cross-referenced the temporary regulations (REG–115795–97, 1998–1 C.B. 591 [63 FR 39–01]) that amended the 1988 temporary regulations. The 1998 temporary regulations provided that a shareholder of a former PFIC that was a controlled foreign corporation (as defined in section 957(a)) (CFC) during its last taxable year as a PFIC under section 1297(a), may apply the rules of the deemed dividend election under section 1291(d)(2)(B) and §1.1291–9 to its section 1298(b)(1) election. The 1998 temporary regulations expired on January 2, 2001, pursuant to section 7805(e)(2).

Explanation of Provisions

The regulations contained in this document provide guidance on making a deemed sale or a deemed dividend election for a shareholder of a section 1297(e) PFIC. Section 1.1291–9T(j)(2)(v) defines a section 1297(e) PFIC as a foreign corporation that qualifies as a PFIC under section 1297(a) on the first day of the qualified portion of the shareholder's holding period under section 1297(e), and is also treated as a PFIC with respect to the shareholder under section 1298(b)(1) because at any time during the shareholder's holding period of the stock, other than the qualified portion, the foreign corporation was a PFIC that was not a QEF.

The deemed sale and deemed dividend election rules contained herein generally conform to the deemed sale and deemed dividend election provisions under §§1.1291–9 and –10, which apply to shareholders making a purging election in conjunction with a QEF election. The deemed sale and deemed dividend election rules contained in these regulations, which apply to shareholders of section 1297(e) PFICs, however, differ from those contained in §§1.1291–9 and –10 in several minor respects.

First, under the deemed dividend or deemed sale election rules contained in §§1.1291–9 and –10, the deemed dividend or the gain recognized on the deemed sale, is taxed as an excess distribution received by the shareholder on the qualification date, defined as the first day of the PFIC's first taxable year as a QEF. See §1.1291–9T(e). Under these regulations, for purposes of a deemed dividend or deemed sale election made by a shareholder of a section 1297(e) PFIC, the deemed dividend, or the gain recognized on the deemed sale, is taxed as an excess distribution received on the CFC qualification date. The "CFC qualification date" is defined in §1.1297–3T(d) as the first day on which the qualified portion of the shareholder's holding period in the Section 1297(e) PFIC begins, as determined under section 1297(e)(3).

Second, under §1.1291–9(a)(2), the term "post-1986 earnings and profits" is defined as certain undistributed earnings and profits as of the day before the qualification date. These regulations contain a similar rule. Section 1.1297–3T(c) provides, in general, that "post-1986 earnings and profits" means certain undistributed earnings as of the day before the CFC qualification date. Unlike the qualification date under §1.1291–9, which is the first day of the taxable year, the CFC qualification date may be a day after the first day of the taxable year. Thus, §1.1297–3T(c)(3)(i)(B) also contains a special rule for determining post-1986 earnings and profits when the CFC qualification date is a day after the first day of the taxable year. In such instances, the undistributed earnings and profits will be determined at the close of the taxable year that includes the CFC qualification date.

Finally, taxpayers have commented that, if a foreign corporation is a PFIC under the "once a PFIC, always a PFIC" rule of section 1298(b)(1) but the corporation has ceased to qualify as a PFIC under section 1297(a) or is a corporation to which section 1297(e) applies, and if the shareholder fails to make a timely purging election, the shareholder has no way to remove the PFIC taint. To address this situation, the IRS and Treasury Department also have included late election relief provisions in the regulations. These provisions, contained in §§1.1297–3T(e) and 1.1298–3T(e), allow shareholders of a section 1297(e) PFIC or a former PFIC to make a late deemed dividend or deemed sale election with the consent of the Commissioner, provided certain requirements are met. Under this provision, the shareholder applies the rules of §§1.1297–3T and 1.1298–3T as if its purging election were timely made. If the taxable year for which the purging election is made (*i.e.*, the taxable year that includes the CFC qualification date or the termination date) is a closed taxable year, the taxpayer must enter into a closing agreement to agree to eliminate any prejudice to the interests of the U.S. government as a consequence of the taxpayer's inability to file an amended return.

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. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analyses section of the preamble of the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, this

regulation will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Ethan Atticks, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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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. New §1.1291–9T is added to read as follows:

§1.1291–9T Deemed dividend election (temporary).

(a) through (i)(2)(iv) [Reserved]. For further guidance, see §1.1291–9(a) through (j)(2)(iv).

(j)(2)(v) *Section 1297(e) PFIC*. A foreign corporation is a section 1297(e) PFIC with respect to a shareholder (as defined in §1.1291–9(j)(3)) if—

(A) The foreign corporation qualifies as a PFIC under section 1297(a) on the first day on which the qualified portion of the shareholder's holding period in the foreign corporation begins, as determined under section 1297(e)(2); and

(B) The stock of the foreign corporation held by the shareholder is treated as stock of a PFIC, pursuant to section 1298(b)(1), because, at any time during the shareholder's holding period of the stock, other than the qualified portion, the corporation was a PFIC that was not a QEF.

(3) [Reserved]. For further guidance, see §1.1291–9(j)(3).

(k) *Effective date*. (1) The rules of this section are applicable as of December 8, 2005.

(2) The applicability of this section will expire on or before December 5, 2008.

Par. 3. Section 1.1297–0T is added to read as follows:

§1.1297–0T Table of contents (temporary).

This section contains a listing of the headings for §1.1297–3T.

§1.1297–3T Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC (temporary).

(a) In general.

(b) Application of deemed sale election rules.

(1) Eligibility to make the deemed sale election.

(2) Effect of the deemed sale election.

(3) Time for making the deemed sale election.

(4) Manner of making the deemed sale election.

(5) Adjustments to basis.

(6) Treatment of holding period.

(c) Application of deemed dividend election rules.

(1) Eligibility to make the deemed dividend election.

(2) Effect of the deemed dividend election.

(3) Post–1986 earnings and profits defined.

(4) Time for making the deemed dividend election.

(5) Manner of making the deemed dividend election.

(6) Adjustments to basis.

(7) Treatment of holding period.

(8) Coordination with section 959(e).

(d) CFC qualification date.

(e) Late elections requiring special consent.

(1) In general.

(2) Prejudice to the interests of the U.S. government.

(3) Procedural requirements.

(4) Time and manner of making late election.

(f) Effective date.

Par. 4. Section 1.1297–3T is revised to read as follows:

§1.1297–3T Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC (temporary).

(a) *In general*. A shareholder (as defined in §1.1291–9(j)(3)) of a foreign corporation that is a section 1297(e) PFIC (as defined in §1.1291–9T(j)(2)(v)) with respect to such shareholder, shall be treated for tax purposes as holding stock in a PFIC and therefore continues to be subject to taxation under section 1291 unless the shareholder makes a purging election under section 1298(b)(1). A purging election under section 1298(b)(1) is made under rules similar to the rules of section 1291(d)(2). Section 1291(d)(2) allows a shareholder to purge the continuing PFIC taint by either making a deemed sale election or a deemed dividend election.

(b) *Application of deemed sale election rules*—(1) *Eligibility to make the deemed sale election*. A shareholder of a foreign corporation that is a section 1297(e) PFIC with respect to such shareholder may make a deemed sale election under section 1298(b)(1) by applying the rules of this paragraph (b).

(2) *Effect of the deemed sale election*. A shareholder making the deemed sale election with respect to a section 1297(e) PFIC shall be treated as having sold all of its stock in the section 1297(e) PFIC for its fair market value on the CFC qualification date, as defined in paragraph (d) of this section. A deemed sale under this section is treated as a disposition subject to taxation under section 1291. Thus, the gain from the deemed sale is taxed as an excess distribution received on the CFC qualification date. In the case of an election made by an indirect shareholder, the amount of gain to be recognized and taxed as an excess distribution is the amount of gain that the direct owner of the stock of the PFIC would have realized on an actual sale or disposition of the stock of the PFIC indirectly owned by the shareholder. Any loss realized on the deemed sale is not recognized. After the deemed sale election, the shareholder's stock with respect to which the election was made under this paragraph (b) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the qualified portion of the shareholder's holding period ends, as determined under section 1297(e)(2), and

the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Time for making the deemed sale election*. Except as provided in paragraph (e) of this section, a shareholder shall make the deemed sale election under this paragraph (b) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the CFC qualification date (election year). If the deemed sale election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(4) *Manner of making the deemed sale election*. A shareholder makes the deemed sale election under this paragraph (b) by filing Form 8621 ("*Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*") with the return of the shareholder for the election year, reporting the gain as an excess distribution pursuant to section 1291(a) as if such sale occurred under section 1291(d)(2), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed sale election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year. An electing shareholder that realizes a loss shall report the loss on Form 8621, but shall not recognize the loss.

(5) *Adjustments to basis*. A shareholder that makes the deemed sale election increases its adjusted basis of the PFIC stock owned directly by the amount of gain recognized on the deemed sale. If the shareholder makes the deemed sale election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of gain recognized by the shareholder. In addition, solely for purposes of determining the subsequent treatment under the Code and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of gain recognized on the deemed sale. A shareholder shall not adjust the basis of any stock with respect to which the shareholder realized a loss on the deemed sale, which loss is not recognized under paragraph (b)(2) of this section.

(6) *Treatment of holding period*. If a shareholder of a foreign corporation has made a deemed sale election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed sale, the shareholder's holding period in the stock of the foreign corporation begins on the CFC qualification date, without regard to whether the shareholder recognized gain on the deemed sale. For other purposes of the Code and regulations, this holding period rule does not apply.

(c) *Application of deemed dividend election rules*—(1) *Eligibility to make the deemed dividend election*. A shareholder of a foreign corporation that is a section 1297(e) PFIC with respect to such shareholder may make the deemed dividend election under the rules of this paragraph (c). A deemed dividend election may be made by a shareholder whose *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the PFIC stock held on the CFC qualification date is zero.

(2) *Effect of the deemed dividend election*. A shareholder making the deemed dividend election with respect to a section 1297(e) PFIC shall include in income as a dividend its *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to all of the stock it held, directly or indirectly on the CFC qualification date, as defined in paragraph (d) of this section. The deemed dividend is taxed under section 1291 as an excess distribution received on the CFC qualification date. The excess distribution determined under this paragraph (c) is allocated under section 1291(a)(1)(A) only to each day of the shareholder's holding period of the stock during which the foreign corporation qualified as a PFIC. For purposes of the preceding sentence, the shareholder's holding period of the PFIC stock ends on the day before the CFC qualification date. After the deemed dividend election, the shareholder's stock with respect to which the election was made under this paragraph (c) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the qualified portion of the shareholder's holding period ends, as determined under section 1297(e)(2), and the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Post–1986 earnings and profits defined*—(i) *In general*—(A) *General rule*. For purposes of this section, the term post-1986 earnings and profits means the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3)), as of the day before the CFC qualification date, that were accumulated and not distributed in taxable years of the PFIC beginning after 1986 and during which it was a PFIC, without regard to whether the earnings related to a period during which the PFIC was a CFC.

(B) *Special rule*. If the CFC qualification date is a day that is after the first day of the taxable year, the term post-1986 earnings and profits means the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3)), as of the close of the taxable year that includes the CFC qualification date. For purposes of this computation, only earnings and profits accumulated in taxable years during which the foreign corporation was a PFIC shall be taken into account, but without regard to whether the earnings related to a period during which the PFIC was a CFC.

(ii) *Pro rata share of post-1986 earnings and profits attributable to shareholder's stock*—(A) *In general*. A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the stock held by the shareholder on the CFC qualification date is the amount of post-1986 earnings and profits of the PFIC accumulated during any portion of the shareholder's holding period ending at the close of the day before the CFC qualification date and attributable, under the principles of section 1248 and the regulations under that section, to the PFIC stock held on the CFC qualification date.

(B) *Reduction for previously taxed amounts*. A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC does not include any amount that the shareholder demonstrates to the satisfaction of the Commissioner (in the manner provided in paragraph (c)(5)(ii) of this section) was, pursuant to another provision of the law, previously included in the income of the shareholder, or of another U.S. person if the shareholder's holding period of the PFIC stock includes

the period during which the stock was held by that other U.S. person.

(4) *Time for making the deemed dividend election*. Except as provided in paragraph (e) of this section, the shareholder shall make the deemed dividend election under this paragraph (c) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the CFC qualification date (election year). If the deemed dividend election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(5) *Manner of making the deemed dividend election*—(i) *In general*. A shareholder makes the deemed dividend election by filing Form 8621 and the attachment to Form 8621 described in paragraph (c)(5)(ii) of this section with the return of the shareholder for the election year, reporting the deemed dividend as an excess distribution pursuant to section 1291(a)(1), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed dividend election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year.

(ii) *Attachment to Form 8621*. The shareholder must attach a schedule to Form 8621 that demonstrates the calculation of the shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC that is treated as distributed to the shareholder on the CFC qualification date, pursuant to this paragraph (c). If the shareholder is claiming an exclusion from its *pro rata* share of the post-1986 earnings and profits for an amount previously included in its income or the income of another U.S. person, the shareholder must include the following information:

(A) The name, address and taxpayer identification number of each U.S. person that previously included an amount in income, the amount previously included in income by each such U.S. person, the provision of law, pursuant to which the amount was previously included in income, and the taxable year or years of inclusion of each amount.

(B) A description of the transaction pursuant to which the shareholder acquired, directly or indirectly, the stock of the PFIC from another U.S. person, and the provision of law pursuant to which the shareholder's holding period includes the period the other U.S. person held the CFC stock.

(6) *Adjustments to basis*. A shareholder that makes the deemed dividend election increases its adjusted basis of the stock of the PFIC owned directly by the shareholder by the amount of the deemed dividend. If the shareholder makes the deemed dividend election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of the deemed dividend. In addition, solely for purposes of determining the subsequent treatment under the Code and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of the deemed dividend.

(7) *Treatment of holding period*. If the shareholder of a foreign corporation has made a deemed dividend election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed dividend, the shareholder's holding period of the stock of the foreign corporation begins on the CFC qualification date. For other purposes of the Code and regulations, this holding period rule does not apply.

(8) *Coordination with section 959(e)*. For purposes of section 959(e), the entire deemed dividend is treated as having been included in gross income under section 1248(a).

(d) *CFC qualification date*. For purposes of this section, the CFC qualification date is the first day on which the qualified portion of the shareholder's holding period in the section 1297(e) PFIC begins, as determined under section 1297(e).

(e) *Late elections requiring special consent*—(1) *In general*. This section prescribes the exclusive rules under which a shareholder of a section 1297(e) PFIC may make a section 1298(b)(1) election after the time prescribed in paragraph (b)(2) or (c)(4) of this section for making a deemed sale or a deemed dividend election has elapsed (late purging election). Therefore, a shareholder may not seek such relief under any other provisions of the law, including §301.9100–3 of this chapter. A shareholder may request the consent of the Commissioner to make a late deemed sale or deemed dividend election for the taxable year of the shareholder that includes the CFC qualification date provided the shareholder satisfies the requirements set forth in this paragraph (e). The Commissioner may, in his discretion, grant relief under this paragraph (e) only if—

(i) In a case where the shareholder is requesting consent under this paragraph (e) after June 30, 2006, the shareholder requests such consent before a representative of the Internal Revenue Service raises upon audit the PFIC status of the foreign corporation for any taxable year of the shareholder;

(ii) The shareholder has agreed in a closing agreement with the Commissioner, described in paragraph (e)(3) of this section, to eliminate any prejudice to the interests of the U.S. government, as determined under paragraph (e)(2) of this section, as a consequence of the shareholder's inability to file amended returns for its taxable year in which the CFC qualification date falls, or an earlier closed taxable year in which the shareholder has taken a position that is inconsistent with the treatment of the foreign corporation as a PFIC; and

(iii) The shareholder satisfies the procedural requirements set forth in paragraph (e)(3) of this section.

(2) *Prejudice to the interests of the U.S. government*. The interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability (other than by a *de minimis* amount), taking into account applicable interest charges, for the taxable year that includes the CFC qualification date (or a prior taxable year in which the taxpayer took a position on a return that was inconsistent with the treatment of the foreign corporation as a PFIC) than the shareholder would have had if the shareholder had properly made the section 1298(b)(1) election in the time prescribed in paragraph (b)(2) or (c)(3) of this section (or had not taken a position in a return for an earlier year that was inconsistent with the status of the foreign corporation as a PFIC). The time value of money is taken into account for purposes of this computation.

(3) *Procedural requirements*—(i) *In general*. The amount due with respect to a late purging election is determined in

the same manner as if the purging election had been timely filed. However, the shareholder is also liable for interest on the amount due, determined for the period beginning on the due date (without extensions) for the taxpayer's income tax return for the year in which the CFC qualification date falls and ending on the date the late purging election is filed with the IRS.

(ii) *Filing instructions*. A late purging election is made by filing a completed Form 8621-A, "*Return by a Shareholder Making Certain Late Elections to End Treatment as a Passive Foreign Investment Company*."

(4) *Time and manner of making late election*—(i) *Time for making a late purging election*. A shareholder may make a late purging election in the manner provided in paragraph (e)(4)(ii) of this section at any time. The date the election is filed with the IRS will determine the amount of interest due under paragraph (e)(3) of this section.

