Internal Revenue bulletin

Bulletin No. 2006-4
January 23, 2006

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 9234, page 329.

Final regulations under section 141 of the Code provide rules in regulations section 1.141–13 for the application of the private activity bond tests to bonds issued to refund prior bonds. Section 1.141–13 was previously reserved when the comprehensive private activity bonds were released in 1997. The regulations will generally be effective on the date they are published in the Federal Register.

T.D. 9235, page 338.

Final and temporary regulations under section 7701 of the Code make additions to the list of foreign business entities that are always classified as corporations, *per se* corporations, and, therefore, are not eligible to check the box to change their classification.

REG–107722–00, page 354.

Proposed regulations under section 6655 of the Code provide guidance to corporations on the requirements to make estimated tax payments and withdraw proposed regulations under section 6655 that the Service issued in 1984. These regulations reflect changes to the law since 1984 and address abuses that are inherent in the current regulations. A public hearing is scheduled for March 15, 2006.

Notice 2006–1, page 347.

Information reporting by organizations that receive contributions of qualified vehicles. This notice provides guidance to donee organizations that receive contributions of qualified vehicles on their reporting obligations under section 170(f)(12)(D) of the Code. It instructs the donee organization on how, where, and when to report to the IRS the information contained in the contemporaneous written acknowledgment that the donee organization provides to the donor. Notice 2005–44 supplemented.

Rev. Proc. 2006–14, page 350.

Use of replacement cost method to value parts inventory of heavy equipment dealers. Heavy equipment dealers may approximate the cost of their heavy equipment parts inventory using the safe harbor replacement cost method described in this revenue procedure. Procedures are provided for heavy equipment dealers to obtain the automatic consent of the Commissioner to change to this replacement cost method of accounting. Rev. Proc. 2002–9 modified and amplified. Rev. Proc. 2002–17 modified.

EXEMPT ORGANIZATIONS

Notice 2006–1, page 347.

Information reporting by organizations that receive contributions of qualified vehicles. This notice provides guidance to donee organizations that receive contributions of qualified vehicles on their reporting obligations under section 170(f)(12)(D) of the Code. It instructs the donee organization on how, where, and when to report to the IRS the information contained in the contemporaneous written acknowledgment that the donee organization provides to the donor. Notice 2005–44 supplemented.

Announcement 2006–5, page 378.

A list is provided of organizations now classified as private foundations.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

TAX CONVENTIONS

Announcement 2006–6, page 340.

This document announces the memorandum of understanding (MOU) signed by the U.S. and Japanese Competent Authorities concerning the meaning of the term "investment bank" under Article 11(3)(c)(i) of the U.S.–Japan income tax treaty.

Announcement 2006–7, page 342.

This document announces the memorandum of understanding (MOU) signed by the U.S. and Canadian Competent Authorities concerning the principles, guidelines, and procedures to resolve disagreements about underlying facts and circumstances in cases that are referred to them under the mutual agreement procedure (MAP) article of the U.S.–Canada income tax treaty.

Announcement 2006–8, page 344.

This document announces the mutual agreement between the U.S. and Mexican Competent Authorities that specifies the case in which fiscally transparent entities are entitled to treaty benefits and clarifies the procedures for claiming those benefits under the U.S.–Mexico income tax treaty.

ADMINISTRATIVE

T.D. 9235, page 338.

Final and temporary regulations under section 7701 of the Code make additions to the list of foreign business entities that are always classified as corporations, *per se* corporations, and, therefore, are not eligible to check the box to change their classification.

Notice 2006–5, page 348.

This notice provides information to payees/filers who receive payments of interest on qualified education loans who are unable to comply with the reporting requirements for loan origination fees and capitalized interest under section 6050S of the Code and the regulations for calendar year 2005 returns. The notice explains that a payee/filer who is unable to comply with the reporting requirements for loan origination fees and capitalized interest may request that the Service waive, upon a showing of reasonable cause under section 6724 and the regulations, any penalty that might otherwise be imposed under sections 6721 or 6722 for failure to report these amounts.

Rev. Proc. 2006–14, page 350.

Use of replacement cost method to value parts inventory of heavy equipment dealers. Heavy equipment dealers may approximate the cost of their heavy equipment parts inventory using the safe harbor replacement cost method described in this revenue procedure. Procedures are provided for heavy equipment dealers to obtain the automatic consent of the Commissioner to change to this replacement cost method of accounting. Rev. Proc. 2002–9 modified and amplified. Rev. Proc. 2002–17 modified.

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 141.—Private Activity Bond; Qualified Bond

26 CFR 1.141–13: Refunding issues.

T.D. 9234

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Obligations of States and Political Subdivisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations on the definition of private activity bond applicable to tax-exempt bonds issued by State and local governments. These regulations affect issuers of tax-exempt bonds and provide needed guidance for applying the private activity bond restrictions to refunding issues.

DATES: *Effective Date:* These regulations are effective February 17, 2006.

Applicability Date: For dates of applicability, see §1.141–15(j) of these regulations.

FOR FURTHER INFORMATION CONTACT: Johanna Som de Cerff, (202) 622–3980 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR part 1) under section 141 of the Internal Revenue Code (Code) by providing rules on the application of the private activity bond tests to refunding issues. This document also amends the Income Tax Regulations under sections 145, 149 and 150 by providing rules on certain related matters.

On May 14, 2003, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–113007–99, 2003–1 C.B. 1004 [68 FR 25845]) (the proposed regulations) relating to the matters addressed in this Treasury decision. A public hearing on the proposed regulations was scheduled for September 9, 2003. However, the public hearing was cancelled because no requests to speak were received. Written comments on the proposed regulations were received. After consideration of all the written comments, the proposed regulations are adopted as revised by this Treasury decision (the final regulations). The revisions are discussed below.

Explanation of Provisions

A. *Introduction*

In general, under section 103, gross income does not include the interest on any State or local bond. However, this exclusion does not apply to private activity bonds (other than certain qualified bonds). Section 141(a) defines a private activity bond as any bond issued as part of an issue that meets either (1) the private business use test in section 141(b)(1) and the private security or payment test in section 141(b)(2) (the private business tests) or (2) the private loan financing test in section 141(c) (the private business tests and the private loan financing test are referred to collectively as the "private activity bond tests").

The private business use test is met if more than 10 percent of the proceeds of an issue are to be used for any private business use. Section 141(b)(6) defines private business use as use directly or indirectly in a trade or business that is carried on by any person other than a governmental unit.

The private security or payment test is met if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of an issue is directly or indirectly (1) secured by an interest in property used or to be used for a private business use, (2) secured by an interest in payments in respect of such property, or (3) to be derived from payments, whether or not to the issuer, in respect of property, or borrowed money, used or to be used for a private business use.

The private loan financing test is satisfied if more than the lesser of $5 million or 5 percent of the proceeds of an issue are to be used to make or finance loans to persons other than governmental units.

On January 16, 1997, final regulations (T.D. 8712, 1997–1 C.B. 15) relating to the definition of private activity bonds and related rules under sections 103, 141, 142, 144, 145, 147, 148, and 150 were published in the **Federal Register** (62 FR 2275) (the 1997 regulations). Under the 1997 regulations, the amount of private business use of property financed by an issue is equal to the average percentage of private business use of that property during a defined measurement period. The measurement period begins on the later of the issue date of the issue or the date that the property is placed in service and ends on the earlier of the last date of the reasonably expected economic life of the property or the latest maturity date of any bond of the issue financing the property (determined without regard to any optional redemption dates). In general, under the 1997 regulations, the amount of private security or private payments is determined by comparing the present value of the private security or private payments to the present value of the debt service to be paid over the term of the issue, using the bond yield as the discount rate. The 1997 regulations reserve §1.141–13 for rules regarding the application of the private business tests and the private loan financing test to refunding issues.

B. *Application of Private Activity Bond Tests to Refunding Issues*

1. *In general*

The proposed regulations provide that, in general, a refunding issue and a prior issue are tested separately under section 141. Thus, the determination of whether a refunding issue consists of private activity bonds generally does not depend on whether the prior issue consists of private activity bonds.

Commentators supported this separate testing principle. The final regulations retain this approach.

2. *Allocation of proceeds*

The proposed regulations provide that, in applying the private business tests and the private loan financing test to a refunding issue, the proceeds of the refunding issue are allocated to the same purpose investments (including any private loan under section 141(c)) and expenditures as the proceeds of the prior issue.

Comments were not received on this allocation provision. The final regulations retain this rule.

3. *Measurement of private business use*

The proposed regulations generally provide that the amount of private business use of a refunding issue is determined based on the separate measurement period for the refunding issue under §1.141–3(g) (for example, without regard to any private business use that occurred before the issue date of the refunding issue). Thus, for instance, if an issuer refunds a taxable bond or an exempt facility bond, any private business use of the refinanced facilities before the issue date of the refunding issue is disregarded in applying the private business use test to the refunding issue.

In the case of a refunding issue that refunds a prior issue of governmental bonds, however, the amount of private business use is generally determined based on a combined measurement period. For purposes of the proposed regulations, a governmental bond is any bond that, when issued, purported to be either a governmental bond, as defined in §1.150–1(b), or a qualified 501(c)(3) bond, as defined in section 145(a). The combined measurement period is the period that begins on the first day of the measurement period (as defined in §1.141–3(g)) for the prior issue (or the first issue of governmental bonds in the case of a series of refundings of governmental bonds) and ends on the last day of the measurement period for the refunding issue.

As an alternative to the combined measurement period approach, the proposed regulations permit issuers to measure private business use based on the separate measurement period of the refunding issue, but only if the prior issue of governmental bonds does not meet the private business use test during a shortened measurement period. The shortened measurement period begins on the first day of the measurement period of the prior issue (or the first issue of governmental bonds in the case of a series of refundings of governmental bonds) and ends on the issue date of the refunding issue. Whether a prior issue meets the private business use test during the shortened measurement period is determined based on the actual use of proceeds, without regard to the reasonable expectations test of §1.141–2(d).

Commentators suggested that the proposed regulations be modified with respect to governmental bonds: (1) to delete the shortened measurement period concept; (2) to provide, absent any evidence to the contrary, and subject to general anti-abuse rules, a presumption that an issuer did not exceed the ten percent private business use limit; and (3) to specify that the amount of private business use of the refunding issue is the amount of private business use during either the separate measurement period for the refunding issue or the combined measurement period.

These commentators suggested that a separate measurement period approach would not allow an issuer to increase the amount of private business use without jeopardizing the tax exemption of the prior issue, and thus an issuer generally should be permitted to measure private business use of a refunding issue using a separate measurement period. Nevertheless, these commentators suggested that the regulations include a general anti-abuse rule. They noted, for example, that a separate measurement period approach could permit an issuer to have an additional ten percent of private business use in connection with a refunding issue after the period of limitations for the prior bonds has run. These commentators suggested that, in such a situation, it would be fair to consider the refunding issue to be an abuse if the issuer is deliberately trying to exploit the private business use limit.

The final regulations retain the basic approach of the proposed regulations to measuring private business use. The final regulations do not adopt the suggestions to delete the shortened measurement period concept and to provide that private business use may be measured during either a separate or combined measurement period. These suggestions are not adopted because they could result in more private business use than otherwise would be permitted after the expiration of the period of limitations for the prior issue.

The final regulations do not adopt the suggestion to create a presumption that the private business use limit was not exceeded with respect to prior bonds. It is not clear such a presumption is warranted in all cases.

The final regulations also do not adopt the suggestion to add an anti-abuse rule. The IRS and Treasury Department have concluded that the bright-line rule in the proposed regulations for determining when issuers must apply a combined measurement period and when issuers may apply either a combined measurement period or a separate measurement period is an appropriate methodology for measuring the private business use of a refunding issue and provides more administrative certainty than would be provided by an anti-abuse rule.

Commentators expressed concern regarding an issuer's ability to establish the amount of private business use during a combined measurement period if the period begins a significant amount of time before the refunding bonds are issued. They noted that, in some cases, the refunded bonds may have been issued as many as twenty years or more before the refunding bonds are issued. These commentators stated that document retention policies vary by issuer and retaining or locating the necessary information over such long periods of time may be difficult.

The final regulations apply prospectively and only to refunding bonds that are subject to the 1997 regulations. In general, under §1.141–15, the 1997 regulations apply to refunding bonds only if, among other requirements, (1) the refunded bonds were originally issued on or after May 16, 1997, (2) the weighted average maturity of the refunding bonds is longer than the weighted average maturity of the refunded bonds, or (3) the issuer chooses to apply the 1997 regulations to the refunding bonds. Thus, the final regulations will not apply to any refunding of bonds originally issued before May 16, 1997, unless the issuer extends the weighted average maturity of the prior bonds or otherwise chooses to have the 1997 regulations apply to the refunding bonds (or an earlier issue of bonds).

In addition, to address commentators' concerns, the final regulations provide

transitional relief for refundings of bonds originally issued before May 16, 1997 (the effective date of the 1997 regulations). Specifically, the final regulations provide that, if the prior issue (or, in the case of a series of refundings of governmental bonds, the first issue of governmental bonds in the series) was issued before May 16, 1997, then the issuer, at its option, may treat the combined measurement period as beginning on the date (the transition date) that is the earlier of (1) December 19, 2005, or (2) the first date on which the prior issue (or an earlier issue in the case of a series of refundings of governmental bonds) became subject to the 1997 regulations. This transitional relief, which was not contained in the proposed regulations, has been added to the final regulations in response to concerns expressed by commentators regarding an issuer's ability to establish the amount of private business use during a combined measurement period if the period begins a significant amount of time before the refunding bonds are issued.

Some commentators requested guidance on how the private business tests apply to the shortened and combined measurement periods for refundings of bonds originally issued before the effective date of the Tax Reform Act of 1986, 100 Stat. 2085 (the 1986 Act), if the refunding does not qualify for transitional relief under the 1986 Act or prior law. Specifically, commentators requested guidance on whether (1) the ten-percent private business use limitation under the 1986 Act or (2) the applicable private business use limitation under prior law (for example, the 25-percent limitation under the Internal Revenue Code of 1954) applies in the case of a non-transitioned refunding of a bond issued under law in effect prior to the 1986 Act. The final regulations clarify in an example that the 1986 Act limitations apply to the shortened and combined measurement periods. The issuer, however, may treat these periods as beginning on the transition date described above.

4. *Measurement of private security and private payments*

Under the proposed regulations, if the amount of private business use is determined based on the separate measurement period for the refunding issue, then the amount of private security and private payments allocable to the refunding issue is determined under §1.141–4 by treating the refunding issue as a separate issue. On the other hand, if the amount of private business use is determined based on a combined measurement period, then the amount of private security and private payments allocable to the refunding issue is determined under §1.141–4 by treating the refunding issue and all earlier issues taken into account in determining the combined measurement period as a combined issue. The proposed regulations contain specific rules for determining the present value of the debt service on, and the private security and private payments allocable to, a combined issue.

Commentators requested clarification regarding how the private security or payment test applies under the combined issue methodology in the case of a refunding of only a portion of the original principal amount of a prior issue. The final regulations clarify that, in these circumstances, (1) the refunded portion of the prior issue is treated as a separate issue and (2) any private security or private payments with respect to the prior issue are allocated ratably between the combined issue and the unrefunded portion of the prior issue in a consistent manner based on relative debt service.

The proposed regulations also permit an issuer to use the yield on a prior issue of governmental bonds to determine the present value of private security or private payments under arrangements that were not entered into in contemplation of the refunding issue. For this purpose, any arrangement that was entered into more than one year before the issue date of the refunding issue will be treated as not entered into in contemplation of the refunding issue.

Comments were not received on this special rule for arrangements not entered into in contemplation of the refunding issue. The final regulations retain this provision.

5. *Multipurpose issue allocations*

Section 1.148–9(h) permits an issuer to use a reasonable, consistently applied allocation method to treat the portion of a multipurpose issue allocable to a separate purpose as a separate issue for certain of the arbitrage provisions of section 148. Section 1.141–13(d) of the proposed regulations allows an issuer to apply §1.148–9(h) to a multipurpose issue for certain purposes under section 141. An allocation will not be reasonable for this purpose if it achieves more favorable results under section 141 than could be achieved with actual separate issues. In addition, allocations under the proposed regulations and §1.148–9(h) must be consistent for purposes of sections 141 and 148. The proposed regulations do not permit allocations for purposes of section 141(c)(1) (relating to the private loan financing test) or section 141(d)(1) (relating to certain restrictions on acquiring nongovernmental output property).

Commentators supported the multipurpose allocation provisions in the proposed regulations. The final regulations retain those provisions. Commentators also requested clarification that an allocation under §1.141–13(d) may be made at any time. The final regulations provide that an allocation under §1.141–13(d) may be made at any time, but once made may not be changed. The final regulations also provide that the issue to be allocated and each of the separate issues under the allocation must consist of one or more tax-exempt bonds. Thus, an allocation of a multipurpose issue into two or more separate issues is not permitted under §1.141–13(d) if, at the time of the allocation, the issue to be allocated or any of the separate issues under the allocation consists of taxable private activity bonds.

6. *Application of reasonable expectations test to certain refunding bonds*

Section 1.141–2(d) provides that an issue consists of private activity bonds if the issuer (1) reasonably expects, as of the issue date, that the issue will meet either the private business tests or the private loan financing test, or (2) takes a deliberate action, subsequent to the issue date, that causes the conditions of either the private business tests or the private loan financing test to be satisfied. Section 1.141–2(d)(3) provides, in general, that a deliberate action is any action taken by the issuer that is within its control.

The proposed regulations provide that an action that would otherwise cause a refunding issue to satisfy the private busi-

ness tests or the private loan financing test is not taken into account under the reasonable expectations test of §1.141–2(d) if (1) the action is not a deliberate action within the meaning of §1.141–2(d)(3), and (2) the weighted average maturity of the refunding bonds is not greater than the remaining weighted average maturity of the prior bonds.

Commentators suggested that the limitation on the weighted average maturity of the refunding bonds to the remaining weighted average maturity of the prior bonds could penalize issuers for issuing shorter-term obligations initially, or provide an incentive to issue longer-term obligations initially. These commentators requested that the weighted average maturity of the refunding bonds be limited only to 120 percent of the weighted average reasonably expected economic life of the property financed by the prior bonds. The final regulations amend this provision to provide that the weighted average maturity of the refunding bonds may not exceed the weighted average reasonably expected economic life of the property financed by the prior bonds.

Commentators also requested that an example illustrating this provision be added to the regulations. The final regulations add such an example.

7. *Refundings of certain general obligation bonds*

Section 1.141–2(d)(5) provides that the determination of whether bonds of an issue are private activity bonds may be based solely on the issuer's reasonable expectations as of the issue date (and not on whether there are any subsequent deliberate actions) if, among other requirements, the issue is an issue of general obligation bonds of a general purpose governmental unit that finances at least 25 separate purposes.

Commentators suggested that a refunding issue should not consist of private activity bonds if the prior issue meets the requirements of §1.141–2(d)(5). The final regulations adopt this comment.

C. *Treatment of Issuance Costs Financed by Prior Issue of Qualified 501(c)(3) Bonds*

Under the 1997 regulations, the use of proceeds of an issue of qualified 501(c)(3) bonds to pay issuance costs of the issue is treated as a private business use. The proposed regulations provide that, solely for purposes of applying the private business use test to a refunding issue, the use of proceeds of the prior issue (or any earlier issue in a series of refundings) to pay issuance costs of the prior issue (or the earlier issue) is treated as a government use.

Comments were not received on this provision. The final regulations retain this rule.

D. *Limitation on Advance Refundings of Private Activity Bonds*

Under section 149(d)(2), interest on a bond is not excluded from gross income if any portion of the issue of which the bond is a part is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond). The proposed regulations provide that, for purposes of section 149(d)(2), the term private activity bond includes a qualified bond described in section 141(e) (other than a qualified 501(c)(3) bond), regardless of whether the refunding issue consists of private activity bonds under the proposed regulations. The proposed regulations also provide that, for purposes of section 149(d)(2), the term private activity bond does not include a taxable bond. Section 1.150–1(b) defines *taxable bond* as any obligation the interest on which is not excludable from gross income under section 103.

Commentators recommended that the regulations be modified to permit a tax-exempt private activity bond to be advance refunded by a governmental bond if the nongovernmental entity's participation in the financing has been terminated and the only beneficiary of the financing is the governmental unit. Based on the plain language of section 149(d)(2) and the policies underlying that Code provision, the final regulations do not adopt this comment.

Effective Date

The final regulations apply to bonds that are (1) sold on or after February 17, 2006, and (2) subject to the 1997 regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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.

Drafting Information

The principal authors of these regulations are Johanna Som de Cerff and Laura W. Lederman, Office of Chief Counsel (Tax-Exempt and Government Entities), Internal Revenue Service and Stephen J. Watson, Office of Tax Legislative Counsel, Department of the Treasury. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.141–0 is amended by adding entries to the table in numerical order for §§1.141–13 and 1.141–15(j) to read as follows:

§1.141–0 Table of contents

* * * * *

§1.141–13 Refunding issues.

(a) In general.

(b) Application of private business use test and private loan financing test.

(1) Allocation of proceeds.

(2) Determination of amount of private business use.

(c) Application of private security or payment test.

(1) Separate issue treatment.

(2) Combined issue treatment.

(3) Special rule for arrangements not entered into in contemplation of the refunding issue.

(d) Multipurpose issue allocations.

(1) In general.

(2) Exceptions.

(e) Application of reasonable expectations test to certain refunding bonds.

(f) Special rule for refundings of certain general obligation bonds.

(g) Examples.

* * * * *

§1.141–15 Effective dates.

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(j) Effective dates for certain regulations relating to refundings.

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Par. 3. In §1.141–1, paragraph (b) is amended by revising the definition of governmental bond to read as follows:

§1.141–1 Definitions and rules of general application.

* * * * *

(b) * * *

Governmental bond has the same meaning as in §1.150–1(b), except that, for purposes of §1.141–13, governmental bond is defined in §1.141–13(b)(2)(iv).

* * * * *

Par. 4. Section 1.141–13 is added to read as follows:

§1.141–13 Refunding issues

(a) *In general*. Except as provided in this section, a refunding issue and a prior issue are tested separately under section 141. Thus, the determination of whether a refunding issue consists of private activity bonds generally does not depend on whether the prior issue consists of private activity bonds.

(b) *Application of private business use test and private loan financing test*—(1) *Allocation of proceeds*. In applying the private business use test and the private loan financing test to a refunding issue, the proceeds of the refunding issue are allocated to the same expenditures and purpose investments as the proceeds of the prior issue.

(2) *Determination of amount of private business use*—(i) *In general*. Except as provided in paragraph (b)(2)(ii) of this section, the amount of private business use of a refunding issue is determined under §1.141–3(g), based on the measurement period for that issue (for example, without regard to any private business use that occurred prior to the issue date of the refunding issue).

(ii) *Refundings of governmental bonds*. In applying the private business use test to a refunding issue that refunds a prior issue of governmental bonds, the amount of private business use of the refunding issue is the amount of private business use—

(A) During the combined measurement period; or

(B) At the option of the issuer, during the period described in paragraph (b)(2)(i) of this section, but only if, without regard to the reasonable expectations test of §1.141–2(d), the prior issue does not satisfy the private business use test, based on a measurement period that begins on the first day of the combined measurement period and ends on the issue date of the refunding issue.

(iii) *Combined measurement period*—(A) *In general*. Except as provided in paragraph (b)(2)(iii)(B) of this section, the *combined measurement period* is the period that begins on the first day of the measurement period (as defined in §1.141–3(g)) for the prior issue (or, in the case of a series of refundings of governmental bonds, the first issue of governmental bonds in the series) and ends on the last day of the measurement period for the refunding issue.

(B) *Transition rule for refundings of bonds originally issued before May 16, 1997*. If the prior issue (or, in the case of a series of refundings of governmental bonds, the first issue of governmental bonds in the series) was issued before May 16, 1997, then the issuer, at its option, may treat the combined measurement period as beginning on the date (the transition date) that is the earlier of December 19, 2005, or the first date on which the prior issue (or an earlier issue in the case of a series of refundings of governmental bonds) became subject to the 1997 regulations (as defined in §1.141–15(b)). If the issuer treats the combined measurement period as beginning on the transition date in accordance with this paragraph (b)(2)(iii)(B), then paragraph (c)(2) of this section shall be applied by treating the transition date as the issue date of the earliest issue, by treating the bonds as reissued on the transition date at an issue price equal to the value of the bonds (as determined under § 1.148–4(e)) on that date, and by disregarding any private security or private payments before the transition date.

(iv) *Governmental bond*. For purposes of this section, the term *governmental bond* means any bond that, when issued, purported to be a governmental bond, as defined in §1.150–1(b), or a qualified 501(c)(3) bond, as defined in section 145(a).

(v) *Special rule for refundings of qualified 501(c)(3) bonds with governmental bonds*. For purposes of applying this paragraph (b)(2) to a refunding issue that refunds a qualified 501(c)(3) bond, any use of the property refinanced by the refunding issue before the issue date of the refunding issue by a 501(c)(3) organization with respect to its activities that do not constitute an unrelated trade or business under section 513(a) is treated as government use.

(c) *Application of private security or payment test*—(1) *Separate issue treatment*. If the amount of private business use of a refunding issue is determined based on the measurement period for that issue in accordance with paragraph (b)(2)(i) or (b)(2)(ii)(B) of this section, then the amount of private security and private payments allocable to the refunding issue is determined under §1.141–4 by treating the refunding issue as a separate issue.

(2) *Combined issue treatment*. If the amount of private business use of a refunding issue is determined based on the combined measurement period for that issue in accordance with paragraph (b)(2)(ii)(A) of this section, then the amount of private security and private payments allocable to the refunding issue is determined under §1.141–4 by treating the refunding issue and all earlier issues taken into account in determining the combined measurement period as a combined issue. For this purpose, the present value of the private security and private payments is compared to the present value of the debt service on the combined issue (other than debt service paid with proceeds of any refunding bond). Present values are computed as of the issue date of the earliest issue taken into account in determining the combined measurement period (the earliest issue). Except as provided in paragraph (c)(3) of this section, present values are determined by using the yield on the combined issue as

the discount rate. The yield on the combined issue is determined by taking into account payments on the refunding issue and all earlier issues taken into account in determining the combined measurement period (other than payments made with proceeds of any refunding bond), and based on the issue price of the earliest issue. In the case of a refunding of only a portion of the original principal amount of a prior issue, the refunded portion of the prior issue is treated as a separate issue and any private security or private payments with respect to the prior issue are allocated ratably between the combined issue and the unrefunded portion of the prior issue in a consistent manner based on relative debt service. See paragraph (b)(2)(iii)(B) of this section for special rules relating to certain refundings of governmental bonds originally issued before May 16, 1997.

(3) *Special rule for arrangements not entered into in contemplation of the refunding issue*. In applying the private security or payment test to a refunding issue that refunds a prior issue of governmental bonds, the issuer may use the yield on the prior issue to determine the present value of private security and private payments under arrangements that were not entered into in contemplation of the refunding issue. For this purpose, any arrangement that was entered into more than 1 year before the issue date of the refunding issue is treated as not entered into in contemplation of the refunding issue.

(d) *Multipurpose issue allocations*—(1) *In general*. For purposes of section 141, unless the context clearly requires otherwise, §1.148–9(h) applies to allocations of multipurpose issues (as defined in §1.148–1(b)), including allocations involving the refunding purposes of the issue. An allocation under this paragraph (d) may be made at any time, but once made may not be changed. An allocation is not reasonable under this paragraph (d) if it achieves more favorable results under section 141 than could be achieved with actual separate issues. The issue to be allocated and each of the separate issues under the allocation must consist of one or more tax-exempt bonds. Allocations made under this paragraph (d) and §1.148–9(h) must be consistent for purposes of section 141 and section 148.