(ii) *Manner of making a late purging election*. A shareholder makes a late purging election by completing Form 8621-A in the manner required by that form and this section and filing that form with the Internal Revenue Service, DP 8621-A, Ogden, UT 84201.

(f) *Effective date*. (1) The rules of this section are applicable as of December 8, 2005.

(2) The applicability of this section will expire on or before December 5, 2008.

Par. 5. Section 1.1298–0T is added to read as follows:

§1.1298–0T Table of contents (temporary).

This section contains a listing of the paragraph headings for §1.1298–3T.

§1.1298–3T Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC (temporary).

(a) through (d) [Reserved]. For further guidance, see §1.1298–0, the entries for §1.1298–3T(a) through (d).

(e) Late purging elections requiring special consent.

(1) In general.

(2) Prejudice to the interests of the U.S. government.

(3) Procedural requirement.

(4) Time and manner of making late election.

Par. 6. Section 1.1298–3T is added to read as follows:

§1.1298–3T Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC (temporary).

(a) through (d) [Reserved]. For further guidance, see §1.1298–3(a) through (d).

(e) *Late purging elections requiring special consent*—(1) *In general*. This section prescribes the exclusive rules under which a shareholder of a former PFIC may make a section 1298(b)(1) election after the time prescribed in paragraph (b)(2) or (c)(4) of this section for making a deemed sale or a deemed dividend election has elapsed (late purging election). Therefore, a shareholder may not seek such relief under any other provisions of the law, including §301.9100–3 of this chapter. A shareholder may request the consent of the Commissioner to make a late purging election for the taxable year of the shareholder that includes the termination date provided the shareholder satisfies the requirements set forth in this paragraph (e). The Commissioner may, in his discretion, grant relief under this paragraph (e) only if—

(i) In a case where the shareholder is requesting consent under this paragraph (e) after June 30, 2006, the shareholder requests such consent before a representative of the Internal Revenue Service raises upon audit the PFIC status of the foreign corporation for any taxable year of the shareholder;

(ii) The shareholder has agreed in a closing agreement with the Commissioner, described in paragraph (e)(3) of this section, to eliminate any prejudice to the interests of the U.S. government, as determined under paragraph (e)(2) of this section, as a consequence of the shareholder's inability to file amended returns for its taxable year in which the termination date falls, or an earlier closed taxable year in which the shareholder has taken a position that is inconsistent with the treatment of the foreign corporation as a PFIC; and

(iii) The shareholder satisfies the procedural requirements set forth in paragraph (e)(3) of this section.

(2) *Prejudice to the interests of the U.S. government*. The interests of the U.S. government are prejudiced if granting relief would result in the shareholder having a lower tax liability (other than by a *de minimis* amount), taking into account applicable interest charges, for the taxable year that includes the termination date (or a prior taxable year in which the taxpayer took a position on a return that was inconsistent with the treatment of the foreign corporation as a PFIC) than the shareholder would have had if the shareholder had properly made the section 1298(b)(1) election in the time prescribed in paragraph (b)(2) or (c)(3) of this section (or had not taken a position in a return for an earlier year that was inconsistent with the status of the foreign corporation as a PFIC). The time value of money is taken into account for purposes of this computation.

(3) *Procedural requirement*—(i) *In general*. The amount due with respect to a late purging election is determined in the same manner as if the purging election had been timely filed. However, the shareholder is also liable for interest on the amount due, determined for the period beginning on the due date (without extensions) for the taxpayer's income tax return for the year in which the CFC qualification date falls and ending on the date the late purging election is filed with the IRS.

(ii) *Filing instructions*. A late purging election is made by filing a completed Form 8621-A, "*Return by a Shareholder Making Certain Late Elections to End Treatment as a Passive Foreign Investment Company*."

(4) *Time and manner of making late election*—(i) *Time for making a late purging election*. A shareholder may make a late purging election in the manner provided in paragraph (e)(4)(ii) of this section at any time. The date the election is filed with the IRS will determine the amount of interest due under paragraph (e)(3) of this section.

(ii) *Manner of making a late purging election*. A shareholder makes a late purging election by completing Form 8621-A in the manner required by that form and this section and filing that form with the Internal Revenue Service, DP 8621-A, Ogden, UT 84201.

(f) *Effective date*. (1) The rules of this section are applicable as of December 8, 2005.

(2) The applicability of this section will expire on or before December 5, 2008.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation of part 602 continues to read as follows:

Authority: 26 U.S.C. 7805

Par. 8. In §602.101, paragraph (b) is amended by revising an entry in the table for "1.1297–3T" as follows:

§602.101 OMB Control numbers

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1297–3T	1545–1965
* * * * *	

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

Approved November 21, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 7, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 8, 2005, 70 F.R. 72908)

Section 1298.—Special Rules

26 CFR 1.1298–3: Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

T.D. 9231

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

Guidance on Passive Foreign Investment Company (PFIC) Purging Elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide specific elections that give relief to certain United States persons that continue to be subject to the PFIC excess distribution regime of section 1291 even though the foreign corporation in which they hold stock no longer satisfies the definition of a PFIC under section 1297(a). The final regulations affect U.S. persons owning stock in a PFIC.

DATES: *Effective Date*: These regulations are effective December 8, 2005.

Applicability Date: For dates of applicability, see §1.1298–3(f).

FOR FURTHER INFORMATION CONTACT: Ethan Atticks at (202) 622–3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been previously 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 1545–1028, which was later incorporated into control number 1545–1507.

The collection of information in these final regulations is in §1.1298–3(c)(5). This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income, gain or loss from that taxpayer's interest in the foreign corporation.

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

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

Background

This document contains final regulations under section 1298(b)(1). Section 1298(b)(1) was originally enacted as section 1297 by the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2085) and was redesignated as section 1298 by the Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 788).

Section 1298(b)(1) provides that if a shareholder owns stock in a foreign corporation that, at any time during the shareholder's holding period with respect to such stock, was a PFIC that was not a qualified electing fund (QEF), the stock will retain its character as PFIC stock, even if the corporation later ceases to qualify as a PFIC under section 1297(a), unless the shareholder elects to purge the PFIC taint under rules similar to the rules of section 1291(d)(2).

On March 2, 1988, the IRS and Treasury Department published temporary regulations (T.D. 8178, 1988–1 C.B. 313 [53 FR 6770]), and proposed regulations that cross-referenced the temporary regulations (INTL 941–86, 1988–1 C.B. 916 [53 FR 6781]), concerning the election under section 1298(b)(1) (then section 1297(b)(1)) (1988 temporary regulations). The 1988 temporary regulations permitted a shareholder of a former PFIC, as defined in §1.1291–9(j)(2)(iv), to purge the PFIC taint by making a deemed sale election. On January 2, 1998, the IRS and

Treasury Department published temporary regulations (T.D. 8750, 1998–1 C.B. 562 [63 FR 6]) and proposed regulations that cross-referenced the temporary regulations (REG–115795–97, 1998–1 C.B. 591 [63 FR 39–01]) that amended the 1988 temporary regulations. The 1998 temporary regulations provided that a shareholder of a former PFIC that was a controlled foreign corporation (as defined in section 957(a)) during its last taxable year as a PFIC under section 1297(a), may apply the rules of the deemed dividend election under section 1291(d)(2)(B) and §1.1291–9 to its section 1298(b)(1) election. The 1998 temporary regulations expired on January 2, 2001, pursuant to section 7805(e)(2).

One written comment was received regarding the deemed sale election in response to the notice of proposed rulemaking published by cross-reference to the 1988 regulations. No public hearing was requested or held on the notice of proposed rulemaking. After consideration of the comment, the 1988 temporary regulations, as modified by the 1998 temporary regulations that permit a deemed dividend election in certain circumstances, are adopted as final regulations with the changes discussed below.

Summary of Comments and Explanation of Revisions

A. Time and Manner of Making the Deemed Sale Election

One comment was received on the 1988 temporary regulations regarding the deemed sale election under §1.1297–3T. The comment recommended that the regulations permit a shareholder to make a deemed sale election without having to file an amended return in instances where an election could be filed by the due date of the shareholder's original return for the last taxable year during which the foreign corporation continued to qualify as a PFIC under section 1297(a). This suggestion was adopted with respect to both the deemed sale and deemed dividend elections, and the regulations have been revised accordingly.

B. Additional Revisions

Additional revisions were made to the final regulations to reflect the redesignation of certain Code sections pursuant to the Taxpayer Relief Act of 1997 (Public Law 105–34, 111 Stat. 788). Similar revisions were made to the definition of former PFIC contained in §1.1291–9(j)(2)(iv). In addition, the deemed dividend election provisions were added and the deemed sale election provisions were revised to conform generally the elections under section 1298(b)(1) to the deemed dividend and deemed sale election provisions contained in §§1.1291–9 and –10 (purging elections in connection with election to treat PFIC as a QEF).

Special Analyses

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

Drafting Information

The principal author of this regulation is Ethan Atticks, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1291–9 is amended as follows:

1. Paragraph (i)(1) is removed.

2. The paragraph heading of paragraph (i)(2) is removed.

3. The text of paragraph (i)(2) is redesignated as paragraph (i).

4. Paragraph (j)(2)(iv) is revised.

5. Paragraph (j)(2)(v) is added.

The revision and addition reads as follows:

§ 1.1291–9 Deemed dividend election.

* * * * *

(j) * * *

(2) * * *

(iv) *Former PFIC*. A foreign corporation is a former PFIC with respect to a shareholder if the corporation satisfies neither the income test of section 1297(a)(1) nor the asset test of section 1297(a)(2), but its stock, held by that shareholder, is treated as stock of a PFIC, pursuant to section 1298(b)(1), because the corporation was a PFIC that was not a QEF at some time during the shareholder's holding period of the stock.

(v) *Section 1297(e) PFIC*. [Reserved]. For further guidance, see §1.1291–9T(j)(2)(v).

* * * * *

Par. 3. Section 1.1297–0 is revised to read as follows:

§1.1297–0 Table of contents.

This section contains a listing of the paragraph headings for §1.1297–3.

§1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC.

[Reserved]. For further guidance, see the entries in §1.1297–3T.

Par. 4. Section 1.1297–3 is added to read as follows:

§1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC.

[Reserved]. For further guidance, see §1.1297–3T.

Par. 5. Sections 1.1298–0 and 1.1298–3 are added to read as follows:

§ 1.1298–0 Table of contents.

This section contains a listing of the paragraph headings for §1.1298–3.

§ 1.1298–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

(a) In general.

(b) Application of deemed sale election rules.

(1) Eligibility to make the deemed sale election.

(2) Effect of deemed sale election.

(3) Time for making the deemed sale election.

(4) Manner of making the deemed sale election.

(5) Adjustments to basis.

(6) Treatment of holding period.

(c) Application of deemed dividend election rules.

(1) Eligibility to make the deemed dividend election.

(2) Effect of the deemed dividend election.

(3) Post–1986 earnings and profits defined.

(4) Time for making the deemed dividend election.

(5) Manner of making the deemed dividend election.

(6) Adjustments to basis.

(7) Treatment of holding period.

(8) Coordination with section 959(e).

(d) Termination date.

(e) Late purging elections requiring special consent. [Reserved]. For further guidance, see §1.1298–0T.

(f) Effective date.

§ 1.1298–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

(a) *In general.* A shareholder (as defined in §1.1291–9(j)(3)) of a foreign corporation that is a former PFIC, (as defined in §1.1291–9(j)(2)(iv)) with respect to such shareholder, shall be treated for tax purposes as holding stock in a PFIC and therefore continues to be subject to taxation under section 1291 unless the shareholder makes a purging election under section 1298(b)(1). A purging election under section 1298(b)(1) is made under rules similar to the rules of section 1291(d)(2). Section 1291(d)(2) allows a shareholder to purge the continuing PFIC taint by making either a deemed sale election or a deemed dividend election.

(b) *Application of deemed sale election rules*—(1) *Eligibility to make the deemed sale election.* A shareholder of a foreign corporation that is a former PFIC with respect to such shareholder may make a deemed sale election under section 1298(b)(1) by applying the rules of this paragraph (b).

(2) *Effect of deemed sale election.* A shareholder making the deemed sale election with respect to a former PFIC shall be treated as having sold all its stock in the former PFIC for its fair market value on the termination date, as defined in paragraph (d) of this section. A deemed sale is treated as a disposition subject to taxation under section 1291. Thus, gain from the deemed sale is taxed under section 1291 as an excess distribution received on the termination date. In the case of an election made by an indirect shareholder, the amount of gain to be recognized and taxed as an excess distribution is the amount of gain that the direct owner of the stock of the PFIC would have realized on an actual sale or disposition of the stock of the PFIC indirectly owned by the shareholder. Any loss realized on the deemed sale is not recognized. After the deemed sale election, the shareholder's stock with respect to which the election was made under this paragraph (b) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Time for making the deemed sale election.* Except as provided in paragraph (e) of this section, the shareholder shall make the deemed sale election under this paragraph (b) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the termination date (election year). If the deemed sale election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(4) *Manner of making the deemed sale election.* A shareholder makes the deemed sale election under this paragraph (b) by filing Form 8621 ("*Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*") with the return of the shareholder for the election year, reporting the gain as an excess distribution pursuant to section 1291(a) as if such deemed sale occurred under section 1291(d)(2), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed sale election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year. An electing shareholder that realizes a loss shall report the loss on Form 8621, but shall not recognize the loss.

(5) *Adjustments to basis.* A shareholder that makes the deemed sale election increases its adjusted basis of the PFIC stock owned directly by the amount of gain recognized on the deemed sale. If the shareholder makes the deemed sale election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of gain recognized by the shareholder. In addition, solely for purposes of determining the subsequent treatment under the Code and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of gain recognized on the deemed sale. A shareholder shall not adjust the basis of any stock with respect to which the shareholder realized a loss on the deemed sale, but which loss is not recognized under paragraph (b)(2) of this section.

(6) *Treatment of holding period.* If a shareholder of a foreign corporation has made a deemed sale election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed sale, the shareholder's holding period in the stock of the foreign corporation begins on the day following the termination, without regard to whether the shareholder recognized gain on the deemed sale. For other purposes of the Code and regulations, this holding period rule does not apply.

(c) *Application of deemed dividend election rules*—(1) *Eligibility to make the deemed dividend election.* A shareholder of a foreign corporation that is a former PFIC with respect to such shareholder may make the deemed dividend election under the rules of this paragraph (c) provided the foreign corporation was a controlled

foreign corporation (as defined in section 957(a) (CFC)) during its last taxable year as a PFIC. A shareholder may make the deemed dividend election without regard to whether the shareholder is a United States shareholder within the meaning of section 951(b). A deemed dividend election may be made by a shareholder whose *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the PFIC stock held on the termination date is zero.

(2) *Effect of the deemed dividend election*. A shareholder making the deemed dividend election with respect to a former PFIC shall include in income as a dividend its *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to all of the stock it held, directly or indirectly on the termination date, as defined in paragraph (d) of this section. The deemed dividend is taxed under section 1291 as an excess distribution received on the termination date. The excess distribution determined under this paragraph (c) is allocated under section 1291(a)(1)(A) only to each day of the shareholder's holding period of the stock during which the foreign corporation qualified as a PFIC. For purposes of the preceding sentence, the shareholder's holding period of the PFIC stock ends on the termination date. After the deemed dividend election, the shareholder's stock with respect to which the election was made under this paragraph (c) shall not be treated as stock in a PFIC and the shareholder shall not be subject to taxation under section 1291 with respect to such stock unless the foreign corporation thereafter qualifies as a PFIC under section 1297(a).

(3) *Post-1986 earnings and profits defined*—(i) *In general*. For purposes of this section, the term *post-1986 earnings and profits* means the post-1986 undistributed earnings, within the meaning of section 902(c)(1) (determined without regard to section 902(c)(3)), as of the close of the taxable year that includes the termination date. For purposes of this computation, only earnings and profits accumulated in taxable years during which the foreign corporation was a PFIC shall be taken into account, without regard to whether the earnings relate to a period during which the PFIC was a CFC.

(ii) *Pro rata share of post-1986 earnings and profits attributable to shareholder's stock*—(A) *In general*. A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC attributable to the stock held by the shareholder on the termination date is the amount of post-1986 earnings and profits of the PFIC accumulated during any portion of the shareholder's holding period ending at the close of the termination date and attributable, under the principles of section 1248 and the regulations under that section, to the PFIC stock held on the termination date.

(B) *Reduction for previously taxed amounts*. A shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC does not include any amount that the shareholder demonstrates to the satisfaction of the Commissioner (in the manner provided in paragraph (c)(5)(ii) of this section) was, pursuant to another provision of the law, previously included in the income of the shareholder, or of another U.S. person if the shareholder's holding period of the PFIC stock includes the period during which the stock was held by that other U.S. person.

(4) *Time for making the deemed dividend election*. Except as provided in paragraph (e) of this section, the shareholder shall make the deemed dividend election under this paragraph (c) and section 1298(b)(1) in the shareholder's original or amended return for the taxable year that includes the termination date (election year). If the deemed dividend election is made in an amended return, the return must be filed by a date that is within three years of the due date, as extended under section 6081, of the original return for the election year.

(5) *Manner of making the deemed dividend election*—(i) *In general*. A shareholder makes the deemed dividend election by filing Form 8621 and the attachment to Form 8621 described in paragraph (c)(5)(ii) of this section with the return of the shareholder for the election year, reporting the deemed dividend as an excess distribution pursuant to section 1291(a)(1), and paying the tax and interest due on the excess distribution. A shareholder that makes the deemed dividend election after the due date of the return (determined without regard to extensions) for the election year must pay additional interest, pursuant to section 6601, on the amount of underpayment of tax for that year.

(ii) *Attachment to Form 8621*. The shareholder must attach a schedule to Form 8621 that demonstrates the calculation of the shareholder's *pro rata* share of the post-1986 earnings and profits of the PFIC that is treated as distributed to the shareholder on the termination date pursuant to this paragraph (c). If the shareholder is claiming an exclusion from its *pro rata* share of the post-1986 earnings and profits for an amount previously included in its income or the income of another U.S. person, the shareholder must include the following information:

(A) The name, address, and taxpayer identification number of each U.S. person that previously included an amount in income, the amount previously included in income by each such U.S. person, the provision of law pursuant to which the amount was previously included in income, and the taxable year or years of inclusion of each amount.

(B) A description of the transaction pursuant to which the shareholder acquired, directly or indirectly, the stock of the PFIC from another U.S. person, and the provision of law pursuant to which the shareholder's holding period includes the period the other U.S. person held the CFC stock.

(6) *Adjustments to basis*. A shareholder that makes the deemed dividend election increases its adjusted basis of the stock of the PFIC owned directly by the shareholder by the amount of the deemed dividend. If the shareholder makes the deemed dividend election with respect to a PFIC of which it is an indirect shareholder, the shareholder's adjusted basis of the stock or other property owned directly by the shareholder, through which ownership of the PFIC is attributed to the shareholder, is increased by the amount of the deemed dividend. In addition, solely for purposes of determining the subsequent treatment under the Code and regulations of a shareholder of the stock of the PFIC, the adjusted basis of the direct owner of the stock of the PFIC is increased by the amount of the deemed dividend.

(7) *Treatment of holding period*. If the shareholder of a foreign corporation has made a deemed dividend election, then, for purposes of applying sections 1291 through 1298 to such shareholder after the deemed dividend, the shareholder's holding period of the stock of the foreign corporation begins on the day following

the termination date. For other purposes of the Code and regulations, this holding period rule does not apply.

(8) *Coordination with section 959(e).* For purposes of section 959(e), the entire deemed dividend is treated as having been included in gross income under section 1248(a).

(d) *Termination date.* For purposes of this section, the termination date is the last day of the last taxable year of the foreign corporation during which it qualified as a PFIC under section 1297(a).

(e) *Late purging elections requiring special consent.* [Reserved]. For further guidance, see §1.1298–3T(e).

(f) *Effective date.* This section applies for taxable years of shareholders beginning on or after December 8, 2005. However, taxpayers may apply the rules of this section to a taxable year beginning prior to December 8, 2005, provided the statute of limitations on the assessment of tax has not expired.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In §602.101, paragraph (b) is amended by adding an entry in numerical order to the table:

§602.101 OMB Control numbers

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1298–3	1545–1507
* * * * *	

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

Approved November 21, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 7, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 8, 2005, 70 F.R. 72914)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Section 7701.—Definitions

26 CFR 301.7701–2: Business entities; definitions.

Japanese Yugen Kaisha (YK) and Tokurei Yugen Kaisha (TYK). A Yugen Kaisha, a Japanese business entity, which will become a Tokurei Yugen Kaisha under recently enacted Japanese legislation, will continue to be eligible to elect its U.S. entity classification under the check the box regulations.

Rev. Rul. 2006–3

ISSUE

Will a Japanese Yugen Kaisha business entity ("YK") that becomes a Japanese Tokurei Yugen Kaisha business entity ("TYK") pursuant to the Kaisha Ho, Law No. 86 of 2005 (Company Law) and the Seibi Ho, Law No. 87 of 2005 (the Law Concerning the Coordination, Etc., of Associated Laws in Connection with the Enforcement of the Companies Law) (Coordination Law), as promulgated on July 26, 2005, remain an eligible entity for purposes of § 301.7701–1 through 3 of the Procedure and Administration Regulations?

FACTS

On July 26, 2005, the Japanese Diet reorganized Japanese corporate law through the promulgation of the Company Law and the Coordination Law, which were passed on June 29, 2005. Pursuant to the Coordination Law, the YK will be abolished as a Japanese corporate entity. All YKs in existence as of the effective date of the Coordination Law will continue as TYKs, a special type of Kabushiki Kaisha business entity ("KK") under the Company Law. The effective date of these laws will be determined by a Cabinet enforcement order; however, the provisions will be effective no later than January 26, 2007. After the effective date of the new laws, no new YKs or TYKs may be formed.

LAW AND ANALYSIS

Section 301.7701–2(a) defines the term "business entity" as any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under § 301.7701–3) that is not properly classified as a trust under § 301.7701–4 or otherwise subject to special treatment under the Code. A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as a corporation or is disregarded. However, § 301.7701–2(b)(8) provides that certain foreign business entities are always classified as corporations for federal tax purposes (*per se* corporations). Under § 301.7701–2(b)(8), a KK is a *per se* corporation. Further, a YK is an eligible entity, for which an entity classification election can be made under § 301.7701–3.

Based on the Company Law and Coordination Law promulgated on July 26, 2005, TYKs are not *per se* corporations described in § 301.7701–2(b)(8) and will be classified in the same manner as YKs were prior to the effective date of the new Japanese corporate law. Therefore, a YK that be-

comes a TYK will remain an eligible entity for purposes of § 301.7701–1 through 3.

HOLDING

A Japanese YK that becomes a Japanese TYK, pursuant to the Company Law and the Coordination Law, as promulgated on July 26, 2005, will remain an eligible entity for purposes of § 301.7701–1 through 3.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ronald M. Gootzeit of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Ronald M. Gootzeit at (202) 622–3860 (not a toll-free call).

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of January 2006. See Rev. Rul. 2006-4, page 264.

Part III. Administrative, Procedural, and Miscellaneous

Extension of Transition Relief for Certain Partnerships and Other Pass-Thru Entities Under Section 470

Notice 2006–2

PURPOSE

This notice extends by one year the transition relief provided in Notice 2005–29, 2005–13 I.R.B. 796, under § 470 of the Internal Revenue Code to partnerships and other pass-thru entities that are treated as holding tax-exempt use property as a result of the application of § 168(h)(6).

BACKGROUND

Section 848 of the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418, 1602, enacted on October 22, 2004, added § 470, which imposed new limitations on the deductibility of losses relating to tax-exempt use property. Under § 470(c)(2), "tax-exempt use property" has the meaning provided under § 168(h) (with certain modifications). Under § 168(h)(6), if any property that is not otherwise "tax-exempt use property" under § 168(h) is owned by a partnership that has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, and any allocation to the tax-exempt entity of partnership items is not a qualified allocation, an amount equal to the tax-exempt entity's proportionate share of the property generally is treated as tax-exempt use property. Section 168(h)(6)(E) provides that rules similar to those applicable to partnerships in determining whether property is tax-exempt use property apply to other pass-thru entities. Section 470 generally applies to leases entered into after March 12, 2004.

Notice 2005–29 provides transition relief to partnerships and other pass-thru entities that are treated by § 470 as holding tax-exempt use property as a result of the application of § 168(h)(6). Specifically, Notice 2005–29 provides that in the case of partnerships and pass-thru entities described in § 168(h)(6)(E), for taxable years that begin before January 1, 2005, the Internal Revenue Service will not apply § 470 to disallow losses associated with property that is treated as tax-exempt use property solely as a result of the application of § 168(h)(6).

The Treasury Department and the Service understand that Congress is considering possible legislation that would affect the application of § 470 to certain transactions involving partnerships and other pass-thru entities.

EXTENSION OF TRANSITION RELIEF

In the case of partnerships and pass-thru entities described in § 168(h)(6)(E), for taxable years that begin before January 1, 2006, the Service will not apply § 470 to disallow losses associated with property that is treated as tax-exempt use property solely as a result of the application of § 168(h)(6). Abusive transactions involving partnerships and other pass-thru entities remain subject to challenge by the Service under other provisions of the tax law.

EFFECT ON OTHER DOCUMENTS

Notice 2005–29 is modified and superseded.

DRAFTING INFORMATION

For further information regarding this notice, contact John Aramburu of the Office of the Associate Chief Counsel (Income Tax & Accounting) at (202) 622–4960 (not a toll-free call).

Section 482.—Allocation of Income and Deductions Among Taxpayers

Rev. Proc. 2006–9

TABLE OF CONTENTS

SECTION 1: PURPOSE

.01 This revenue procedure explains the manner in which taxpayers may request an advance pricing agreement ("APA") from the APA Program within the Office of the Associate Chief Counsel (International), the manner in which such a request will be processed by the APA Program, and the effect and administration of APAs. This revenue procedure updates and supersedes Revenue Procedure 2004–40, 2004–2 C.B. 50.

SECTION 2: PRINCIPLES OF THE APA PROGRAM

.01 The APA Program provides a voluntary process whereby the Internal Revenue Service ("Service") and taxpayers may resolve transfer pricing issues under § 482 of the Internal Revenue Code ("Code"), the Income Tax Regulations ("the regulations") thereunder, and relevant income tax treaties to which the United States is a party in a principled and cooperative manner on a prospective basis. The APA process increases the efficiency of tax administration by encouraging taxpayers to come forward and present to the Service all the facts relevant to a proper transfer pricing analysis and to work towards a mutual agreement in a spirit of openness and cooperation. The prospective nature of APAs lessens the burden of compliance by giving taxpayers greater certainty regarding their transfer pricing methods, and promotes the principled resolution of these issues by allowing for their discussion and resolution in advance before the consequences of such resolution are fully known to taxpayers and the Service.

.02 The APA Program's central goal is the prompt, proper, and fair resolution of APA requests and renewals consistent with the principles of sound tax administration.

.03 The APA Program reserves the right not to accept an APA request or to terminate consideration of an APA request if the request or the continued development of the case is contrary to the principles of sound tax administration.

.04 An APA is an agreement between a taxpayer and the Service in which the parties set forth, in advance of controlled transactions, the best transfer pricing method ("TPM") within the meaning of § 482 of the Code and the regulations. The agreement specifies the controlled transactions or transfers ("covered transactions"), TPM, APA term, operational and compliance provisions, appropriate adjustments, critical assumptions regarding future events, required APA records, and annual reporting responsibilities.

(1) APAs are intended to supplement traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues.

(2) Taxpayers formally initiate the process for APAs. Thereafter, APAs require discussions among the taxpayer, one or more associated enterprises, and one or more tax administrations, including the Service.

(3) Ordinarily, an APA is reached only on the proposed covered transactions. In some cases, however, the APA Program may require that the scope of the proposed covered transactions be expanded or contracted, or may determine that the TPM proposed by the taxpayer is not appropriate for some subset of the proposed covered transactions.

.05 The taxpayer's participation in the APA process is entirely voluntary. In some cases, the Service may approach a taxpayer to discuss the advantages of an APA.

.06 The APA Program is under the immediate supervision of a Director (the "APA Director") within the Office of the Associate Chief Counsel (International). The APA Director reports to the Associate Chief Counsel (International) who exercises general oversight over the APA Program. The APA Director, directly or by delegation, may take any action - not contrary to statute, regulation, or treaty - necessary to carry out the provisions of this revenue procedure. The APA Director may modify the provisions contained in this revenue procedure (for example, time limits or content of an APA request) if that modification would be consistent with sound tax administration.

.07 Under the APA request procedure, the taxpayer proposes a TPM and provides data intended to show that the TPM constitutes the appropriate application of the best method rule under the § 482 regulations. The Service, through an APA Team, evaluates the APA request by analyzing all relevant data and information submitted with the initial request and at any time thereafter.

.08 Taxpayers may request a bilateral, multilateral, or, if appropriate, a unilateral APA. A bilateral or multilateral APA involves a request for an APA between the taxpayer and the Service, accompanied by a request for a mutual agreement between relevant competent authorities. A unilateral APA involves only an agreement between the taxpayer and the Service. Where possible, in the interest of sound tax administration and to ensure that no potential for double taxation results from an APA, an APA should be concluded on a bilateral or multilateral basis between the competent authorities through the mutual agreement procedure of the relevant income tax treaty or treaties.

.09 The APA Policy Board establishes policy on matters of substantial genuine importance pertaining to the APA Program. It consists of the Associate Chief

Counsel (International), the APA Director, the Director, International (Large and Mid-Size Business (LMSB) Operating Division), Treasury's International Tax Counsel, and other senior officials.

.10 In a bilateral or multilateral case, the APA Program prepares a recommended negotiating position for the U.S. Competent Authority. The negotiating position serves as a basis for discussions with the relevant foreign competent authority or authorities under the mutual agreement article of the applicable income tax treaty or treaties. Prior to finalizing its recommendation, the APA Program, through the Team Leader (see section 6.03), conveys the substance of the APA Team's position to the taxpayer to provide an opportunity for the taxpayer to comment. The Team Leader, in coordination with other members of the APA Team, considers the merits of the taxpayer's timely received comments in finalizing the recommended position.

.11 If the U.S. Competent Authority and the relevant foreign competent authority or authorities reach a mutual agreement, the taxpayer and the Service may execute one or more APAs consistent with that mutual agreement.

.12 In appropriate cases, the TPM may be applied to tax years prior to those covered by the APA ("rollback" of the TPM, see section 8). The Service's policy is to use rollbacks whenever feasible based on the consistency of the facts, law, and available records for the prior years. This policy does not apply to unilateral APA requests in which a rollback would decrease taxable income on a return filed for a taxable year not covered by the APA (see § 1.482–1(a)(3)).

.13 Filing an APA request does not suspend any examination or other enforcement proceedings. The APA Program will coordinate its activities with those of other Service proceedings to avoid duplicative information requests to the taxpayer, enhance the efficiency of Service operations, and reduce overall taxpayer compliance burdens.

SECTION 3: PREFILING CONFERENCES

.01 General Principles

A taxpayer may request a prefiling conference ("PFC") with the APA Program to discuss informally the suitability of an APA.

.02 Discussion Topics

The taxpayer may use a PFC to clarify what information, documentation, and analyses are likely to be necessary for the Service to consider an APA request. Among the areas of discussion are the covered transactions, the potentially applicable TPMs, the probability of agreement among the competent authorities, and the APA Program's schedule and method for coordinating and evaluating the request. To provide for the efficient use of taxpayer resources, PFCs are recommended in order to ensure that the APA request is appropriate and focuses on relevant issues.

.03 Scheduling

A taxpayer or its representative may contact the APA Program Office in Washington, D.C. or California to schedule a PFC. The taxpayer or its representative should propose three alternative dates, and should generally allow two weeks before the first proposed date. The telephone and facsimile numbers are:

Washington, DC

Voice: (202) 435–5220

Facsimile: (202) 435–5238

California

Voice: (949) 360–3486

Facsimile: (949) 360–3446

.04 PFC May be Named or Anonymous

The taxpayer may request a PFC either on an identified or anonymous basis.

.05 Participation

If a taxpayer identifies itself, representatives of the Service Operating Division with responsibility for the taxpayer's return normally will participate in the PFC. Representatives from Appeals and the Division Counsel field offices may also attend. In the case of a PFC regarding a bilateral APA request, a Competent Authority analyst may attend. If a taxpayer initially requests a PFC on an anonymous basis but prior to the meeting chooses to identify itself, the meeting may be rescheduled to permit necessary Service personnel to attend. When requesting a PFC on an identified basis, the taxpayer must inform the APA Program whether transactions similar or related to those to be covered by the proposed APA are currently under consideration by a Service Operating Division, an Appeals Office, a Division Counsel, or an Associate Chief Counsel.

.06 Prefiling Submission

A taxpayer must send a brief prefiling submission to the relevant APA Program Office in Washington, D.C. or California that lists the persons attending the PFC for the taxpayer (first names only or job titles are sufficient if the PFC will be on an anonymous basis) and that outlines and describes the issues to be discussed. This brief submission should be provided at least one week in advance of the PFC. If the document is twenty pages or less, it may be sent by facsimile; but if it exceeds twenty pages, eight copies (or if anonymous, only three copies) and one original should be delivered.

SECTION 4: CONTENT OF APA REQUESTS

.01 Introduction

A complete APA request is essential to a timely and efficient APA process. In the APA Program's experience, a complete APA request may save many months of case processing time and hundreds of hours of labor, as it allows the APA Team to narrow its focus immediately to the core issue or issues and avoids delays caused by the need to supplement the original APA request. The goal of completing a unilateral APA or a recommended negotiating position within 12 months (see section 6.01) is predicated in large part on the assumption that the taxpayer has submitted a complete APA request.

A complete APA request should provide the information specified below and all other information reasonably necessary to permit the APA Program to evaluate fully the taxpayer's proposed TPM. The level of detail required will depend on the particular facts and circumstances of each case and should be governed by relevancy and materiality considerations (keeping in mind that the request should provide enough information to allow the reader to concur that a matter is not relevant or

material). The detailed information supporting the APA request should be tailored to the specific facts relating to the taxpayer, the proposed covered transactions, and relevant legal authority. It should also take into account discussions with the APA Program in any PFC.