(2) *Exceptions*. This paragraph (d) does not apply for purposes of sections 141(c)(1) and 141(d)(1).

(e) *Application of reasonable expectations test to certain refunding bonds*. An action that would otherwise cause a refunding issue to satisfy the private business tests or the private loan financing test is not taken into account under the reasonable expectations test of §1.141–2(d) if—

(1) The action is not a deliberate action within the meaning of §1.141–2(d)(3); and

(2) The weighted average maturity of the refunding bonds is not greater than the weighted average reasonably expected economic life of the property financed by the prior bonds.

(f) *Special rule for refundings of certain general obligation bonds*. Notwithstanding any other provision of this section, a refunding issue does not consist of private activity bonds if—

(1) The prior issue meets the requirements of §1.141–2(d)(5) (relating to certain general obligation bond programs that finance a large number of separate purposes); or

(2) The refunded portion of the prior issue is part of a series of refundings of all or a portion of an issue that meets the requirements of §1.141–2(d)(5).

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

Example 1. Measuring private business use. In 2002, Authority A issues tax-exempt bonds that mature in 2032 to acquire an office building. The measurement period for the 2002 bonds under §1.141–3(g) is 30 years. At the time A acquires the building, it enters into a 10-year lease with a nongovernmental person under which the nongovernmental person will use 5 percent of the building in its trade or business during each year of the lease term. In 2007, A issues bonds to refund the 2002 bonds. The 2007 bonds mature on the same date as the 2002 bonds and have a measurement period of 25 years under §1.141–3(g). Under paragraph (b)(2)(ii)(A) of this section, the amount of private business use of the proceeds of the 2007 bonds is 1.67 percent, which equals the amount of private business use during the combined measurement period (5 percent of 1/3rd of the 30-year combined measurement period). In addition, the 2002 bonds do not satisfy the private business use test, based on a measurement period beginning on the first day of the measurement period for the 2002 bonds and ending on the issue date of the 2007 bonds, because only 5 percent of the proceeds of the 2002 bonds are used for a private business use during that period. Thus, under paragraph (b)(2)(ii)(B) of this section, A may treat the amount of private business use of the 2007 bonds as 1 percent (5 percent of 1/5th of the 25-year measurement period for the 2007 bonds). The 2007 bonds do not satisfy the private business use test.

Example 2. Combined issue yield computation. (i) On January 1, 2000, County B issues 20-year bonds to finance the acquisition of a municipal auditorium. The 2000 bonds have a yield of 7.7500 percent, compounded annually, and an issue price and par amount of $100 million. The debt service payments on the 2000 bonds are as follows:

Date	Debt Service
1/1/01	$9,996,470
1/1/02	9,996,470
1/1/03	9,996,470
1/1/04	9,996,470
1/1/05	9,996,470
1/1/06	9,996,470
1/1/07	9,996,470
1/1/08	9,996,470
1/1/09	9,996,470
1/1/10	9,996,470
1/1/11	9,996,470
1/1/12	9,996,470
1/1/13	9,996,470
1/1/14	9,996,470
1/1/15	9,996,470
1/1/16	9,996,470

Date	Debt Service
1/1/17	9,996,470
1/1/18	9,996,470
1/1/19	9,996,470
1/1/20	9,996,470
	$199,929,400

(ii) On January 1, 2005, B issues 15-year bonds to refund all of the outstanding 2000 bonds maturing after January 1, 2005 (in the aggregate principal amount of $86,500,000). The 2005 bonds have a yield of 6.0000 percent, compounded annually, and an issue price and par amount of $89,500,000. The debt service payments on the 2005 bonds are as follows:

Date	Debt Service
1/1/06	$9,215,167
1/1/07	9,215,167
1/1/08	9,215,167
1/1/09	9,215,167
1/1/10	9,215,167
1/1/11	9,215,167
1/1/12	9,215,167
1/1/13	9,215,167
1/1/14	9,215,167
1/1/15	9,215,167
1/1/16	9,215,167
1/1/17	9,215,167
1/1/18	9,215,167
1/1/19	9,215,167
1/1/20	9,215,167
	$138,227,511

(iii) In accordance with §1.141–15(h), B chooses to apply §1.141–13 (together with the other provisions set forth in §1.141–15(h)), to the 2005 bonds. For purposes of determining the amount of private security and private payments with respect to the 2005 bonds, the 2005 bonds and the refunded portion of the 2000 bonds are treated as a combined issue under paragraph (c)(2) of this section. The yield on the combined issue is determined in accordance with §§1.148–4, 1.141–4(b)(2)(iii) and 1.141–13(c)(2). Under this methodology, the yield on the combined issue is 7.1062 percent per year compounded annually, illustrated as follows:

Date	Previous Debt Service on Refunded Portion of Prior Issue	Refunding Debt Service	Total Debt Service	Present Value on 1/1/00
1/1/00				($86,500,000.00)
1/1/01	$6,689,793		$6,689,793	6,245,945.33
1/1/02	6,689,793		6,689,793	5,831,545.62
1/1/03	6,689,793		6,689,793	5,444,640.09
1/1/04	6,689,793		6,689,793	5,083,404.58
1/1/05	6,689,793		6,689,793	4,746,135.95
1/1/06		$9,215,167	9,215,167	6,104,023.84
1/1/07		9,215,167	9,215,167	5,699,040.20
1/1/08		9,215,167	9,215,167	5,320,926.00
1/1/09		9,215,167	9,215,167	4,967,898.55
1/1/10		9,215,167	9,215,167	4,638,293.40
1/1/11		9,215,167	9,215,167	4,330,556.57
1/1/12		9,215,167	9,215,167	4,043,237.15
1/1/13		9,215,167	9,215,167	3,774,980.51
1/1/14		9,215,167	9,215,167	3,524,521.90
1/1/15		9,215,167	9,215,167	3,290,680.46
1/1/16		9,215,167	9,215,167	3,072,353.70
1/1/17		9,215,167	9,215,167	2,868,512.26
1/1/18		9,215,167	9,215,167	2,678,195.09
1/1/19		9,215,167	9,215,167	2,500,504.89

Date	Previous Debt Service on Refunded Portion of Prior Issue	Refunding Debt Service	Total Debt Service	Present Value on 1/1/00
1/1/20		9,215,167	9,215,167	2,334,603.90
	$33,448,965	$138,227,511	$171,676,476	0.00

Example 3. Determination of private payments allocable to combined issue. The facts are the same as in *Example 2*. In addition, on January 1, 2001, B enters into a contract with a nongovernmental person for the use of the auditorium. The contract results in a private payment in the amount of $500,000 on each January 1 beginning on January 1, 2001, and ending on January 1, 2020. Under paragraph (c)(2) of this section, the amount of the private payments allocable to the combined issue is determined by treating the refunded portion of the 2000 bonds ($86,500,000 principal amount) as a separate issue, and by allocating the total private payments ratably between the combined issue and the unrefunded portion of the 2000 bonds ($13,500,000 principal amount) based on relative debt service, as follows:

Date	Private Payments	Debt Service on Unrefunded Portion of Prior Issue	Debt Service on Combined Issue	Percentage of Private Payments Allocable to Combined Issue	Amount of Private Payments Allocable to Combined Issue
1/1/01	$500,000	$3,306,677	$6,689,793	66.92%	$334,608
1/1/02	500,000	3,306,677	6,689,793	66.92	334,608
1/1/03	500,000	3,306,677	6,689,793	66.92	334,608
1/1/04	500,000	3,306,677	6,689,793	66.92	334,608
1/1/05	500,000	3,306,677	6,689,793	66.92	334,608
1/1/06	500,000		9,215,167	100.00	500,000
1/1/07	500,000		9,215,167	100.00	500,000
1/1/08	500,000		9,215,167	100.00	500,000
1/1/09	500,000		9,215,167	100.00	500,000
1/1/10	500,000		9,215,167	100.00	500,000
1/1/11	500,000		9,215,167	100.00	500,000
1/1/12	500,000		9,215,167	100.00	500,000
1/1/13	500,000		9,215,167	100.00	500,000
1/1/14	500,000		9,215,167	100.00	500,000
1/1/15	500,000		9,215,167	100.00	500,000
1/1/16	500,000		9,215,167	100.00	500,000
1/1/17	500,000		9,215,167	100.00	500,000
1/1/18	500,000		9,215,167	100.00	500,000
1/1/19	500,000		9,215,167	100.00	500,000
1/1/20	500,000		9,215,167	100.00	500,000
	$10,000,000	$16,533,385	$171,676,476		$9,173,039

Example 4. Refunding taxable bonds and qualified bonds. (i) In 1999, City C issues taxable bonds to finance the construction of a facility for the furnishing of water. The bonds are secured by revenues from the facility. The facility is managed pursuant to a management contract with a nongovernmental person that gives rise to private business use. In 2007, C terminates the management contract and takes over the operation of the facility. In 2009, C issues bonds to refund the 1999 bonds. On the issue date of the 2009 bonds, C reasonably expects that the facility will not be used for a private business use during the term of the 2009 bonds. In addition, during the term of the 2009 bonds, the facility is not used for a private business use. Under paragraph (b)(2)(i) of this section, the 2009 bonds do not satisfy the private business use test because the amount of private business use is based on the measurement period for those bonds and therefore does not take into account any private business use that occurred pursuant to the management contract.

(ii) The facts are the same as in paragraph (i) of this *Example 4*, except that the 1999 bonds are issued as exempt facility bonds under section 142(a)(4). The 2009 bonds do not satisfy the private business use test.

Example 5. Multipurpose issue. In 2001, State D issues bonds to finance the construction of two office buildings, Building 1 and Building 2. D expends an equal amount of the proceeds on each building. D enters into arrangements that result in 8 percent of Building 1 and 12 percent of Building 2 being used for a private business use during the measurement period under §1.141–3(g). These arrangements result in a total of 10 percent of the proceeds of the 2001 bonds being used for a private business use. In 2006, D purports to allocate, under paragraph (d) of this section, an equal amount of the outstanding 2001 bonds to Building 1 and Building 2. D also enters into another private business use arrangement with respect to Building 1 that results in an additional 2 percent (and a total of 10 percent) of Building 1 being used for a private business use during the measurement period. An allocation is not reasonable under paragraph (d) of this section if it achieves more favorable results under section 141 than could be achieved with actual separate issues. D's allocation is unreasonable because, if permitted, it would result in more than 10 percent of the proceeds of the 2001 bonds being used for a private business use.

Example 6. Non-deliberate action. In 1998, City E issues bonds to finance the purchase of land and construction of a building (the prior bonds). On the issue date of the prior bonds, E reasonably expects that it will be the sole user of the financed property for the entire term of the bonds. In 2003, the federal government acquires the financed property in a condemnation action. In 2006, E issues bonds to refund the prior bonds (the refunding bonds). The weighted average maturity of the refunding bonds is not greater than the reasonably expected economic life of the financed property. In general, under §1.141–2(d) and this section, reasonable expectations must be separately tested on the issue date of a refunding issue. Under paragraph (e) of this section, however, the condemnation action is not taken into account in applying the reasonable expectations test to the refunding bonds because the condemnation action is not a deliberate action within the meaning of §1.141–2(d)(3)

and the weighted average maturity of the refunding bonds is not greater than the weighted average reasonably expected economic life of the property financed by the prior bonds. Thus, the condemnation action does not cause the refunding bonds to be private activity bonds.

Example 7. Non-transitioned refunding of bonds subject to 1954 Code. In 1985, County F issues bonds to finance a court house. The 1985 bonds are subject to the provisions of the Internal Revenue Code of 1954. In 2006, F issues bonds to refund all of the outstanding 1985 bonds. The weighted average maturity of the 2006 bonds is longer than the remaining weighted average maturity of the 1985 bonds. In addition, the 2006 bonds do not satisfy any transitional rule for refundings in the Tax Reform Act of 1986, 100 Stat. 2085 (1986). Section 141 and this section apply to determine whether the 2006 bonds are private activity bonds including whether, for purposes of §1.141–13(b)(2)(ii)(B), the 1985 bonds satisfy the private business use test based on a measurement period that begins on the first day of the combined measurement period for the 2006 bonds and ends on the issue date of the 2006 bonds.

Par. 5. Section 1.141–15 is amended by revising paragraphs (b)(1), (c), (d) and (h) and adding paragraph (j) to read as follows:

§1.141–15 Effective dates.

* * * * *

(b) *Effective dates*—(1) *In general*. Except as otherwise provided in this section, §§1.141–0 through 1.141–6(a), 1.141–9 through 1.141–12, 1.141–14, 1.145–1 through 1.145–2(c), and the definition of bond documents contained in §1.150–1(b) (the 1997 regulations) apply to bonds issued on or after May 16, 1997, that are subject to section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602).

* * * * *

(c) *Refunding bonds*. Except as otherwise provided in this section, the 1997 regulations (defined in paragraph (b)(1) of this section) do not apply to any bonds issued on or after May 16, 1997, to refund a bond to which those regulations do not apply unless—

(1) The refunding bonds are subject to section 1301 of the Tax Reform Act of 1986 (100 Stat. 2602); and

(2)(i) The weighted average maturity of the refunding bonds is longer than—

(A) The weighted average maturity of the refunded bonds; or

(B) In the case of a short-term obligation that the issuer reasonably expects to refund with a long-term financing (such as a bond anticipation note), 120 percent of the weighted average reasonably expected economic life of the facilities financed; or

(ii) A principal purpose for the issuance of the refunding bonds is to make one or more new conduit loans.

(d) *Permissive application of regulations*. Except as provided in paragraph (e) of this section, the 1997 regulations (defined in paragraph (b)(1) of this section) may be applied in whole, but not in part, to actions taken before February 23, 1998, with respect to—

(1) Bonds that are outstanding on May 16, 1997, and subject to section 141; or

(2) Refunding bonds issued on or after May 16, 1997, that are subject to 141.

* * * * *

(h) *Permissive retroactive application*. Except as provided in paragraphs (d), (e) or (i) of this section, §§1.141–1 through 1.141–6(a), 1.141–7 through 1.141–14, 1.145–1 through 1.145–2, 1.149(d)–1(g), 1.150–1(a)(3), the definition of bond documents contained in §1.150–1(b) and §1.150–1(c)(3)(ii) may be applied by issuers in whole, but not in part, to—

(1) Outstanding bonds that are sold before February 17, 2006, and subject to section 141; or

(2) Refunding bonds that are sold on or after February 17, 2006, and subject to section 141.

* * * * *

(j) *Effective dates for certain regulations relating to refundings*. Except as otherwise provided in this section, §§1.141–13, 1.145–2(d), 1.149(d)–1(g), 1.150–1(a)(3) and 1.150–1(c)(3)(ii) apply to bonds that are sold on or after February 17, 2006, and that are subject to the 1997 regulations (defined in paragraph (b)(1) of this section).

Par. 6. Section 1.145–0 is amended by adding an entry to the table in numerical order for §1.145–2(d) to read as follows:

§1.145–0 Table of contents.

* * * * *

§1.145–2 Application of private activity bond regulations

* * * * *

(d) Issuance costs financed by prior issue.

Par. 7. In §1.145–2, paragraph (d) is added to read as follows:

§1.145–2 Application of private activity bond regulations

* * * * *

(d) *Issuance costs financed by prior issue*. Solely for purposes of applying the private business use test to a refunding issue under §1.141–13, the use of proceeds of the prior issue (or any earlier issue in a series of refundings) to pay issuance costs of the prior issue (or the earlier issue) is treated as a government use.

Par. 8. Section 1.149(d)–1 is amended by revising paragraph (g) and adding paragraph (h) to read as follows:

§1.149(d)–1 Limitations on advance refundings

* * * * *

(g) *Limitation on advance refundings of private activity bonds*. Under section 149(d)(2) and this section, interest on a bond is not excluded from gross income if any portion of the issue of which the bond is a part is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond). For this purpose, the term private activity bond—

(1) Includes a qualified bond described in section 141(e) (other than a qualified 501(c)(3) bond), regardless of whether the refunding issue consists of private activity bonds under §1.141–13; and

(2) Does not include a taxable bond.

(h) *Effective dates*—(1) *In general*. Except as provided in this paragraph (h), this section applies to bonds issued after June 30, 1993, to which §§1.148–1 through 1.148–11 apply, including conduit loans that are treated as issued after June 30, 1993, under paragraph (b)(4) of this section. In addition, this section applies to any issue to which the election described in §1.148–11(b)(1) is made.

(2) *Special effective date for paragraph (b)(3)*. Paragraph (b)(3) of this section applies to any advance refunding issue issued after May 28, 1991.

(3) *Special effective date for paragraph (f)(3)*. Paragraph (f)(3) of this section applies to bonds sold on or after July 8, 1997, and to any issue to which the election described in §1.148–11(b)(1) is made. See

§1.148–11A(i) for rules relating to certain bonds sold before July 8, 1997.

(4) *Special effective date for paragraph (g)*. See §1.141–15 for the applicability date of paragraph (g) of this section.

Par. 9. Section 1.150–1 is amended by revising paragraphs (a)(3) and (c)(3)(ii) to read as follows:

§1.150–1 Definitions.

(a) * * *

(3) *Exceptions to general effective date*. See §1.141–15 for the applicability date of the definition of bond documents contained in paragraph (b) of this section and the effective date of paragraph (c)(3)(ii) of this section.

* * * * *

(c) * * *

(3) * * *

(ii) *Exceptions*. This paragraph (c)(3) does not apply for purposes of sections 141, 144(a), 148, 149(d) and 149(g).

* * * * *

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

Approved November 23, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 16, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 19, 2005, 70 F.R. 75028)

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446–1: General rule for methods of accounting.

May heavy equipment dealers approximate the cost of their heavy equipment parts inventory using a replacement cost method? Is so, can heavy equipment dealers obtain the automatic consent of the Commissioner to change to the replacement cost method of accounting? See Rev. Proc. 2006-14, page 350.

Section 471.—General Rule for Inventories

26 CFR 1.471–3: Inventories at cost.

May heavy equipment dealers approximate the cost of their heavy equipment parts inventory using a replacement cost method of accounting? See Rev. Proc. 2006-14, page 350.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481–1: Adjustments in general.

Can heavy equipment dealers obtain the automatic consent of the Commissioner to change to a replacement cost method to approximate the cost of their heavy equipment parts inventory? If so, is the change made with a § 481(a) adjustment? See Rev. Proc. 2006-14, page 350.

Section 6050S.—Returns Relating to Higher Education Tuition and Related Expenses

26 CFR 1.6050S–3: Information reporting for payments of interest on qualified education loans.

A notice provides information to payees/filers who receive payments of interest on qualified education loans who are unable to comply with the reporting requirements for loan origination fees and capitalized interest under section 6050S of the Code and the regulations for calendar year 2005 returns. See Notice 2006-5, page 348.

Section 6724.—Waiver; Definitions and Special Rules

26 CFR 301.6724–1: Reasonable cause.

A notice explains that a payee/filer who is unable to comply with the reporting requirements for loan origination fees and capitalized interest may request that the Service waive, upon a showing of reasonable cause under section 6724 and the regulations, any penalty that might otherwise be imposed under sections 6721 or 6722 for failure to report these amounts. See Notice 2006-5, page 348.

Section 7701.—Definitions

26 CFR 301.7701–2: Business entities; definitions.

T.D. 9235

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Classification of Certain Foreign Entities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to certain business entities included on the list of foreign business entities that are always classified as corporations for Federal tax purposes.

DATES: *Effective Date:* These regulations are effective on December 16, 2005.

Applicability Date: For the dates of applicability of these regulations, see §301.7701–2(e)(4).

FOR FURTHER INFORMATION CONTACT: Ronald M. Gootzeit, (202) 622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On April 14, 2005, the IRS and Treasury Department published in the **Federal Register** temporary regulations (T.D. 9197, 2005–18 I.R.B. 985 [70 FR 19697]) and a notice of proposed rulemaking (REG–148521–04, 2005–18 I.R.B. 995 [70 FR 19722] under section 7701 of the Internal Revenue Code (Code). The regulations added certain foreign business entities to the list of entities in §301.7701–2(b)(8) (the *per se* corporation list) in response to the adoption by the Council of the European Union of a Council Regulation (2157/2001 2001 O.J. (L 294)) permitting a new business entity, the European public limited liability company (Societas Europaea or

SE). Specifically, the temporary and proposed regulations added the SE, Estonian Aktsiaselts, Latvian Akciju Sabiedriba, Lithuanian Akcine Bendroves, Slovenian Delniska Druzba, and Liechtenstein Aktiengesellschaft to the *per se* list of corporations. For further background, see T.D. 9197, 2005–18 I.R.B. 985 [70 FR 19697] and Notice 2004–68, 2004–2 C.B. 706.

Explanation of Provisions

No substantive comments were received regarding the temporary and proposed regulations. Accordingly, these regulations finalize the proposed regulations without modification and revise the temporary regulations to cross reference to the new provisions.

Special Analysis

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

Drafting Information

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

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301 — PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.7701–2 is amended by:

1. Adding six entries in alphabetical order to paragraph (b)(8)(i).
2. Removing paragraph (b)(8)(vi).
3. Adding paragraphs (e)(3) and (4).

The additions read as follows:

§301.7701–2 Business entities; definitions.

* * * * *

(b) * * *

(8) * * *

(i) * * *

Estonia, Aktsiaselts

European Economic Area/European Union, Societas Europaea

* * * * *

Latvia, Akciju Sabiedriba

* * * * *

Liechtenstein, Aktiengesellschaft

Lithuania, Akcine Bendroves

* * * * *

Slovenia, Delniska Druzba.

* * * * *

(e) * * *

(3) [Reserved]. For further guidance, see §301.7701–2T(f).

(4) The reference to the Estonian, Latvian, Liechtenstein, Lithuanian, and Slovenian entities in paragraph (b)(8)(i) of this section applies to such entities formed on or after October 7, 2004, and to any such entity formed before such date from the date any person or persons, who were not owners of the entity as of October 7, 2004, own in the aggregate a 50 percent or greater interest in the entity. The reference to the European Economic Area/European Union entity in paragraph (b)(8)(i) of this section applies to such entities formed on or after October 8, 2004.

Par. 3. Section 301.7701–2T is amended by:

1. Removing paragraph (b)(8)(vi).
2. Revising paragraph (e)(3).

The revision reads as follows:

§301.7701–2T Business entities; definitions (temporary).

* * * * *

(e) * * *

(3) [Reserved]. For further guidance, see §301.7701–2(e)(4).

* * * * *

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

Approved December 8, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 15, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 16, 2005, 70 F.R. 74658)

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions and Other Related Items

Japan Investment Bank Memorandum of Understanding

Announcement 2006–6

The following is a copy of the Memorandum of Understanding ("MOU") entered into on December 27, 2005, by the Competent Authorities of the United States and Japan, regarding the term "investment bank" in the U.S.-Japan income tax treaty.

The text of the MOU is as follows:

MEMORANDUM OF UNDERSTANDING

The Competent Authorities of the United States and Japan agree to the following Guidelines ("Guidelines") concerning the meaning of the term "investment bank" under Article 11(3)(c)(i) of the Convention Between the Government of the United States of America and the Government of Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income (the "Treaty"). These Guidelines are entered into under paragraph 3 of Article 25 (Mutual Agreement Procedure).

In order to provide certainty to taxpayers, the Competent Authorities of the United States and Japan have confirmed that:

A. As used in Article 11(3)(c)(i) of the Treaty, the term "investment bank" means any person regularly engaged in one or more of the following activities ("investment bank activities") if 60% or more of its gross income for each of the three taxable years preceding the taxable year the interest payment is made (or if it has been in existence for less than three taxable years, for each business year of its existence) arises from such activities:

   1. Underwriting issues of stock, debt instruments or other securities under best efforts or firm commitment agreements for customers.

   2. Providing merger and acquisition advisory services, fiduciary services, trust services, custodial services, clearing services, agency paying services, collection agency services, investment or correspondent banking services, financial or investment advisory services, or investment management services, including fund management service.

   3. Originating, structuring, purchasing, selling, discounting, or negotiating on a regular basis notes, drafts, checks, bills of exchange, acceptances, mortgages, industrial loans or other evidences of indebtedness for customers including structured, project, and lease financing and factoring evidences of indebtedness for unrelated parties; brokerage activities; purchasing or selling stock, debt instruments, commodities, interest rate, or currency, commodities or economic futures or other securities or derivative financial products (including notional principal contracts) from or to customers; holding stock, debt instruments and other securities as inventory for sale to customers; arranging futures, forwards, options, foreign exchange transactions, or notional principal contracts for, or entering into such transactions with customers; borrowing or lending stocks or securities for customers, or engaging in securities repurchase or reverse repurchase transactions with customers; providing margin or any other financing for a customer secured by securities or money market instruments, including repurchase agreements; providing financing in connection with financial services activities; and engaging in hedging activities with respect to the activities described in this paragraph 3.

   4. Repackaging financial assets, including mortgages, into securities; purchasing and/or holding such financial assets in contemplation of repackaging them; or servicing activities with respect to such financial assets (including the accrual of interest incidental to such activities).

B. Look-through rules:

   1. Except to the extent provided in paragraph 3 of this Section B, for purposes of applying the 60% gross income test of section A, if an entity (tested entity) owns or controls (directly or indirectly) 50% or more of another entity and the tested entity is affiliated with a registered securities dealer that is resident in either the United States or Japan, the tested entity shall be treated as engaging in the same activities as the other entity and as directly earning its proportionate share of the gross income of the other entity with respect to those activities. A tested entity is affiliated with a registered securities dealer if

      a. the tested entity either owns or controls (directly or indirectly) 80% or more of a registered securities dealer,

      b. the tested entity is owned or controlled (directly or indirectly) 80% or more by a registered securities dealer, or

      c. the tested entity, and a registered securities dealer, are both commonly owned or controlled (directly or indirectly) 80% or more by an issuer of publicly traded debt or equity securities.

   2. For purposes of paragraphs B.1 and C.1.a, all gross income of a bank shall be treated as gross income arising from investment bank activities and the tested entity (for purposes of paragraph

B.1) and owner (for purposes of paragraph C.1.a) shall be treated as directly earning its proportionate share of such gross income.

3. The look-through rules of Section B.1 do not apply to determine the gross income of a tested entity that otherwise meets the gross income test under Section A. A tested entity that meets the gross income test under Section A or this Section B must also meet the group-wide tests under Section C.

C. Group-wide tests.

1. Gross income tests. For purposes of these Guidelines, no entity will be considered an "investment bank" unless

   a. such entity and its affiliates, considered as a single entity, would qualify under Section A (60-percent test), and

   b. The gross income with respect to the activities described in paragraphs A.1, A.2 and A.4, above, of such entity and its affiliates (other than banks), considered as single entity, is equal to or greater than 10% (ten-percent) of all gross income of such entity and its affiliates (other than banks) other than the gross income with respect to activities described in paragraphs A.3, above (10-percent test).

2. Activities tests. For purposes of this Guidelines, no entity will be considered an "investment bank" unless

   a. Such entity or an affiliate is engaged in activities described in paragraph A.1 above,

   b. Such entity or an affiliate is engaged in activities described in paragraph A.2 above,

   c. Such entity or an affiliate is a member of one or more recognized stock exchanges within the meaning of Article 22(5)(b)(i) or (ii), or such entity or an affiliate is a market maker in one or more Over-the-Counter ("OTC") markets located in either the United States or Japan.

3. For purposes of paragraphs C.1 and C.2 above, two entities are affiliates if:

   a. One of the two entities owns (directly or indirectly) 80% or more of the other entity, or

   b. Both entities are commonly owned (directly or indirectly) 80% or more by another entity.

D. Publicly traded requirement

A tested entity must either (a) be an issuer of publicly traded debt or equity securities, or (b) have at least 80 percent of its equity owned directly or indirectly by an issuer of publicly traded debt or equity securities.