An APA request will normally be considered not "substantially complete" for purposes of sections 4.07, 4.12, 6.01, and 6.03 unless the request contains the information required below (as may be modified by agreement of the parties).

.02 General Principles

(1) For purposes of requesting an APA, each taxpayer that is a member of a consolidated group (as defined in Treasury Regulations § 1.1502–1) must comply with the provisions of § 1.1502–77.

(2) All materials submitted with the APA request become part of the APA Program's case file and will not be returned. Therefore, taxpayers should not submit original documents.

(3) The taxpayer must submit copies of any documents relating to the proposed TPM. All materials submitted must be properly labeled, indexed, and referenced in the request. Any previously submitted documents that the taxpayer wishes to associate with the request must be referenced.

(4) If the records or documents to be submitted are too voluminous for transmittal with the request, the taxpayer must describe the contents of such items in the request and confirm that the items will promptly be made available upon request.

(5) All documents submitted in a foreign language must be accompanied by an accurate English translation.

(6) All documents in the APA request that are available in electronic format should be submitted, on either a CD-ROM or diskette, along with the paper submission. Suitable formats include Microsoft Word, Excel, PowerPoint, and Adobe Portable Document Format. Other formats may be arranged on a case-by-case basis.

.03 Factual, Legal, and Analytical Items for All Proposed APAs

Unless otherwise agreed, each APA request must include an appropriate discussion of the items set forth below.

(1) A comprehensive table of contents.

(2) The names, addresses, telephone and facsimile numbers, taxpayer identification numbers (if applicable), and both the Standard Industrial Classification (SIC) and the North American Industry Classification System (NAICS) codes reported on the most recently filed federal tax returns (if applicable) of (a) the organizations, trades, and businesses engaging in the proposed covered transactions, and (b) the controlling taxpayer of the parties, if the controlling taxpayer is not itself engaging in the proposed covered transactions.

(3) The controlling taxpayer's industry (for example, Heavy Manufacturing and Transportation) within LMSB; or if the taxpayer files its tax returns with the Small Business/Self-Employed (SB/SE) Operating Division, a statement to that effect.

(4) A properly completed Form 2848 (*Power of Attorney and Declaration of Representative*) for any person authorized to represent the taxpayer in connection with the request, disregarding if appropriate the line 3 instruction limiting the authorization to three future tax periods. If the taxpayer or the taxpayer's authorized representative retains any other person (for example, a law firm, accounting firm, or economic consulting firm) to assist the taxpayer in pursuing the APA request, the taxpayer must also provide a separate written authorization for disclosures to the person and such person's employees during the APA Program's consideration of the request, according to the instructions in § 301.6103(c)–1T (see also T.D. 9011, 2002–2 C.B. 356, 31 C.F.R. Part 10 (July 26, 2002)). Such written authorization may be made by completing Form 8821 (*Tax Information Authorization*), disregarding, if appropriate, the line 3 instruction limiting the authorization to three future tax periods.

(5) A description of the general history of business operations, worldwide organizational structure, ownership, capitalization, financial arrangements, principal businesses, the place or places where such businesses are conducted, and major transaction flows of the parties to the proposed covered transactions. The description must also identify any branches or entities disregarded for tax purposes (see § 301.7701–3) that are involved in the proposed covered transactions.

(6) A description and analysis of the transactions covered by the APA request, as well as the estimated dollar value of each proposed covered transaction for each year of the proposed term of the APA. The discussion must also describe how the proposed covered transactions relate to other controlled transactions that the taxpayer does not propose to cover.

(7) A statement addressing the extent to which the tested party has transactions involving commission sales and ordinary distribution sales (*i.e.*, buying and reselling). If the APA request involves both kinds of transactions, the taxpayer must propose a TPM and analyze the extent to which it is appropriate under the facts and circumstances to (a) test both kinds of transactions on an aggregated basis; (b) test the two kinds of transactions separately; or (c) exclude one of the two kinds of transactions from the APA.

(8) For each party to the proposed covered transactions, a detailed analysis of:

(a) the functions and economic activities performed;

(b) the assets employed;

(c) the economic costs incurred;

(d) the risks assumed;

(e) relevant contractual terms;

(f) relevant economic conditions; and

(g) relevant non-recognition transactions.

(9) Copies of the principal written agreement(s), if any, setting forth the contractual terms for the covered transactions (within the meaning of § 1.482–1(d)(3)(ii), including without limitation the form of consideration charged or paid); and an explanation of any significant discrepancy between the applicable written agreement(s) and the economic substance of the covered transactions (including payment form) to date and as proposed for the APA.

(10) Representative financial and tax data of the parties to the proposed covered transactions for the last three taxable years (or more years if relevant to the proposed TPM), together with other pertinent data and documents in support of the TPM. This item may include (but need not be limited to) data from the following:

(a) Form 5471 (*Information Return of U.S. Persons With Respect To Certain Foreign Corporations*);

(b) Form 5472 (*Information Return of a 25% Foreign-Owned U.S. Corpo-*

ration or a Foreign Corporation Engaged in a U.S. Trade or Business);

(c) income tax returns;

(d) financial statements;

(e) annual reports to stockholders;

(f) other pertinent U.S. and foreign government filings (for example, customs reports or SEC filings);

(g) existing pricing, distribution, or licensing agreements;

(h) marketing and financial studies;

(i) documentation prepared in consideration of § 6662(e); and

(j) company-wide accounting procedures, budgets, projections, business plans, and worldwide product line or business segment profitability reports.

(11) The functional currency of the parties to the proposed covered transactions and their respective foreign currency exchange risks.

(12) The taxable year of each party to the proposed covered transactions.

(13) A description of significant financial accounting methods employed by the parties that have a bearing on any proposed TPM.

(14) An explanation of any relevant financial and tax accounting differences between the U.S. and the foreign countries.

(15) A discussion of any relevant statutory provisions, tax treaties, court decisions, regulations, revenue rulings, or revenue procedures that relate to the appropriateness of the proposed TPM for the requested APA. For cases in which the taxpayer requests a rollback, the discussion should state whether the period of limitations for the rollback years has expired in the U.S. or in foreign countries, and if not, when the periods of limitations do expire.

(16) (a) A statement describing all previous and current issues at the examination, Appeals, judicial, or competent authority levels that relate to the proposed TPM, including an explanation of the taxpayer's and the government's positions and any resolution of the issues.

(b) If the taxpayer is requesting a rollback that involves any issues relevant to the proposed covered transactions that are unresolved and still under consideration by Appeals, the taxpayer must include with its APA request a waiver of its right to be present during communications between the Appeals Office and the APA Team members (as described in section 6.04). See Rev. Proc. 2000–43, 2000–2 C.B. 404. The following language satisfies this requirement:

> Waiver of *Ex Parte* Communication: [Name of taxpayer(s)] agrees to the participation of the Appeals Office in the consideration of this APA request, and hereby waives its right to be present during, or participate in, communications related to the APA request or the proposed covered transactions between the Appeals Office and the APA Team members.

(17) A statement describing any APAs with, or rulings by, foreign tax authorities relating to the proposed covered transactions (or any pending requests for such APAs or rulings) and, if requested, copies of such APAs or rulings.

(18) An economic analysis or study of the general industry pricing practices and economic functions performed within the markets and geographical areas covered by the APA request.

(19) A list of the taxpayer's competitors and a discussion of any uncontrolled transactions, lines of business or types of businesses comparable or similar to those addressed in the request.

(20) An explanation of the proposed TPMs, including any method used to convert results from one payment form to another (*e.g.*, to convert from a lump sum to a contingent payment such as a sales-based royalty), and an analysis of why each proposed TPM is the best method within the meaning of § 1.482–1(c).

(21) A detailed presentation of the research efforts and criteria used to identify and select possible independent comparables. This presentation should include a list of potential comparables and an explanation of why each was either accepted or rejected. The taxpayer may request an APA even though no comparable uncontrolled prices, transactions, or companies can be identified. In such cases, a taxpayer must demonstrate that the proposed TPM otherwise satisfies the requirements of § 482 and this revenue procedure.

(22) Detailed financial data (and licenses or other agreements, if applicable) on the selected independent comparables in print and electronic formats. For example, if the proposed TPM uses the comparable uncontrolled price (CUP) method, the comparable pricing information should be included; if the TPM uses the comparable uncontrolled transaction (CUT) method, the comparable license agreements should be included; and if the TPM uses the comparable profits method (CPM), the annual and multiple year period results using the selected profit level indicator should be included. If pertinent, the taxpayer should demonstrate consideration of alternative measurements of profitability and return on investment (for example, gross profit margin or markup, ratio of gross income to total operating expenses, net operating profit margin, or return on assets).

(23) A detailed explanation of any adjustments to the selected comparables, such as: accounting for product line segregations; differences in accounting practices; differences relating to functions, assets employed, risks assumed, and costs incurred; volume or scale differences; and differing economic and market conditions.

(24) An illustration of the application of each proposed TPM by applying the TPM, in a consistent format, to the prior three taxable years' financial and tax data of the parties to the covered transactions. If historical data cannot be used to illustrate a TPM (for example, when the TPM applies to a new product or business), the request should include an illustration based on projected or hypothetical data, as well as a description of the source of the data. If coverage of three taxable years is inappropriate for any reason, the taxpayer should provide data for an appropriate period and explain why the period was chosen.

.04 Specific Items for a Cost Sharing Arrangement

In addition to the items in section 4.03, an APA request related to a cost sharing arrangement ("CSA") must include:

(1) A copy of (a) the documents forming or revising the CSA, (b) the documents relevant to the making available of any pre-existing intangible property to the CSA), including the documents relevant to the acquisition or licensing of any pre-existing intangible property that is made available to the CSA, for purposes of research in the intangible development area, and (c) a statement that the CSA conforms to the requirements of § 1.482–7(b).

(2) A specific description of intangible development costs for all participants under the CSA. Such description should include a description of the costs included and excluded (for example, costs of technology acquired from third parties; the treatment of stock-based compensation under the CSA; non-product specific development costs; costs associated with abandoned projects; costs associated with specific stages of product development; relevant labor, material, and overhead costs; and support and administrative costs); a description of any services performed for participants that will be included in intangible development costs (for example, contract research) and how those services would be taken into account; and, for a representative period, a breakdown of total costs incurred, and the costs borne by each participant, according to the CSA.

(3) The basis (as described in § 1.482–7(f)(3)(ii)) used to measure anticipated benefits, the projections used to estimate benefits, and why such basis and projections yield the most reliable estimate of reasonably anticipated benefits.

(4) The method used to calculate each participant's share of intangible development costs; the reason why that method can reasonably be expected to reflect that participant's share of anticipated benefits; and a statement of the circumstances under which the participants' shares of intangible development costs will be adjusted to account for changes in economic conditions, business operations and practices, and the ongoing development of intangibles under the CSA.

(5) The accounting method used to determine the costs and benefits of the intangible development (including the method used to translate foreign currencies).

(6) Each participant's sales, cost of sales, operating expenses, research and development costs, and operating profit (historical for the five most recently completed taxable years and projected for two taxable years) for the product area covered by the CSA.

(7) A description of any amounts to be received from non-participants for the use of covered intangibles (for example, as a royalty pursuant to a license agreement) and how the participants would take into account such amounts.

(8) Representative internal manuals, directives, guidelines, and similar documents prepared for purposes of implementing or operating the CSA (for example, research and development committee meeting minutes, market studies, economic impact analyses, capital expenditure budgets, engineering studies, reports and studies of trends and profitability in the industry, and financial analyses for financing and cash flow purposes).

(9) A description of any prior research undertaken in the intangible development area; the identification of any pre-existing intangible property made available to the CSA; the amount of any buy-in or buy-out payment (as defined in § 1.482–7(g)(2)); a complete economic analysis to support the payment; the form of the payment, the method used to determine the amount of the payment (that is, the method used to value the pre-existing intangible property and to calculate any royalty, lump sum, or installment payments, including, if applicable, any conversion between different payment forms); and an explanation of any discrepancy between the proposed payment form and the payment form established in the documents listed in paragraph (1) above (see section 4.03(9)); and an analysis demonstrating that the method used constitutes the best method under § 1.482–1(c).

(10) The treatment of cost sharing and buy-in or buy-out payments for U.S. income tax purposes (for example, the source and character of those payments).

(11) Evidence of the participants' compliance with the reporting requirements under § 1.482–7(j) of the cost sharing regulations.

(12) For taxpayers requesting an APA that covers a CSA but does not cover the related buy-in transaction, or an APA that covers a buy-in transaction but does not cover the related CSA, the reasons why an APA limited in this manner is consistent with the principles of the APA process, as set forth in this revenue procedure. The APA Program will evaluate the requests to ensure their consistency with the principles of this revenue procedure and sound tax administration. If an APA request is limited to covering only buy-in payments, the APA must include a representation by the taxpayer, as a term and condition of the APA, that the CSA to which the buy-in payments relate meets the § 482 regulatory requirements for CSAs.

.05 Critical Assumptions

The taxpayer should propose and describe any relevant critical assumptions. A critical assumption is any fact the continued existence of which is material to the taxpayer's proposed TPM, whether related to the taxpayer, a third party, an industry, or business and economic conditions. Critical assumptions might include, for example, a particular mode of conducting business operations, a particular corporate or business structure, a range of expected business volume, or the relative value of foreign currencies.

.06 Contents of Annual Report

Section 11.01 provides that the taxpayer must file an annual report for each taxable year covered by the APA. The taxpayer should propose in the request a list of items to be included in each report. Consideration should be given to all items listed in Appendix C to the APA Program's current Model APA.

.07 Term and First Year of APA

(1) The taxpayer must propose a term for the APA appropriate to the industry, products, and transactions involved. Although the appropriate APA term is determined on a case-by-case basis, a request for an APA should propose an APA term of at least five years unless the taxpayer states a compelling reason for a shorter term. Additionally, the APA Program strives to have at least three prospective years remaining in the term upon the execution of an APA (in the case of a unilateral APA) or completion of the APA Program's recommended negotiating position for Competent Authority (in the case of a bilat-

eral or multilateral APA), except in unusual circumstances. Accordingly, taxpayers should anticipate that the APA Program may require their agreement to extend the proposed term of an APA if necessary to ensure such prospectivity.

(2) The taxpayer must file its APA request within the time prescribed by statute (including extensions) for filing its Federal income tax return for the first proposed APA year. If the taxpayer receives an extension to file its Federal income tax return, it must file its APA request no later than the actual filing date of the return. An APA request will be considered filed on the date the required user fee is paid (within the meaning of § 7502(a)), provided that a substantially complete APA request is filed with the APA Program within 120 days of the return due date (including extensions) for the first proposed APA year. Because of the need to begin the processing of the APA request in a manner that ensures appropriate prospectivity, the APA Director will consider extending the 120-day period pursuant to section 2.06 only in unusual circumstances. If the APA Program's evaluation of an APA request is delayed due to a lack of responsiveness or timeliness by the taxpayer subsequent to the filing of its request, the APA Director may deem the taxpayer's APA request to have been filed for purposes of this paragraph on a date subsequent to its actual filing.

.08 Request for Competent Authority Consideration

(1) The taxpayer must state whether any of the parties to the proposed covered transactions are residents of or conduct activities in a treaty partner country or U.S. possession, and whether the taxpayer proposes an agreement among competent authorities (see section 7 for guidelines). For purposes of this revenue procedure, "competent authority" includes the Director, International (LMSB) and designated foreign competent authorities under income tax treaties to which the U.S. is a party, and also includes the Director, International (LMSB) acting as the U.S. Competent Authority with respect to a possession tax agency described in Rev. Proc. 89–8, 1989–1 C.B. 778, as well as a designated possession tax official within the meaning of that revenue procedure.

(2) If the APA request is unilateral and involves transactions with an entity in a treaty jurisdiction, the taxpayer must provide an explanation of why the request is not bilateral. See sections 2.08 and 7.06.

(3) If the taxpayer requests a bilateral or multilateral APA, the taxpayer's request must include the information described in section 4.05(a) and (b) and, in a separate document, section 4.05(n), of Rev. Proc. 2002–52, 2002–2 C.B. 242 (or its successor), or similar information pursuant to a request for relief under Rev. Proc. 89–8. The following wording satisfies section 4.05(n) of Rev. Proc. 2002–52:

[Name of taxpayer(s)] consents to the disclosure to the competent authority of [name of foreign country] and the competent authority's staff of any or all of the items of information set forth or enclosed in the [bilateral/multilateral] APA request for the taxable year(s) _____ [and accompanying rollback request for relief from economic double taxation of income for the taxable years _____], and any further submissions, within the limits contained in the [name of treaty].

.09 Perjury Statement

(1) The taxpayer must include in any APA request and supplemental submission a declaration in the following form:

Under penalties of perjury, I declare that I have examined this [APA request] [supplemental submission relating to this APA request] including accompanying documents, and, to the best of my knowledge and belief, the [APA request] [supplemental submission] contains all the relevant facts relating to the [APA request] [supplemental submission], and such facts are true, correct, and complete.