E. Confirmation of Benefits:

1. The Competent Authority of a Contracting State shall make a primary test (which shall consist of a determination by such Competent Authority that self-certification has been properly submitted according to any applicable domestic procedures) of whether an entity which is a resident of the Contracting State and applies for the treaty benefit under Article 11(3)(c)(i) meets the conditions provided in these Guidelines, and shall notify the Competent Authority of the other Contracting State, as promptly as practicable after the self-certification, of the name of each entity that has so certified.

2. The list of the notified entities shall be announced to the public and renewed on an as-needed basis.

3. If an entity which is a resident of a Contracting State ceases to meet the conditions in these Guidelines due to a material change in the facts and circumstances, or if it has been found to no longer meet the conditions in these Guidelines by the secondary assessment by the Competent Authority of the other Contracting State, such entity shall lose the entitlement to the treaty benefit under Article 11(3)(c)(i) retroactively to the first day the entity does not meet the conditions of these Guidelines.

Robert H. Green
Director, International (LMSB)
Internal Revenue Service
U. S. Competent Authority
December 27, 2005
Date

Keiji Aoyama
Deputy Commissioner, International
National Tax Agency
Japanese Competent Authority
December 27, 2005
Date

Canadian Memorandum of Understanding on Mutual Agreement Procedure

Announcement 2006–7

The following is a copy of the Memorandum of Understanding ("MOU") entered into on December 8, 2005, by the Competent Authorities of the United States and Canada, providing guidelines and procedures to resolve factual disagreements under the Mutual Agreement Procedure of the U.S.-Canada income tax treaty.

The text of the MOU is as follows:

MEMORANDUM OF UNDERSTANDING BETWEEN THE COMPETENT AUTHORITIES OF CANADA AND THE UNITED STATES REGARDING FACTUAL DISAGREEMENTS UNDER THE MUTUAL AGREEMENT PROCEDURE

The Competent Authorities of Canada and the United States agree to the following principles, guidelines and procedures to resolve disagreements in respect of the underlying facts and circumstances in cases that are referred to them under the mutual agreement procedure ("MAP") article of the *Canada - United States Income Tax Convention* (*1980*), as amended from time to time (the "Convention").

Section I. Definitions

In this Memorandum of Understanding ("MOU"):

"Appeals organization(s)" means either the Appeals Branch of the Canada Revenue Agency (CRA) or Appeals of the Internal Revenue Service (IRS), or both;

"CA or CAs" means either the Canadian or the U.S. Competent Authority, or both;

"Assistant Commissioner of Appeals" means the Assistant Commissioner, Appeals Branch, CRA or his/her authorized representative;

"Chief of Appeals" means the Chief of Appeals, IRS or his/her authorized representative; and

"Appeals Review Panel" ("ARP") means a joint panel comprised of officials of the respective Appeals organizations chosen by the Assistant Commissioner of Appeals and the Chief of Appeals.

Section II. Purpose and Scope of the MOU

1. The purpose of this MOU is to establish an independent review process for resolving disagreements regarding the underlying facts and circumstances ("factual disagreement") of a specific MAP case for further negotiations by the CAs.

   A factual disagreement is a disagreement concerning any of (i) whether a fact has occurred (*e.g.*, whether a party made a payment or not), (ii) the relevance of a fact agreed to exist (*e.g.*, if the payment was made, is that fact relevant to determining the transfer price for transactions covered by the MAP case), or (iii) the significance to be accorded a fact agreed to exist (*e.g.*, what significance should be given to the fact that a payment was made).

2. Unless the CAs otherwise agree this MOU will not apply to:

   - MAP cases involving the interpretation of treaty provisions; and
   - MAP cases involving taxpayers who fail to cooperate with either of the CAs in providing relevant information and data during the MAP process.

Section III. Independent Review Process

1. Independent Review

   - Except as provided in the second bullet of this part (III.1), if either CA determines that the CAs have been unable to agree on the underlying facts and circumstances of a specific MAP case within six months after the first face-to-face negotiating meeting for the case, the CAs must refer the case to the independent review process.
   - If mutually agreed by the CAs, a referral to the ARP can be made at a date that is earlier or later than that provided in the first bullet of this part (III.1). Each CA agrees to consult promptly upon the request of the other CA for early or late referral.

2. Referral Request

   - Unless the CAs mutually agree to a different referral date, each CA must refer any MAP case required to be referred under the first bullet of part 1 of this section (III) to its respective Appeals organization by no later than 30 days after the expiration of the six-month period referenced therein, or, if one or more face-to-face negotiating meetings for the MAP case were held prior to the full execution of this MOU, then by no later than 6 months plus 30 days after full execution of this MOU.
   - Each referral will be in the form of a written submission prepared by the respective CA setting out

in detail the nature of the factual disagreement and the views of the CAs.

- If the CAs mutually agree for any MAP case, they may make a joint referral request that does not disclose the country identity of the subject taxpayer(s), and, for such cases, alter the procedures set forth in this MOU.

3. Acknowledgement of Referral

   Each Appeals organization will, within 30 days after the date that a referral request is made pursuant to part 2 of this section (III), advise its CA in writing of the receipt of the referral request and the identities of the individuals selected, pursuant to part 4 of this section (III), for the ARP for the subject MAP case.

4. Selection of the ARP

   - The Chief of Appeals and the Assistant Commissioner of Appeals will each appoint one voting member from their respective Appeals organizations to the ARP. Those two individuals will have independent authority to resolve the factual disagreement involved in the MAP case. The Chief of Appeals and the Assistant Commissioner of Appeals may also appoint one or more non-voting member(s) from their respective Appeals organization to the ARP. The voting and non-voting members of the ARP will, collectively, be referred to as "Members".

   - Unless the CAs agree otherwise, no ARP Member may have had any previous involvement in an audit of the subject taxpayer(s) or in a resolution of objections filed by such taxpayer(s).

5. *Ex Parte Contacts*

   - The ARP may request supplementary information/representation from any party possessing relevant information.

   - There will be no *ex-parte* contact with Members of the ARP by either the CAs or the subject taxpayers or their representatives unless at the request of the ARP. If any prohibited *ex-parte* contact occurs, the Member who was contacted shall immediately disclose such contact to the voting Member(s).

   - The work of the ARP is a government-to-government process. Accordingly, the Appeals organizations will not disclose their processes or findings to the subject taxpayer(s), the taxpayer'(s') representatives or any person other than the CAs.

6. Meetings and Timeframe

   - If the ARP requires face-to-face discussions, such discussions will be held in Ottawa or Washington, D.C., on an alternating basis.

   - The ARP must conclude its work and render its decision by no later than 150 days after the date on which the referral request is required or agreed to be made pursuant to part 2 of this section (III). Either CA may grant an extension upon request by the ARP.

7. ARP Decision

   - If the voting members pursuant to part 4 of this section (III) agree on a resolution of the factual disagreement(s), the ARP will issue a written report that identifies the subject taxpayer(s), describes the factual disagreement(s), and summarizes the resolution of the factual disagreement(s). The CAs will follow the ARP's resolution of the factual disagreement(s).

   - If the voting members pursuant to part 4 of this section (III) cannot agree on a resolution of the factual disagreement(s), each Appeals organization will provide a written explanation of its voting member's finding.

8. Not to Be Used as Precedent

   A decision by the ARP will not be considered as establishing a precedent for resolving other MAP cases.

9. Appeals Process

   No Members of this ARP should participate in any subsequent resolution of the subject MAP case.

Section IV. Other

The CAs agree to publish this MOU to demonstrate their mutual commitment to improving the MAP process.

This MOU sets forth procedures to be applied in addressing MAP cases under the Convention. Nothing in this MOU shall be construed as affecting taxpayers' rights under applicable domestic law.

This MOU is not to be interpreted as creating or limiting any cause of action, rights or benefits in favour of third parties or taxpayers.

This MOU is effective when fully executed. It may be terminated at any time by either CA giving written notice to the other CA and it may be modified at any time by mutual agreement of the CAs.

The information furnished to the ARP is provided under the terms of the Convention, which governs its disclosure and use. For purposes of this MOU, the Members will be delegated as members of the staff of their respective CAs in accordance with their administrative procedures.

Competent Authority for Canada	Competent Authority for the United States
______________________	______________________
Frederick R. O'Riordan Director General International Tax Directorate Canada Revenue Agency	Robert H. Green Director-International Large and Medium Size Business Internal Revenue Service
Date: ________________	Date: ________________

Mexico LLC MAP Agreement

Announcement 2006–8

The following is a copy of the Mutual Agreement entered into on December 22, 2005, by the Competent Authorities of the United States and Mexico, regarding fiscally transparent entities under the U.S.-Mexico income tax treaty.

The text of the Agreement is as follows:

COMPETENT AUTHORITY MUTUAL AGREEMENT

The Competent Authorities of the United States and Mexico hereby enter into the following mutual agreement ("the Agreement"), which supersedes and clarifies the Competent Authority Mutual Agreement entered into on Aug. 26, 2005, Announcement 2005–72, I.R.B. 2005–41. The Agreement specifies the cases where fiscally transparent entities are entitled to treaty benefits and clarifies the procedure for claiming benefits from Mexico. The Agreement is entered into under paragraph 3 of Article 26 (Mutual Agreement Procedure) of the Convention Between the United States of America and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, along with a Protocol, signed on September 18, 1992, and as amended by the Additional Protocol signed on September 8, 1994, and the Second Additional Protocol signed on November 26, 2002 (the "Treaty").

1) *Eligibility of fiscally transparent entities for treaty benefits*

Paragraph 2(b) of the Protocol provides:

> For purposes of paragraph 1 of Article 4 it is understood that:
>
> * * * * *
>
> b) a partnership, estate, or trust is a resident of a Contracting State only to the extent that the income it derives is subject to tax in that State as the income of a resident, either in the hands of the partnership, estate or trust, or in the hands of its partners or beneficiaries;

The Competent Authorities agree that in applying paragraph 2(b) of the Protocol, it is understood that income from sources within one of the Contracting States received by an entity that is organized in either of the Contracting States, or a third state with which Mexico has in force a comprehensive exchange of information agreement, and that is treated as fiscally transparent under the laws of either Contracting State will be treated as income derived by a resident of the other Contracting State to the extent that such income is subject to tax as the income of a resident of the other Contracting State.

For Mexican tax purposes, a fiscally transparent entity organized in the United States, such as a U.S. limited liability company (LLC) that has elected to be treated as a partnership for federal tax purposes, will be treated as a U.S. resident for purposes of paragraph 2(b) of the Protocol, and entitled to claim treaty benefits, to the extent that the income it derives is subject to tax as the income of a U.S. resident in the hands of its members, owners, partners or beneficiaries. Similar rules will apply to a U.S. subchapter S Corporation, an LLC that is disregarded as an entity separate from its owner, or a U.S. grantor trust.

For example, if a U.S. LLC that is treated as a partnership for U.S. federal tax purposes receives a royalty payment from Mexico, and the U.S. LLC has two members with equal interests in the LLC, one Mexican and one U.S., the LLC may claim treaty benefits as a U.S. resident with respect to 50% of the royalty payment because 50% of the payment is subject to tax in the United States in the hands of a U.S. resident member.

Consistent with this agreement, if a U.S. LLC that is treated as a partnership for U.S. federal tax purposes owns 99 percent of the stock of a Mexican corporation, and the U.S. LLC has five members with equal interests in the LLC, under paragraph 4 of Article 13 (Capital Gains), the gains derived by the LLC from the alienation of such shares may be taxed in Mexico because the LLC had, at any time during the 12-month period preceding such alienation, a participation, directly or indirectly, of at least 25 percent in the capital of the company.

Mexico agrees to apply this Agreement with respect to amounts paid to an entity created and subject to the laws of a third state or jurisdiction only where such third state or jurisdiction has in force a comprehensive exchange of information agreement as provided in Mexican tax provisions and such information is effectively exchanged. The following is the current list of countries that Mexico has a comprehensive exchange of information in force. Such a list is published under Mexican administrative regulations and may be amended from time to time.

- Belgium
- Canada
- Korea
- Israel
- Spain
- France
- Italy
- Norway
- Netherlands
- Singapore
- Sweden
- Finland
- Chile
- Ecuador
- Romania
- Czech Republic

Accordingly, if an LLC organized in one of the states listed above receives an interest payment from Mexico, and the LLC has two member owners with equal interests in the LLC, one third jurisdiction resident and one U.S. resident, the LLC may claim treaty benefits as a U.S. resident with respect to 50% of the interest payment because 50% of the payment is subject to tax in the United States in the hands of a U.S. resident member.

2) *U.S. Residency Certification for LLCs and other fiscally transparent entities*

A LLC or other entity organized within or without the United States that is treated as a partnership for U.S. tax purposes may certify U.S. residence for treaty purposes by obtaining a certificate of residence on Form 6166 in the same manner as a partnership. A Form 6166 confirms the filing of Form 1065, U.S. Return of Partnership Income, by the LLC and includes a list of members of the LLC that are residents of the United States for U.S. federal tax purposes. The Form 6166 will inform the withholding agent to contact the LLC directly to provide information regarding the allocation of a particular payment to a specific member.

A LLC or other entity organized within or without the United States that is disregarded as an entity separate from its owner for U.S. federal tax purposes may certify U.S. residence for treaty purposes by obtaining a Form 6166 that provides that the LLC is a branch, division, or business unit of its single member owner, and that such single member owner is a resident of the United States.

A U.S. corporation that has made an election to be treated as an S Corporation for U.S. federal tax purposes may certify U.S. residence for treaty purposes by obtaining a Form 6166 certificate of residence in a manner similar to that of a partnership. A Form 6166 confirms the filing of an information return, Form 1120S, U.S. Income Tax Return for an S Corporation, as required for a domestic S Corporation, and includes a list of shareholders that are residents of the United States for purposes of U.S. taxation.

3) *Effective dates*

Upon signature by both competent authorities, this Agreement is effective with respect to Mexican source payments made to Mexican or U.S. entities to the extent the Mexican statute of limitations is open for such payments. This Agreement is effective with respect to Mexican source payments made to entities organized in third countries or jurisdictions identified in the Agreement as of January 1, 2006.

Agreed to by the undersigned Competent Authorities:

Robert H. Green U.S. Competent Authority	Ana Bertha Thierry Mexican Competent Authority
December 22, 2005	*December 22, 2005*

Part III. Administrative, Procedural, and Miscellaneous

Information Reporting by Organizations That Receive Charitable Contributions of Certain Motor Vehicles, Boats, and Airplanes

Notice 2006–1

SECTION 1. PURPOSE

This notice provides guidance on the reporting requirements under § 170(f)(12)(D) of the Internal Revenue Code, which apply to any donee organization that receives a contribution of a qualified vehicle after December 31, 2004, the claimed value of which is more than $500.

A donee organization is an organization eligible to receive charitable contributions as described in § 170(c).

A qualified vehicle is any: (i) motor vehicle manufactured primarily for use on public streets, roads, and highways; (ii) boat; or (iii) airplane; but the term does not include any property described in § 1221(a)(1) (*e.g.*, property held primarily for sale to customers). See § 170(f)(12)(E).

This notice complements Notice 2005–44, 2005–25 I.R.B. 1287, which provides guidance under § 170(f)(12) on the allowable deduction for a charitable contribution of a qualified vehicle and the requirements applicable to the contemporaneous written acknowledgment that the donee organization provides to the donor.

SECTION 2. BACKGROUND

Section 884 of the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418 (AJCA), added §§ 170(f)(12) and 6720 to the Internal Revenue Code effective for contributions of qualified vehicles made after December 31, 2004.

Section 170(f)(12)(A) disallows a deduction under § 170(a) for a contribution of a qualified vehicle the claimed value of which is more than $500 unless the donor substantiates the contribution by a contemporaneous written acknowledgment that meets the requirements of § 170(f)(12)(B).

Section 170(f)(12)(D) requires a donee organization to provide the Secretary of the Treasury or his delegate with the information contained in the acknowledgment furnished to the donor.

The Internal Revenue Service has provided Form 1098–C for reporting to the Service the information required to be reported under § 170(f)(12)(D). Form 1098–C can be viewed online at *http://www.irs.gov/pub/irs-pdf/f1098c.pdf*.

Form 1098–C will be revised to take account of the Gulf Opportunity Zone Act of 2005, Pub. L. No. 109–135, 119 Stat. 2577 (GO Zone Act), which was enacted on December 21, 2005. Section 403(gg) of the GO Zone Act contains a technical amendment to § 884 of the AJCA. The technical amendment added clauses (v) and (vi) to § 170(f)(12)(B). Section 170(f)(12)(B)(v) requires the acknowledgment to include information concerning whether the donee organization provided any goods or services in consideration, in whole or in part, for the qualified vehicle. In addition, § 170(f)(12)(B)(vi) requires the acknowledgment to contain a description and good faith estimate of the value of any goods or services referred to in clause (v) or, if such goods or services consist solely of intangible religious benefits (as defined in § 170(f)(8)(B)), a statement to that effect. Notwithstanding these reporting requirements, as set forth below in Section 5, donees may continue to use the current version of Form 1098–C to satisfy the requirements for a contemporaneous written acknowledgment until a new form is provided.

SECTION 3. INFORMATION REPORTING TO THE INTERNAL REVENUE SERVICE

If a donee organization receives a contribution of a qualified vehicle with a claimed value of more than $500 after December 31, 2004, the donee organization is required to provide a contemporaneous written acknowledgment to the donor. The donee organization may use a completed Form 1098–C for the contemporaneous written acknowledgment. See section 3.03 of Notice 2005–44, 2005–25 I.R.B. 1287, for guidance on the information that must be included in a contemporaneous written acknowledgment and the deadline for furnishing the acknowledgment to the donor.

Any donee organization that provides a contemporaneous written acknowledgment to a donor under this section is required to report to the Service the information contained in the acknowledgment. The report is due by February 28 (March 31 if filing electronically) of the year following the year in which the donee organization provides the acknowledgment to the donor.

The donee organization must file the report on Copy A of the official Form 1098–C. The official paper Form 1098–C can be ordered online at *Forms and Publications by U.S. Mail (http://www.irs.gov/formspubs/page/0,,id=10768,00.html)* or by calling 1–800–829–3676. Instructions for Form 1098–C are available at *http://www.irs.gov/pub/irs-pdf/i1098c.pdf*. General instructions on filing information returns and reporting on paper or electronic/magnetic media, including instructions on where to file Form 1098–C, can be found in the General Instructions for Forms 1099, 1098, 5498, and W–2G, which are available at *http://www.irs.gov/pub/irs-pdf/i1099gi.pdf*.

A donee organization that files Form 1098–C on paper should send it with Form 1096, *Annual Summary and Transmittal of U.S. Information Returns*, to the Internal Revenue Service Center, Ogden, UT 84201–0027.

A donee organization that is required to file 250 or more Forms 1098–C during the calendar year must file them electronically or magnetically. Specifications for Filing Forms 1098, 1099, 5498, and W–2G Electronically or Magnetically can be found in Publication 1220 at *http://www.irs.gov/pub/irs-pdf/p1220.pdf*.

Example. On December 31, 2006, D contributes a qualified vehicle to O, an organization that is described in § 170(c). On January 15, 2007, O sells the qualified vehicle in an arm's length transaction to an unrelated party without any significant intervening use or material improvement by O. On February 14, 2007, O provides D an acknowledgment that meets the requirements of a contemporaneous written acknowledgment under § 170(f)(12). D properly claims the deduction allowable under § 170(f)(12) in taxable year 2006 by attaching the acknowledgment to Form 1040, *U.S. Individual Income Tax Return*, that D files by April 15, 2007. To meet its reporting requirements

under § 170(f)(12)(D), O must report the information contained in the acknowledgment on Copy A of Form 1098–C and file the report with the Service by February 28, 2008. But if O files electronically, the report is due on March 31, 2008.

The filing of Form 1098–C does not relieve the donee organization of its obligation under § 6050L to report information about dispositions of charitable deduction property on Form 8282, *Donee Information Return*.

SECTION 4. INTERIM GUIDANCE FOR REPORTING A CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT FURNISHED TO A DONOR IN 2005

For any contemporaneous written acknowledgment furnished to a donor on or before December 31, 2005, a donee organization may report to the Service the information contained in such acknowledgment by filing either Copy A of Form 1098–C or a copy of the acknowledgment. Electronic/magnetic media filing of Form 1098–C is permitted, but not required.

Reports filed on paper should be transmitted with Form 1096 and sent to the Internal Revenue Service Center, Ogden, UT 84201–0027, by February 28, 2006. Even though it files a copy of an acknowledgment instead of a Form 1098–C, the donee organization should check the box on the transmittal Form 1096 that indicates a Form 1098–C is being filed. But if a donee organization already filed a report with the Service in a reasonable manner before January 6, 2006, it need not resubmit such report.

The guidance in this section supersedes any instruction to the contrary in the 2005 Instructions for Form 1098–C.

SECTION 5. SPECIAL TRANSITION RULE CONCERNING CONTENT OF CONTEMPORANEOUS WRITTEN ACKNOWLEDGMENT

Form 1098–C will be revised to reflect the information described in clauses (v) and (vi) of § 170(f)(12)(B) as added by the GO Zone Act. Until Form 1098–C is revised, a contemporaneous written acknowledgment will be treated as meeting the requirements of § 170(f)(12)(B) even if it does not contain the information described in clauses (v) and (vi) of § 170(f)(12)(B).

SECTION 6. SECTION 6720 PENALTY

Section 6720 imposes penalties on any donee organization required under § 170(f)(12)(A) to furnish an acknowledgment to a donor that knowingly furnishes a false or fraudulent acknowledgment, or knowingly fails to furnish an acknowledgment in the manner, at the time, and showing the information required under § 170(f)(12) or regulations thereunder. The Service and the Treasury Department intend to issue regulations under § 6720 clarifying that the donee organization information report described in section 3 of this notice is an integral part of the acknowledgment requirement. The regulations will clarify the application of the § 6720 penalties to a donee organization that knowingly files a false or fraudulent information report with the Service, or that knowingly fails to file such information report with the Service in the manner, at the time, and showing the information required under § 170(f)(12) or the regulations prescribed thereunder and this notice. The regulations will be effective as of the date of publication of this notice.

SECTION 7. PAPERWORK REDUCTION ACT

The collections of information in this notice have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1980.

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

The collections of information in section 3 of this notice are required from donee organizations to satisfy the donee reporting requirements of § 170(f)(12)(D). The collections of information are mandatory. The likely respondents are tax-exempt charitable organizations.

The estimated total annual reporting burden is 21,500 hours for donee organizations.

The estimated annual burden per donee organization varies from 30 minutes to 16 hours, depending on individual circumstances. The estimated average annual burdens are 5 hours for donee organizations. The estimated number of donee organizations is 4,300.

The estimated annual frequency of responses (used for reporting requirements only) is annually.

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

SECTION 8. DRAFTING INFORMATION

The principal author of this notice is Sean Barnett of the Exempt Organizations, Tax Exempt and Government Entities Division. For further information regarding this notice, contact Mr. Barnett at (202) 283–8912 (not a toll-free call).

Waiver for Reasonable Cause for Failure to Report Loan Origination Fees and Capitalized Interest on Qualified Education Loans

Notice 2006–5

PURPOSE

This notice provides information for payees/filers who receive payments of interest on qualified education loans to request a waiver of penalties for failure to report payments of loan origination fees and capitalized interest received in 2005 for qualified education loans made on or after September 1, 2004.

BACKGROUND

Section 6050S requires certain payees who receive payments of interest on one or more qualified education loans, as defined in section 221(d)(1), to file information returns with the Internal Revenue Service (Service) and to furnish information statements to borrowers. In the case of interest payments received or collected by a person on behalf of a payee, the information reporting requirements are generally imposed on that other person (filer) and not the payee. See section 1.6050S–3(e)(3)(i) of the Income Tax Regulations. For qual-

ified education loans made on or after September 1, 2004, payees/filers are required to report on Form 1098–E, "*Student Loan Interest Statement*," payments of interest received on qualified education loans, including payments of loan origination fees and capitalized interest. See section 1.6050S–3(e)(1)(ii) of the regulations (T.D. 9125, 2004–1 C.B. 1012), published on May 7, 2004. 67 Fed. Reg. 25,489. A prior version of these regulations (T.D. 8992, 2002–1 C.B. 981), published on April 29, 2002, provided that, for calendar year 2003 returns and later years, payees/filers were not required to report payments of loan origination fees and capitalized interest for qualified education loans made before January 1, 2004. 67 Fed. Reg. 20,901.

After publication of the amended final section 1.6050S–3 regulations on May 7, 2004, the Treasury Department and Service received comments that additional time was required to make the programming changes necessary to comply with the reporting requirements for loan origination fees and capitalized interest under those regulations. In response, the Treasury Department and Service issued Notice 2004–63, 2004–2 C.B. 597, which provides that the Service will not assert penalties under section 6721 or section 6722 for the failure to report on Form 1098–E returns payments attributable to loan origination fees and capitalized interest received in calendar year 2004 on a qualified education loan made on or after September 1, 2004. The notice explained that the penalty relief was limited to calendar year 2004 returns and would provide payees/filers additional time to make the necessary programming changes to capture information on and report payments of loan origination fees and capitalized interest received in 2005 and future calendar years, consistent with the reporting requirements of the section 6050S regulations.

Some payees/filers have taken steps to comply with the reporting requirements for loan origination fees and capitalized interest for calendar year 2005 returns. However, some commentators have requested additional relief to provide more time to comply with the reporting requirements for calendar year 2005 returns.

REQUEST FOR WAIVER FOR REASONABLE CAUSE

A payee/filer who is not able to comply with the reporting requirements under section 1.6050S–3 for loan origination fees and capitalized interest for calendar year 2005 returns may request that the Service waive, under section 6724 and the regulations thereunder, any penalty that might otherwise be imposed under section 6721 or section 6722 for failure to report these amounts. Section 6724 authorizes the Service to waive the penalties under section 6721 (failure to file correct information returns) or section 6722 (failure to furnish correct payee statements) if the failure was due to reasonable cause and not due to willful neglect. Under section 301.6724–1(a)(2) of the Regulations on Procedure and Administration, a payee/filer may establish reasonable cause if there are significant mitigating factors with respect to the failure, or if the failure arose from events beyond the payee/filer's control. In addition, a payee/filer must show that it acted in a responsible manner both before and after the failure occurred.

A payee/filer seeking a waiver under this notice should send its request in the text of an e-mail to: *1098ewaiver@irs.gov* on or before the due date of the information returns. The Service will acknowledge receipt of a waiver request under this notice. The waiver request must include the following information:

(1) a notation at the top of the request in large letters stating, "Form 1098–E Waiver Request under Notice 2006–5";

(2) the payee/filer's name, taxpayer identification number, and mailing address;

(3) a statement that describes:

(a) the steps the payee/filer has taken in an attempt to report loan origination fees and capitalized interest, including the date on which the payee/filer first took steps to attempt to implement systems to comply with the reporting requirements and the amount of time and resources devoted to efforts to comply; and

(b) the undue hardship that would result by complying with the obligation to report loan origination fees and capitalized interest, including an indication of the size of the payee/filer's student loan portfolio and the revenue derived from the loan portfolio;

(4) a statement that the payee/filer is in compliance with the Additional Rules set forth in this notice; and

(5) a statement, made under penalty of perjury, that the information contained in the waiver request is true, correct, and complete to the best of the payee/filer's knowledge and belief. The perjury statement must be signed by a person who is authorized to sign federal tax returns on behalf of the payee/filer by entering his or her name and date of birth.

The Service currently anticipates that it will decide, within six months after receipt of a complete request for a waiver, whether to grant a waiver of penalties for failure to report information required by section 6050S and the regulations thereunder based on each payee/filer's particular facts and circumstances as described in the waiver request. For purposes of this notice, the Service generally will waive penalties if the payee/filer's request demonstrates that: (1) the payee/filer acted in a responsible manner because it took reasonable efforts sufficiently before the due date of the information return to attempt to implement necessary programming changes to enable the payee/filer to capture information on and report payments of loan origination fees and capitalized interest; and (2) there are significant mitigating factors or the failure arose from events beyond the payee/filer's control, including hardship resulting from incremental costs to the payee/filer.

ADDITIONAL RULES

A payee/filer who is not able to comply with the reporting requirements for loan origination fees and capitalized interest received in calendar year 2005 on a qualified education loan made on or after September 1, 2004, and who seeks a penalty waiver under this notice, must:

(1) file and furnish in a timely manner a Form 1098–E (or other appropriate information statement) that (i) includes the amount of interest (except for any loan origination fees or capitalized interest) received in 2005 in Box 1, (ii) does not include a check mark in Box 2, and (iii) includes all other required information; and

(2) furnish a statement to the borrower indicating that the amount of interest reported in Box 1 of Form 1098–E for calendar year 2005 does not include payments

attributable to either loan origination fees or capitalized interest received on qualified education loans made on or after September 1, 2004, and that the borrower may be able to deduct amounts in addition to the amounts reported in Box 1.

Notwithstanding sections 1.163–7(a) and 1.1275–2(a), a borrower who receives a Form 1098–E (or other appropriate information statement) indicating that it does not include payments of loan origination fees may use any reasonable method to allocate the loan origination fees over the term of the loan for purposes of the deduction allowable under section 221. A method that results in the double deduction of the same portion of a loan origination fee would not be reasonable.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice 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 1545–1996.

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

The collection of information in this notice is required in order for a payee/filer to receive a waiver of penalties for failure to report loan origination fees and capitalized interest. The collection of information is required to obtain benefits. The likely respondents are for profit organizations as well as not for profit organizations.

The estimated total annual recordkeeping and reporting burden is 5,000. The estimated annual recordkeeping and reporting burden per respondent is 10 hours. The estimated number of respondents is 500.

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

CONTACT INFORMATION

For further information regarding a waiver of penalties, contact Kelli Winegardner (Office of Penalties and Interest Administration) at (202) 283–0454 (not a toll-free call). For further information regarding this notice, contact Donna Welch (Office of Associate Chief Counsel (Procedure and Administration)) at (202) 622–4910 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 446, 471, 472, 481; 1.446–1, 1.471–3(d), 1.472–8, 1.481–1.)

Rev. Proc. 2006–14

SECTION 1. PURPOSE

This revenue procedure provides heavy equipment dealers (as defined in section 4.05 of this revenue procedure) with a safe harbor method of accounting for their heavy equipment parts inventory (as defined in section 4.06 of this revenue procedure). This safe harbor method permits heavy equipment dealers to approximate the cost of their heavy equipment parts inventory using the replacement cost of the heavy equipment parts pursuant to the replacement cost method described in section 4 of this revenue procedure. This revenue procedure also provides procedures for heavy equipment dealers to obtain the automatic consent of the Commissioner to change to the replacement cost method.

SECTION 2. BACKGROUND

.01 Section 471 of the Internal Revenue Code provides that inventories must be taken on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting income.

.02 Section 1.471–3(d) of the Income Tax Regulations provides that in any industry in which the usual rules for computation of cost are inapplicable, cost may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry.

.03 Section 472(a) provides that a taxpayer may use the last-in, first-out (LIFO) inventory method. Under the LIFO inventory method, a taxpayer treats those goods remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof, and second, those acquired in the taxable year. The change to, and use of, the LIFO inventory method must be in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.

.04 Section 472(b)(2) provides that a taxpayer using the LIFO inventory method must inventory its goods at cost.

.05 Section 1.472–8(a) provides that a taxpayer may elect to determine the cost of its LIFO inventories under the dollar-value LIFO method, provided such method is used consistently and clearly reflects the income of the taxpayer in accordance with the rules of that section.

.06 Section 1.472–8(e)(2)(ii) provides that the total current-year cost of items making up a dollar-value LIFO pool may be determined: (a) by reference to the actual cost of the goods most recently purchased or produced; (b) by reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition; (c) by application of an average unit cost equal to the aggregate cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced; or (d) pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

.07 Section 263A generally requires direct costs and an allocable portion of indirect costs of certain property produced or acquired for resale by a taxpayer to be included in inventory costs, in the case of property that is inventory, or to be capitalized, in the case of other property. Section 1.263A–1(e)(2)(ii) provides that resellers must capitalize the acquisition costs of property acquired for resale. In addition, resellers must capitalize the indirect costs described in § 1.263A–1(e)(3), which are properly allocable to property acquired for resale. These indirect costs often include purchasing, handling, and storage costs. See § 1.263A–3(c)(1).

.08 In *Mountain State Ford v. Commissioner*, 112 T.C. 58 (1999), the Tax Court held that a taxpayer that sold heavy truck parts and used the dollar-value LIFO method to account for its parts inventory was not entitled to determine the current-year cost of the parts in its ending inventory by reference to their

replacement cost. In so doing, the court found that the taxpayer's replacement cost method was not in accordance with the method elected on its Form 970, *Application To Use LIFO Inventory Method*. The taxpayer's Form 970 indicated that it would determine the current-year cost of the items in its ending inventory by reference to the actual cost of the goods most recently purchased or produced in accordance with § 1.472–8(e)(2)(ii)(a). The court further concluded that even if the taxpayer had elected to use another proper method under § 1.472–8(e)(2)(ii)(d), it could not use the replacement cost of the parts to determine current-year cost because replacement cost does not determine current-year cost on the basis of, or by reference to, actual cost (or in some instances a reasonable approximation of actual cost) in accordance with § 472(b).

.09 Subsequent to the *Mountain State Ford* decision, the Internal Revenue Service gave careful consideration to the following unique circumstances surrounding the use of replacement cost by automobile dealers:

(1) *Industry practice*. It has been the long-standing and widespread practice of automobile dealers to use replacement cost to determine the cost of their vehicle parts inventory both for financial accounting and federal income tax purposes.

(2) *Use of replacement cost required by third party*. Automobile dealers are commonly required by their franchisors (*i.e.*, the vehicle's manufacturer) to value their vehicle parts inventory using replacement cost, rather than actual cost.

(3) *Substantial burden associated with switching to actual cost*. The automobile dealer industry has represented that automobile dealers that are presently using replacement cost to value their vehicle parts inventory likely would incur substantial expense if they were required to modify their existing record keeping systems to determine the cost of such inventory using actual cost.

(4) *Replacement cost approximates actual cost in this industry*. The automobile dealer industry has provided data to demonstrate that, on average, in their industry, due to relatively low inflation and high inventory turnover, the replacement cost of vehicle parts approximates the actual cost of such parts.

.10 Consideration of these factors led the Service to conclude that, for reasons of administrative convenience, burden reduction, and avoidance of further controversy in this area, a safe harbor method of accounting to determine the cost of vehicle parts inventory using replacement cost to approximate actual cost should be provided to automobile dealers. Accordingly, automobile dealers were provided a safe harbor method of accounting in Rev. Proc. 2002–17, 2002–1 C.B. 676. The Service stated in Rev. Proc. 2002–17 that it was willing to consider requests of other industries for similar safe harbors if the facts of those industries are similar to those described above.

.11 Subsequent to the publication of Rev. Proc. 2002–17, the heavy equipment dealer industry asked the Service to provide a similar safe harbor that would allow heavy equipment dealers to value their heavy equipment parts inventories at replacement cost. The information submitted on behalf of the heavy equipment dealers has led the Service to conclude that the circumstances in the heavy equipment dealer industry are similar to those described in section 2.09 of this revenue procedure. Accordingly, the Service has concluded, for reasons of administrative convenience and burden reduction, that a safe harbor method of accounting to determine the cost of heavy equipment parts inventory, using replacement cost to approximate actual cost, should be provided to heavy equipment dealers. The safe harbor method is provided in section 4 of this revenue procedure and is available to heavy equipment dealers described in section 4.05 of this revenue procedure.

SECTION 3. SCOPE

This revenue procedure applies to any heavy equipment dealer that is engaged in the trade or business of selling heavy equipment parts at retail and that is authorized under an agreement with one or more heavy equipment manufacturers or distributors to sell new heavy equipment.

SECTION 4. REPLACEMENT COST METHOD

.01 *In General*. A taxpayer that is within the scope of this revenue procedure is permitted to use the replacement cost method to approximate the actual cost of its heavy equipment parts inventory. Under the replacement cost method, a taxpayer must determine the cost of the heavy equipment parts in its inventory by reference to the replacement cost of the heavy equipment parts as defined in section 4.02 of this revenue procedure, determine the replacement cost using a standard price list as defined in section 4.03 of this revenue procedure, and satisfy the book conformity requirement as described in section 4.04 of this revenue procedure. Taxpayers within the scope of this revenue procedure may use the replacement cost method in conjunction with either the first-in, first-out inventory method or the LIFO inventory method. Taxpayers that use the replacement cost method provided by this section 4 and that are subject to the provisions of § 263A must include in inventory costs the additional amounts that are required by §§ 1.263A–1 and 1.263A–3 (*e.g.*, freight costs).

.02 *Replacement Cost*. Replacement cost means the amount provided in a standard price list at which a heavy equipment part may be purchased by the taxpayer on the date of the inventory. If, on the date of the inventory, the heavy equipment part is not provided in a standard price list, the replacement cost for the part is equal to the last amount provided in a standard price list (*i.e.*, the price at which the part was last offered for purchase in a standard price list).

.03 *Use of Standard Price List*. A "standard price list" is a price list that is widely recognized and used for business purposes in the heavy equipment dealer industry and that is used by the taxpayer in the ordinary course of its business to purchase the heavy equipment parts for which it is determining the cost.

.04 *Book Conformity*. A taxpayer satisfies the book conformity requirement if it determines the cost of heavy equipment parts in its inventory using the replacement cost of the heavy equipment parts as defined in section 4.02 when it ascertains the income, profit, or loss of its trade or business for purposes of its books, records, and reports (including financial statements) to its shareholders, partners, other proprietors, beneficiaries, and creditors.

.05 *Heavy Equipment Dealer Defined*. For purposes of this revenue procedure,

a taxpayer is a "heavy equipment dealer" only if it sells new heavy equipment under an agreement with one or more heavy equipment manufacturers or distributors and earns a majority of its revenue from the sale, or sale and lease, of new heavy equipment. Heavy equipment is defined as those items that fall within the Bureau of Labor Statistics Producer Price Indices WPU111 and WPU112.

.06 *Heavy Equipment Parts Inventory*. For purposes of this revenue procedure, "heavy equipment parts inventory" means goods held as inventory that are, or could be, used to replace original parts on heavy equipment, are necessary for the proper operation of that heavy equipment, and are not accessories.

.07 *Future Reconsideration of the Use of Replacement Cost*. If the Service later determines that circumstances have changed so that the replacement cost of heavy equipment parts no longer approximates the actual cost of heavy equipment parts, the Service may reconsider the safe harbor replacement cost method provided in this section 4 of this revenue procedure and may modify or revoke the method for future taxable years.

SECTION 5. AUDIT PROTECTION FOR TAXPAYERS CURRENTLY USING THE REPLACEMENT COST METHOD

A taxpayer within the scope of this revenue procedure that is using the replacement cost method provided in section 4 of this revenue procedure on January 4, 2006, may continue to use this safe harbor method for taxable years ending on or after April 30, 2005, without filing a Form 3115, *Application for Change in Accounting Method*. Such taxpayer's method of using replacement cost to determine cost for its heavy equipment parts inventory will not be raised as an issue by the Service in a taxable year that ends before April 30, 2005. Moreover, if such taxpayer's method of using replacement cost to determine cost for its heavy equipment parts inventory is already an issue under consideration in a taxable year that ends before April 30, 2005, the issue will not be further pursued by the Service.

SECTION 6. CHANGE IN METHOD OF ACCOUNTING

.01 *In General*. A change to the replacement cost method provided by this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. Therefore, a taxpayer within the scope of this revenue procedure that does not use the replacement cost method provided in section 4 of this revenue procedure on January 4, 2006, but wants to use this safe harbor method may do so for a taxable year ending on or after April 30, 2005, and must file a Form 3115.

.02 *Automatic change to the replacement cost method*. A taxpayer within the scope of this revenue procedure that wants to change its method of determining cost to the replacement cost method provided by this revenue procedure must follow the automatic change in accounting method provisions of Rev. Proc. 2002–9, 2002–1 C.B. 327, as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to make the change for its first or second taxable year ending on or after April 30, 2005;

(2) A change to the replacement cost method under the provisions of Rev. Proc. 2002–9 must be effected on a cut-off method. Thus, the change in method of accounting is made without a § 481(a) adjustment;

(3) A taxpayer making a change under this section 6.02 of this revenue procedure for its first taxable year ending on or after April 30, 2005, that before February 3, 2006, filed its original federal income tax return for such year is not required to comply with the filing requirement in section 6.02(3)(a) of Rev. Proc. 2002–9, provided the taxpayer complies with the following filing requirement. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to an amended federal income tax return for the taxpayer's first taxable year ending on or after April 30, 2005. This amended return must be filed no later than July 3, 2006. A copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002–9) no later than when the taxpayer's amended return is filed; and

(4) For purposes of Line 1a of Form 3115, the designated number for the automatic accounting method change authorized by this revenue procedure is "96." A taxpayer making the automatic change in method of accounting authorized by this revenue procedure and another automatic change in method of accounting under § 263A for the same taxable year may file one Form 3115 to make both changes, but must comply with the ordering rules of § 1.263A–7(b)(2), and must enter the automatic accounting method change numbers for both changes on Line 1a of Form 3115.

.03 *Audit Protection*. If a taxpayer complies with the requirements of this revenue procedure and changes its method of determining cost for its heavy equipment parts inventory to the replacement cost method provided in section 4 of this revenue procedure, the taxpayer will receive audit protection for any taxable year before the year of change with respect to the taxpayer's method of determining cost for its heavy equipment parts inventory under § 471 or 472. See section 7 of Rev. Proc. 2002–9. However, if this change in method of accounting is made for the taxpayer's first or second taxable year ending on or after April 30, 2005, and the taxpayer's method of determining cost (other than by use of replacement cost) for its heavy equipment parts inventory under § 471 or 472 is an issue under consideration as of January 4, 2006, in a taxable year that ends before April 30, 2005, the taxpayer will not receive audit protection.

SECTION 7. RECORD KEEPING

Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. The books or records required by § 6001 must be kept at all times available for inspection by authorized internal revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law. Section 1.6001–1(e). In order

to satisfy the record keeping requirements of § 6001 and the regulations thereunder, a taxpayer that uses the replacement cost method should maintain records supporting all aspects of its inventory valuation including, but not limited to, the price list described in section 4 of this revenue procedure.

SECTION 8. MODIFICATION OF REV. PROC. 2002–17

Rev. Proc. 2002–17 is amended by adding the following new section 4.05: *Future Reconsideration of the Use of Replacement Cost*. If the Service later determines that circumstances have changed so that the replacement cost of vehicle parts no longer approximates the actual cost of vehicle parts, the Service may reconsider the safe harbor replacement cost method provided in this section 4 of this revenue procedure and may modify or revoke the method for future taxable years.

SECTION 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include this automatic change in section 10.02 of the APPENDIX.

Rev. Proc. 2002–17 is modified.

SECTION 10. EFFECTIVE DATE

This revenue procedure generally is effective for taxable years ending on or after April 30, 2005.

DRAFTING INFORMATION

The principal author of this revenue procedure is Richard Shevak of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Shevak at (202) 622–4930 (not a toll-free number).

Part IV. Items of General Interest

Partial Withdrawal of Previous Proposed Rules, Notice of Proposed Rulemaking, and Notice of Public Hearing

Corporate Estimated Tax

REG–107722–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of previous proposed rules, notice of proposed rulemaking, and notice of public hearing.

SUMMARY: This document withdraws proposed regulations relating to corporate estimated taxes. This document also contains new proposed regulations that provide guidance to corporations with respect to estimated tax requirements. These proposed regulations generally affect corporate taxpayers who are required to make estimated tax payments. These proposed amendments reflect changes to the law since 1984. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by February 22, 2006. Outlines of topics to be discussed at the public hearing scheduled for March 15, 2006, must be received by February 22, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–107722–00), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–107722–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–107722–00). The public hearing will be held in the Auditorium, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Joseph P. Dewald, (202) 622–4910; concerning the submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Robin Jones at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document withdraws §§1.6152–1(a)(1), 1.6654–2(d)(1)(i), 1.6655–1, 1.6655–2, 1.6655–3, 1.6655–4, 1.6655–5, 1.6655–6, and 301.6655–1 in the notice of proposed rulemaking (LR–228–82, 1984–1 C.B. 760) relating to corporate estimated taxes under section 6655 that was published in the **Federal Register** (49 FR 11186) on March 26, 1984 (referred to as the 1984 proposed regulations). This document also contains new proposed amendments to the Income Tax Regulations (26 CFR Part 1) and the Procedure and Administration Regulations (26 CFR Part 301) relating to corporate estimated taxes under section 6425 and section 6655 of the Internal Revenue Code. The IRS is withdrawing the 1984 proposed regulations because significant changes to the law since 1984 have caused them to become outdated.

These proposed regulations reflect changes to the law made by the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 494), the Superfund Amendments and Reauthorization Act of 1986, Public Law 99–499 (100 Stat. 1613), the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2085), the Omnibus Budget Reconciliation Act of 1987, Public Law 100–203 (101 Stat. 1330), the Revenue Act of 1987, Public Law 100–203 (101 Stat. 1330–382), the Omnibus Trade and Competitiveness Act of 1988, Public Law 100–418 (102 Stat. 1107), the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3342), the Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (103 Stat. 2106), the Omnibus Budget Reconciliation Act of 1990, Public Law 101–508 (104 Stat. 1388), the Tax Extension Act of 1991, Public Law 102–227 (105 Stat. 1686), the Act of Feb. 7, 1992, Public Law 102–244 (106 Stat. 3), the Unemployment Compensation Amendments of 1992, Public Law 102–318 (106 Stat. 290), the Omnibus Budget Reconciliation Act of 1993, Public Law 103–66 (107 Stat. 312), the Uruguay Round Agreements Act of 1994, Public Law 103–465 (108 Stat. 4809), the Small Business Job Protection Act of 1996, Public Law 104–188 (110 Stat. 1755), the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788), the Ticket to Work and Work Incentives Improvement Act of 1999, Public Law 106–170 (113 Stat. 1860), the Community Renewal Tax Relief Act of 2000, Public Law 106–554 (114 Stat. 2763), the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107–16 (115 Stat. 38), the Jobs and Growth Tax Relief Reconciliation Act of 2003, Public Law 108–27 (117 Stat. 752), and the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418).

The existing regulations under section 6655 do not reflect significant changes to the tax law since 1984, most notably the enactment of the economic performance rules under section 461(h). Since the enactment of section 461(h), the determination of when economic performance must occur for taxpayers to take a deduction into account for purposes of computing a quarterly estimated tax payment has been unclear, particularly for taxpayers that compute their quarterly estimated tax payments using an annualization method.

In addition, the IRS and Treasury Department have become aware of techniques employed by taxpayers, particularly those taxpayers computing their estimated tax payments using an annualization method, that reduce, if not eliminate, estimated tax payments for one or more installments for a taxable year. The proposed regulations provide rules that the IRS and Treasury Department believe result in a more accurate reflection of annualized income than methods that taxpayers may currently be employing. For example, the proposed regulations make it clear that taxpayers may not, for any purpose, determine taxable income for an annualization period or an adjusted

seasonal installment period as though the period is a short taxable year. The proposed regulations provide specific rules for determining taxable income for any annualization period, including how section 461(h) is to be applied in computing taxable income for any annualization period. For example, with respect to an item of income or gain, the proposed regulations provide that the item must be taken into account in computing annualized taxable income for a particular annualization period if the item is includible in computing taxable income in accordance with section 451 on or before the last day of the annualization period. With respect to an item of deduction, the proposed regulations generally provide that an accrual method taxpayer may take into account a deduction in computing annualized taxable income for a particular annualization period only to the extent the item is incurred under §1.461–1(a)(2) on or before the last day of the annualization period. For purposes of determining whether a deduction may be taken into account by an accrual method taxpayer in determining annualized taxable income for a particular annualization period, the provisions of section 170(a)(2) and §1.170A–11(b) (charitable contributions by accrual method corporations), §1.461–4(d)(6)(ii) (provision of services or property to a taxpayer), §1.461–5 (recurring item exception), and any other provision that has a similar effect are not taken into account in determining whether the item of deduction has been incurred under §1.461–1(a)(2) and is deductible in computing annualized taxable income for an annualization period.

Revenue Ruling 76–450, 1976–2 C.B. 444, provides that state property tax and franchise tax are deductible from the income for an annualization period on the date the taxpayer accrues the taxes under the taxpayer's method of accounting. Revenue Ruling 76–450 was issued prior to the enactment of section 461(h) and does not take into account the application of the economic performance requirements of section 461(h) for purposes of computing an estimated tax payment using the annualized income installment method. The proposed regulations address the application of section 461(h) for purposes of the annualized income installment method and provide that a taxpayer using an accrual method of accounting cannot take a deduction into account unless the deduction has been incurred under §1.461–1(a)(2) and is otherwise deductible in computing taxable income for the applicable annualization period. As a result of the rules provided in the proposed regulations regarding the application of section 461(h) to the annualized income installment method, Rev. Rul. 76–450 is no longer applicable and will be obsoleted when these regulations are effective.

For purposes of section 404 and the regulations, regardless of the overall method of accounting employed by the taxpayer, the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10- or 11-month annualization period shall not be treated as a short taxable year and the rules of section 404 and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. Thus, the determination of whether a payment to an employee is deferred compensation under §1.404(b)–1T shall be made by reference to whether the payment is received by the employee more than a brief period of time after the last day of the taxable year for which estimated tax is being determined, and not the last day of the annualization period. With respect to contributions to qualified plans governed by section 404 and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the annualization period (without regard to section 404(a)(6)) and does not, in combination with other such items paid during the annualization period, exceed the applicable deduction limit of section 404(a) for the taxable year. For purposes of sections 419 and 419A and the regulations, regardless of the overall method of accounting employed by the taxpayer, the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month annualization period shall not be treated as a short taxable year and the rules of sections 419 and 419A and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. With respect to contributions to a welfare benefit fund governed by sections 419 and 419A and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the applicable annualization period and does not, in combination with other such items paid during the annualization period, exceed the applicable deduction limit of section 419 for the taxable year.

The proposed regulations provide guidance for annual expenses paid or incurred at the end of the taxable year, or after the end of the taxable year that are deemed paid or incurred during the taxable year. Section 1.6655–2(f)(2)(i) of the proposed regulations provides that if an accrual method taxpayer has a history of incurring a specific item of expense (or paying a specific item of expense, in the case of a cash method taxpayer) that, while attributable to income earned throughout the current taxable year, is not incurred (or paid, in the case of a cash method taxpayer) until the end of the taxable year or after the end of the current taxable year and is deemed incurred (or paid, in the case of a cash method taxpayer) during the current taxable year (taking into account, as applicable, section 170(a)(2) and §1.170A–11(b), section 404(a)(6), §1.461–4(d)(6)(ii), §1.461–5, and any other provision that has a similar effect), then the taxpayer may take into account a proportionate part of the specific item of expense for each annualization period. In such case the taxpayer may take into account a proportionate part of the specific item of expense for each annualization period only if the portion of the annual expense taken into account is determined with reasonable accuracy and the expense is properly deducted by the taxpayer for the current taxable year under the taxpayer's method of accounting. For purposes of §1.6655–2(f)(2)(i), a taxpayer has a history of incurring or paying a specific item of expense at the end of the taxable year, or after the end of the taxable year that is deemed incurred or paid during the taxable year, if, in each of the two taxable years immediately preceding the current taxable year (or the immediately preceding taxable year if the taxpayer was not in existence for the two preceding taxable years), the taxpayer incurred or paid the specific item of expense at the end of each taxable year, or after the end of each taxable year that was deemed incurred or paid during such taxable year. For purposes of §1.6655–2(f)(2)(i), the term "the end of the taxable year" means the period

between and including the 15th and last day of the last month of the taxable year.

The proposed regulations also provide guidance regarding the treatment of specific items for purposes of computing annualized taxable income for an annualization period. For example, net operating loss carryovers must be taken into account in computing an annualized income installment after placing the taxable income for the annualization period on an annualized basis, and section 481(a) adjustments must be recognized ratably over the applicable adjustment period.

Revenue Ruling 67–93, 1967–1 C.B. 366, provides that a taxpayer should deduct a net operating loss (NOL) carryover from the income for an annualization period before annualizing the income for that period. As previously stated, the IRS and Treasury Department believe that it is not appropriate for taxpayers to determine taxable income for an annualization period or an adjusted seasonal installment period as though the period is a short taxable year. As a result, the IRS and Treasury Department now believe that it is a more appropriate reflection of annualized taxable income if a NOL carryover is deducted after annualizing the taxable income for an applicable annualization period or adjusted seasonal installment period. Accordingly, the proposed regulations provide that a taxpayer must annualize taxable income before taking into account a NOL carryover and reduce the annualized amount by the NOL carryover. As a result, Rev. Rul. 67–93 will be obsoleted when these regulations are effective.

In addition, the proposed regulations provide guidance on the amount of depreciation and amortization (depreciation) expense that a taxpayer may take into account for an annualization period. The proposed regulations generally provide that a proportionate amount of a taxpayer's estimated annual depreciation expense shall be taken into account when determining any annualized income installment for the taxable year. In determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, depreciation permitted by sections 168(k) and 1400L, and other similar events that, based on all of the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), the taxpayer reasonably expects to occur during the taxable year. As an alternative to estimating annual depreciation expense based on events that are reasonably expected to occur, the proposed regulations provide that, in general, a taxpayer may claim for an annualization period at least a proportionate amount of 50 percent of the taxpayer's estimated depreciation expense for the current taxable year attributable to assets that the taxpayer had in service on the last day of the preceding taxable year, that remain in service on the first day of the current taxable year, and that are subject to the half-year convention. The proposed regulations also provide that an annualization period cannot be treated as a short taxable year, including for purposes of determining the depreciation allowance for such annualization period.

The proposed regulations also provide guidance regarding short taxable years, including the due dates for required installments for a short taxable year (including a taxpayer's initial taxable year), the computation of such installments, and the applicable percentage of the annual tax due with each installment.

Proposed Effective Date

These regulations are proposed to apply to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**. Until the final regulations become effective, taxpayers may rely on these proposed rules for taxable years beginning on or after the date this notice of proposed rulemaking is published in the **Federal Register**, provided, however, that the taxpayer applies all of these proposed rules in determining its required installments.

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. Except with respect to §1.6655–5, which deals with the rules applicable to a short taxable year, it has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these provisions do not impose a collection of information on small businesses, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. With respect to §1.6655–5, it is hereby certified that this provision of the regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that not many small businesses are going to be subject to the short taxable year rules because: (1) existing small businesses generally are not targets of mergers and acquisitions, which result in a short taxable year; (2) start-up small businesses with a short taxable year of less than four months do not have to pay estimated taxes; and (3) start-up small businesses with a short taxable year of four months or more are not likely to have taxable income that would be subject to the corporate estimated tax rules. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. In particular, the IRS and Treasury Department request comments on whether the 52–53 week taxable year rules under §1.6655–2(e) should be simplified. The IRS and Treasury Department also request comments on whether the final regulations should include an additional exception, similar to the exception provided in §1.6655–2(f)(2)(i), that would permit a taxpayer to take into account for an annualization period a proportionate amount of a specific item of expense that is attributable to income earned through-

out the current taxable year and is paid or incurred during the taxable year but after the applicable annualization period. If such an exception is appropriate, the IRS and Treasury Department request comments on what specific types of expenses would meet the requirements of the rule, and whether the exception should provide for any additional limitations, such as a requirement that a minimum percentage of the annual amount of the expense be paid or incurred on a particular day during the taxable year. All comments will be available for public inspection and copying.