(2) The declaration must be signed by the person or persons on whose behalf the request is being made and not by the taxpayer's representative. The person signing for a corporate taxpayer must be an authorized officer of the taxpayer who has personal knowledge of the facts, whose duties are not limited to obtaining letter rulings or determination letters from the Service, or negotiating APAs, and who is authorized to sign the taxpayer's income tax return pursuant to § 6062. The person signing for any non-corporate taxpayer must be an individual who has personal knowledge of the facts, and who is authorized to sign in accordance with §§ 6061 or 6063, as applicable.

.10 Signatures

The taxpayer or the taxpayer's authorized representative must sign the APA request. If an authorized representative is to sign, the taxpayer and representative must satisfy the relevant instructions on signatures in Rev. Proc. 2005–1, 2005–1 I.R.B. 1 (or its successor).

.11 Mailing, Deliveries, Copies, and Office Location

(1) User fees (accompanied by an identifying cover letter that includes a justification of the fee amount) must be sent to:

Internal Revenue Service
Attn: CC:PA:LPD:DRU
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

The fee payment may also be hand delivered to the drop box at the 12th Street entrance of 1111 Constitution Avenue, N.W., Washington, DC.

(2) All other communications must be mailed or delivered as follows to (unless arranged otherwise, for example, mailing to the California office):

Office of Associate Chief Counsel
(International)
Advance Pricing Agreement Program
Attn: CC:INTL:APA; MA2–266
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

(3) The taxpayer must provide the original and eight copies of its APA request and any supplemental materials submitted while the request is pending.

(4) The APA Program is located at:

799 9th Street, N.W.
Washington, D.C. 20001

.12 User Fees.

(1) A separate user fee is required for each APA request. For this purpose, an APA request means a substantially complete and timely-filed APA submission, as required by section 4, and includes all such APA submissions filed by the taxpayer within any single sixty-day period. The taxpayer, for purposes of the preceding sentence, includes all members of a

controlled group as defined in Treasury Regulations § 1.482–1(i)(6).

(2) User fees shall be made payable to the United States Treasury.

(3) Except as provided in paragraphs (4), (5), and (7), the user fee for an APA request is $50,000.

(4) Except as provided in paragraph (5), the user fee for an APA renewal request is $35,000. For this purpose, an APA request will be considered an APA renewal request if its subject matter is substantially the same as in a previous APA request by the taxpayer.

(5) The user fee for a small business APA request is $22,500. For this purpose, an APA request will be considered a small business APA request if the taxpayer has gross income of less than $200 million or the aggregate value of the covered transactions does not exceed (i) $50 million annually, and (ii) $10 million annually with respect to covered transactions involving intangible property.

(6) For purposes of paragraph 5, the gross income of a taxpayer includes the gross income of all organizations, trades, or businesses owned or controlled directly or indirectly by the same interests controlling the taxpayer. Gross income must be computed for the last full (12-month) taxable year ending before the date the taxpayer filed the APA request. If the information on the taxpayer's gross income for the last full taxable year is not available, the taxpayer must use its projected gross income for the first twelve months of the APA term.

(7) The user fee to amend an APA request or to amend a completed APA is $10,000. For this purpose, a request to amend will be deemed to occur if a taxpayer requests changes to an APA request or to a completed APA that requires substantial additional work by the APA Team. Generally, no user fee will be imposed if substantial changes are requested by the Service or by a foreign competent authority.

(8) The APA Director may require a corrected user fee after submission of an APA request if the request does not meet the criteria for the user fee amount initially paid by the taxpayer. The taxpayer may either pay the corrected fee and continue the APA process or withdraw the request.

SECTION 5: TAXPAYER DISCLOSURE OBLIGATIONS

.01 Any information submitted by a taxpayer in connection with its APA request must be true, correct, and accurate (see section 4.09). If the APA Program determines that it needs additional information to analyze the APA request, the APA Program may require the taxpayer to provide such information.

.02 A taxpayer has an obligation to update on a timely basis all material facts and information that it submits in connection with its APA request. In addition, while an APA request is pending and after an APA is executed, a taxpayer is under a continuing duty to timely supplement its disclosures if the taxpayer discovers that information that it provided in connection with an APA request was false, incorrect, or incomplete in some material respect. If a taxpayer discovers such an error or omission after the APA is executed, the taxpayer must disclose the error or omission in its next-filed annual report (see section 11.01(1)).

.03 While the APA request is pending, the taxpayer should be prepared to update the financial data for the selected comparables as new or revised data become available.

.04 If a taxable year is completed while the APA request is pending, the taxpayer should be prepared to update its APA submission following the close of the taxable year by demonstrating the application of the proposed TPM to the taxpayer's actual financial results for that year.

.05 Failure by a taxpayer to provide all materials required by this revenue procedure in its APA request (see section 4), or requested by the APA Program while the request is pending, can cause significant delays in case processing and may result in rejection of the APA under section 6.10.

SECTION 6: PROCESSING OF APA REQUESTS

.01 General

The processing of an APA request follows one of two paths, depending on whether the request is for a bilateral or multilateral APA, or for a unilateral APA. The scheduling of due diligence, analysis, discussion, agreement, and drafting is designed to complete the recommended U.S. negotiating position (bilateral or multilateral APA request), or a unilateral APA, within 12 months from the date the full request was filed. The filing of a full APA request includes not only the payment of a user fee, but also the receipt by the APA Program of the materials specified in sections 4.02 through 4.10. Significant analysis of the APA request will not begin until a substantially complete request has been filed.

.02 Initial Contact

After receiving an APA request, a representative of the APA Program will contact the taxpayer or its representative to discuss any preliminary questions the APA Program may have, or to ask for any additional information or documents necessary in order to initiate processing of the request. The taxpayer must supply the additional information and documents, accompanied by the perjury statement described in section 4.09, by the date specified by the APA Program, as extended for good cause.

.03 Designation of Team Leader

Upon the receipt of a substantially complete APA request, the APA Director will designate a Team Leader to oversee the APA Team's activities in processing the request. If a prefiling conference was held with the taxpayer, the Team Leader generally will be designated from among the APA Program staff attending the prefiling conference.

.04 Formation of APA Team

The Team Leader will organize the APA Team, which normally consists of the following personnel: the Team Leader, an APA Program economist and/or a Service Operating Division economist, an LMSB international examiner, a Division Counsel attorney, and, in bilateral or multilateral cases, a competent authority analyst. In appropriate cases, an LMSB international technical advisor, the international examiner's manager, and other Service Operating Division personnel familiar with the taxpayer may serve on the APA Team. If the APA or a rollback of the APA affects taxable years in Appeals, the appropriate Appeals Officer will be invited to participate. The APA Team Leader will assure that copies of the APA request are distributed to all Team members for review.

.05 Function of APA Team

The function of the APA Team is the following: (1) for a bilateral or multilateral APA, to develop, in consultation with the taxpayer and consistent with sound tax administration, a competent authority negotiating position that it can recommend for approval, and (2) for a unilateral APA, to make best efforts, consistent with sound tax administration, to develop an APA that the APA Program can recommend for approval by the Associate Chief Counsel (International). The Service Operating Division field office responsible for the taxpayer's income tax return will be provided an opportunity to review and comment on the recommended U.S. competent authority negotiating position in the case of a bilateral or multilateral APA, and the proposed APA in the case of a unilateral APA.

.06 Due Diligence and Analysis

The APA Team will evaluate the taxpayer's APA request by discussing it with the taxpayer, verifying the data supplied, and requesting additional supporting data if necessary. The evaluation of the request will not constitute an examination or inspection of the taxpayer's books and records under § 7605(b) or other provisions of the Code.

.07 Schedule for Discussion and Drafting

(1) The APA Team will strive to arrange an initial meeting with the taxpayer to take place within 45 days from the assignment of an APA Team Leader (and following receipt of the substantially complete APA request). The function of the initial meeting is to review the taxpayer's facts, to discuss and clarify issues, and to reach agreement on the scope and nature of the APA Team's due diligence.

(2) In connection with the initial meeting, the APA Team and the taxpayer will agree on a Case Plan to which both Service and taxpayer personnel will be expected to adhere. The Case Plan will be signed by both an APA manager and an authorized official of the taxpayer (see section 4.09(2)). The Case Plan may identify issues raised by the APA Team's initial review of the APA request. Firm dates should be agreed upon for resolving all outstanding issues, and case milestones should be cited. Case milestones include: (a) submission of any necessary additional information by the taxpayer; (b) any planned site visits or interviews; (c) evaluation of the information by the Service; (d) meeting dates; and (e) presentation of the competent authority negotiating position or recommended agreement to the APA Director. To minimize delays caused by the need to coordinate different parties' schedules on short notice, the time and place of future meetings required for any steps in the case should be agreed upon at the initial meeting and established in the Case Plan.

(3) The time scheduled for completion of the case milestones will depend to some extent on the scope and complexity of the particular case. In the case of bilateral or multilateral requests, the Service will seek to work with the competent authority of the treaty partner or partners, or the U.S. possession involved to minimize the time needed for competent authority resolution.

(4) Failures by either the taxpayer or the APA Team to meet case milestones will be addressed promptly. The APA Director will assist in remedying any difficulties to ensure a course of action to meet case milestones. Substantial or persistent failure by the taxpayer to comply with the Case Plan may be treated by the APA Program as a withdrawal of the APA request. In this event, if the taxpayer wishes to continue to pursue the APA, the taxpayer must re-file the request and pay a new user fee.

(5) In some circumstances, development of the case will suggest to both the APA Team and the taxpayer that they adjust some milestone dates. To preserve flexibility, the APA Team and the taxpayer may amend the Case Plan by written mutual agreement, consistent with the need to complete the case expeditiously.

(6) If a case is not completed by the date specified in the operative Case Plan, the APA Team Leader and the taxpayer must submit to the APA Director a joint status report (or separate status reports in the event of disagreement) explaining the substantive or procedural matters causing the delay and specifying how the parties propose to resolve the outstanding issues and complete the case within a reasonable time. If the case is not completed by the new target date, APA Program management will hold a status conference. The purpose of the status conference is to reach agreement on how the case will be resolved. The Associate Chief Counsel (International) may participate in this or subsequent conferences if the case is not resolved satisfactorily in a timely manner.

.08 Execution

Signature of an APA by the APA Director and the taxpayer will constitute agreement to the APA. For purposes of executing the APA, each taxpayer that is a member of a consolidated group (as defined in § 1.1502–1) must comply with the provisions of § 1.1502–77. The person signing the APA request on behalf of the taxpayer must satisfy the requirements of section 4.09(2).

.09 Withdrawing the Request

The taxpayer may withdraw the request at any time before the execution of the APA. The user fee generally will not be refunded if the taxpayer withdraws its APA request after the due diligence process has been initiated.

.10 Rejecting the Request

The APA Program may decline either to accept any APA request or to execute any APA after a request has been accepted. If the APA Program declines to execute an APA after the due diligence process has been initiated, the Service normally will retain the user fee, although the fee may be returned if the APA Program determines that such action would be appropriate under the circumstances. If the APA Program proposes to reject an APA request, the taxpayer will be granted one conference of right with the APA Director. Other conferences may be granted at the APA Director's discretion.

SECTION 7: COMPETENT AUTHORITY CONSIDERATION

.01 When any of the parties to a request are entitled to obtain assistance under the mutual agreement provision of a tax treaty between a foreign country and the United States, or under Rev. Proc. 89–8, the competent authorities may enter into agreements concerning the APA. Requests similar to APA requests that are initiated through treaty partners or possession tax agencies and submitted to the U.S. competent authority will be processed under this revenue procedure and Rev. Proc. 2002–52, as appropriate. In order to provide timely clarification of factual issues, minimize the potential for miscommunica-

tion, and assist in development of a multiple party agreement on a timely basis, the Service will generally initiate coordination among the taxpayer, the Service, and the competent authorities of treaty partners at the earliest possible stage of consideration of an APA request, including, where possible, the prefiling stage. In this manner, the U.S. and foreign competent authorities can develop a joint understanding of the case, which should facilitate negotiation and resolution of competent authority issues. The taxpayer should remain available throughout consideration of the request to assist the Service in reaching agreement with the foreign competent authority. Final agreement to the negotiated APA will be sought among the taxpayer, the Service, and the foreign competent authority. As a general matter, the taxpayer should submit APA requests and related correspondence simultaneously to the Service and to foreign competent authorities involved in the requests.

.02 The purpose of a competent authority agreement is to avoid double taxation or taxation not in accordance with the relevant income tax treaty or treaties. If such an agreement is not acceptable to the taxpayer, the taxpayer may withdraw the APA request (see section 6.09). If the competent authorities are unable to reach an agreement, the taxpayer may withdraw its request or, at its discretion, the Service may negotiate and enter into a unilateral APA with the taxpayer (see section 7.06).

.03 The taxpayer must cooperate with the Service and the U.S. competent authority, pursuant to the standards set forth in Rev. Proc. 2002–52 and any other applicable revenue procedures.

.04 Taxpayers have an affirmative obligation to identify relevant concerns that may impact competent authority negotiation of an APA request. For example, it may be necessary for the Service to request sensitive confidential data (including material that may constitute a trade secret), which if disclosed, could harm the taxpayer's competitive position. If the taxpayer identifies such sensitive information, the Service will work with the taxpayer in developing a mechanism to permit consideration or verification by the treaty partner or partners of the information while still preserving its confidentiality.

.05 When the competent authorities enter into an agreement covering an APA, the Service will, to the extent appropriate, agree to a mutual exchange of information with the foreign competent authority concerning any subsequent modifications, cancellation, revocation, requests to renew, evaluation of annual reports, or examination of the taxpayer's compliance with the terms and conditions of the APA. Bilateral APAs may provide for simultaneous filing of the annual report with the Service and with the foreign tax administration.

.06 To minimize taxpayer and governmental uncertainty and administrative cost, bilateral or multilateral APAs are generally preferable to unilateral APAs when competent authority procedures are available with respect to the foreign country or countries involved. In appropriate circumstances, however, the Service may execute an APA with a taxpayer without reaching a competent authority agreement. The taxpayer must show sufficient justification for a unilateral APA. In some circumstances, procedures agreed upon with particular foreign competent authorities, or the requirements of proper relations with treaty partners, may preclude unilateral APAs.

.07 Section 7.05 of Rev. Proc. 2002–52 provides in part that, if a taxpayer reaches a settlement on an issue pursuant to a written agreement, the U.S. competent authority will endeavor only to obtain a correlative adjustment from a treaty country and will not undertake any actions that would otherwise change such agreement. The restrictions imposed under section 7.05 of Rev. Proc. 2002–52 with respect to the discretion of the U.S. competent authority to negotiate correlative relief will not apply to a unilateral APA. However, a unilateral APA may hinder the ability of the U.S. competent authority to reach a mutual agreement that will provide relief from double taxation, particularly when a contemporaneous bilateral or multilateral APA request would have been both effective and practical (within the meaning of § 1.901–2(e)(5)(i)) to obtain consistent treatment of the APA matters in a treaty country. If there is a settlement with respect to taxable years prior to the first year subject to a unilateral APA based on rollback of the APA's TPM (as discussed in sections 2.12 and 8 of this revenue procedure), section 7.05 of Rev. Proc. 2002–52 will apply to the rollback years in the regular manner.

SECTION 8: ROLLBACK OF TPM

.01 Application of the TPM to tax years prior to those covered by the APA ("rollback" of the TPM) may be an effective means of enhancing voluntary compliance and of using available resources to address unresolved transfer pricing issues. The taxpayer may request that the Service consider a rollback (a "rollback request") in connection with a particular APA request. Under regularly applicable procedures, the Service may determine that the same or a similar TPM as that agreed to in an APA should be applied to prior years even in the absence of a rollback request. When applying the TPM to prior years, adjustments may be made to reflect differences in facts, economic conditions, and applicable legal rules. Those adjustments may be made regardless of whether the taxpayer or the Service initiated the rollback request.

.02 The taxpayer may make a rollback request in its APA request or at any time prior to the execution of the APA. The principles set forth in section 2.12 generally will govern the Service's consideration of the request. The balance of prospectivity and retroactivity of the total number of years covered by the proposed overall agreement, and the status of any on-going examination, will also be given consideration in the Service's decision to entertain a rollback request. Rollbacks requested after submission of the APA request must be in writing and addressed to the APA Director.

.03 If a rollback request is submitted in connection with a bilateral or multilateral APA, the rollback request will be deemed to constitute an application for accelerated competent authority consideration as described in section 7.06 of Rev. Proc. 2002–52 (or its successor). The Office of Associate Chief Counsel (International), the Service Operating Division field office involved, and the U.S. Competent Authority will coordinate consideration of the request. The taxpayer's request must include all information required for accelerated competent authority consideration under Rev. Proc. 2002–52 (or its successor), subject to the rules set forth therein. The taxpayer's request can pertain

to any years prior to the first year to be covered under the requested APA. As necessary to reach a competent authority agreement, the Service may require that the rollback be applied to one or more specified years if accelerated competent authority is to be granted. In exercising its discretion over the conduct of accelerated competent authority consideration, the U.S. Competent Authority will seek to implement the policy concerning APA rollbacks stated in section 2.12.