A public hearing has been scheduled for March 15, 2006, beginning at 10:00 a.m. in the Auditorium of the Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit electronic or written comments and an outline of the topics to be discussed and time to be devoted to each topic (a signed original and eight (8) copies) by February 22, 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 receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Robert A. Desilets, Jr., formerly of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division, and Joseph P. Dewald, Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Partial Withdrawal of a Previous Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, §§1.6152–1(a)(1), 1.6654–2(d)(1)(i), 1.6655–1, 1.6655–2, 1.6655–3, 1.6655–4, 1.6655–5, 1.6655–6, and 301.6655–1 in the notice of proposed rulemaking published in the **Federal Register** on March 26, 1984, (LR–228–82) (49 FR 11186) are withdrawn.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.6655–5 also issued under 26 U.S.C. 6655(i)(2). * * *

Par. 2. In §1.56–0, the heading for paragraph (e)(5) is added to read as follows:

§1.56–0 Table of contents to §1.56–1, adjustment for book income of corporations.

* * * * *

(e) * * *

(5) Effective date.

Par. 3. In §1.56–1, paragraph (e)(4) is revised and paragraph (e)(5) is added to read as follows:

§1.56–1 Adjustment for the book income of corporations.

* * * * *

(e) * * *

(4) *Estimating the book income adjustment for purposes of the estimated tax liability*. See §1.6655–7, as issued by T.D. 8307, 1990–2 C.B. 9 (55 FR 33671), for special rules for estimating the corporate alternative minimum tax book income adjustment under the annualization exception.

(5) *Effective date*. Paragraph (e)(4) of this section is applicable for taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 4. In §1.6425–2, paragraph (a) is revised and paragraph (c) is added to read as follows:

§1.6425–2 Computation of adjustment of overpayment of estimated tax.

(a) *Income tax liability defined*. For purposes of §§1.6425–1 through 1.6425–3 and 1.6655–7, relating to excessive adjustment, the term *income tax liability* means the excess of—

(1) The sum of—

(i) The tax imposed by section 11 or 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable; plus

(ii) The tax imposed by section 55; over

(2) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

* * * * *

(c) *Effective date*. Paragraph (a) of this section is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 5. Section 1.6425–3 is amended by:

1. Revising paragraphs (f)(1) and (f)(2).

2. Adding paragraph (f)(3).

The revisions and addition read as follows:

§1.6425–3 Allowance of adjustments.

* * * * *

(f) *Effect of adjustment*. (1) For purposes of all sections of the Internal Revenue Code except section 6655, relating to additions to tax for failure to pay estimated income tax, any adjustment under section 6425 is to be treated as a reduction of prior estimated tax payments as of the date the credit is allowed or the refund is paid. For the purpose of sections 6655(a) through (g), (i), and (j), credit or refund of an adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed. However, an excessive adjustment under section 6425 shall be taken into

account in applying the addition to tax under section 6655(h).

(2) For the effect of an excessive adjustment under section 6425, see §1.6655–7.

(3) This paragraph (f) is applicable to applications for adjustments of overpayments of estimated income tax that are filed in taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 6. Section 1.6655–0 is added to read as follows:

§1.6655–0 Table of contents.

This section lists the table of contents for §§1.6655–1 through 1.6655–7.

§1.6655–1 Addition to the tax in the case of a corporation.

(a) In general.
(b) Amount of underpayment.
(c) Period of the underpayment.
(d) Amount of required installment.
(e) Large corporation required to pay 100 percent of current year tax.
(1) In general.
(2) May use last year's tax for 1st installment.
(f) Required installment due dates.
(1) Number of required installments.
(2) Time for payment of installments.
(i) Calendar year.
(ii) Fiscal year.
(iii) Short taxable year.
(iv) Partial month.
(g) Definitions.
(h) Special rules for consolidated returns.
(i) Overpayments applied to subsequent taxable year's estimated tax.
(1) In general.
(2) Subsequent examinations.
(j) Examples.
(k) Effective date.

§1.6655–2 Annualized income installment method.

(a) In general.
(b) Determination of annualized income installment—In general.
(c) Special rules.
(1) Applicable percentage.
(2) Partial month.
(d) Election of different annualization periods.
(e) 52–53 week taxable year.
(f) Determination of taxable income for an annualization period.
(1) In general.
(2) Exceptions.
(i) Annual expenses paid or incurred at or after the end of the taxable year.
(ii) Net operating loss carryover.
(iii) Credit carryover.
(iv) Section 481(a) adjustment.
(v) Depreciation and amortization.
(A) General rule.
(B) Short taxable years.
(vi) Member of partnership.
(3) Examples.
(g) Items that substantially affect taxable income but cannot be determined accurately by the installment due date.
(1) In general.
(2) Example.
(h) Events arising after installment due date that were not reasonably foreseeable.
(1) In general.
(2) Example.
(i) Effective date.

§1.6655–3 Adjusted seasonal installment method.

(a) In general.
(b) Limitation on application of section.
(c) Determination of amount.
(d) Special rules.
(1) Base period percentage.
(2) Filing month.
(3) Application of the rules related to the annualized income installment method to the adjusted seasonal installment method.
(e) Example.
(f) Effective date.

§1.6655–4 Large corporations.

(a) Large corporation defined.
(b) Testing period.
(c) Computation of taxable income during testing period.
(1) Short taxable year.
(2) Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies.
(d) Members of controlled group.
(1) In general.
(2) Aggregation.
(3) Allocation rule.
(4) Controlled group members.
(e) Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year.
(f) Consolidated returns. [Reserved]
(g) Example.
(h) Effective date.

§1.6655–5 Short taxable year.

(a) In general.
(b) Exception to payment of estimated tax.
(c) Installment due dates.
(1) In general.
(i) Taxable year of four months but less than twelve months.
(ii) Exception.
(2) Early termination of taxable year.
(i) In general.
(ii) Exception.
(d) Amount due for required installment.
(1) In general.
(2) Tax shown on the return for the preceding taxable year.
(3) Applicable percentage.
(e) Examples.
(f) 52 or 53 week taxable year.
(g) Use of annualized income or seasonal installment method.
(1) In general.
(2) Computation of annualized income installment.
(3) Annualization period for final required installment.
(4) Examples.
(h) Preceding taxable year a short taxable year.
(i) Effective date.

§1.6655–6 Methods of accounting.

(a) In general.
(b) Exceptions.
(1) Automatic accounting method changes.
(2) Non-automatic accounting method changes.
(c) Examples.
(d) Effective date.

§1.6655–7 Addition to tax on account of excessive adjustment under section 6425.

Par. 7. Sections 1.6655–1, 1.6655–2, and 1.6655–3 are revised to read as follows:

§1.6655–1 Addition to the tax in the case of a corporation.

(a) *In general.* Section 6655 imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any underpayment of estimated tax by a corporation. An addition to tax due to the underpayment of estimated taxes is determined by applying the underpayment rate established under section 6621 to the amount of the underpayment, for the period of the underpayment. This addition to the tax is in addition to any applicable criminal penalties and is imposed whether or not there was reasonable cause for the underpayment.

(b) *Amount of underpayment.* The amount of the underpayment for any required installment is the excess of—

(1) The required installment; over

(2) The amount, if any, of the installment paid on or before the last date prescribed for such payment.

(c) *Period of the underpayment.* The period of the underpayment of any required installment runs from the date the installment was required to be paid to the 15th day of the 3rd month following the close of the taxable year, or to the date such underpayment is paid, whichever is earlier. For purposes of determining the period of the underpayment—

(1) The date prescribed for payment of any installment of estimated tax shall be determined without regard to any extension of time; and

(2) A payment of estimated tax will be credited against unpaid required installments in the order in which such installments are required to be paid.

(d) *Amount of required installment.* Except as otherwise provided in this section and §§1.6655–2 through 1.6655–7, the amount of any required installment is 25 percent of the lesser of—

(1) 100 percent of the tax shown on the return for the taxable year (or, if no return is filed, 100 percent of the tax for such year); or

(2) 100 percent of the tax shown on the return of the corporation for the preceding taxable year.

(3) Paragraph (d)(2) of this section shall not apply if the preceding taxable year was not a taxable year of 12 months or the corporation did not file a return for such preceding taxable year showing a liability for tax.

(e) *Large corporation required to pay 100 percent of current year tax*—(1) *In general.* Except as provided in paragraph (e)(2) of this section, paragraph (d)(2) of this section shall not apply in the case of a large corporation (as defined in §1.6655–4).

(2) *May use last year's tax for first installment.* Paragraph (e)(1) of this section shall not apply for purposes of determining the amount of the 1st required installment for any taxable year. Any reduction in such 1st installment by reason of the preceding sentence shall be recaptured by increasing the amount of the next required installment determined under paragraph (d)(1) of this section by the amount of such reduction and, if the next required installment is reduced by use of the annualized income installment method under §1.6655–2 or the adjusted seasonal installment method under §1.6655–3, by increasing subsequent required installments determined under paragraph (d)(1) of this section to the extent that the reduction has not previously been recaptured.

(f) *Required installment due dates*—(1) *Number of required installments.* Unless otherwise provided, corporations must make 4 required installments for each taxable year.

(2) *Time for payment of installments*—(i) *Calendar year.* In the case of a calendar year taxpayer, the due dates of the required installments are as follows:

1st	April 15
2nd	June 15
3rd	September 15
4th	December 15

(ii) *Fiscal year.* In the case of a taxpayer other than a calendar year taxpayer, the due dates of the required installments are as follows:

1st	15th day of 4th month of the taxable year
2nd	15th day of 6th month of the taxable year
3rd	15th day of 9th month of the taxable year
4th	15th day of 12th month of the taxable year

(iii) *Short taxable year.* See §1.6655–5 for rules regarding required installments for corporations with a short taxable year.

(iv) *Partial month.* Except as otherwise provided, for purposes of determining the due date of any required installment a partial month shall be treated as a full month.

(g) *Definitions.* (1) The term *tax* as used in this section and §§1.6655–2 through 1.6655–7 means the excess of—

(i) The sum of—

(A) The tax imposed by section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, whichever is applicable;

(B) The tax imposed by section 55; plus

(C) The tax imposed by section 887; over

(D) The credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

(ii) In the case of a foreign corporation subject to taxation under section 11, section 1201(a), or subchapter L of chapter 1 of the Internal Revenue Code, the tax imposed by section 881 shall be treated as a tax imposed by section 11.

(iii) In the case of a partnership that is treated, pursuant to regulations issued under section 1446(f)(2), as a corporation for purposes of this section, the tax imposed by section 1446 shall be treated as a tax imposed by section 11.

(2) For the purposes of paragraph (d)(2) of this section, the term *return for the preceding taxable year* means the Federal income tax return for such taxable year that is required by section 6012(a)(2). However, if an amended Federal income tax return has been filed before the due date for an installment, then the term *return for the preceding taxable year* means the Federal income tax return as amended. Paragraph (d)(2) of this section will apply without regard to whether the taxpayer's Federal income tax return for the preceding taxable year is filed in a timely manner.

(3) If the tax rates for the current taxable year for which estimated tax is being determined differ from the rates applicable to the preceding taxable year, the tax determined for the preceding taxable year shall be recomputed using the rates applicable to the current taxable year.

(h) *Special rules for consolidated returns*. For special rules relating to the determination of the amount of the underpayment in the case of a corporation whose income is included in a consolidated return, see §1.1502–5(b).

(i) *Overpayments applied to subsequent taxable year's estimated tax*—(1) *In general*. If a taxpayer elects under the provisions of sections 6402(b) and 6513(d) and the regulations to apply an overpayment in year one against the estimated tax liability for year two, the overpayment will be applied to the required installment payments for year two in the order due and to the extent necessary to satisfy such installments, similar to the manner in which an actual overpayment of one installment is carried forward to the next installment. No interest is accrued or paid on an overpayment if the election to apply the overpayment against estimated tax is made.

(2) *Subsequent examinations*. If a deficiency is determined in an examination of a return for a taxable year that originally reflected an overpayment that was applied against estimated tax for the succeeding taxable year, interest on the deficiency will not begin to accrue on an amount applied until that amount is used to satisfy a required estimated tax payment in such taxable year. Regardless of whether the taxpayer anticipated the application of such overpayment from the prior taxable year in calculating and paying its required estimated tax installment liabilities for the current taxable year, the subsequently determined underpayment and interest computation thereon will not change the taxpayer's original election to apply the overpayment against the estimated tax liability of the succeeding taxable year. Any changes to the usage of the original overpayment from the prior taxable year are hypothetical only and solely for the purpose of computing deficiency interest. Overpayment interest will not be impacted. For further guidance, see Rev. Rul. 99–40, 1999–2 C.B. 441, (see §601.601(d)(2)(ii)(b) of this chapter).

(j) *Examples*. The method prescribed in paragraphs (d) through (g) of this section may be illustrated by the following examples:

Example 1. X, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2006, will be $85,000. X is not a large corporation as defined in section 6655(g)(2) and §1.6655–4. X reported a liability of $74,900 on its return for the taxable year ended December 31, 2005, with no credits against tax. X paid four installments of estimated tax, each in the amount of $18,725 (25 percent of $74,900), on April 17, 2006, June 15, 2006, September 15, 2006, and December 15, 2006, respectively. X reported a tax liability of $88,900 on its return due March 15, 2007. X had a $5,000 credit against tax for tax year 2006 as provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code. X did not underpay its estimated tax for tax year 2006 for any of the four installments, determined as follows:

(i) Tax as defined in paragraph (g) of this section for 2006 ($88,900-$5,000)	$83,900
(ii) Tax as defined in paragraph (g) of this section for 2005	74,900
(iii) 100% of the lesser of this paragraph (j), *Example 1* (i) or (ii)	74,900
(iv) Amount of estimated tax required to be paid on or before each installment date (25% of $74,900)	18,725
(v) Deduct amount paid on or before each installment date	18,725
(vi) Amount of underpayment for each installment date	0

Example 2. (i) *Facts*. Y, a calendar year corporation, estimates its tax liability for its taxable year ending December 31, 2006, will be $70,000. Y is not a large corporation as defined in section 6655(g)(2) and §1.6655–4. Y reported a Federal income tax liability of $90,000 for its taxable year ending December 31, 2005. Y paid no installment of estimated tax on or before April 17, 2006, June 15, 2006, or September 15, 2006, but made a payment of $63,000 on December 15, 2006. On March 15, 2007, Y filed its income tax return showing a tax of $70,000. Y had no credits against tax for tax year 2006. Of the $63,000 paid by Y on December 15, 2006, $17,500 is applied to each of the first three installments due on April 15, June 15, and September 15, 2006, and the remaining $10,500 is applied to the fourth installment. Y has an underpayment of estimated tax for each of the first three installments of $17,500 and for the fourth installment of $7,000. The addition to tax under section 6655(a) is computed as follows:

(A) Tax as defined in paragraph (g) of this section for 2006	$70,000
(B) Tax as defined in paragraph (g) of this section for 2005	90,000
(C) 100% of the lesser of this paragraph (j), *Example 2* (i)(A) or (i)(B)	70,000

(D) Amount of estimated tax required to be paid on or before each installment date (25% of $70,000)	17,500
(E) Amount paid on or before the first, second, and third installment dates	0
(F) Amount paid on or before the fourth installment date	63,000
(G) Amount of underpayment for the first, second, and third installment dates	17,500
(H) Amount of underpayment for the fourth installment date	7,000

(ii) *Addition to tax*. Assuming that neither the annualized income installment method nor the adjusted seasonal installment method described in §§1.6655–2 and 1.6655–3 would result in a lower payment for any installment period, and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent per annum for the applicable periods of underpayment, the addition to tax is determined as follows:

(A) First installment (underpayment period 4–16–06 through 12–15–06), computed as 244/365 X $17,500 X 8%	$936
(B) Second installment (underpayment period 6–16–06 through 12–15–06), computed as 183/365 X $17,500 X 8%	702
(C) Third installment (underpayment period 9–16–06 through 12–15–06), computed as 91/365 X $17,500 X 8%	349
(D) Fourth installment (underpayment period 12–16–06 through 3–15–07), computed as 90/365 X $7,000 X 8%	138
(E) Total of this paragraph (j), *Example 2* (ii)(A) through (D)	2,125

(k) *Effective date*. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655–2 Annualized income installment method.

(a) *In general*. In the case of any required installment, if the corporation establishes that the annualized income installment determined under this section, or the adjusted seasonal installment determined under §1.6655–3, is less than the amount determined under §1.6655–1—

(1) The amount of such required installment shall be the annualized income installment (or, if less, the adjusted seasonal installment); and

(2) Any reduction in a required installment resulting from the application of this section will be recaptured by increasing the amount of the next required installment determined under §1.6655–1 by the amount of such reduction (and, if the next required installment is similarly reduced, by increasing subsequent required installments to the extent that the reduction has not previously been recaptured).

(b) *Determination of annualized income installment—In general*. In the case of any required installment, the annualized income installment is the excess (if any) of—

(1) The product of the applicable percentage and the tax for the taxable year computed by annualizing the taxable income and alternative minimum taxable income—

(i) For the first 3 months of the taxable year, in the case of the first required installment;

(ii) For the first 3 months of the taxable year, in the case of the second required installment;

(iii) For the first 6 months of the taxable year in the case of the third required installment; and

(iv) For the first 9 months of the taxable year, in the case of the fourth required installment; over

(2) The aggregate amount of any prior required installments for the taxable year.

(c) *Special rules*—(1) *Applicable percentage*. Except as otherwise provided in §1.6655–5(d) with respect to short taxable years—

In the case of the following required installments:	The applicable percentage is:
1st	25
2nd	50
3rd	75
4th	100

(2) *Partial month*. Except as otherwise provided, for purposes of paragraph (b) of this section a partial month shall be treated as a month.

(d) *Election of different annualization periods*. (1) If the taxpayer timely files Form 8842, "*Election To Use Different Annualization Periods for Corporate Estimated Tax*," in accordance with section 6655(e)(2)(C)(iii), and elects Option 1—

(i) Paragraph (b)(1)(i) of this section will be applied by using the language "2 months" instead of "3 months";

(ii) Paragraph (b)(1)(ii) of this section will be applied by using the language "4 months" instead of "3 months";

(iii) Paragraph (b)(1)(iii) of this section will be applied by using the language "7 months" instead of "6 months"; and

(iv) Paragraph (b)(1)(iv) of this section will be applied by using the language "10 months" instead of "9 months".

(2) If the taxpayer timely files Form 8842, in accordance with section 6655(e)(2)(C)(iii), and elects Option 2—

(i) Paragraph (b)(1)(ii) of this section will be applied by using the language "5 months" instead of "3 months";

(ii) Paragraph (b)(1)(iii) of this section will be applied by using the language "8 months" instead of "6 months"; and

(iii) Paragraph (b)(1)(iv) of this section will be applied by using the language "11 months" instead of "9 months".

(e) *52–53 week taxable year*. (1) Generally, in the case of a taxpayer whose taxable year constitutes 52 or 53 weeks in accordance with section 441(f), the rules prescribed by §1.441–2 shall be applicable in determining—

(i) Whether a taxable year is a taxable year of 12 months; and

(ii) When the 2-, 3- ,4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable) commences and ends for purposes of paragraphs (b)(1), (d)(1) and (d)(2) of this section.

(2) If a taxpayer employs four 13-week periods or thirteen 4-week accounting periods and the end of any accounting period employed by the taxpayer does not correspond to the end of the 2-, 3- ,4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period (whichever is applicable), then, provided the taxpayer has at least one full 4-week or 13-week accounting period, as appropriate, within the applicable period, annualized taxable income for the applicable period shall be—

(i) [(x/(y*13))*z], in the case of a taxpayer using four 13-week periods, if—

(A) x = Taxable income for the number of full 13-week periods in the applicable period;

(B) y = The number of full 13-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year; or

(ii) [(x/(y*4))*z], in the case of a taxpayer using thirteen 4-week periods, if—

(A) x = Taxable income for the full 4-week periods in the applicable period;

(B) y = The number of full 4-week periods in the applicable period; and

(C) z = The number of weeks in the taxable year.

(3) If a taxpayer employs four 13-week periods and the taxpayer does not have at least one 13-week period within the applicable 2-, 3- ,4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period, the taxpayer shall be permitted to determine annualized taxable income for the applicable period based upon—

(i) The taxable income for the number of weeks in the applicable period; or

(ii) The taxable income for the full 13-week periods that end before the due date of the required installment.

(4) The following examples illustrate the rules of this paragraph (e):

Example 1. Taxpayer A, an accrual method taxpayer, uses a 52/53 week year-end ending on the last Friday in December and uses four thirteen-week periods. For its year beginning December 30, 2006, A uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installments. For purposes of computing its first and second required installments, the first 3 months of A's taxable year under paragraph (b)(1)(i) of this section will end on March 30th, the thirteenth Friday of A's taxable year. For purposes of its third required installment, the first 6 months of A's taxable year will end on June 29th, the twenty-sixth Friday of A's taxable year. For purposes of its fourth required installment, the first 9 months of A's taxable year will end on September 28th, the thirty-ninth Friday of A's taxable year.

Example 2. Same facts as *Example 1* except that A uses thirteen four-week periods and there are 52 weeks during A's taxable year beginning December 30, 2006, and ending December 28, 2007. For purposes of computing A's first and second required installments, A's annualized taxable income for the first three months will be the taxable income for the first three four-week periods of A's taxable year (December 30, 2006, through March 23, 2007) divided by 12 (number of full four-week periods in the first three months (3) multiplied by 4) and multiplied by 52 (the number of weeks in the taxable year). For purposes of computing A's third required installment, A's annualized taxable income for the first six months will be the taxable income for the first six four-week periods of A's taxable year (December 30, 2006, through June 15, 2007) divided by 24 and multiplied by 52. For purposes of computing A's fourth required installment, A's annualized taxable income for the first nine months will be the taxable income for the first nine four-week periods of A's taxable year (December 30, 2006, through September 7, 2007) divided by 36 and multiplied by 52.

(5) The application of the annualized income installment method is illustrated by the following example:

Example. (i) X, a calendar year corporation, had a taxable year of less than twelve months for tax year 2005 and no credits against tax for tax year 2006. X made an estimated tax payment of $15,000 on the installment dates of April 17, 2006, June 15, 2006, September 15, 2006, and December 15, 2006, respectively. Assume that, under paragraph (d)(1) of this section, X elected Option 1 by timely filing Form 8842, in accordance with section 6655(e)(2)(C)(iii), and determined that its taxable income for the first 2, 4, 7 and 10 months was $25,000, $64,000, $125,000, and $175,000 respectively. The income for each period is annualized as follows:

$25,000 X 12/2=$150,000

$64,000 X 12/4=$192,000

$125,000 X 12/7=$214,286

$175,000 X 12/10=$210,000

(ii)(A) To determine whether the installment payment made on April 17, 2006, equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 2-month period, the following computation is necessary:

(*1*) Annualized income for the 2 month period	$150,000
(*2*) Tax on this paragraph (e)(5), *Example* (ii)(A)(*1*)	41,750
(*3*) 100% of this paragraph (e)(5), *Example* (ii)(A)(*2*)	41,750
(*4*) 25% of this paragraph (e)(5), *Example* (ii)(A)(*3*)	10,438

(B) Because the total amount of estimated tax that was timely paid on or before the first installment date ($15,000) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period, the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on April 15, 2006.

(iii)(A) To determine whether the installment payments made on or before June 15, 2006, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 4-month period, the following computation is necessary:

(*1*) Annualized income for the 4 month period	$192,000
(*2*) Tax on this paragraph (e)(5), *Example* (iii)(A)(*1*)	58,130
(*3*) 100% of this paragraph (e)(5), *Example* (iii)(A)(*2*)	58,130
(*4*) 50% of this paragraph (e)(5), *Example* (iii)(A)(*3*) less $10,438 (amount due with the first installment)	18,627

(B) Because the total amount of estimated tax actually paid on or before the second installment date ($19,562 ($15,000 second required installment payment plus $4,562 overpayment of first required installment)) exceeds the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period, the exception described in paragraphs (a) and (b) of this section applies, and no addition to tax will be imposed for the installment due on June 15, 2006.

(iv)(A) To determine whether the installment payments made on or before September 15, 2006, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 7-month period, the following computation is necessary:

(*1*) Annualized income for the 7 month period	$214,286
(*2*) Tax on this paragraph (e)(5), *Example* (iv)(A)(*1*)	66,821
(*3*) 100% of this paragraph (e)(5), *Example* (iv)(A)(*2*)	66,821
(*4*) 75% of this paragraph (e)(5), *Example* (iv)(A)(*3*) less $29,065 (amount due with the first and second installment)	21,051

(B) Because the total amount of estimated tax actually paid on or before the third installment date ($15,935 ($15,000 third required installment payment plus $935 overpayment of second required installment)) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period, the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the September 15, 2006, installment unless another exception applies to this installment payment.

(v)(A) To determine whether the installment payments made on or before December 15, 2006, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to 100 percent of the tax computed on the annualized income for the 10-month period, the following computation is necessary:

(*1*) Annualized income for the 10 month period	$210,000
(*2*) Tax on this paragraph (e)(5), *Example* (v)(A)(*1*)	65,150
(*3*) 100% of this paragraph (e)(5), *Example* (v)(A)(*2*)	65,150
(*4*) 100% of this paragraph (e)(5), *Example* (v)(A)(*3*) less $50,116 (amount due with the first, second, and third installment)	15,034

(B) Because the total amount of estimated tax payments made on or before the fourth installment date that is available to be applied to the estimated tax due for the fourth installment ($9,884 ($15,000 fourth required installment payment less $5,116 underpayment for the third installment of estimated tax ($21,051 third installment of estimated tax due less $15,935 payments available to be applied to the third installment of estimated tax))) does not equal or exceed the amount required to be paid on or before this date if the estimated tax were 100 percent of the tax determined by placing on an annualized basis the taxable income for the first 10-month period, the exception described in paragraphs (a) and (b) of this section does not apply, and an addition to tax will be imposed with respect to the underpayment of the December 15, 2006, installment unless another exception applies to this installment payment.

(vi) Assuming that no other exceptions apply and the addition to tax is computed under section 6621(a)(2) at the rate of 8 percent per annum for the applicable periods of underpayment, the amount of the addition to tax is as follows:

(A) First installment (no underpayment)	
(B) Second installment (no underpayment)	
(C) Third installment (underpayment period 9–16–06 through 12–15–06), computed as 91/365 X $5,116 X 8%	102
(D) Fourth installment (underpayment period 12–16–06 through 3–15–07), computed as 90/365 X $5,150 X 8%	102
(E) Total of this paragraph (e)(5), *Example* (vi)(A) through (D)	204

(f) *Determination of taxable income for an annualization period*—(1) *In general*. In determining the applicability of the exception described in paragraphs (a) and (b) of this section (relating to the annualization of income) and the exception described in §1.6655–3 (relating to annualization of income for corporations with seasonal income), and for purposes of computing a taxpayer's taxable income (and applicable tax), an item must be taken into account in computing a taxpayer's taxable income for the taxable year for which the estimated tax is being determined, and must be properly taken into account in determining a taxpayer's taxable income (and applicable tax) for the applicable annualization period by the

last day of the such period. Generally, except as provided in paragraph (f)(2) of this section, for an item to be taken into account during an annualization period, the following must occur on or before the last day of the applicable annualization period (determined based on the accounting period employed by the taxpayer):

(i) With respect to an item of gross income, such income is includible in computing taxable income in accordance with section 451 or the appropriate provision of the Internal Revenue Code (for example, section 453 for installment sales or section 460 for long-term contracts).

(ii) With respect to an item of loss, the loss must be permitted to be taken into account under the appropriate provision of the Internal Revenue Code.

(iii) With respect to an item of deduction, for taxpayers using the cash receipts and disbursements method of accounting, the deduction must be paid under §1.461–1(a)(1) and otherwise deductible in computing taxable income for the annualization period or, for taxpayers using an accrual method of accounting, the deduction must be incurred under §1.461–1(a)(2) and otherwise deductible in computing taxable income for the annualization period. In the case of an accrual method taxpayer, the provisions of section 170(a)(2) and §1.170A–11(b) (charitable contributions by accrual method corporations), §1.461–4(d)(6)(ii) (provision of services or property to a taxpayer), §1.461–5 (recurring item exception), and any other provision that has a similar effect can not be used in determining whether the item of deduction has been incurred under §1.461–1(a)(2) and is otherwise deductible for purposes of computing taxable income for an annualization period. For purposes of section 404 and the regulations, regardless of the overall method of accounting employed by the taxpayer, the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10- or 11-month period shall not be treated as a short taxable year and the rules of section 404 and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. Thus, the determination of whether a payment to an employee is deferred compensation under §1.404(b)–1T shall be made by reference to whether the payment is received by the employee more than a brief period of time after the last day of the taxable year for which estimated tax is being determined and not the last day of the applicable annualization period. With respect to contributions to qualified plans governed by section 404 and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the applicable annualization period (without regard to section 404(a)(6)) and does not, in combination with other such items paid during the applicable annualization period, exceed the applicable deduction limit of section 404(a) for the taxable year. For purposes of sections 419 and 419A and the regulations, regardless of the overall method of accounting employed by the taxpayer, the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10-, or 11-month period shall not be treated as a short taxable year and the rules of sections 419 and 419A and the regulations shall be applied on the basis of the taxpayer's taxable year for which estimated tax is being determined. With respect to contributions to a welfare benefit fund governed by sections 419 and 419A and the regulations, in determining whether an item is paid or incurred by the end of an annualization period, economic performance is satisfied only to the extent such item is paid by the last day of the applicable annualization period and does not, in combination with other such items paid during such annualization period, exceed the applicable deduction limit of section 419 for the taxable year.

(iv) With respect to depreciation and amortization (depreciation) expense, a taxpayer shall take into account depreciation expense only as provided in paragraph (f)(2)(v) of this section.

(v) With respect to any item taken into account in computing taxable income for the annualization period that is not described in paragraphs (f)(1)(i), (ii), (iii), and (iv) of this section, the item is includible in computing taxable income in accordance with the appropriate provision of the Internal Revenue Code.

(vi) With respect to an item of credit, the amounts upon which the credit is computed must have been taken into account in computing taxable income for the annualization period pursuant to paragraphs (f)(1)(i), (ii), (iii), (iv), and (v) of this section, as applicable.

(2) *Exceptions*—(i) *Annual expenses paid or incurred at or after the end of the taxable year.* (A) Except as otherwise provided in paragraphs (f)(2)(ii) through (vi) of this section, if an accrual method taxpayer has a history of incurring a specific item of expense under §1.461–1(a)(2) (or a cash method taxpayer has a history of paying a specific item of expense under §1.461–1(a)(1)) that, while attributable to income earned throughout the current taxable year, is not incurred (or paid, in the case of a cash method taxpayer) until the end of the taxable year, or after the end of the current taxable year and is deemed incurred (or paid, in the case of a cash method taxpayer) during the current taxable year (taking into account, as applicable, section 170(a)(2) and §1.170A–11(b), section 404(a)(6), §1.461–4(d)(6)(ii), §1.461–5, and any other provision that has a similar effect), then the taxpayer may, in lieu of any amount determined under paragraph (f)(1) of this section, take into account for the applicable annualization period the amount of such expense properly allocable to such period provided the amount so allocated to such annualization period is determinable with reasonable accuracy and the amount of the item so allocated is properly deducted by the taxpayer during the current taxable year under the taxpayer's method of accounting.

(B) For purposes of this paragraph (f)(2)(i), the portion of an annual expense item allocable to an annualization period will be considered to be determined with reasonable accuracy if such item is allocated evenly throughout the taxable year unless the taxpayer is able to clearly demonstrate such item is more appropriately allocable to an annualization period by some other method including, for example, in proportion to the earning of revenue, the use of property, or the provision of services. For purposes of this paragraph (f)(2)(i), a taxpayer has a history of incurring or paying a specific item of expense at the end of the taxable year, or after the end of the taxable year that is deemed incurred or paid during the taxable year, if, in each of the two taxable years immediately preceding the current taxable year (or the immediately preceding taxable year if the taxpayer was not in existence for the two preceding taxable years), the taxpayer incurred or paid the specific item of expense at the end of each taxable year,

or after the end of each taxable year that was deemed incurred or paid during such taxable year. In addition, for purposes of this paragraph (f)(2)(i), the term "the end of the taxable year" means the period between and including the 15th and last day of the last month of the taxable year.

(ii) *Net operating loss carryover*. Any net operating loss carryover to the current taxable year shall be taken into account in computing an annualized income installment only after annualizing the taxable income for the annualization period.

(iii) *Credit carryover*. Any credit carryover to the current taxable year shall be taken into account in computing an annualized income installment only after annualizing the taxable income for the annualization period and computing the applicable tax, and before applying the applicable percentage.

(iv) *Section 481(a) adjustment*. (A) Any section 481(a) adjustment required to be recognized during the taxable year shall be recognized ratably over the number of months in the taxable year.

(B) With respect to a Form 3115, "*Application for Change in Accounting Method*," filed during the current taxable year or a preceding taxable year, if the change in method of accounting—

(*1*) Is permitted to be made with the automatic consent of the Commissioner, the appropriate portion of the section 481(a) adjustment determined under paragraph (f)(2)(iv)(A) of this section shall be taken into account in determining an annualized income installment if, and only if, the copy of the Form 3115 has been mailed to the IRS National Office on or before the last day of the annualization period; or

(*2*) Requires the prior consent of the Commissioner, the appropriate portion of the section 481(a) adjustment determined under paragraph (f)(2)(iv)(A) of this section shall be taken into account in determining an annualized income installment if, and only if, the consent agreement reflecting the Commissioner's consent to the change in method of accounting and the prescribed terms and conditions for effecting such change has been signed by the taxpayer and mailed to the IRS National Office on or before the last day of the annualization period.

(v) *Depreciation and amortization*—(A) *General rule*. In determining any annualized income installment, a proportionate amount of the taxpayer's estimated annual depreciation and amortization (depreciation) expense shall be taken into account. For purposes of the preceding sentence, estimated annual depreciation expense is the estimated depreciation expense to be properly taken into account in determining the taxpayer's taxable income for the taxable year. In determining the estimated annual depreciation expense, a taxpayer may take into account purchases, sales or other dispositions, changes in use, depreciation deductions permitted under sections 168(k) and 1400L(b), and other similar events and provisions (for example, section 179) that, based on all the relevant information available as of the last day of the annualization period (such as capital spending budgets, financial statement data and projections, or similar reports that provide evidence of the taxpayer's capital spending plans for the current taxable year), are reasonably expected to occur or apply during the taxable year. For purposes of the additional first-year depreciation deduction under sections 168(k) and 1400L(b), only a proportionate amount of the current year's additional first-year depreciation deduction to be taken into account in determining a taxpayer's taxable income for the taxable year is taken into account in computing taxable income for an annualization period. As an alternative to estimating annual depreciation expense based on events that are reasonably expected to occur, a taxpayer may claim for an annualization period at least a proportionate amount of 50 percent of the taxpayer's estimated depreciation expense for the current taxable year attributable to assets that a taxpayer had in service on the last day of the preceding taxable year, that remain in service on the first day of the current taxable year, and that are subject to the half-year convention.

(B) *Short taxable years*. Unless the taxable year is, or will be, a short taxable year, in no circumstance may an annualization period be treated as a short taxable year for purposes of determining the depreciation allowance for such annualization period. If the taxable year is, or will be (based on all relevant information available as of the last day of the annualization period), a short taxable year, annual depreciation expense shall be computed using the rules applicable for computing depreciation during a short taxable year for purposes of determining the annual depreciation expense to be allocated to an annualization period. For this purpose, the rules applicable for computing depreciation during a short taxable year shall be applied on the basis of the date the taxable year is expected to end based on all relevant information available as of the last day of the annualization period. See Rev. Proc. 89–15, 1989–1 C.B. 816, (see §601.601(d)(2)(ii)(b) of this chapter).

(vi) *Member of partnership*. In determining a partner's distributive share of partnership items that must be taken into account during an annualization period, the rules set forth in §1.6654–2(d)(2) are applicable.

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

Example 1. Corporation A, a calendar year taxpayer, uses an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2006 taxable year. Consistent with its historical practice, the board of directors of A, on or before March 31, 2006, make a binding, irrevocable commitment to fund a minimum contribution of $10,000,000 to A's qualified retirement plan by March 15, 2007, which fixes A's liability to make the $10,000,000 contribution. Similarly, consistent with A's historical practice, A plans to remit payments to the retirement plan of $1,000,000 on January 2, 2007, and $9,000,000 on March 1, 2007. The $10,000,000 commitment is not taken into account for purposes of determining A's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because A did not make any payments by March 31, 2006 (and therefore did not satisfy the economic performance requirements of §1.461–4(d)(2)(iii) by March 31, 2006), in accordance with paragraph (f)(1)(iii) of this section. The $10,000,000 is not treated as paid on or before March 31, 2006, under section 404(a)(6) because, pursuant to paragraph (f)(1)(iii) of this section, the last day of the annualization period is not to be treated as the last day of A's taxable year. However, pursuant to paragraph (f)(2)(i)(A) of this section, because A has historically incurred a retirement plan expense during the taxable year pursuant to section 404 that, but for the deeming rule of section 404(a)(6), would have been incurred after the end of the taxable year, and because A satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, A may take into account a $2,500,000 retirement plan expense for purposes of determining A's taxable income to be annualized in computing A's first annualized income installment for 2006 ($10,000,000/12 X 3 = $2,500,000) unless, pursuant to paragraph (f)(2)(i)(B) of this section, A is able to clearly demonstrate that the retirement plan expense is more appropriately allocable by some other method.

Example 2. Same facts as *Example 1* except that, consistent with its historical practice, A remits $9,000,000 to the retirement plan on June 30, 2006, and $1,000,000 to the retirement plan on September 30, 2006. For purposes of determining A's first and second required installments for 2006, which are based on the income and deductions from the first three months of the taxable year, A may not take into account any of the retirement plan expense because A did not make any payments by March 31, 2006 (and therefore did not satisfy the economic performance requirements of §1.461–4(d)(2)(iii) by March 31, 2006), in accordance with paragraph (f)(1)(iii) of this section. For A's third required installment, which is based on the income and deductions from the first six months of the taxable year, A may take into account a $9,000,000 retirement plan expense for purposes of determining A's annualized taxable income because A incurred the $9,000,000 expense by June 30, 2006. For A's fourth required installment, which is based on the income and deductions from the first nine months of the taxable year, A may take into account a $10,000,000 retirement plan expense for purposes of determining A's annualized taxable income because A incurred the $10,000,000 retirement plan expense by September 30, 2006.

Example 3. Corporation B, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment. In each of the three preceding taxable years, B has paid annual bonuses on the Friday immediately preceding December 25 to those employees of B that provided services to B during the taxable year and were employed by B on the date such bonuses were paid. At the beginning of 2006, consistent with its historical experience, B's board of directors pass a resolution that B will pay cash bonuses of $6,000,000 to those employees that have provided services to B during 2006 and are employed by B on December 22, 2006, the Friday immediately preceding December 25, 2006. B plans to pay, and does pay, the cash bonuses to eligible employees on March 1, 2007. The bonuses, pursuant to paragraph (f)(1)(iii) of this section, are not treated as deferred compensation for the taxable year or the annualization period under §1.404(b)–1T because the last day of the annualization period is not to be treated as the last day of B's taxable year. Because the bonuses are not treated as deferred compensation, the bonuses are not subject to section 404, and instead are treated as service liabilities under §1.461–4(d)(2)(i) rather than employee benefit liabilities under §1.461–4(d)(2)(iii). Thus, the bonuses are incurred when all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and the services are provided to B by B's employees. If B's first required installment is made under the provisions of section 6655(e)(1), the $6,000,000 is not taken into account for purposes of determining B's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because B did not incur any liability for bonus payments for the current taxable year by March 31, 2006, in accordance with paragraph (f)(1)(iii) of this section. However, pursuant to paragraph (f)(2)(i)(A) of this section, because B has historically incurred a bonus expense at the end of the taxable year, and because B satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, B may take into account a $1,500,000 bonus expense for purposes of determining B's taxable income to be annualized in computing B's first annualized income installment for 2006 ($6,000,000/12 X 3 = $1,500,000) unless, pursuant to paragraph (f)(2)(i)(B) of this section, B is able to clearly demonstrate that the bonus expense is more appropriately allocable by some other method.

Example 4. Corporation C, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment for its 2006 taxable year. C has a net operating loss carryover to 2006 of $400,000. C's taxable income from January 1, 2006, through March 31, 2006, without regard to any net operating loss carryover, is $500,000. For purposes of determining C's first annualized income installment, C's annualized taxable income is $1,600,000, determined by placing C's first three months of taxable income from January 1, 2006, through March 31, 2006, on an annualized basis ($500,000 X 12/3 = $2,000,000) and reducing the resulting amount of $2,000,000 by the $400,000 net operating loss carryover to 2006.

Example 5. Corporation D, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. On April 15, 2005, D filed a Form 3115, "*Application for Change in Accounting Method*," to request the consent of the Commissioner to change its method of accounting for recognizing revenue. The Commissioner consented to D's requested change, and D signed and mailed the consent letter to the IRS National Office on December 15, 2005. The method change resulted in a positive section 481(a) adjustment of $200,000 to be taken into account over four taxable years beginning in 2005. D's taxable income from January 1, 2006, through March 31, 2006, prior to any section 481(a) adjustment, is $500,000. For purposes of determining D's first annualized income installment for its 2006 taxable year, D's annualized taxable income is $2,050,000, determined by placing the sum of D's first three months of taxable income from January 1, 2006, through March 31, 2006, ($500,000) plus, pursuant to paragraph (f)(2)(iv) of this section, the portion of the section 481(a) adjustment required to be recognized during the taxable year ($200,000/4 = $50,000) that is attributable to the period from January 1, 2006, through March 31, 2006, ($50,000 X 3/12 = $12,500) on an annualized basis ($512,500 X 12/3 = $2,050,000).

Example 6. Corporation E, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. E's taxable income from January 1, 2006, through March 31, 2006, prior to any section 481(a) adjustment, is $500,000. On June 30, 2006, E filed a copy of the Form 3115 with the IRS National Office to request a change in method of accounting that was permitted to be made with the automatic consent of the Commissioner and resulted in a negative section 481(a) adjustment of $400,000 to be taken into account entirely in 2006. For purposes of determining E's first annualized income installment for its 2006 taxable year, E's annualized taxable income is $2,000,000, determined by placing E's first three months of taxable income from January 1, 2006, through March 31, 2006, ($500,000) on an annualized basis ($500,000 X 12/3 = $2,000,000). Because E did not file the accounting method change request until after the last day of the annualization period, no portion of the section 481(a) adjustment is taken into account in computing E's first annualized income installment.

Example 7. Same facts as *Example 6* except that E's taxable income from January 1, 2006, through June 30, 2006, prior to any section 481(a) adjustment, is $800,000. For purposes of determining E's third annualized income installment for its 2006 taxable year, E's annualized taxable income is $1,200,000, determined by placing the sum of E's first six months of taxable income from January 1, 2006, through June 30, 2006, ($800,000) less, pursuant to paragraph (f)(2)(iv) of this section, the portion of the 2006 section 481(a) adjustment required to be recognized during the taxable year that is attributable to the period from January 1, 2006, through June 30, 2006 ($400,000 X 6/12 = $200,000) on an annualized basis ($600,000 X 12/6 = $1,200,000).

Example 8. Same facts as *Example 7* except that E's request for change in method of accounting required the prior consent of the Commissioner and the Form 3115 was filed with the IRS National Office on June 30, 2006. On December 10, 2006, E received the consent of the Commissioner to change its method of accounting. E signed and mailed the consent letter to the IRS National Office on December 15, 2006. For purposes of determining E's third annualized income installment for its 2006 taxable year, E's annualized taxable income is $1,600,000, determined by placing E's first six months of taxable income from January 1, 2006, through June 30, 2006, on an annualized basis ($800,000 x 12/6 = $1,600,000). No portion of the section 481(a) adjustment is taken into account in computing E's third annualized income installment because, although E filed the accounting method change request on or before the last day of E's third annualization period, E did not receive the Commissioner's consent to change its method of accounting, and E did not sign and mail the consent agreement to the IRS National Office, on or before the last day of E's third annualization period.

Example 9. Corporation F, a calendar year taxpayer that began business on January 1, 2003, adopted an accrual method of accounting and will use the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2003 taxable year. As of March 31, 2003, F has purchased and placed in service $100,000 of "5-year property," as defined in section 168(e), and anticipates purchasing and placing in service another $100,000 of "5-year property" before December 31, 2003. F does not anticipate being subject to the mid-quarter convention for the 2003 taxable year, does not anticipate making any depreciation elections for this class of property, does not anticipate making a section 179 election, will deduct the 30% additional first year depreciation deduction, does not anticipate any sales or other dispositions of depreciable property, and no events have occurred, and, based on all relevant information available as of the due date of F's first required installment, F does not know of any event that will cause F's taxable year to be a short taxable

year. F's annual depreciation expense for 2003 is estimated to be $88,000 (total depreciation deduction under section 168(k) of $60,000 ($200,000 X 30% = $60,000) plus annual depreciation of $28,000 (($200,000 minus $60,000) X 20%)). For purposes of determining F's first annualized income installment for its 2003 taxable year, in accordance with paragraph (f)(2)(v)(A) of this section, depreciation expense of $22,000 ($88,000 x 3/12 = $22,000) may be taken into account in computing F's January 1, 2003, through March 31, 2003, taxable income to be annualized. Under paragraph (f)(2)(v)(B) of this section, F may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

Example 10. Corporation G, a calendar year taxpayer that began business on January 5, 2004, adopted an accrual method of accounting and will use the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2005 taxable year. On January 5, 2004, G purchased and placed in service an asset that cost $30,000, qualifies as "5-year property" as defined in section 168(e), is eligible for the 50% additional first year depreciation deduction under section 168(k), and is subject to the half-year convention. G will deduct the 50% additional first year depreciation deduction with respect to the "5-year property." For tax year 2004, G takes a depreciation deduction under section 168(k) of $18,000 ($15,000 ($30,000 X 50% = $15,000) plus annual depreciation of $3,000 ($15,000 X 20% = $3,000)). G does not anticipate being subject to the mid-quarter convention for the 2004 taxable year, does not anticipate making any depreciation elections for this class of property, does not anticipate making a section 179 election, will deduct the 50% additional first year depreciation deduction, does not anticipate any sales or other dispositions of depreciable property, and no events have occurred, and, based on all relevant information available as of the due date of G's first required installment, G does not know of any event that will cause G's taxable year to be a short taxable year. G's annual depreciation expense for 2005 is estimated to be $4,800 ($15,000 X 32% = $4,800). For purposes of determining G's first annualized income installment for its 2005 taxable year, in accordance with paragraph (f)(2)(v)(A) of this section, depreciation expense of $1,200 ($4,800 x 3/12 = $1,200) may be taken into account in computing G's January 1, 2005, through March 31, 2005, taxable income to be annualized. As an alternative to estimating annual depreciation expense based on events that are reasonably expected to occur, depreciation expense of at least $600 ($4,800 x 50% x 3/12 = $600) may be taken into account in computing G's January 1, 2005, through March 31, 2005, taxable income to be annualized. Under paragraph (f)(2)(v)(B) of this section, G may not consider its first annualization period to be a short taxable year for purposes of determining the depreciation allowance for such annualization period.

Example 11. Corporation H, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. H has owned real property in State Y since 2002 and has used the real property in its trade or business. H's method of accounting for real estate taxes is to deduct the taxes on the lien date, subject to the recurring item exception of §1.461–5. Based on historical practice for the past five years, for the 2006 calendar year State Y imposes a lien for real estate taxes on real property owned in State Y on March 15, 2006, with 90% of the tax due on June 30, 2006, and the remaining 10% of the tax due on June 29, 2007. Based on the value of H's real property in State Y, H's real estate tax liability lien imposed on March 15, 2006, is $100,000. H pays the first 90% of this liability on June 30, 2006, and the remaining 10% on June 29, 2007. Under paragraph (f)(1)(iii) of this section, the $100,000 real estate tax liability is not taken into account for purposes of determining H's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because economic performance with respect to the real estate tax liability did not occur by March 31, 2006. However, pursuant to paragraph (f)(2)(i)(A) of this section, because H has historically incurred a real estate tax expense after the end of the taxable year and the real estate tax expense was deemed incurred in 2006 pursuant to §1.461–5, and because H satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, a $2,500 real estate tax expense may be taken into account for purposes of determining H's taxable income to be annualized in computing H's first annualized income installment ($10,000/12 X 3 = $2,500) unless, pursuant to paragraph (f)(2)(i)(B) of this section, H is able to clearly demonstrate that the real estate tax expense is more appropriately allocable by some other method.

Example 12. Same facts as *Example 11*, except that H is computing its third required installment payment for H's 2006 taxable year. Pursuant to paragraph (f)(1)(iii) of this section, H may take into account $90,000 ($100,000 real estate tax liability X 90% paid on June 30, 2006) for purposes of determining the taxable income to be annualized in computing H's third annualized income installment because economic performance with respect to $90,000 of the real estate tax liability occurred by June 30, 2006. In addition, pursuant to paragraph (f)(2)(i)(A) of this section, because H has historically incurred a real estate tax expense after the end of the taxable year and the real estate tax expense was deemed incurred in 2006 pursuant to §1.461–5, and because H satisfies the other requirements of paragraph (f)(2)(i)(A) of this section, a $5,000 real estate tax expense also may be taken into account for purposes of determining H's taxable income to be annualized in computing H's third annualized income installment ($10,000/12 X 6 = $5,000) unless, pursuant to paragraph (f)(2)(i)(B) of this section, H is able to clearly demonstrate that $10,000 of the real estate tax expense is more appropriately allocable by some other method. Therefore, pursuant to paragraphs (f)(1)(iii) and (f)(2)(i)(A) of this section, H may take into account $95,000 of the real estate tax liability for purposes of computing the third required installment payment for H's 2006 taxable year.

Example 13. Same facts as *Example 11*, except that H pays 90% of the real estate tax liability on June 30, 2006, and the remaining 10% of the real estate tax liability on November 30, 2006. Under paragraph (f)(1)(iii) of this section, the $100,000 real estate tax liability is not taken into account for purposes of determining H's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because economic performance with respect to the real estate tax liability did not occur by March 31, 2006. In addition, although H has a history of incurring a real estate tax expense after the end of the taxable year that is deemed incurred during the taxable year, H does not meet the requirements of paragraph (f)(2)(i)(A) of this section in order to take a real estate tax expense into account for purposes of determining H's first annualized income installment because H does not incur a real estate tax at the end of the current taxable year or after the end of the current taxable year that will be deemed incurred during the current taxable year.

Example 14. Same facts as *Example 13* except that H is computing its third required installment payment for H's 2006 taxable year. Pursuant to paragraph (f)(1)(iii) of this section, H may take into account $90,000 ($100,000 real estate tax liability X 90% paid on June 30, 2006) for purposes of determining the taxable income to be annualized in computing H's third annualized income installment because economic performance with respect to $90,000 of the real estate tax liability occurred by June 30, 2006.

Example 15. Corporation I, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2006 taxable year. As of December 31, 2005, I had a $1,000,000 account receivable due from Z related to the sale of goods from I to Z during 2005. I has traditionally incurred bad debt expense for worthless accounts receivable and, as of January 1, 2006, I projects that it will have a bad debt expense of $1,600,000 under section 166 and the regulations for its calendar year 2006. On March 31, 2006, I determined that its receivable from Z was totally worthless under section 166 and the regulations. No other receivables were determined to be worthless between January 1, 2006, and March 31, 2006. In accordance with paragraph (f)(1)(ii) of this section, a $1,000,000 bad debt write-off is taken into account for purposes of determining the taxable income to be annualized in computing I's first annualized income installment.

Example 16. Same facts as *Example 15* except that I determines that its receivable from Z was totally worthless under section 166 and the regulations on April 10, 2006. As of March 31, 2006, I had not determined that any receivables were worthless under section 166 and the regulations. In accordance with paragraph (f)(1)(ii) of this section, the $1,000,000 bad debt expense attributable to the receivable from Z is not taken into account for purposes of determining the taxable income to be annualized in computing I's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year, because the receivable from Z became totally worthless after the last day of I's annualization period. Furthermore, I may not take the bad debt expense into account for purposes of determining the taxable income to be annualized in computing I's first annualized income installment because the receivable from Z does not meet the requirements of paragraph (f)(2)(i) of this section.

Example 17. Corporation J, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required install-

ment payment for its 2006 taxable year. J projects its annualized tax for its 2006 taxable year, based on annualizing J's taxable income for its first annualization period from January 1, 2006, through March 31, 2006, to be $1,500,000 before reduction for any credits. J has an unused credit for increasing research activities from 2005 of $500,000 that is carried over to 2006. For purposes of determining J's first annualized income installment, J's annualized tax for 2006 is $1,000,000, determined as the tax for the taxable year computed by placing on an annualized basis J's taxable income from its first annualization period from January 1, 2006, through March 31, 2006, ($1,500,000) reduced by the $500,000 credit carryover from 2005.

Example 18. Corporation K, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2006 taxable year. K projects its annualized tax for its 2006 taxable year, based on annualizing K's taxable income for its first annualization period from January 1, 2006, through March 31, 2006, to be $2,000,000 before reduction for any credits. K has historically earned a credit for increasing research activities and, for 2006, K estimates that it will earn a credit for increasing research activities under section 41 of $1,200,000. However, pursuant to paragraph (f)(1)(vi) of this section, if K were to annualize all components involved in computing the current year credit based on K's activity from January 1, 2006, through March 31, 2006, K would generate a credit of $1,600,000 for 2006. For purposes of determining K's first annualized income installment, K's annualized tax for 2006 is $400,000, determined as the tax for the 2006 taxable year ($2,000,000) computed by placing on an annualized basis K's taxable income from its first annualization period January 1, 2006, through March 31, 2006, reduced by a $1,600,000 current year credit from increasing research activities.

Example 19. Same facts as *Example 18* except that K does not begin any research activities until April 3, 2006, and will not incur any research expenses described in paragraph (f)(2)(i) of this section. As a result, if K were to annualize all components involved in computing the current year credit based on K's activity from January 1, 2006, through March 31, 2006, K would generate no section 41 research credit for purposes of determining its first annualized income installment. Pursuant to paragraph (f)(1)(vi) of this section, K can not take into account any credit for its first annualization period because K did not incur the credit by the last day of the first annualization period. Accordingly, for purposes of determining K's first annualized income installment, K's annualized tax for its first annualization period January 1, 2006, through March 31, 2006, is $2,000,000.