.04 Rollback requests submitted in connection with a bilateral or multilateral APA and involving a taxable year under the jurisdiction of Appeals will be deemed to constitute an application for simultaneous Appeals and competent authority consideration. That application is described in section 8 of Rev. Proc. 2002–52 and is subject to the rules of that section. The Office of Associate Chief Counsel (International), Appeals, and the U.S. Competent Authority will coordinate consideration of the request. In exercising its discretion in a simultaneous Competent Authority-Appeals proceeding, the U.S. Competent Authority will seek to implement the policy concerning APA rollbacks stated in section 2.12. Taxpayers are encouraged to request accelerated competent authority consideration under section 8.03 above, in conjunction with an application for the simultaneous Appeals and competent authority process.

.05 Subject to the policy stated in section 2.12, the Service official with jurisdiction over the taxable year subject to the rollback has discretion as to whether the rollback is applied. That official may be either the Service Operating Division executive responsible for the taxpayer's income tax return, the National Chief of Appeals, the U.S. Competent Authority (for matters subject to competent authority negotiations), or the Division Counsel (for matters pending litigation). Except to the extent inconsistent with this revenue procedure, APA rollbacks will be implemented using regularly applicable procedures for resolving tax issues. Such procedures include but are not limited to closing agreements and other settlement documents and Forms 870 and 870AD.

SECTION 9: SMALL BUSINESS TAXPAYER APAs

.01 Special Provisions Available to Small Business Taxpayers

At the request of a small business taxpayer ("SBT"), the APA Program may apply any or all of the provisions in this section. A SBT is any U.S. taxpayer with total gross income of $200 million or less, as determined under section 4.12(6). In addition, SBT procedures will be available for APAs that cover small transactions described in section 4.12(5). Although transactions involving valuable intangible property or CSAs would not ordinarily be appropriate for these SBT procedures (because of the complexity of valuing such intangibles), the APA Program will consider employing special procedures for such transactions on a case-by-case basis.

.02 PFC Procedures

(1) As set forth in the general rules above, a taxpayer contemplating an APA may request a PFC with the APA Program (see section 3). If a PFC is requested, the APA Program provides informal advice to the taxpayer regarding the taxpayer's proposal, but ordinarily does not begin significant due diligence until the taxpayer formally files an APA request and pays the appropriate user fee (see section 6.01). In the case of an SBT, however, the APA Program will commence its due diligence analysis earlier in the process to accelerate the conclusion of the APA negotiations.

(2) The APA Program and a SBT may hold a PFC to determine as early as possible the best method for the SBT's proposed covered transactions. The APA Program will need a detailed description of the underlying facts and the proposed TPM for the SBT's proposed covered transactions at least 60 days prior to the scheduled conference. The SBT may provide the information it maintains under § 6662(e) to satisfy this requirement. Prior to its prefiling submission, the SBT must consult with the APA Program to determine the information required to evaluate the SBT's covered transactions.

(3) An APA Team will evaluate the APA prefiling information to determine items of concern and the additional documentation needed to evaluate the request. The SBT will be advised of the APA Team's initial conclusions before the PFC so that it can address these items before or at the conference.

(4) At the PFC, the SBT and APA Program will agree on a schedule with the objective of finalizing the recommended negotiating position for a bilateral APA, or concluding a unilateral APA, within six months of the date the SBT files its APA request. The APA Program expects that performing this analysis earlier in the process should result in a reduced number of post-filing meetings and supplemental information requests.

.03 Items Required for an SBT APA Request

Before an SBT submits an APA request, the APA Program and the SBT may agree to reduce or eliminate specific items that would otherwise be required by section 4.

.04 Locale and Number of Meetings for SBT APA Requests

The APA Program will endeavor to hold meetings with the SBT at a location convenient to the SBT. To minimize the number of meetings, teleconferences will be employed whenever feasible.

.05 Assistance in Economic Analysis

At the SBT's request, the APA Program will assist the SBT in the selection and evaluation of comparables, as well as the computation of any appropriate adjustments to comparables.

.06 APA

For unilateral APA requests, a SBT should submit a proposed draft APA in a form substantially similar to the APA Program's current Model APA (see Announcement 2005–27, 2005–16 I.R.B. 918, 950). The electronic component of the APA request should include a "redline" version showing the differences between the Model APA and the SBT's proposed draft APA (see section 4.02(6)).

.07 APA Program's Consideration of Other Alternative Procedures

The APA Program may consider other procedures suggested by the SBT to reduce the SBT's administrative and financial burden, consistent with the objectives of the APA Program and the requirements of § 482.

SECTION 10: LEGAL EFFECT OF THE APA

.01 An APA is a binding agreement between the taxpayer and the Service. See sections 2.01 - 2.04.

.02 If the taxpayer complies with the terms and conditions of the APA, the Service will not contest the application of the TPM to the subject matter of the APA except as provided in this revenue procedure. The taxpayer remains otherwise subject to U.S. income tax laws and applicable income tax conventions.

.03 An APA will have no legal effect except with respect to the taxpayer, taxable years, and transactions to which the APA specifically relates.

.04 Unless provided otherwise by written agreement or regulations, the Service and the taxpayer may not introduce the APA or non-factual oral and written representations made in conjunction with the APA request as evidence in any judicial or administrative proceeding regarding any tax year, transaction, or person not covered by the APA. This paragraph does not preclude the Service and the taxpayer from agreeing to roll back the APA TPM, or the Service's use of any non-factual material otherwise discoverable or obtained other than in the APA process merely because the parties considered the same or similar material in the APA process.

.05 Unless provided otherwise by written agreement or regulations, the Service and the taxpayer may not introduce a proposed, cancelled, or revoked APA, or any non-factual oral or written representations or submissions made during the APA process, as an admission by the other party, in any judicial or administrative proceeding regarding any taxable year of the requested APA term. This paragraph does not preclude the Service's use of any non-factual material otherwise discoverable or obtained other than in the APA process merely because the APA Program and the taxpayer considered the same or similar material in the APA process.

SECTION 11: ADMINISTERING THE APA

.01 Annual Reports

(1) For each taxable year covered by the APA, the taxpayer must file a timely and complete annual report describing its actual operations for the year and demonstrating compliance with the APA's terms and conditions. The report must include all items required by the APA, describe any pending or contemplated requests to renew, modify or cancel the APA, and report any adjustments made pursuant to section 11.02. In addition, the annual report must identify any material information submitted while the APA request was pending that the taxpayer discovers during the taxable year was false, incorrect, or incomplete. See section 5.02.

(2) The taxpayer must file an original and four copies of the annual report by the later of (a) 90 days after the time prescribed by statute (including extensions) for filing its federal income tax return for the year covered by the report, or (b) 90 days after the effective date of the APA. The Service and the taxpayer may agree to alternative filing dates. The taxpayer should file the original annual report and copies with the APA Director in Washington, D.C., as indicated in section 4.11. For bilateral or multilateral APAs, the Service may require the taxpayer to file simultaneously a copy of the annual report with the treaty partner or partners.

(3) The Service Operating Division or the APA Program Office will contact the taxpayer regarding an annual report if it is necessary to clarify or complete the information submitted in the annual report. The taxpayer must supply the additional information by the date specified.

(4) Any contact between the Service Operating Division, or the APA Program Office, and the taxpayer to clarify or complete the information in an annual report is not an examination or the commencement of an examination of the taxpayer for purposes of § 7605(b) or any other Code provision.

(5) If a filed annual report contains incomplete or incorrect information, or reports an incorrect application of the TPM, the taxpayer must amend it within 45 days after becoming aware of the need to amend the report. The time may be extended for good cause.

(6) An annual report must contain the following declaration:

> Under penalties of perjury, I declare that I have examined this annual report including accompanying documents, and, to the best of my knowledge and belief, this annual report contains all the relevant facts relating to the annual reporting requirements pursuant to the APA, and such facts are true, correct, and complete.
>
> [If applicable: An adjustment to conform taxable income and other relevant items to reflect the results reported herein has been reported to the appropriate responsible Service Operating Division personnel.]
>
> [If applicable: An amended income tax return to conform taxable income and other relevant items to reflect the results reported herein [has been] [will be] filed with the appropriate Internal Revenue Service Center.]

(7) The taxpayer must sign the declaration in compliance with sections 4.09 (Perjury Statement) and 4.10 (Signatures).

(8) Failure to file a timely, complete, or accurate annual report may be grounds for canceling or revoking the APA under sections 11.06.

.02 APA Primary Adjustments, Secondary Adjustments, and Revenue Procedure Treatment

(1) APA Primary Adjustments. The APA provides the TPM for determining the proper amount of the taxpayer's gross or net income, deductions, credits, or allowances with respect to the APA's covered transactions. In general, the taxpayer's actual covered transactions during an APA year, as reported in its books and records, should comply with the TPM and be clearly reflected on the taxpayer's timely-filed original return for the year. Under some TPMs, however, the taxpayer may have to wait until the close of the taxable year to determine whether the intercompany prices it actually paid or received complied with the TPM (for example, a comparable profits method providing for a particular operating margin range). If the taxpayer's actual covered transactions do not comply with the TPM, the taxpayer must nonetheless report its taxable income in an amount consistent with the TPM (an "APA primary adjustment") on either a timely-filed original return or an amended return. The generally applicable Code rules, including additions to tax, penalties and interest, apply with respect to an APA primary adjustment. When the taxpayer makes an APA primary adjustment, an appropriate correlative adjustment will also be made with respect to the related foreign

entity affected by the APA primary adjustment. See § 1.482–1(g)(2). To the extent the APA covers years for which federal income tax returns were filed prior to, or no later than 60 days after, the effective date of the APA, the taxpayer must file, unless otherwise agreed to in the APA, an amended return or returns that reflect any required primary adjustment and pay any tax due because of such adjustments, within 120 days of entering into the APA. The generally applicable Code rules will apply with respect to the primary adjustment with respect to the APA years for which federal income tax returns were filed before the APA was executed, except: (a) the computation of any required estimated tax installments for the taxable year will not take into account the primary adjustment and related secondary adjustments (see section 11.02(2)); and (b) the taxpayer will not be subject to the failure to pay penalties under §§ 6651 and 6655, or the failure to make timely deposit of taxes penalty under § 6656, by reason of the primary adjustment and related secondary adjustments.

(2) Secondary Adjustments. Absent an election of the APA revenue procedure treatment described in section 11.02(3), an APA primary adjustment requires a secondary adjustment to conform the taxpayer's accounts. The secondary adjustment may result in additional tax consequences. See § 1.482–1(g)(3).

(3) APA Revenue Procedure Treatment. If a taxpayer makes an APA primary adjustment, the taxpayer and its related foreign entity may elect APA revenue procedure treatment and avoid the possible adverse tax consequences of a secondary adjustment that would otherwise follow the APA primary adjustment. Under APA revenue procedure treatment, consistent with the principles of Rev. Proc. 99–32, 1999–2 C.B. 296, the taxpayer will be permitted to establish an account receivable from, or payable to, its related foreign entity in the amount of the APA primary adjustment as of the last day of the taxable year to which the APA primary adjustment applies. The account will not bear interest and must be paid within 90 days of the later of (a) the date for timely filing (with extensions) of the federal income tax return for the taxable year to which the APA primary adjustment applies, or (b) the APA's effective date. The account must be paid within the 90 day period to receive revenue procedure treatment. Payment must be in the form of money, a written debt obligation payable at a fixed date and bearing interest at an arm's length rate as provided in § 1.482–2(a)(2), or through an accounting entry offsetting such account against an existing *bona fide* debt between the U.S. taxpayer and the related foreign entity. The taxpayer must document the payment or offset of the account, and disclose it in the APA annual report for the year of the payment.

(4) The Service will give effect to an APA primary adjustment, secondary adjustment, and payment under APA revenue procedure treatment, if applicable, for all U.S. income tax purposes. The tax treatment of any such adjustment or payment depends on the facts and circumstances of the adjustment or payment. For example, if a taxpayer's APA primary adjustment involves the reporting of an additional royalty expense for a transaction with a related foreign entity, the Service will deem a payment in the nature of a royalty in the amount of the APA primary adjustment to have been made by the taxpayer to the related foreign entity. This deemed payment may be subject to U.S. withholding tax, and interest would accrue on the tax required to be withheld from the due date of the taxpayer's federal income tax return without regard to extensions. Similarly, a taxpayer's APA revenue procedure treatment may involve the recharacterization of a dividend paid by its foreign subsidiary as a payment of an account receivable established in connection with an APA primary adjustment. Any foreign tax withheld from the payment may be treated as a noncompulsory payment ineligible for the foreign tax credit, unless the taxpayer exhausts all effective and practical remedies, including invocation of competent authority procedures, to obtain consistent treatment that would eliminate the foreign tax liability. See § 1.901–2(e)(5).

(5) If the Service proposes a tax adjustment or the taxpayer files an amended return that does not require an APA primary adjustment, generally applicable Code rules will apply.

(6) If the taxpayer requests a bilateral or multilateral APA, the U.S. Competent Authority will discuss the principles of this section with the appropriate foreign competent authority to seek substantially identical treatment of the taxpayer's related foreign entity.

.03 Examination

(1) With respect to the application of § 482 to the covered transactions, the Service will limit the examination of a taxpayer's income tax return for a tax year covered by an APA to the requirements described in the next paragraph and will not reconsider the TPM.

(2) For the year under examination, the Service may require the taxpayer to establish: (a) compliance with the APA's terms and conditions; (b) validity and accuracy of the annual report's material representations; (c) correctness of the supporting data and computations used to apply the TPM; (d) satisfaction of the critical assumptions; and (e) consistent application of the TPM.

(3) The Service Operating Division must inform the APA Director if the taxpayer has not satisfied any requirement in the prior paragraph. After consulting with the appropriate Service Operating Division personnel, the Associate Chief Counsel (International) may decide to apply the terms of the APA, or revise (see section 11.05), cancel, or revoke (see section 11.06) the APA.

(4) The Service Operating Division may audit and propose adjustments to the taxpayer's operating results as determined under the TPM without affecting the APA's validity or applicability. The taxpayer may agree with the proposed adjustments in the same manner as any other adjustment, and the Service Operating Division will assess any resulting additional tax or refund any resulting overpayment of tax. If the taxpayer does not agree with the proposed adjustment, the taxpayer may contest it through the normal administrative and judicial procedures. The taxpayer must include the audit adjustments as finally determined for the purpose of applying the TPM and, as necessary, make any APA primary, secondary and correlative adjustments under section 11.02. APA revenue procedure treatment under section 11.02(3) is unavailable for audit adjustments.

.04 Record Retention

(1) The taxpayer must maintain books and records sufficient to enable the Service Operating Division to examine whether the taxpayer has complied with the APA.

The taxpayer's compliance with this paragraph fulfills the record-keeping requirements of §§ 6038A and 6038C as applied to the covered transactions.

(2) Upon examination, the Service Operating Division may submit a written request to the taxpayer requiring the submission of requested information or the translation of specific documents within 30 days, as extended for good cause. The fact that a foreign jurisdiction may impose a penalty upon the taxpayer or other person for disclosing the material will not constitute reasonable cause for noncompliance with the Service Operating Division's request.

.05 Revising the APA

(1) An APA may be revised by agreement of the parties, consistent with the principles set forth herein and the interests of sound tax administration. The Associate Chief Counsel (International) may agree to revise an APA in lieu of canceling or revoking it. If the parties agree to revise the APA, the revised APA will indicate its effective date.

(2) If the parties agree to revise a bilateral or multilateral APA, the Team Leader will submit the revised APA to the U.S. Competent Authority to obtain the consent of the foreign competent authority. If the foreign competent authority refuses to accept the revised APA, or if the competent authorities cannot agree on a revised APA acceptable to all parties, the APA Director and the taxpayer may agree to: (a) apply the existing APA, if appropriate; (b) apply the revised APA or agree to further revisions; or (c) request the Associate Chief Counsel (International) to cancel the APA as of an agreed date. If the APA Director and the taxpayer cannot agree on how to proceed, the Associate Chief Counsel (International) will cancel the APA pursuant to section 11.06.

.06 Revoking or Canceling the APA

(1) The Associate Chief Counsel (International) may revoke an APA due to fraud or malfeasance (as defined in § 7121), or disregard (as defined in § 6662(b)(1) and (c)) by the taxpayer in connection with the APA, including, but not limited to, fraud, malfeasance, or disregard involving (a) material facts in the request or subsequent submissions (including an annual report) or (b) lack of good faith compliance with the APA's terms and conditions.

(2) The Associate Chief Counsel (International) may cancel an APA due to the taxpayer's misrepresentation, mistake as to a material fact, failure to state a material fact, failure to file a timely annual report, or lack of good faith compliance with the terms and conditions of the APA.

(3) Unless the parties agree to revise the APA, the Associate Chief Counsel (International) will cancel an APA in the event of a failure of a critical assumption, or a material change in governing case law, statute, regulation, or a treaty (as described in section 11.07).

(4) For purposes of this section 11.06(1) and (2) the Associate Chief Counsel (International) will consider facts as material if, for example, knowledge of the facts could reasonably have resulted in an APA with significantly different terms and conditions. In regard to annual reports, the Associate Chief Counsel (International) will consider facts as material if, for example, knowledge of the facts would have resulted in (a) a materially different allocation of income, deductions, or credits than reported in the annual report, or (b) the failure to meet a critical assumption.