Example 20. Corporation L, a calendar year taxpayer, uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate its first required installment payment for its 2006 taxable year. L has licensed technology from Corporation M for the past five years. Pursuant to the license agreement, L pays a license fee to M equal to $.01 for every dollar of gross receipts earned by L. For 2006, L projects gross receipts of $200,000,000, of which $100,000,000 is earned by March 31, 2006, and no portion of L's license fee expense is described in paragraph (f)(2)(i) of this section. Pursuant to paragraph (f)(1)(iii) of this section, a license fee expense of $1,000,000 ($100,000,000 X $.01) is incurred by March 31, 2006, and may be taken into account for purposes of determining the taxable income to be annualized in computing L's first annualized income installment.

Example 21. Same facts as *Example 20* except that L does not earn any gross receipts by March 31, 2006. In accordance with paragraph (f)(1)(iii) of this section, because the license fee expense was not incurred under §1.461–1(a)(2) by the last day of the annualization period, no license fee expense is taken into account for purposes of determining the taxable income to be annualized in computing L's first annualized income installment, which is based on the income and deductions from the first three months of the taxable year.

Example 22. Corporation N is a calendar year taxpayer that produces and sells candy bars. N uses an accrual method of accounting and the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2007 taxable year. N annually conducts, and will conduct for 2007 and 2008, a contest for its customers whereby N awards, on a quarterly basis, a cash prize of $100,000, $200,000, $300,000, and $400,000 to the first, second, third, and fourth quarter winners, respectively. Winners are announced on the last day of each calendar quarter and the prize is payable on the last day of the month following the announcement of the winner. N uses the recurring item exception of section 461(h) and the regulations with respect to its liability to the prize winner. On December 31, 2006, N announced its fourth quarter winner and remitted payment of $400,000 to the winner on January 31, 2007. Although the contest liability is incurred in accordance with §1.461–4(g)(4) on January 31, 2007, at the time payment is made to the award winner, N may not take such item into account in computing N's first annualized income installment for 2007 because, pursuant to the recurring item exception, the $400,000 is deductible in determining N's 2006 taxable income and is not taken into account in determining N's taxable income for 2007, as required pursuant to paragraph (f)(1) of this section. However, because N has historically incurred an annual prize expense of $400,000 that is described in paragraph (f)(2)(i)(A) of this section, $100,000 may be taken into account for purposes of determining the taxable income to be annualized in computing N's first annualized income installment for N's 2007 taxable year based on the $400,000 liability N will incur for the 2007 taxable year when N makes the payment in January of 2008 to the 2007 fourth quarter winner ($400,000/12 X 3 = $100,000), unless, pursuant to paragraph (f)(2)(i)(B) of this section, N is able to clearly demonstrate that the annual prize expense is more appropriately allocable by some other method.

(g) *Items that substantially affect taxable income but cannot be determined accurately by the installment due date*—(1) *In general*. In determining the applicability of the annualization exceptions described in paragraphs (a) and (b) of this section and §1.6655–3, reasonable estimates may be made from existing data for items that substantially affect income if the amount of such items cannot be determined accurately by the installment due date. Examples of these items are the inflation index for taxpayers using the dollar-value LIFO (last-in, first-out) inventory method, intercompany adjustments for taxpayers that file consolidated returns, and the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year.

(2) *Example*. The following example illustrates the rules of this paragraph (g):

Example. Corporation X accounts for its inventory using the dollar-value LIFO method of accounting. If, when computing its first annualized income installment, no reliable inflation index exists for the period January 1, 2006, through March 31, 2006, X may interpolate from an available inflation index for the same months in the previous year to calculate its cost of goods sold.

(h) *Events arising after installment due date that were not reasonably foreseeable*—(1) *In general*. Events arising subsequent to an installment due date that cause the taxpayer's computation of its taxable income for a prior installment period to be understated will not result in a recomputation of its taxable income for the prior installment period. The preceding sentence applies only if, based on all the facts and circumstances as of the due date of an installment payment, it was not reasonably foreseeable that these subsequent events would occur.

(2) *Example*. The following example illustrates the rules of this paragraph (h):

Example. Assume that Congress enacts retroactively effective legislation that causes the taxable income for the applicable 2-, 3-, 4-, 5-, 6-, 7-, 8-, 9-, 10- or 11-month period to be understated. This event, which occurs after the applicable installment due date and was not reasonably foreseeable at the time the installment payment was made, will not result in a recomputation of a corporation's taxable income for the applicable installment period because such an event was not reasonably foreseeable.

(i) *Effective date*. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655–3 Adjusted seasonal installment method.

(a) *In general*. In the case of any required installment, the amount of the ad-

justed seasonal installment is the excess (if any) of—

(1) 100 percent of the amount determined under paragraph (c) of this section; over

(2) The aggregate amount of all prior required installments for the taxable year.

(b) *Limitation on application of section*. This section shall apply only if the base period percentage (as defined in section 6655(e)(3)(D)(i) and paragraph (d)(1) of this section) for any six consecutive months of the taxable year equals or exceeds seventy percent.

(c) *Determination of amount*. The amount determined under this section for any installment will be determined in the following manner—

(1) Take the taxable income for all months during the taxable year preceding the filing month;

(2) Divide such amount by the base period percentage for all months during the taxable year preceding the filing month;

(3) Determine the tax on the amount determined under paragraph (c)(2) of this section; and

(4) Multiply the tax computed under paragraph (c)(3) of this section by the base period percentage for the filing month and all months during the taxable year preceding the filing month.

(d) *Special rules*—(1) *Base period percentage*. The base period percentage for any period of months shall be the average percent that the taxable income for the corresponding months in each of the three preceding taxable years bears to the taxable income for the three preceding taxable years.

(2) *Filing month*. The term *filing month* means the month in which the installment is required to be paid.

(3) *Application of the rules related to the annualized income installment method to the adjusted seasonal installment method*. The rules governing the computation of taxable income (and resulting tax) for purposes of determining any required installment payment of estimated tax under the annualized income installment method under §1.6655–2 shall apply to the computation of taxable income (and resulting tax) for purposes of determining any required installment payment of estimated tax under the adjusted seasonal installment method.

(e) *Example*. The provisions of this section may be illustrated by the following example:

Example. (i) X, a corporation that reports on a calendar year basis, expected that it would have an estimated tax liability of $1,200,000 for its taxable year ending December 31, 2006. On its 2005 tax return, X reported a tax liability of $652,800. X paid four installments of estimated tax, each in the amount of $250,000, $250,000, $250,000, and $450,000 on April 17, 2006, June 15, 2006, September 15, 2006, and December 15, 2006, respectively. X reported a tax liability of $1,152,600 on its return due March 15, 2007, with no credits against tax. Under the general provision of section 6655(b) and section 6655(d), there was an underpayment in the amount of $76,300 for the second installment through September 15, 2006, and $114,450 for the third installment through December 15, 2006, determined as follows:

(A) Tax as defined in section 6655(g)	$1,152,600
(B) 100% of this paragraph (e), *Example* (i)(A)	1,152,600
(C) Amount of estimated tax required to be paid on or before the first installment (25% of $652,800)	163,200
(D) Deduct amount timely paid on or before the first installment due date under the general rule of section 6655(b)	250,000
(E) Amount of overpaid estimated tax for the first installment date	86,800
(F) Amount of estimated tax required to be paid on or before the second installment (25% of $1,152,600 plus the recapture amount under section 6655(d)(2)(B) of $124,950 (25% of $1,152,600 less 163,200))	413,100
(G) Deduct amount paid on or before the due date of the second installment less amount applied towards the first installment under the general rule of section 6655(b) ($250,000 paid in each of the first and second installments less this paragraph (e), *Example* (i)(C))	336,800
(H) Amount of underpayment for the second installment date	76,300
(I) Amount of estimated tax required to be paid on or before the third installment (25% of $1,152,600)	288,150
(J) Deduct amount paid on or before the due date of the third installment less amount applied towards the first and second installments under the general rule of section 6655(b) ($250,000 paid in each of the first, second, and third installments less this paragraph (e), *Example* (i)(C) less this paragraph (e), *Example* (i)(F))	173,700
(K) Amount of underpayment for the third installment date	114,450
(L) Amount of estimated tax required to be paid on or before the fourth installment (25% of $1,152,600)	288,150
(M) Deduct amount paid on or before the due date of the fourth installment less amount applied towards the first, second, and third installments under the general rule of section 6655(b) ($250,000 paid in each of the first, second, and third installments plus $450,000 paid in the fourth installment less this paragraph (e), *Example* (i)(C) less this paragraph (e), *Example* (i)(F) less this paragraph (e), *Example* (i)(I))	335,550
(N) Amount of overpaid estimated tax for the fourth installment date	47,400

(ii) X wants to determine if it qualifies for the adjusted seasonal installment method. X determines that its monthly taxable income for the preceding three taxable years and for the current taxable year 2006 is as follows:

January	February	March	April	May	June	July	August	September	October	November	December
2003 $100,000	$90,000	$80,000	$70,000	$60,000	$20,000	*2003* $10,000	$10,000	$10,000	$10,000	$10,000	$10,000
2004 200,000	170,000	170,000	130,000	125,000	45,000	*2004* 21,000	19,000	20,000	20,000	20,000	20,000
2005 410,000	350,000	330,000	270,000	240,000	80,000	*2005* 40,000	40,000	40,000	40,000	40,000	40,000
2006 600,000	680,000	650,000	560,000	460,000	170,000	*2006* 70,000	60,000	50,000	40,000	30,000	20,000

(iii) X must initially determine if its base period percentage for the same 6 consecutive months of the 3 preceding taxable years equals or exceeds 70 percent (see section 6655(e)(3) and paragraphs (b) and (c) of this section). By using its taxable income for the first 6 months of 2003, 2004, and 2005, X qualifies for the adjusted seasonal installment method because its base period percentage is 87.5 percent (which exceeds 70 percent) computed as follows:

(A) Taxable income for first 6 months of 2003	$420,000
(B) Total taxable income for 2003	480,000
(C) Divide this paragraph (e), *Example* (iii)(A) by this paragraph (e), *Example* (iii)(B)	.875
(D) Taxable income for first 6 months of 2004	840,000
(E) Total taxable income for 2004	960,000
(F) Divide this paragraph (e), *Example* (iii)(D) by this paragraph (e), *Example* (iii)(E)	.875
(G) Taxable income for first 6 months of 2005	1,680,000
(H) Total taxable income for 2005	1,920,000
(I) Divide this paragraph (e), *Example* (iii)(G) by this paragraph (e), *Example* (iii)(H)	.875
(J) Add this paragraph (e), *Example* (iii)(C), (F), and (I)	2.625
(K) Divide this paragraph (e), *Example* (iii)(J) by 3	.875

(iv) To determine the amount of the first installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 3 months of 2006	$1,930,000
(B) Taxable income for first 3 months of 2003 ($270,000) divided by total taxable income for 2003 ($480,000)	.5625
(C) Taxable income for first 3 months of 2004 ($540,000) divided by total taxable income for 2004 ($960,000)	.5625
(D) Taxable income for first 3 months of 2005 ($1,090,000) divided by total taxable income for 2005 ($1,920,000)	.5677
(E) Add this paragraph (e), *Example* (iv)(B), (C), and (D) and divide by 3	.5642
(F) Divide this paragraph (e), *Example* (iv)(A) by this paragraph (e), *Example* (iv)(E)	3,420,773
(G) Determine the tax on this paragraph (e), *Example* (iv)(F)	1,163,049
(H) Taxable income for first 4 months of 2003 ($340,000) divided by total taxable income for 2003 ($480,000)	.7083
(I) Taxable income for first 4 months of 2004 ($670,000) divided by total taxable income for 2004 ($960,000)	.6979
(J) Taxable income for first 4 months of 2005 ($1,360,000) divided by total taxable income for 2005 (1,920,000)	.7083
(K) Add this paragraph (e), *Example* (iv)(H), (I), and (J) and divide by 3	.7048
(L) Multiply this paragraph (e), *Example* (iv)(G) by this paragraph (e), *Example* (iv)(K)	819,717
(M) 100% of this paragraph (e), *Example* (iv)(L)	819,717
(N) Amount of all prior required installments for 2006	0
(O) Amount of adjusted seasonal installment for the first installment payment (this paragraph (e), *Example* (iv)(M) less this paragraph (e), *Example* (iv)(N))	819,717

(v) To determine the amount of the second installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 5 months of 2006	$2,950,000
(B) Taxable income for first 5 months of 2003 ($400,000) divided by total taxable income for 2003 ($480,000)	.8333
(C) Taxable income for first 5 months of 2004 ($795,000) divided by total taxable income for 2004 ($960,000)	.8281
(D) Taxable income for first 5 months of 2005 ($1,600,000) divided by total taxable income for 2005 ($1,920,000)	.8333
(E) Add this paragraph (e), *Example* (v)(B), (C), and (D) and divide by 3	.8316
(F) Divide this paragraph (e), *Example* (v)(A) by this paragraph (e), *Example* (v)(E)	3,547,379
(G) Determine the tax on this paragraph (e), *Example* (v)(F)	1,206,109
(H) Taxable income for first 6 months of 2003 ($420,000) divided by total taxable income for 2003 ($480,000)	.875
(I) Taxable income for first 6 months of 2004 ($840,000) divided by total taxable income for 2004 ($960,000)	.875
(J) Taxable income for first 6 months of 2005 ($1,680,000) divided by total taxable income for 2005 ($1,920,000)	.875
(K) Add this paragraph (e), *Example* (v)(H), (I), and (J) and divide by 3	.875
(L) Multiply this paragraph (e), *Example* (v)(G) by this paragraph (e), *Example* (v)(K)	1,055,345
(M) 100% of this paragraph (e), *Example* (v)(L)	1,055,345
(N) Amount of all prior required installments for 2006	163,200
(O) Amount of adjusted seasonal installment for the second installment payment (this paragraph (e), *Example* (v)(M) less this paragraph (e), *Example* (v)(N))	892,145

(vi) To determine the amount of the third installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 8 months of 2006	$3,250,000
(B) Taxable income for first 8 months of 2003 ($440,000) divided by total taxable income for 2003 ($480,000)	.9167
(C) Taxable income for first 8 months of 2004 ($880,000) divided by total taxable income for 2004 ($960,000)	.9167
(D) Taxable income for first 8 months of 2005 ($1,760,000) divided by total taxable income for 2005 ($1,920,000)	.9167
(E) Add this paragraph (e), *Example* (vi)(B), (C), and (D) and divide by 3	.9167
(F) Divide this paragraph (e), *Example* (vi)(A) by this paragraph (vi)(E)	3,545,326
(G) Determine the tax on this paragraph (e), *Example* (vi)(F)	1,205,411
(H) Taxable income for first 9 months of 2003 ($450,000) divided by total taxable income for 2003 ($480,000)	.9375
(I) Taxable income for first 9 months of 2004 ($900,000) divided by total taxable income for 2004 ($960,000)	.9375
(J) Taxable income for first 9 months of 2005 ($1,800,000) divided by total taxable income for 2005 ($1,920,000)	.9375
(K) Add this paragraph (e), *Example* (vi)(H), (I), and (J) and divide by 3	.9375
(L) Multiply this paragraph (e), *Example* (vi)(G) by this paragraph (e), *Example* (vi)(K)	1,130,073
(M) 100% of this paragraph (e), *Example* (vi)(L)	1,130,073
(N) Amount of all prior required installments for 2006	576,300
(O) Amount of adjusted seasonal installment for the third installment payment (this paragraph (e), *Example* (vi)(M) less this paragraph (e), *Example* (vi)(N))	553,773

(vii) To determine the amount of the fourth installment under the rules of section 6655(e)(3) and paragraph (a) of this section, the following computation is necessary:

(A) Taxable income for first 11 months of 2006	$3,370,000
(B) Taxable income for first 11 months of 2003 ($470,000) divided by total taxable income for 2003 ($480,000)	.9792
(C) Taxable income for first 11 months of 2004 ($940,000) divided by total taxable income for 2004 ($960,000)	.9792
(D) Taxable income for first 11 months of 2005 ($1,880,000) divided by total taxable income for 2005 ($1,920,000)	.9792
(E) Add this paragraph (e), *Example* (vii)(B), (C), and (D) and divide by 3	.9792
(F) Divide this paragraph (e), *Example* (vii)(A) by this paragraph (e), *Example* (vii)(E)	3,441,585
(G) Determine the tax on this paragraph (e), *Example* (vii)(F)	1,170,139
(H) Taxable income for first 12 months of 2003 ($480,000) divided by total taxable income for 2003 ($480,000)	1.0000
(I) Taxable income for first 12 months of 2004 ($960,000) divided by total taxable income for 2004 ($960,000)	1.0000
(J) Taxable income for first 12 months of 2005 ($1,920,000) divided by total taxable income for 2005 ($1,920,000)	1.0000
(K) Add this paragraph (e), *Example* (vii)(H), (I), and (J) and divide by 3	1.0000
(L) Multiply this paragraph (e), *Example* (vii)(G) by this paragraph (e), *Example* (vi)(K)	1,170,139
(M) 100% of this paragraph (e), *Example* (vii)(L)	1,170,139
(N) Amount of all prior required installments for 2006	864,450
(O) Amount of adjusted seasonal installment for the fourth installment payment (this paragraph (e), *Example* (vii)(M) less this paragraph (e), *Example* (vii)(N))	305,689

(viii) Because the total amount of each required estimated tax payment determined under section 6655(e)(3) and paragraph (a) of this section exceeds the amount of each required estimated tax payment determined under section 6655(d) and §1.6655–1(d) and (e), the exception described in section 6655(e) and this section does not apply and the addition to the tax with respect to the underpayment for the June 15, 2006, and September 15, 2006, installments will be imposed unless another exception (for example, see section 6655(e)(2)) applies with respect to these installments.

(f) *Effective date*. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 8. Section 1.6655–4 is added to read as follows:

§1.6655–4 Large corporations.

(a) *Large corporation defined*. The term *large corporation* means any corporation (or a predecessor corporation) that had taxable income of at least $1,000,000 for any taxable year during the testing period. For purposes of this section, a predecessor corporation is the distributor or transferor corporation in a transaction to which section 381 (relating to carryovers in certain corporate acquisitions) applies.

(b) *Testing period*. For purposes of paragraph (a) of this section, the term *testing period* means the 3 taxable years immediately preceding the taxable year for which estimated tax is being determined (the current taxable year) or, if less, the number of taxable years the taxpayer has been in existence.

(c) *Computation of taxable income during testing period*—(1) *Short taxable year*. In the case of a corporation (or predecessor corporation) that had a short taxable year during the testing period, for purposes of determining whether the $1,000,000 amount referred to in paragraph (a) of this section is equaled or exceeded, the taxable income for the short taxable year is computed by—

(i) Multiplying the taxable income for the short taxable year by 12; and

(ii) Dividing the resulting amount by the number of months in the short taxable year.

(2) *Computation of taxable income in taxable year when there occurs a transaction to which section 381 applies*. (i) For purposes of determining whether an acquiring corporation had taxable income of $1,000,000 or more for a taxable year in which there occurs a transaction to which section 381 applies, the acquiring corporation's taxable income will be the sum of—

(A) The taxable income of the acquiring corporation for its taxable year; plus

(B) The taxable income of the distributor or transferor corporation for that portion of the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)–1(b)).

(ii) For purposes of determining whether a transferor or distributor corporation had taxable income of $1,000,000 or more for a taxable year in which there occurs a transaction to which section 381 applies, the distributor or transferor corporation's taxable income shall be reduced by the amount of its taxable income for that portion of its taxable year corresponding to the acquiring corporation's taxable year up to and including the date of distribution or transfer (as defined in §1.381(b)–1(b)).

(d) *Members of controlled group*—(1) *In general*. For purposes of applying

paragraph (a) of this section, the taxable income of members of a controlled group of corporations (as defined in section 1563(a)) must be aggregated for each year of the testing period. The provisions of this section shall not apply to a controlled group for any taxable year in which the aggregate taxable income of the members of the controlled group is less than $1,000,000.

(2) *Aggregation*. For purposes of paragraph (d)(1) of this section, a taxable loss of any member of the controlled group for a taxable year during the testing period is not taken into account.

(3) *Allocation rule*. If the aggregate taxable income of members of a controlled group computed pursuant to paragraph (d)(1) of this section exceeds $1,000,000 during the testing period, the $1,000,000 amount that is relevant for purposes of determining, under paragraph (a)(1) of this section, whether a corporation is a large corporation shall be divided equally among the component members of such group (including component members excluded pursuant to paragraph (d)(2) of this section) unless all of such component members consent to an apportionment plan providing for an alternative allocation of such amount. The procedure for making and filing this plan will be the same as the procedure used for making and filing an apportionment plan under section 1561. See section 1561 and the regulations.

(4) *Controlled group members*. (i) In the case of any corporation that was a member of a controlled group of corporations at any time during the testing period but is not a member of such group during the taxable year involved, the taxable income of the former member for the testing period is determined as if such corporation were not a member of a group at any time during that period. With respect to the controlled group, the taxable income of its former member will not be taken into account in determining such group's taxable income for any taxable year during the testing period for purposes of applying paragraph (a)(1) of this section.

(ii) For purposes of paragraph (d)(4)(i) of this section, the determination of whether a corporation is a member of a controlled group during the testing period is based on whether the corporation was a member of the controlled group on the last day of the month preceding the due date of the required installment.

(e) *Effect on a corporation's taxable income of items that may be carried back or carried over from any other taxable year*. In determining whether a corporation (or predecessor corporation) is a large corporation for its current taxable year, items that could offset taxable income during a taxable year included in the testing period (for example, those described in sections 172 and 1212) are not to be taken into account and the taxable income of a corporation for any taxable year during the testing period shall be determined without regard to items carried back or carried over from any other taxable year.

(f) *Consolidated returns*. [Reserved].

(g) *Example*. The provisions of this section may be illustrated by the following example:

Example. Y Corporation and Z Corporation are calendar year taxpayers. In 2006, Z acquires all of the assets of Y in a transaction to which section 381 applies. Z's taxable income for both 2004 and 2005 was less than $1,000,000. Y's taxable income for 2006 is determined under paragraph (c)(2) of this section to be $300,000 for that portion of the acquiring corporation's taxable year up to and including the date of transfer. Z's taxable income for 2006 is $800,000. Under the provisions of paragraph (c)(2) of this section, Z's 2006 taxable income for purposes of determining whether it is a large corporation for taxable year 2007 is $1,100,000 ($800,000 + $300,000). Thus, Z is a large corporation for the 2007 taxable year. In addition, if Z's 2006 taxable income, as determined under paragraph (c)(2) of this section, had been less than $1,000,000 but Y's taxable income in 2004 or 2005 had been $1,000,000 or more, Z would be a large corporation for taxable year 2007 because Y is a predecessor corporation.

(h) *Effective date*. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655–7 [Removed]

Par. 9. Section 1.6655–7 is removed.

§1.6655–5 [Redesignated as §1.6655–7]

Par. 10. Section 1.6655–5 is redesignated as §1.6655–7.

Par. 11. Sections 1.6655–5 and 1.6655–6 are added to read as follows:

§1.6655–5 Short taxable year.

(a) *In general*. Except as otherwise provided in this section, the provisions of section 6655 and the regulations are applicable in the case of a short taxable year (including an initial taxable year) for which a payment of estimated tax is required to be made.

(b) *Exception to payment of estimated tax*. In the case of a short taxable year, no payment of estimated tax is required if—

(1) The short taxable year is a period of less than 4 full calendar months; or

(2) The tax shown on the return for such taxable year (or, if no return is filed, the tax) is less than $500.

(c) *Installment due dates*—(1) *In general*—(i) *Taxable year of four months but less than twelve months*. Except as otherwise provided, in the case of a short taxable year, if such year results in a taxable year of four or more full calendar months but less than twelve full calendar months, the due dates prescribed in §1.6655–1(f)(2) shall apply.

(ii) *Exception*. If the date determined under paragraph (c)(1)(i) of this section for the first required installment due during the taxpayer's short taxable year is earlier than the 15th day of the fourth month of the taxpayer's short taxable year, the taxpayer's first required installment shall be due on the first due date otherwise determined under paragraph (c)(1)(i) of this section that is on or after the 15th day of the fourth month of the short taxable year.

(2) *Early termination of taxable year*—(i) *In general*. Except as provided in paragraph (c)(2)(ii) of this section, if a taxable year ends early (for example, as a result of an acquisition or a change in taxable year), the due date for the final required installment shall be the date that would have been the due date of the next required installment if the event that gave rise to the short taxable year had not occurred.

(ii) *Exception*. If the date determined under paragraph (c)(2)(i) of this section is within thirty days of the last day of the short taxable year, the due date for the final required installment shall be the fifteenth day of the second month following the month that includes the last day of the short taxable year.

(d) *Amount due for required installment*—(1) *In general*. The amount due for any required installment determined under section 6655(d)(1)(B)(i) for a short taxable year shall be 100% of the required annual payment for the short taxable year divided

by the number of required installments due (as determined under this section) for the short taxable year.

(2) *Tax shown on the return for the preceding taxable year*. If the current taxable year is a short taxable year, the amount due for any required installment determined under section 6655(d)(1)(B)(ii) shall be determined in the following manner—

(i) Take 100% of the tax shown on the return of the corporation for the preceding taxable year;

(ii) Multiply such amount by the number of full calendar months in the current short taxable year and divide by 12; and

(iii) Divide the amount determined under paragraph (d)(2)(ii) of this section by the number of required installments due (as determined under this section) for the current short taxable year.

(3) *Applicable percentage*. In the case of any required installment determined under section 6655(e), the applicable percentage under section 6655(e)(2)(B)(ii) shall be—

(i) 25%, 50%, 75%, and 100% for the first, second, third, and fourth (last) required installments, respectively, if the taxpayer will have four required installments due for the short taxable year;

(ii) 33.33%, 66.67%, and 100% for the first, second, and third (last) required installments, respectively, if the taxpayer will have three required installments due for the short taxable year;

(iii) 50% and 100% for the first and second (last) required installments, respectively, if the taxpayer will have two required installments due for the short taxable year; or

(iv) 100% for the first (and last) required installment if the taxpayer will have one required installment for the short taxable year.

(e) *Examples*. The following examples illustrate the rules of this section:

Example 1. A corporation is a calendar year taxpayer that was acquired by B corporation on April 16, 2007, resulting in A having a short taxable year from January 1 through April 16, 2007. Because A has a taxable year of less than four full calendar months, no estimated tax payments are required by A for the short taxable year.

Example 2. B corporation began business on January 10, 2007, and adopted a calendar year as its taxable year. B computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(i), the due dates of B's required installments for B's initial taxable year from January 10, 2007, through December 31, 2007, are April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007. However, because the due dates for the first, third, and fourth required installments fall on a weekend, B's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, September 17, 2007, and December 17, 2007, respectively, for the first, third, and fourth required installments. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 25% of the required annual payment for B's first required installment, 50% of the required annual payment for B's second required installment, 75% of the required annual payment for B's third required installment, and 100% of the required annual payment for B's fourth required installment.

Example 3. Corporation C began business on February 12, 2007, and adopted a calendar year as its taxable year. C computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(i), the due dates of C's required installments for C's initial taxable year from February 12, 2007, through December 31, 2007, are April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007. However, in accordance with paragraph (c)(1)(ii) of this section, C's first required installment is due June 15, 2007, because April 15, 2007, is earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second required installment is due September 15, 2007, and C's third (and last) installment is due December 15, 2007. However, because the due dates for the second and third (and last) required installments fall on a weekend, C's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, September 17, 2007, and December 17, 2007, respectively, for the second and third (and last) required installments. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 33.33% of the required annual payment for C's first required installment, 66.67% of the required annual payment for C's second required installment, and 100% of the required annual payment for C's third (and last) required installment.

Example 4. Same facts as *Example 3* except C began business on April 10, 2007. In accordance with paragraph (c)(1)(ii) of this section, C's first required installment is due September 15, 2007, because April 15, 2007, and June 15, 2007, are earlier than the fifteenth day of the fourth month of C's taxable year. As a result, C's second (and last) required installment is due December 15, 2007. However, because the due dates for the first and second (and last) required installments fall on a weekend, C's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, September 17, 2007, and December 17, 2007, respectively, for the first and second (and last) required installments. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for C's first required installment, and 100% of the required annual payment for C's second (and last) required installment.

Example 5. D corporation began business on February 12, 2007, and adopted a fiscal year ending October 31 as its taxable year. D computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). Pursuant to §1.6655–1(f)(2)(ii), the due dates of D's required installments for D's initial taxable year from February 12, 2007, through October 31, 2007, are February 15, 2007, April 15, 2007, July 15, 2007, and October 15, 2007. However, in accordance with paragraph (c)(1)(ii) of this section, D's first required installment is due July 15, 2007, because February 15, 2007, and April 15, 2007, are earlier than the fifteenth day of the fourth month of D's taxable year. As a result, D's second (and last) installment is due October 15, 2007. However, because the due date for the first required installment falls on a weekend, D's first required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, July 16, 2007. Pursuant to paragraph (d)(1) of this section, the amount due with each required installment is 50% of the required annual payment for D's first required installment, and 100% of the required annual payment for D's second (and last) required installment.

Example 6. Same facts as *Example 5* except D corporation began business on May 10, 2007. In accordance with paragraph (c)(1)(ii) of this section, D's first (and last) installment is due October 15, 2007, because July 15, 2007, is earlier than the fifteenth day of the fourth month of D's taxable year. Pursuant to paragraph (d)(1) of this section, the amount due with D's required installment is 100% of the required annual payment, computed as 100% divided by the number of required installments due for the short taxable year.

Example 7. E corporation is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). E computes its 2007 required installments based on a projected 2007 total tax liability of $600,000. On July 31, 2007, E is acquired by F corporation resulting in E having a short taxable year from January 1, 2007, through July 31, 2007. E determines that its total tax liability for the short period is $350,000. The due dates for E's first and second required installments are April 15, 2007, and June 15, 2007, respectively. However, because the due date for the first required installment falls on a weekend, E's first required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, April 16, 2007. Pursuant to section 6655(d)(1)(A), E paid $150,000 with each required installment. Pursuant to paragraph (c)(2) of this section, E's third (and last) required installment of estimated tax is due on September 15, 2007, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. However, because the due date for the third (and last) required installment falls on a weekend, E's third (and last) required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, September 17, 2007. Accordingly, E is required to pay $50,000 with its

final required installment on September 17, 2007 ($350,000 total tax liability for the short taxable year less prior installment payments of $300,000).

Example 8. Same facts as *Example 7* except that E is acquired by F corporation on August 31, 2007. Pursuant to paragraph (c)(2)(ii) of this section, E's third (and last) required installment of estimated tax is due on October 15, 2007, because September 15, 2007, the date that would have been the due date of E's next required installment if F's acquisition of E had not occurred, is within thirty days of the last day of E's short taxable year, and 100% of the required annual payment is due with such installment.

Example 9. F corporation is a calendar year taxpayer that computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). F computes its 2007 estimated tax payments based on a projected 2007 total tax liability of $900,000. On December 3, 2007, F is acquired by G corporation resulting in F having a short taxable year from January 1, 2007, through December 3, 2007. F determined its total tax liability for the short period to be $800,000. The due dates for F's first, second, and third required installments are April 15, 2007, June 15, 2007, and September 15, 2007, respectively. However, because the due dates for the first and third required installments fall on a weekend, F's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, and September 17, 2007, respectively, for the first and third required installments. Pursuant to section 6655(d)(1)(A), F paid $225,000 with each required installment. Pursuant to paragraph (c)(2)(ii) of this section, F's fourth (and last) required installment of estimated tax is due on February 15, 2008, and the percentage of the required annual payment due with such installment is 100% pursuant to paragraph (d)(1) of this section. Accordingly, F is required to pay $125,000 with its final required installment due February 15, 2008 ($800,000 total tax liability for the short taxable year less prior installment payments of $675,000).

Example 10. G corporation, a calendar year taxpayer, reported a tax liability of $75,000 on its return for the taxable year ending December 31, 2006, and is not a large corporation as defined in section 6655(g). On July 31, 2007, G makes a final distribution of its assets, in connection with a plan of complete liquidation, resulting in a short taxable year from January 1, 2007, through July 31, 2007. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii) for payments determined by reference to the tax shown on the return of the corporation for the preceding taxable year, pursuant to paragraph (d)(2) of this section, G must pay in a proportionate amount of its 2006 tax liability based on the number of months in the current taxable year. Accordingly, G must pay $43,750 ($75,000 X 7/12) through payments of estimated tax payments in 2007, with $14,583 due on April 15, 2007, June 15, 2007, and September 15, 2007. However, because the due dates for the first and third required installments fall on a weekend, G's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, and September 17, 2007, respectively, for the first and third required installments.

Example 11. Same facts as *Example 10* except that G makes a final distribution of its assets, in connection with a plan of complete liquidation, on October 1, 2007, resulting in a short taxable year from January 1, 2007, through October 1, 2007. To satisfy the requirements of the exception described in section 6655(d)(1)(B)(ii), G must pay $56,250 ($75,000 x 9/12) through payments of estimated tax in 2007, with $14,063 due on April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007, respectively. However, because the due dates for the first, third, and fourth required installments fall on a weekend, G's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, September 17, 2007, and December 17, 2007, respectively, for the first, third, and fourth required installments.

Example 12. H corporation began business on February 15, 2007, and adopted a calendar year. H computes its required installments based on 100 percent of the tax shown on the return for the taxable year in accordance with section 6655(d)(1)(B)(i). H estimated at the beginning of its short taxable year that its estimated tax liability for short taxable year February 15, 2007, through December 31, 2007, would be $180,000. H paid its first required installment of estimated tax of $60,000 on June 15, 2007, its second required installment of estimated tax of $60,000 on September 17, 2007, and its third (and last) required installment of estimated tax of $60,000 on December 17, 2007 ($180,000 total estimated tax liability for the short taxable year less prior installment payments of $120,000). H reported a tax liability of $240,000 on its return for the short period February 15, 2007, through December 31, 2007, with no credits against tax. There was an underpayment in the amount of $20,000 on the first installment date through September 15, 2007, $40,000 on the second installment date through December 15, 2007, and $60,000 on the third (and last) installment date through March 15, 2008, determined as follows:

(i) Tax as defined in section 6655(d)(1)(B)(i)	$240,000
(ii) 100% of this paragraph (e), *Example 12* (i)	240,000
(iii) Amount of estimated tax required to be paid by the first installment date (33.33% of $240,000)	80,000
(iv) Amount of estimated tax required to be paid by the second installment date (66.67% of $240,000 less $80,000 (amount due with first installment))	80,000
v) Amount of estimated tax required to be paid by the third installment date (100% of $240,000 less $160,000 (amount due with first and second installment))	80,000
(vi) Deduct amount paid on or before the first installment date	60,000
(vii) Amount of underpayment for the first installment date (this paragraph (e), *Example 12* (iii) minus this paragraph (e), *Example 12* (vi))	20,000
(viii) Deduct amount available for the second installment date ($60,000 second installment payment less this paragraph (e), *Example 12* (vii) applied towards the first installment underpayment)	40,000
(ix) Amount of underpayment for the second installment date (this paragraph (e), *Example 12* (iv) minus this paragraph (e), *Example 12* (viii))	40,000
(x) Deduct amount available for the third installment date ($60,000 third installment payment less this paragraph (e), *Example 12* (ix) applied towards the second installment underpayment)	20,000
(xi) Amount of underpayment for the third installment date (this paragraph (e), *Example 12* (v) minus this paragraph (e), *Example 12* (x))	60,000

(f) *52 or 53 week taxable year*. For purposes of this section, a taxable year of 52 or 53 weeks shall be deemed a period of 12 months in the case of a corporation that computes its taxable income in accordance with the election permitted by section 441(f).

(g) *Use of annualized income or seasonal installment method*—(1) *In general*. Regardless of the annual accounting period used by a corporation (for example, calendar year, fiscal year) the taxpayer may use the method described in §1.6655–2 (annualized income installment method) or §1.6655–3 (adjusted seasonal installment method) to compute its required installments of estimated tax when the current taxable year is a short taxable year.

(2) *Computation of annualized income installment*. To the extent a short taxable year includes an annualization period elected by the taxpayer, the taxpayer shall compute its annualized income installment by determining the tax on the basis of such annualized income for the annualization period multiplied by the number of months in the short taxable year divided by 12.

(3) *Annualization period for final required installment*. For purposes of determining the final required installment (as described in paragraph (c)(2) of this section) for a short taxable year, annualized taxable income shall be determined by placing on an annualized basis the taxable income for the last complete annualization period that occurs within the short taxable year.

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

Example 1. X corporation began business on February 12, 2007, and adopted a calendar year as its taxable year. X adopts an accrual method of accounting and uses the annualized income installment method under section 6655(e)(2)(A)(i) to calculate all of its required installment payments for its 2007 taxable year. Pursuant to §1.6655–1(f)(2)(i), the due dates of X's required installments for X's initial taxable year from February 12, 2007, through December 31, 2007, are April 15, 2007, June 15, 2007, September 15, 2007, and December 15, 2007. However, in accordance with paragraph (c)(1)(ii) of this section, X's first required installment is due June 15, 2007. As a result, X's second required installment is due September 15, 2007, and X's third (and last) required installment is due December 15, 2007. However, because the due dates for the third and fourth required installments fall on a weekend, X's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, September 17, 2007, and December 17, 2007, respectively, for the third and fourth required installments. The amount of X's first and second required installments are each based on annualizing X's taxable income from February 12, 2007, through April 30, 2007, (the first three months of X's taxable year) and X's third (and last) required installment is based on annualizing X's taxable income from February 12, 2007, through July 31, 2007 (the first six months of X's taxable year). Because X will have three required installments due for its short taxable year, pursuant to paragraph (d)(3)(ii) of this section, the applicable percentage is 33.33% for X's first required installment, 66.67% for X's second required installment, and 100% for X's third (and last) required installment.

Example 2. Y, a calendar year corporation, made a final distribution of its assets, in connection with a plan of complete liquidation, on August 1, 2007. Y filed a timely election to use the alternative annualization periods described under section 6655(e)(2)(C)(i) and determined that its taxable income for the first 2, 4 and 7 months of the taxable year was $25,000, $50,000 and $140,000. The due dates for Y's required installments for its short taxable year January 1, 2007, through August 1, 2007, are April 15, 2007, June 15, 2007, and September 15, 2007. However, because the due dates for the first and third required installments fall on a weekend, Y's required installment payments will be timely if paid on or before the first business day following the actual due date of the required installments, that is, April 16, 2007, and September 17, 2007, respectively, for the first and third required installments. Y made installment payments of $10,000, $10,000, and $20,000, respectively, on April 16, 2007, June 15, 2007, and September 17, 2007. The taxable income for each period is annualized as follows:

$25,000 X 12/2 = $150,000

$50,000 X 12/4 = $150,000

$140,000 x 12/7 = $240,000

(i)(A) To determine whether the first required installment equals or exceeds the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 2-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 2 month period	$150,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (i)(A)(*1*)	39,250
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (i)(A)(*2*) multiplied by 7 (the number of months in the short taxable year) divided by 12	22,896
(*4*) 100% of this paragraph (g)(4), *Example 2* (i)(A)(*3*)	22,896
(*5*) 33.33% of this paragraph (g)(4), *Example 2* (i)(A)(*4*)	7,631

(B) Because the total amount of estimated tax that is timely paid on or before the first installment date ($10,000) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 2-month period taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) applies and no addition to tax will be imposed for the installment due on April 15, 2007.

(ii)(A) To determine whether the required installments made on or before June 15, 2007, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 4-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 4 month period	$150,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (ii)(A)(*1*)	39,250
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (ii)(A)(*2*) multiplied by 7 (the number of months in the short taxable year) divided by 12	22,896
(*4*) 100% of this paragraph (g)(4), *Example 2* (ii)(A)(*3*)	22,896
(*5*) 66.67% of this paragraph (g)(4), *Example 2* (ii)(A)(*4*) less $7,631 (amount due with first installment)	7,631

(B) Because the total amount of estimated tax available to apply towards the amount due for the second installment ($12,369 ($10,000 paid on the second installment date plus $2,369 overpayment of the first installment)) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 4-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) applies and no addition to tax will be imposed for the installment due on June 15, 2007.

(iii)(A) Pursuant to paragraph (c) and (d) of this section, the final required installment is due by September 15, 2007, and the applicable percentage due for the final required installment is 100%. However, because the due date for the final required installment falls on a weekend, Y's final required installment payment will be timely if paid on or before the first business day following the actual due date of the required installment, that is, September 17, 2007. To determine whether the installment payments made on or before September 17, 2007, equal or exceed the amount that would have been required to have been paid if the estimated tax were equal to one hundred percent of the tax computed on the annualized income for the 7-month period taking into account the number of months in the short taxable year, the following computation is necessary:

(*1*) Annualized income for the 7 month period	$240,000
(*2*) Tax on this paragraph (g)(4), *Example 2* (iii)(A)(*1*)	56,100
(*3*) Tax determined under this paragraph (g)(4), *Example 2* (iii)(A)(*2*) multiplied by 7 (the number of months in the short taxable year) divided by 12	32,725
(*4*) 100% of this paragraph (g)(4), *Example 2* (iii)(A)(*3*)	32,725
(*5*) 100% of this paragraph (g)(4), *Example 2* (iii)(A)(*4*) less $15,262 (amount due with first and second installment)	17,463

(B) Because the total amount of estimated tax available to apply towards the amount due for the final installment ($24,738 ($20,000 that is timely paid on the third installment date plus $4,738 overpayment of the second installment)) exceeds the amount required to be paid on or before this date if the estimated tax were one hundred percent of the tax determined by placing on an annualized basis the taxable income for the first 7-month period for the taxable year taking into account the number of months in the short taxable year, the exception described in §1.6655–2(a) applies and no addition to tax will be imposed for the final installment due on September 15, 2007.

(h) *Preceding taxable year a short taxable year*. If the preceding taxable year referred to in section 6655(d)(1) was a short taxable year, the tax computed on the basis of the facts shown on the return for such preceding year, for purposes of determining the applicability of the exception described in section 6655(d)(2), shall be the tax computed on the annual basis in the manner described in section 443(b)(1) (prior to the reduction of the tax liability in the manner described in the last sentence).

(i) *Effective date*. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

§1.6655–6 Methods of accounting.

(a) *In general*. In computing any required installment, a corporation must use the methods of accounting used in computing taxable income for the taxable year for which estimated tax is being determined (the current taxable year).

(b) *Exceptions*—(1) *Automatic accounting method changes*. If a taxpayer is making a change in method of accounting for the current taxable year that is permitted to be made with the automatic consent of the Commissioner, the new method of accounting shall be used in determining any required installment if, and only if, the copy of the Form 3115, "*Application for Change in Accounting Method*," has been mailed to the IRS National Office on or before the last day of the annualization period.

(2) *Non-automatic accounting method changes*. If a taxpayer is making a change in method of accounting for the current taxable year that requires the prior consent of the Commissioner, the new method of accounting shall be used in determining any required installment if, and only if, the consent agreement reflecting the Commissioner's consent to the change in method of accounting and the prescribed terms and conditions for effecting such change has been signed by the taxpayer and mailed to the IRS National Office on or before the last day of the annualization period.

(c) *Examples*. The following examples illustrate the rules of this section:

Example 1. X corporation, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate its 2006 required installments. X receives advance payments each taxable year with respect to agreements for the sale of goods properly includible in X's inventory. The advance payments received by X qualify for deferral under §1.451–5(c). Although X is eligible to defer the advance payments in accordance with §1.451–5(c), X's method of accounting with respect to the advance payments is to include the advance payments in income when received. If, as of the last day of the annualization period, X's method of accounting for advance payments is to include the advance payments in income when received, and the requirements of paragraph (b)(1) or (b)(2) of this section, as applicable, are not met, then X must use that method of accounting for purposes of computing such required installment.

Example 2. Y corporation, a calendar year taxpayer, uses an accrual method of accounting and the annualization method under section 6655(e)(2)(A)(i) to calculate its 2006 required installments. Y computes its annual taxable income by deducting its liability for state income taxes in the taxable year the

taxes are paid, without regard to the recurring item exception of section 461(h) and the regulations. If, as of the last day of the annualization period, Y's method of accounting for state income taxes is to deduct such taxes in the taxable year the taxes are paid without regard to the recurring item exception, and the requirements of paragraph (b)(1) or (b)(2) of this section, as applicable, are not met, then Y must use that method of accounting for purposes of computing such required installment.

(d) *Effective date*. This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

Par. 12. Newly designated §1.6655–7 is revised to read as follows:

§1.6655–7 Addition to tax on account of excessive adjustment under section 6425.

(a) Section 6655(h) imposes an addition to the tax under chapter 1 of the Internal Revenue Code in the case of any excessive amount (as defined in paragraph (c) of this section) of an adjustment under section 6425 that is made before the 15th day of the third month following the close of a taxable year beginning after December 31, 1967. This addition to tax is imposed whether or not there was reasonable cause for an excessive adjustment.

(b) If the amount of an adjustment under section 6425 is excessive, there shall be added to the tax under chapter 1 of the Internal Revenue Code for the taxable year an amount determined at the annual rate referred to in the regulations under section 6621 upon the excessive amount from the date on which the credit is allowed or refund paid to the 15th day of the third month following the close of the taxable year. A refund is paid on the date it is allowed under section 6407.

(c) The excessive amount is equal to the lesser of the amount of the adjustment or the amount by which—

(1) The income tax liability (as defined in section 6425(c)) for the taxable year, as shown on the return for the taxable year; exceeds

(2) The estimated income tax paid during the taxable year, reduced by the amount of the adjustment.

(d) The computation of the addition to the tax imposed by section 6425 is made independent of, and does not affect the computation of, any addition to the tax that a corporation may otherwise owe for an underpayment of an installment of estimated tax.

(e) The following example illustrates the rules of this section:

Example. (i) Corporation X, a calendar year taxpayer, had an underpayment as defined in section 6655(b), for its fourth installment of estimated tax that was due on December 15, 2006, in the amount of $10,000. On January 2, 2007, X filed an application for adjustment of overpayment of estimated income tax for 2006 in the amount of $20,000.

(ii) On February 16, 2007, the IRS, in response to the application, refunded $20,000 to X. On March 15, 2007, X filed its 2006 tax return and made a payment in settlement of its total tax liability. Assuming that the addition to tax is computed under section 6621(a)(2) at a rate of 8% per annum for the applicable periods of underpayment, under section 6655(a), X is subject to an addition to tax in the amount of $197 (90/365 X $10,000 X 8%) on account of X's December 15, 2006, underpayment. Under section 6655(h), X is subject to an addition to tax in the amount of $118 (27/365 X $20,000 X 8%) on account of X's excessive adjustment under section 6425. In determining the amount of the addition to tax under section 6655(a) for failure to pay estimated income tax, the excessive adjustment under section 6425 is not taken into account.

(f) An adjustment is generally to be treated as a reduction of estimated income tax paid as of the date of the adjustment. However, for purposes of §1.6655–1 through §1.6655–6, the adjustment is to be treated as if not made in determining whether there has been any underpayment of estimated income tax and, if there is an underpayment, the period during which the underpayment existed.

(g) This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 13. The authority citation for part 301 continues to read, in part, as follows:

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

Par. 14. Section 301.6655–1 is revised to read as follows:

§301.6655–1 Failure by corporation to pay estimated income tax.

(a) For regulations under section 6655, see §§1.6655–1 through 1.6655–7 of this chapter.

(b) This section applies to taxable years beginning after the date that is 30 days after the date the final regulations are published in the **Federal Register**.

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

(Filed by the Office of the Federal Register on December 7, 2005, 8:45 a.m., and published in the issue of the Federal Register for December 12, 2005, 70 F.R. 73393)

Foundations Status of Certain Organizations

Announcement 2006–5

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

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

2nd Chance Young Adult Organization, Seattle, WA
29 11 Student Ministries, Mars Hill, NC
E. 107th St. Oldtimers Alumni, New York, NY
A. E. Thomas Foundation for Integrative Medicine, Albuquerque, NM
After School Tutoring Homework Assistance Program, Hazelton, PA
AGAPE, Hobbs, NM
America Health Care Resuscitation Organization, New York, NY
Association of Priest, Inc., Jacksonville, FL
Avalon R & D, Inc., Williamsville, NY
Baskets of Hope, Brecksville, OH
Ben Rush Elementary School Foundation, Redmond, WA
Bexar County Youth in Action, San Antonio, TX
Bright Future Foundation, Beverly Hills, CA
Broadcast Freedom International, Inc., Blandford, MA

Bucks County Affordable Housing Corporation, Doylestown, PA
Buffalo Soldiers Foundation, Ft. Myer, FL
Capoeira Arts Foundation, Inc., Berkeley, CA
Carequest Group, Inc., Memphis, TN
Carl Aven Ministries, Inc., Catoosa, OK
Casa Major, Inc., Fountain Valley, CA
Center for US-Japan Comparative Social Studies, San Diego, CA
Chicago Metropolitan Development Association, Aurora, IL
Child & Family Development Services, Inc., Tulsa, OK
Childrens Amputee Foundation, Inc., Greensboro, NC
City Youth Adventures, Cincinnati, OH
Compassion Unlimited IC, Chico, CA
Connections to Success, Houston, TX
Costa Rica-Latin America School Supplies, Inc., Palm Bay, FL
Daughters of the King of Judah Ministry, Albany, GA
Destiny Foundation, Moss Point, MS
Doc Communications Media Group, Somerset, NJ
Educators Basketball Association, Inc., Boyds, MD
El Segundo Youth Football & Cheerleading, Inc., Redondo Beach, CA
Elementary Decisions, Inc., Richmond, VA
Fathers on Rights for Custody Equality, Louisville, KY
Firearms Owners Against Crime Educational Fund, Inc., McDonald, PA
First Homebuyers Group, Inc., Greensboro, NC
Fort Smith Christian School Foundation, Fort Smith, AR
Garden City Boxing Club, Garden City, KS
Gehazi Group Home, Inc., Railto, CA
Georgia Guides, Inc., Reidsville, GA
Grace Foundation, Folsom, CA
Great American Duck Race of Deming, Inc., Deming, NM
Greater Houston Charismatic Youth Center, Inc., Pasadena, TX
Harris Low Income Medication Assistance Organization, Huntington, WV
Hawthorne Smith House Lil Bit of Heaven, Dallas, TX
Hokkaido International School Endowment Fund, Inc., Portland, OR
Homes for the Hopeless, Rocky Mount, NC
Hope and a Future, Inc., Suitland, MD
House of Dreams, Inc., Rockmart, GA
Humanitarian Force, Fayetteville, NC
Illinois State Police Heritage Foundation, Incorporated, Springfield, IL
Images for Nonprofit, Inc., Wilmette, IL
Inland Mom & Dad Mission, Ontario, CA
Inspiring Excellence, Tucson, AZ
Institute for the Study of American Religion, Santa Barbara, CA
International Healing Network, Inc., Houston, TX
International Museum of Military History, Dighton, MA
Islam & the Community of Sacramento, Sacramento, CA
Jeremiah Group, Inc., Pontevedra Beach, FL
Justus Curry Foundation, Husum, WA
Kansas City Eritrean Development Foundation, Kansas City, MO
Kimberly Asther Ministries, Roland, AR
King Works, Inc., Tampa, FL
Kitchen K – A Design Gallery, Inc., Washington, DC
Last Resort Foundation, Inc., Hercules, CA
Lay Claim Gods New Covenant Ministry, St. Louis, MO
Liberty Historical Society, Inc., Kansas City, MO
Life's Blood Ministry, Colorado Springs, CO
Light of the Trinity Montessori School, Inc., West Orange, NJ
Literacy Indiana, Inc., Bloomington, IN
Memorable Moments Wishes and Youth Services, Inc., Birmingham, AL
Men Against Domestic Violence, Bonifay, FL
Meristem, Inc., Brooklyn, NY
Metropolitan Alliance, Inc., Washington, DC
Metropolitan New York Chapter Delaware State Univ. Alumni Assoc., Bronx, NY
Mid-Texas Cultural Center, Inc., New Braunfels, TX
Mission Endowment Fund of Malta Lutheran Church, Malta, MT
Mount Olive Adult Day Care Home, Charlotte, NC
Music With a Mission, Inc., Lexington, KY
New Future Education Fund, San Marino, CA
New Jerusalem Assistance Ministries, Houston, TX
Norman Borlaug Heritage Foundation, Cresco, IA
North Firefighters Benevolent Fund, Inc., Naples, FL
North Hills Jaycees Foundation Charitable Trust, Simi Valley, CA
Northeast Mississippi Heritage Tr, Corinth, MS
Northern Tier Neighborhood Crime Watch, Great Bend, PA
Northwest Action Council, Inc., Chicago, IL
NSI-Hannibal Riverbluff, Inc., Bowling Green, MO
Oak Center Neighborhood Association, Oakland, CA
Oklahoma Film Academy, Tulsa, OK
Ole Gilliam Mill Park, Sandford, NC
Omentum Research Foundation, San Gabriel, CA
On My Way, Atlanta, GA
One Accord Asset Development Fund, Hilliard, OH
One By One, Inc., Clarkston, GA
Open Door Society, Inc., N. Hollywood, CA
Organization for Islamic Learning, Charlottesville, VA
Peace B Still Foundation, Inc., Lehigh Acres, FL
Pennfield Parent Teacher and Student Organization, Battle Creek, MI
People Awareness Council, Inc., American Falls, ID
Planet Dog Philanthropy, Portland, ME
Prescott Center for Nonviolent Communication, Prescott, AZ
Pro Desarrollo Comunitario Prodecom, Inc., Los Angeles, CA
Project R O S E – B U D S, Inc., Romeoville, IL
Prop Development Group, Missouri City, TX
Real Malibu Players, Malibu, CA
Residents Council of Harriet Tubman Terrace Apartments, Detroit, MI
Resource Alliance, Inc., Washington, DC
Right One Corporation, Los Angeles, CA
Rocky Mountain Horse Foundation, Tabernash, CO
Rowland Youth Club, Greentown, PA
Saegertown Heritage Society, Saegertown, PA
Saints Helping Saints Community Outreach, Inc., Victorville, CA
Selective Multi-Services, Inc., Bronx, NY
Sequel Mental Health, Detroit, MI
Serenity Village, Inc., Eastman, GA
Sierra Watch, Piedmont, CA

Sociedad Humantaria Pro-Animales, Inc., Guayama, PR
Sons of Thunder Ministries, Lathrup Village, MI
St. Mark Development Corporation, Inc., Cincinnati, OH
Sunshine Ethority, Far Rockaway, NY
The Way, Norman, OK
Threshold–The Next Step, Inc., Reedville, VA
Triad of West Virginia, Inc., Charleston, WV
Turning Point Emergency Shelter, Houston, TX
United Cancer Research Foundation, Longhorne, PA
Victoria Lions Fastpitch Association, Victoria, MN
West End Clinic, Inc., St. Louis, MO
West Tallahatchie County Consortium, Inc., Webb, MS
Wilson Community Development Corp., Phoenix, AZ
Winters Institute, Winters, CA
Witness, Inc., Albuquerque, NM
Woodruff-Adams Foundation, Poplar Bluff, MO
World of Wonders, Port St. Lucie, FL
Wound Biotechnology Foundation, Inc., Boston, MA
Yeshua Foundation, Inc., Elgin, IL

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

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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