(5) The Associate Chief Counsel (International) may waive cancellation if the taxpayer can satisfactorily show good faith and reasonable cause and agrees to make any adjustment proposed to correct for the misrepresentation, mistake as to a material fact, failure to state a material fact, or noncompliance.

(6) If the Associate Chief Counsel (International) revokes an APA, the revocation relates back to the first day of the APA's first taxable year. The Service may: (a) determine deficiencies in income taxes and additions thereto; (b) deny relief under Rev. Proc. 99–32, 1999–2 C.B. 296; (c) allow the taxpayer relief under Rev. Proc. 99–32, but determine the interest on any account receivable established under Rev. Proc. 99–32, section 4.01, without mutual agreement or correlative relief; (d) revoke the APA as an "egregious case" under Rev. Rul. 80–231, 1980–2 C.B. 219, so as to deny the taxpayer a foreign tax credit; and (e) not make available the unilateral relief provisions of Rev. Proc. 2002–52 (see section 12.07). The Service will seek to coordinate any action concerning revocation of a bilateral or multilateral APA with the foreign competent authority.

(7) If the Associate Chief Counsel (International) cancels an APA, the cancellation normally relates back to the beginning of the year in which the critical assumption failed, or the beginning of the year to which the misrepresentation, mistake as to a material fact, failure to state a material fact, or noncompliance relates. If, however, the cancellation results from a change in case law, statute, regulation, or treaty, the cancellation normally relates back to the beginning of the year that contains the effective date of the change in case law, statute, regulation, or treaty.

(8) As of the effective date of the cancellation, the APA has no further force and effect with respect to the Service and the taxpayer for U.S. income tax purposes. The Service will seek to coordinate any action concerning the cancellation of a bilateral or multilateral APA with the foreign competent authority.

.07 Change in Case Law, Statute, Regulation, or Treaty

If applicable U.S. case law, statutes, regulations, or treaties change the federal income tax treatment of any matter covered by the APA, the new case law, statute, regulation, or treaty provision supersedes inconsistent terms and conditions of the APA.

SECTION 12: RENEWING THE APA

.01 A taxpayer may request renewal of an APA using the procedures for initial APA requests. To expedite the preparation and evaluation of an APA renewal request, however, taxpayers are encouraged to request a prefiling conference to discuss with the APA Program the suitability of streamlined submission requirements. Taxpayers are encouraged to file the renewal request nine months before the expiration of the APA term.

.02 The APA Program will endeavor to expedite the processing of a renewal APA. Expedited processing will be most likely where the taxpayer demonstrates that the following conditions exist: (a) substantially the same law and policy applied to the existing APA; (b) no substantial differences exist between the taxpayer's proposed TPM and the TPM under the existing APA; (c) no material changes occurred

in the taxpayer's facts or circumstances since the parties entered into the existing APA; and (d) for a bilateral APA, a rollback or closed year considerations did not influence the TPM in the existing APA.

.03 If the conditions in the prior paragraph exist, the APA Team begins its evaluation of the renewal APA by considering the continuing applicability of the existing APA, using updated comparables as appropriate. The APA Team will focus on any changed facts and circumstances. While the APA Team will endeavor to streamline the renewal process, certain cases may require additional analysis. That is, experience and insight gained from applying the TPM to actual data (for example, APA annual reports) may provide insight that indicates the need to modify the TPM. The APA Program will use its best efforts to advise the taxpayer at a prefiling conference whether a streamlined APA renewal process will be achievable.

SECTION 13: DISCLOSURE

.01 An APA, any background information related to the APA, and the taxpayer's APA request for that APA, are return information and are confidential. See §§ 6103, 6105, 894, and 7852(d).

.02 An APA, any background information related to the APA, and the taxpayer's APA request, are not "written determinations," and they are not open to public inspection. See § 6110.

.03 The Secretary must prepare an annual report for public disclosure. See § 521(b) of the Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. 106–170, 113 Stat. 1860, 1925. That report includes specifically designated information concerning all APAs, but in a form that does not identify taxpayers or their trade secrets or proprietary or confidential business or financial information.

.04 An APA, any annual reports, and any factual information contained in the background files is subject to exchange of information under income tax treaties or tax information exchange agreements in accordance with the terms of such treaties and agreements (including terms regarding relevancy, confidentiality and the protection of trade secrets). In cases where the exchange of information would be discretionary, information may be exchanged to the extent consistent with sound tax administration and the practices of the relevant foreign competent authority, including where relevant the existence and application by the foreign competent authority of rules similar to those described in sections 10.04 and 10.05.

SECTION 14: EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2004–40, 2004–2 C.B. 50, is superseded.

SECTION 15: EFFECTIVE DATE

This revenue procedure will apply to all APA requests, including requests for renewal, received on or after February 1, 2006. By agreement, this revenue procedure may apply to any APA resulting from an APA request pending on such date.

SECTION 16: PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1503.

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

The collections of information are in sections 3.06, 4, 5, 8.03, 11.01, 11.02(1), 11.04, 11.05 and 12.01. This information is required to provide the Service sufficient information to evaluate and process the APA request or request for renewal of an existing APA, or to determine whether the taxpayer is in compliance with the terms and conditions of an APA. This information will be used to evaluate the proposed TPM, and the taxpayer's compliance with the terms and conditions of any APA to which it is a party. The collections of information are required to obtain an APA. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 8200 hours.

The estimated average burden for an APA prefiling conference is 10 hours; the estimated average burden for an APA request is 50 hours; and the estimated average burden for preparation of an annual report by a party to an APA is 15 hours. The estimated number of respondents and/or recordkeepers is 230.

The estimated annual frequency of responses is one request or report per year per applicant or party to an APA, except that a taxpayer requesting an APA may also request a prefiling conference.

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 § 6103.

DRAFTING INFORMATION

The principal authors of this document are various members of the Advance Pricing Agreement Program of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, please contact Mr. Craig A. Sharon or Mr. Craig R. Gilbert at (202) 435–5220 (not a toll-free number).

26 CFR 301.6109–1: Guidance for qualification as an acceptance agent, and execution of an agreement between an acceptance agent and the Internal Revenue Service (IRS) relating to the issuance of certain taxpayer identifying numbers.

Rev. Proc. 2006–10

TABLE OF CONTENTS

SECTION 1. PURPOSE

This revenue procedure describes the application procedures for becoming an acceptance agent and the requisite agreement that an acceptance agent must execute with the IRS. Persons may wish to become an acceptance agent for purposes of facilitating the issuance of (1) IRS individual taxpayer identification numbers (ITINs) to alien individuals who are ineligible to obtain social security numbers (SSNs), or (2) employer identification numbers (EINs) to other foreign persons who need an EIN for Federal tax purposes. This revenue procedure supersedes Rev. Proc. 96–52, 1996–2 C.B. 372.

The four major changes to the revenue procedure for becoming an acceptance agent are as follows:

.01 Acceptance agent applicants may be required to submit to suitability checks, as explained in section 6 of this revenue procedure.

.02 An acceptance agent agreement entered into after the publication of this revenue procedure will expire on December 31 of the fourth full calendar year after the year in which the agreement goes into effect, as explained in section 7.02(8)(a) of this revenue procedure. Accordingly, acceptance agents will have to periodically reapply to retain their acceptance agent status.

.03 Existing acceptance agent agreements in effect on the date of publication of this revenue procedure will expire on December 31, 2006, as explained in section 8 of this revenue procedure. Acceptance agents subject to those expiring agreements must reapply to retain their acceptance agent status.

.04 Acceptance agents may request to be included on a public list of acceptance agents published periodically by the IRS, as explained in section 4.02(3)(b)(vii) of this revenue procedure.

SECTION 2. BACKGROUND

.01 Section 301.6109–1(d)(3) of the Procedure and Administration Regulations provides general procedures for an alien individual to obtain an ITIN that require the submission of an application form (Form W–7), together with documentation considered as evidence of the alien individual's identity and alien status. Section 301.6109–1(d)(2) of the regulations provides general procedures for obtaining an EIN that require the submission of an application form (Form SS–4) together with any supplementary statement as may be required. The regulations require that an applicant for an ITIN or an EIN furnish the information required by the form, the accompanying instructions, and any applicable regulations. An applicant for an ITIN or an EIN may submit the application form directly to the IRS or, as provided in §301.6109–1(d)(3)(iv), may apply with the assistance of an acceptance agent.

.02 In Rev. Proc. 96–52, the IRS provided guidance regarding the qualification requirements for acceptance agents and the execution of an agreement between an acceptance agent and the IRS. Acceptance agents facilitate and expedite the issuance of ITINs and EINs by verifying the foreign status and identity of the applicants. Since the program's inception, hundreds of acceptance agents have successfully assisted individuals who are ineligible to obtain SSNs to obtain ITINs. The IRS is pleased with the success of the acceptance agent program and values the contributions made by acceptance agents. This revenue procedure modifies screening requirements to ensure that acceptance agents

are adequately qualified to serve ITIN and EIN applicants. Acceptance agent applicants now may be required to undergo a suitability check, which includes a review of their tax filing histories to ensure compliance with their tax obligations and, in some cases, a credit history and FBI background check. The new procedures also call for the acceptance agent agreement to expire at the end of the fourth full calendar year. These new requirements are intended to ensure that ITIN and EIN applicants continue to receive assistance from credible and responsible acceptance agents.

SECTION 3. DEFINITIONS

For purposes of this revenue procedure, the terms listed below are defined as follows.

.01 An *acceptance agent* is a person (*i.e.*, an individual or an entity) who, pursuant to a written agreement with the IRS, is authorized to assist alien individuals and other foreign persons in obtaining ITINs or EINs from the IRS. See section 4.01 of this revenue procedure for the role of an acceptance agent. A person acting in its capacity as an acceptance agent does not act as an agent of the IRS and is not authorized to hold itself out as an agent of the IRS.

.02 A *certifying acceptance agent* is a person (*i.e.*, an individual or an entity) who, pursuant to a written agreement with the IRS, is authorized to assist alien individuals and other foreign persons in obtaining ITINs from the IRS and who also assumes a greater responsibility than an acceptance agent in facilitating the application process for obtaining ITINs. The certifying acceptance agent process does not apply to obtaining EINs. See section 5.01 of this revenue procedure for the role of a certifying acceptance agent. A person acting in its capacity as a certifying acceptance agent does not act as an agent of the IRS and is not authorized to hold itself out as an agent of the IRS.

.03 An *alien individual* is an individual who is not a citizen or a national of the United States (U.S.).

.04 A *foreign person* is a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust, a foreign estate, or any other person that is not a U.S. person.

.05 *Alien status* refers to an individual's status as a non-U.S. citizen or non-U.S. national.

.06 *Identity* refers to the fact of being the same individual as is represented, claimed, or described.

.07 *TIN* (taxpayer identifying number) refers to both ITINs and EINs.

.08 *Form W–7* refers to IRS Form W–7, *Application for IRS Individual Taxpayer Identification Number*, including the Spanish-language version, IRS Form W–7(SP).

.09 *Form SS–4* refers to IRS Form SS–4, *Application for Employer Identification Number*.

SECTION 4. ACCEPTANCE AGENT

.01 *Role of acceptance agent*. The role of an acceptance agent is to facilitate the application process for the issuance of TINs to alien individuals and other foreign persons who need TINs for Federal tax purposes. An acceptance agent facilitates the ITIN application process by forwarding the completed Form W–7 (together with the required documentary evidence) to the IRS at the address listed in the Form W–7 instructions. An acceptance agent facilitates the EIN application process by submitting to the IRS a Form SS–4 (together with any supplementary statement if required) by following one of the procedures described in the Form SS–4 instructions.

.02 *Application process for acceptance agent*.

(1) *Eligible persons*. Persons eligible to become acceptance agents include a financial institution defined in section 265(b)(5) of the Internal Revenue Code (Code) or §1.165–12(c)(1)(iv) of the regulations, a college or university that is an educational organization defined in §1.501(c)(3)–1(d)(3)(i), a federal agency defined in section 6402(g) of the Code, persons that provide assistance to taxpayers in the preparation of their tax returns, and any other person or categories of persons that may be authorized by regulations or IRS procedures. An eligible person may be a U.S. person or a foreign person.

(2) *Pre-application conference*. Prior to submitting a formal application, a person interested in becoming an acceptance agent may, but is not required to, request a telephone or in-person conference with the IRS to explore informally the benefits and burdens associated with the role of an acceptance agent. Requests for pre-application conferences should be directed to the Commissioner of the Wage and Investment Division at (404) 338–8963 (not a toll-free number).

(3) *Written application*.

(a) *Where to apply*. A person may apply to become an acceptance agent by submitting a written request to:

Internal Revenue Service
Mail Stop 983
Andover, MA 05501

(b) *Content of application*. The application shall indicate that the person is requesting permission to execute an agreement with the IRS pursuant to §301.6109–1(d)(3)(iv) of the regulations, and in accordance with this revenue procedure. The application shall include the following information:

(i) The applicant's complete legal name, street address, city, state, country, zip code, EIN, and SSN or ITIN if an individual, and Electronic Filing Identification Number (EFIN), if available. All acceptance agents must have EINs. Therefore, if the applicant does not have an EIN, the applicant must obtain an EIN by following one of the procedures described in the Form SS–4 instructions;

(ii) A description of the type of person(s) the applicant expects to help obtain a TIN (*e.g.*, visiting professors, nonresident gaming winners, etc.) and the approximate number of persons the applicant expects to help during each calendar year;

(iii) A description of the applicant, including the professional status of the applicant (*e.g.*, financial institution, educational organization, federal agency, tax preparer, attorney, certified public accountant (CPA), etc.), the organizational status of the applicant (*e.g.*, corporation, partnership, sole proprietorship, etc.) and if the applicant is an entity, the state, including the District of Columbia (or if outside the United States, the country) under whose laws the entity is created or organized;

(iv) A list of the offices or branches, if any, intended to be covered by the agreement and their locations, including mailing addresses;

(v) A description of the business relationship the applicant has with the per-

sons whom it expects to assist in obtaining TINs;

(vi) The name, telephone number, fax number, and e-mail address of an individual the IRS can contact regarding the application; and

(vii) If the applicant assists with the preparation of tax returns, the applicant may request to be included on a public list of acceptance agents published periodically by the IRS.

(c) *Standard application form*. Application should be made on Form 13551 (revised), *Application to Participate in the IRS Acceptance Agent Program*.

(4) *IRS review of application*.

(a) *Request for additional information*. Upon review of the application, the IRS may request additional information.

(b) *Determination and notification of status*. The IRS will determine whether the applicant qualifies to become an acceptance agent and will notify the applicant in writing of this determination upon completion of a suitability check as described in section 6 of this revenue procedure. If the applicant is approved as an acceptance agent, the IRS will provide written instructions to the applicant regarding the procedures for entering into the acceptance agent agreement with the IRS.

SECTION 5. CERTIFYING ACCEPTANCE AGENT

.01 *Role of a certifying acceptance agent*. A certifying acceptance agent is a person that is authorized under an agreement with the IRS to submit a Form W–7 to the IRS on behalf of an ITIN applicant without furnishing supporting documentary evidence. Instead, when a certifying acceptance agent submits a Form W–7 to the IRS, it certifies to the IRS that it has reviewed the appropriate documentation evidencing the ITIN applicant's identity and alien status, and that it is maintaining a record of such documentation. In addition, the certifying acceptance agent must certify that, to the best of its knowledge and belief, the documentation is authentic, complete, and accurate. As part of the certification, the certifying acceptance agent must describe the documentation upon which it is relying. The certification is not binding on the IRS, and, in appropriate cases, the IRS may request to see appropriate documentation before issuing an ITIN.

.02 *Application process for certifying acceptance agent*.

(1) *Written application*. IRS permission to act as a certifying acceptance agent is conditioned upon the acceptance agent's agreeing to verify documentation supporting the identity and alien status of an ITIN applicant, maintain certain records, and submit certain information to the IRS upon request. As a result, in addition to the information required to be submitted with an application to become an acceptance agent as outlined in section 4.02(3) of this revenue procedure, an applicant also must state that it is applying for certifying acceptance agent status.

(2) *Pre-application conference*. Prior to submitting a formal application, a person interested in becoming a certifying acceptance agent may, but is not required to, request a telephone or in-person conference with the IRS. Such a conference provides an opportunity to address such matters as the scope of the agreement, corresponding obligations for the applicant that arise under the agreement, and the nature of documentation, record maintenance, and verification procedures that arise under the agreement. Requests for pre-application conferences should be directed to the Commissioner of the Wage and Investment Division at (404) 338–8963 (not a toll-free number).

.03 *Agreement*. The terms of a certifying acceptance agent agreement may vary from case to case depending upon such factors as local laws and practices, know-your-customer procedures, supervisory controls, and the types of internal controls and recordkeeping procedures in effect in the normal course of the business of the certifying acceptance agent. Generally, the certifying acceptance agent agreement will contain the terms and conditions necessary to insure proper administration of the process, described in section 7.02 of this revenue procedure, by which the IRS issues ITINs to alien individuals. The following terms for certifying acceptance agents are in addition to those outlined in section 7 of this revenue procedure for all acceptance agents.

(1) *Procedures for collecting, reviewing, and maintaining a record of required documentation for assignment of an ITIN*. A certifying acceptance agent agreement will describe the procedures by which the certifying acceptance agent will verify the identity and alien status of ITIN applicants and submit a certification to the IRS. To the extent possible, procedures already in place to identify persons for local regulatory purposes or as part of the certifying acceptance agent's normal course of business will be used to support the representations made by the applicant regarding these matters. To the extent applicable, a certifying acceptance agent may use documentation evidencing citizenship, nationality, residency, or immigration status to support its determination of the alien status of ITIN applicants. The reliability of any documentation should be evaluated by the certifying acceptance agent on the basis of the type of information stated on the document, the source of the document, and the ease with which the document could be counterfeited. If the IRS determines that these requirements or practices are not sufficient, it may require that additional procedures and documentation be established.

The certifying acceptance agent will agree to maintain a record of the documentation obtained and reviewed pursuant to the obligations set forth in the agreement. All documentation submitted with respect to an ITIN applicant shall be maintained for a reasonable period, as prescribed in the agreement.

(2) *Procedures for IRS compliance checks of certifications*. A certifying acceptance agent must also agree to furnish supporting documentary evidence to the IRS upon request in such manner as the IRS and the certifying acceptance agent will establish. In order to conduct periodic compliance checks, the IRS may rely on sampling techniques and/or verification by random selection with ITIN recipients to assure reliability of the certifying acceptance agent's certifications while limiting the disruption and burden to the acceptance agent. The certifying acceptance agent agreement will specify the manner in which IRS compliance checks will take place (*i.e.*, either on site or through correspondence). Where the certifying acceptance agent resides outside of the United States, in appropriate cases, assistance may be obtained from the tax authorities of the country where the acceptance agent resides.

SECTION 6. SUITABILITY CHECK

In general, applicants for approval as an acceptance agent or certifying acceptance agent must pass a suitability background check before being admitted into the acceptance agent program.

.01 *Suitability Background Check*.

(1) *In general*. Acceptance agent and certifying acceptance agent applicants will be subject to an IRS review of the applicant's tax filing history to determine if the applicant is in full compliance with filing and payment responsibilities under the Internal Revenue Code and its regulations.

(2) *Additional requirements*.

(a) The acceptance agent or certifying acceptance agent applicant or the applicant's representative who has the authority to sign the acceptance agent or certifying acceptance agent agreement, if applicable, will be subject to the following requirements:

(i) A credit history check; and

(ii) An FBI background check.

(b) Any individual who is authorized to practice before the IRS under Circular 230 and provides evidence of current professional status will not be subject to the requirements under section 6.01(2)(a)(i) or (ii) for purposes of becoming an acceptance agent or certifying acceptance agent.

.02 *Exceptions*.

(1) Financial institutions, as defined in section 265(b)(5) of the code or §1.165–12(c)(1)(iv) of the Income Tax Regulations, colleges and universities that qualify as educational organizations under §1.501(c)(3)–1(d)(3)(i), and casinos will not be subject to the requirements under section 6.01 of this revenue procedure, but the IRS may consider the tax filing history of the entity in evaluating an application from such entity;

(2) Applicants who have passed the suitability check for Electronic Return Originator (ERO) status and who remain in good standing with the IRS will not be subject to the requirements under section 6.01 of this revenue procedure; and

(3) Federal agencies, as defined in section 6402(g) of the Code, will not be subject to the requirements under section 6.01 of this revenue procedure.

SECTION 7. ACCEPTANCE AGENT AGREEMENT

.01 *In general*. An acceptance agent agreement described in §301.6109–1(d)(3)(iv)(A) of the regulations is an agreement between the IRS and a person authorized to act as an acceptance agent on behalf of an alien individual or other foreign person with respect to their need to obtain TINs from the IRS. The Commissioner of the Wage and Investment Division or his/her designee will sign the agreement on behalf of the IRS. If the acceptance agent is a person other than an individual, the agreement must be signed by an authorized representative of the acceptance agent.

.02 *Terms and procedures*. The terms of an acceptance agent agreement may vary depending upon such factors as the professional status of the applicant (*e.g.*, financial institution, educational organization, U.S. federal agency, tax preparer, attorney, CPA, etc.), the organizational status of the applicant (*e.g.*, corporation, partnership, sole proprietorship, etc.), and the place of residence or organization of the applicant (*i.e.*, inside or outside the United States). The acceptance agent agreement will generally contain the following terms and conditions to ensure proper administration of the process by which the IRS issues TINs to alien individuals and other foreign persons.

(1) *Procedures for providing TIN application forms*. An acceptance agent shall agree to maintain a supply of Forms W–7 for obtaining ITINs, and of Forms SS–4 for obtaining EINs. The acceptance agent may use a substitute form that is approved by the IRS. For example, if the acceptance agent is a financial institution, the Form W–7 or Form SS–4 may be incorporated as part of an account opening package. See Rev. Proc. 2004–62, 2004–2 C.B. 730, for the procedures governing the use of substitute forms.

(2) *Procedures for assisting in completion of TIN application forms*. An acceptance agent shall agree to assist in the preparation of the TIN application form. For example, the acceptance agent should confirm that every item included on the application form has been completed and should assist the TIN applicant in understanding the information required by the application form. The acceptance agent should contact the IRS for assistance regarding any questions about the forms, application process, the requirement to have TINs, etc., that it cannot reasonably answer. Questions regarding such matters should be directed to the Commissioner of the Wage and Investment Division at (404) 338–8963 (not a toll-free number).

(3) *Procedures for IRS communication with acceptance agent.* The ITIN applicant's signature on the Form W–7 authorizes the acceptance agent to communicate with the IRS regarding only the ITIN applicant's application. The acceptance agent may act as an agent for the ITIN applicant with regard to any additional communication with the IRS that is necessary for completion of the application form. However, an EIN applicant must complete and execute Form 2848, *Power of Attorney and Declaration of Representative*, to authorize an acceptance agent to communicate with the IRS on the applicant's behalf in connection with a completed Form SS–4 application.

(4) *Procedures for submitting TIN application forms*. An acceptance agent shall agree to submit promptly the TIN application forms or approved substitute forms (together with the required documentation for ITINs or the supplementary statement, if required, for EINs) to the IRS at the mailing address specified in the agreement.

(5) *Procedures for collecting and reviewing required documentation for assignment of an ITIN*. A Form W–7 must be accompanied by documentary evidence of the ITIN applicant's alien status and identity. The types of acceptable documentary evidence may vary depending upon such factors as the ITIN applicant's country of citizenship or nationality, the ITIN applicant's residency at the time of the application (*i.e.*, inside or outside the United States), etc. The acceptance agent must review the ITIN applicant's documentation in order to determine whether the documentation is of a type which the IRS regards as reliable evidence of alien status and identity. Examples of acceptable documentary evidence are provided in the Form W–7 instructions. Generally, ITIN applicants must submit the required documentation during a personal interview with the acceptance agent. The agreement generally will require that original (or certified copies of the original) documentation be submitted to the IRS with Form

W–7. All valid original documents will be returned to the acceptance agent. Copies of original documents, if allowed to be submitted under the acceptance agent agreement, will not be returned to the acceptance agent.

(6) *Procedures for assisting taxpayers with notification procedures in the event of a change of alien status*. When an acceptance agent knows that an individual assigned an ITIN has become eligible to obtain (or has, in fact, obtained) a SSN, such acceptance agent shall agree to inform the individual of the obligation to (1) apply for a SSN, (2) stop using the previously-assigned ITIN upon receipt of the new SSN, and (3) notify the IRS of this change in alien status. The acceptance agent's duty with respect to this matter shall apply only to situations in which the acceptance agent has a continuing business relationship with the individual. An alien individual may become eligible to obtain a SSN if, for example, such individual has become a U.S. citizen or a permanent U.S. resident (*i.e.*, "green card" holder), or is lawfully permitted to work in the United States.

(7) *Procedures for IRS verification of compliance with acceptance agent agreement*. The acceptance agent agreement will specify the procedures by which the IRS will verify the acceptance agent's compliance with the agreement. In particular, the procedures must enable the IRS to verify that the acceptance agent has adequate procedures in effect to assist applicants properly. The procedures also must enable the IRS to verify that the acceptance agent is complying with any record retention requirements relating to the issuance of TINs. Verification of compliance with the acceptance agent agreement does not constitute an examination of the books and records of the acceptance agent.

(8) *Procedures regarding expiration and termination of acceptance agent agreement*.

(a) *Expiration*. An acceptance agent agreement shall be in effect on the date the agreement is signed by an authorized representative of the IRS and shall expire on December 31 of the fourth full calendar year after the year in which the agreement became effective. Acceptance agents subject to expiring agreements who wish to retain their acceptance agent status must enter into new acceptance agent agreements pursuant to the procedures set forth in this revenue procedure. In order to avoid a lapse in acceptance agent status, a new application should be filed with the IRS at least six months prior to the expiration of an acceptance agent agreement.

(b) *Termination*. In general, either the acceptance agent or the IRS may terminate the agreement after delivery of a notice of termination to the other party. The decision to terminate an agreement is solely within the discretion of the party giving such notice. However, the IRS generally will not terminate an agreement unless the acceptance agent knowingly fails to comply with procedures required by the agreement or to perform any duty or obligation required in the agreement (including failing to exercise due diligence under the agreement) and such failure constitutes material non-compliance. In addition, the IRS may terminate an agreement if the acceptance agent has misrepresented material information provided on its acceptance agent application or on a TIN application. Further, the IRS may terminate an agreement if the acceptance agent accepts a TIN application with knowledge that material information on the form is false. The acceptance agent may request that the IRS reinstate the acceptance agent agreement by submitting, within 30 days of termination, a written explanation to the ITIN Program Office, 401 West Peachtree Street, Atlanta, GA 30308, of how the acceptance agent proposes to correct the violation and, if appropriate, of how it proposes to modify its procedures to ensure that such a violation will not occur in the future. The IRS shall accept or reject the request, or make a counterproposal, within 30 days of receipt of the request. This decision is not subject to appeal.

SECTION 8. EXPIRATION OF EXISTING ACCEPTANCE AGENT AGREEMENTS

Acceptance agent agreements and certifying acceptance agent agreements that are in effect on the date of the publication of this revenue procedure will expire on December 31, 2006. Acceptance agents and certifying acceptance agents subject to expiring agreements who wish to retain their acceptance agent status must enter into new acceptance agent agreements pursuant to the procedures set forth in this revenue procedure. To avoid a lapse in acceptance agent status, a new application should be filed with the IRS by June 30, 2006.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective on the date of publication.

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Rul. 96–52 is superseded.

SECTION 11. 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 1545–1499.

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

The collection of information contained in this revenue procedure is in section 4.02(3), section 5.02(1), and section 7.02(6). This information is required to assist the IRS in issuing TINs to certain alien individuals and foreign persons. In addition, this information will be used to enable the IRS to determine whether persons qualify as acceptance agents. The collection of information is required to obtain an acceptance agent agreement. The likely respondents are state or local governments, business or other for-profit institutions, federal agencies, and nonprofit institutions.

The estimated total annual reporting/recordkeeping burden is 24,960 hours.

The estimated average annual burden per respondent/recordkeeper is 3 hours, 12 minutes. The estimated number of respondents/recordkeepers is 8,000.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return

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

SECTION 12. DRAFTING INFORMATION

The principal author of this revenue procedure is Ethan A. Atticks of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact the Commissioner of the Wage and Investment Division at (404) 338–8963 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations, Notice of Proposed Rulemaking, and Notice of Public Hearing

Guidance on Passive Foreign Investment Company (PFIC) Purging Elections

REG–133446–03

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9232) that provide certain elections for taxpayers, who in limited circumstances, continue to be subject to the excess distribution regime of section 1291 even though the foreign corporation in which they own stock is no longer treated as a PFIC under section 1297(e). The regulations are necessary to provide guidance about purging the PFIC taint for such foreign corporations. The regulations will affect U.S. persons that hold stock in a PFIC. The text of those temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by March 8, 2006. Outlines of topics to be discussed at the public hearing scheduled for March 22, 2006, at 10 a.m. must be received by March 1, 2006.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–133446–03), room 5203, Internal Revenue Building, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–133446–03), Courier's Desk, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC, electronically via the IRS Internet site at *www.irs.gov/regs* or via the Federal Rulemaking Portal at *http://www.regulations.gov* (IRS REG–133446–03). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Ethan Atticks at (202) 622–3840, concerning submissions and the hearing, LaNita Van Dyke (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by February 6, 2006. Comments are specifically requested concerning:

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

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

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

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

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

The collection of information in these proposed regulations is in §1.1297–3(c)(5)(ii). This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income, gain or loss from that taxpayer's interest in the foreign corporation. The collections of information are mandatory. The respondents are shareholders of PFICs.

Estimated total annual reporting burden: 250 hours.

The estimated annual burden per respondent is 1 hour.

Estimated number of respondents: 250.

The estimated annual frequency of responses: one time.

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

Temporary regulations in this issue of the Bulletin provide certain elections for taxpayers that continue to be subject to the excess distribution regime of section 1291 even though the foreign corporation in which they own stock is no longer treated as a PFIC under section 1297(e) or section 1298(b)(1). The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and these proposed regulations.

Special Analyses

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

Comments and Public Hearing

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

A public hearing is scheduled for March 22, 2006, beginning at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the entrance more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to this hearing. Persons who wish to present oral comments must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by March 1, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of this regulation is Ethan Atticks, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. In §1.1291–9, paragraph (j)(2)(v) is revised to read as follows:

§1.1291–9 Deemed dividend election.

* * * * *

(j) * * *

(2) * * *

(v) [The text of the proposed amendment to §1.1291–9(j)(2)(v) is the same as the text for §1.1291–9T(j)(2)(v) published elsewhere in this issue of the Bulletin.]

* * * * *

Par. 3. Section 1.1297–0 is revised to read as follows:

§1.1297–0 Table of contents.

[The text of proposed §1.1297–0 is the same as the text of §1.1297–0T published elsewhere in this issue of the Bulletin.]

Par. 4. Section 1.1297–3 is added to read as follows:

§1.1297–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a section 1297(e) PFIC.

[The text of proposed §1.1297–3 is the same as the text of §1.1297–3T published elsewhere in this issue of the Bulletin.]

Par. 5. Section 1.1298–0 is revised to read as follows:

§1.1298–0 Table of contents.

[The text of proposed §1.1298–0 is the same as the text of §1.1298–0T published elsewhere in this issue of the Bulletin].

Par. 6. In §1.1298–3, paragraphs (e) and (f) are revised to read as follows:

§1.1298–3 Deemed sale or deemed dividend election by a U.S. person that is a shareholder of a former PFIC.

* * * * *

(e) [The text of the proposed revision to §1.1298–3(e) is the same as the text of §1.1298–3T(e) published elsewhere in this issue of the Bulletin].

(f) [The text of the proposed revision to §1.1298–3(f) is the same as the text of §1.1298–3T(f) published elsewhere in this issue of the Bulletin].

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

(Filed by the Office of the Federal Register on December 7, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 8, 2005, 70 F.R. 72952)

Low-Income Housing Credit Information for Housing Credit Agencies and Building Owners

Announcement 2006–2

This announcement is to advise housing credit agencies and building owners of changes reflected in the December 2005 revision of Form 8609, *Low-Income Housing Credit Allocation and Certification*, and to inform claimers of the low-income housing credit of new Form 8609–A, *Annual Statement for Low-Income Housing Credit*.

Form 8609—Housing Credit Agencies

Generally, the December 2005 revision of Form 8609 is to be used for allocations made in 2005 or later. In the case of carryover allocations, the December 2005 revision of Form 8609 is to be used for buildings placed in service in 2005 or later. In the case of buildings financed with tax-exempt bonds, the December 2005 revision of Form 8609 is to be used for bonds issued or buildings placed in service in 2005

or later. However, if for 2005 the housing credit agency used the November 2003 revision of Form 8609, the housing credit agency does not have to issue an amended Form 8609.

Form 8609—Building Owners

With the December 2005 revision, Form 8609 is no longer attached to the building owner's tax return for each year of the 15-year compliance period. Instead, the building owner will make a one-time submission of the appropriate revision of Form 8609 to the Low-Income Housing Credit Unit at the IRS Philadelphia campus. This one-time submission must take place by the due date (including extensions) of the first tax return with which the building owner is filing Form 8609–A. This one-time submission must be made even if the building owner has filed Form 8609 with a prior tax return.

The procedures are explained in detail on the December 2005 revision of Form 8609. Follow the submission instructions set forth in the December 2005 revision that correspond with the revision date found on the Form 8609 that the housing credit agency sent to you. The December 2005 revision of Form 8609 (including instructions) can be found at *www.irs.gov*.

Although a housing credit agency may have used the November 2003 revision of Form 8609 for 2005, the building owner still must follow the submission procedures detailed in the instructions on the December 2005 revision.

Form 8609–A

For tax years beginning after 2004, Form 8609–A replaces Schedule A (Form 8609), *Annual Statement*. Please see Form 8609–A for detailed instructions on completing and filing the form.

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.

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2005–27 through 2005–52 is in Internal Revenue Bulletin 2005–52, dated December 27, 2005.

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[1] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2005–27 through 2005–52 is in Internal Revenue Bulletin 2005–52, dated December 27, 2005.