Internal Revenue
bulletin

Bulletin No. 2006-10
March 6, 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

Rev. Rul. 2006–10, page 557.

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

T.D. 9249, page 546.

Final regulations under section 468B of the Code provide rules for the taxation and reporting of income earned on qualified settlement funds, escrow accounts established in connection with sales of property, and disputed ownership funds. Rev. Rul. 77–230 obsoleted.

REG–113365–04, page 580.

Proposed regulations under section 468B of the Code withdraw in part a notice of proposed rulemaking and re-propose rules relating to the taxation of the income earned on escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property, and propose rules under section 7872 of the Code regarding below-market loans to facilitators of these exchanges. A public hearing is scheduled for June 6, 2006.

Notice 2006–7, page 559.

This notice, which supplements Notice 2005–98, 2005–52 I.R.B. 1211, provides guidance with respect to facilities that may be financed with the proceeds of clean renewable energy bonds under section 54(a) of the Code. In addition, the notice provides guidance with respect to the entities that may own facilities financed with the proceeds of clean renewable energy bonds and the entities that may issue clean renewable energy bonds. Notice 2005–98 supplemented.

ADMINISTRATIVE

REG–122380–02, page 563.

Proposed regulations under section 330 of title 31 of the U.S. Code provide proposed amendments to the provisions of Circular 230 relating to various non-shelter items. This document proposes amendments reflecting the Treasury Department and the IRS consideration of the comments received in response to the 2002 advance notice of proposed rulemaking and reflecting amendments to section 330 of title 31 made by the American Jobs Creation Act of 2004. The regulations also include conforming amendments to reflect the final regulations relating to best practices, covered opinions and other written advice published as T.D. 9165, 2005–4 I.R.B. 357, and as T.D. 9201, 2005–23 I.R.B. 1153, but do not otherwise address those final regulations. A public hearing is scheduled for June 21, 2006.

Notice 2006–17, page 559.

This notice states that the deadline to make an election under section 165(i) of the Code to deduct in the preceding taxable year certain losses attributable to Hurricane Katrina, Rita, or Wilma is postponed until October 16, 2006.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Notice 2006–20, page 560.

This notice supplements Notice 2005–73, 2005–42 I.R.B. 723, News Release IR–2005–112, Notice 2005–81, 2005–47 I.R.B. 977, and Notice 2005–66, 2005–40 I.R.B. 620, which, under the authority of section 7508A, postponed until February 28, 2006, deadlines for certain taxpayers affected by Hurricane Katrina to perform the acts described in Notice 2005–73 (*e.g.*, filing returns and other documents, payment of taxes), and for the Internal Revenue Service (IRS) to perform the acts described in Notice 2005–81 (*e.g.*, assessment, collection). The notice further postpones those deadlines through August 28, 2006, for the IRS and for affected taxpayers in the parishes in Louisiana and the counties in Mississippi and Alabama that the Federal Emergency Management Agency (FEMA) determined were eligible for individual assistance. Notices 2005–66, 2005–73, and 2005–81 supplemented.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

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

The adjusted applicable federal long-term rate is set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 468B.—Special Rules for Designated Settlement Funds

26 CFR 1. 468B–1: Qualified settlement funds.

T.D. 9249

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

Escrow Funds and Other Similar Funds

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the taxation and reporting of income earned on qualified settlement funds and certain other escrow accounts, trusts, and funds, and other related rules. The final regulations affect qualified settlement funds, escrow accounts established in connection with sales of property, disputed ownership funds, and the parties to these escrow accounts, trusts, and funds.

DATES: *Effective Date*: These regulations are effective on February 3, 2006.

Applicability Dates: For dates of applicability, see §§1.468B–5(c), 1.468B–7(f), and 1.468B–9(j).

FOR FURTHER INFORMATION CONTACT: Richard Shevak or A. Katharine Jacob Kiss, (202) 622–4930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(d)) under control number 1545–1631. The collections of information in §§1.468B–1(k)(2) and 1.468B–9(c)(2)(ii) are to obtain benefits and the collection of information in §1.468B–9(g) is mandatory.

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

The estimated annual burden per respondent is .40 hours.

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

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

Background

This document contains amendments to 26 CFR part 1 under section 468B of the Internal Revenue Code (Code). This document does not adopt §1.468B–6 of a notice of proposed rulemaking (REG–209619–93, 1999–1 C.B. 689) published in the **Federal Register** on February 1, 1999 (64 FR 4801), relating to the current taxation and reporting of income earned on qualified settlement funds and certain other escrow accounts, trusts, and funds, which is withdrawn and reproposed by a notice of proposed rulemaking (REG–113365–04) published elsewhere in this issue of the Bulletin. This document also does not adopt §1.468B–8 of the notice of proposed rulemaking, which is reserved.

Section 468B was added to the Code by section 1807(a)(7)(A) of the Tax Reform Act of 1986, Public Law 99–514 (100 Stat. 2814), and was amended by

section 1018(f) of the Technical and Miscellaneous Revenue Act of 1988, Public Law 100–647 (102 Stat. 3582). Section 468B(g) provides that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income taxation, and that the Secretary shall prescribe regulations providing for the taxation of such accounts or funds, whether as a grantor trust or otherwise.

On December 23, 1992, final regulations (T.D. 8459, 1993–1 C.B. 68) under section 468B(g) concerning the taxation of qualified settlement funds (QSF) were published in the **Federal Register** (57 FR 60983) (the QSF regulations). The QSF regulations do not address the taxation of other types of escrow accounts, trusts, or funds. The preamble to the QSF regulations states that future regulations would address the income tax treatment of accounts, trusts, or funds other than QSFs, specifically, escrow accounts used in the sale of property and section 1031 qualified escrow accounts.

On February 1, 1999, the IRS and the Treasury Department published a notice of proposed rulemaking (REG–209619–93) in the **Federal Register** (64 FR 4801) regarding the proposed income tax treatment of these other funds. The proposed regulations provide rules for taxing income earned by (1) qualified escrow accounts and qualified trusts used in deferred like-kind exchanges under section 1031, (2) pre-closing escrows used in sales or exchanges of real or personal property, (3) contingent-at-closing escrows established on account of contingencies existing at the closing of certain sales of business or investment property, and (4) disputed ownership funds established under the jurisdiction of a court to hold money or property subject to disputed claims of ownership. Additionally, the proposed regulations provide rules permitting a transferor to a QSF to elect taxation of the QSF as a grantor trust.

Written comments responding to the notice of proposed rulemaking were received. A public hearing was held on May 12, 1999. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions and Summary of Comments

1. *Election to Treat a Qualified Settlement Fund as a Grantor Trust Under §1.468B–1(k)*

The proposed regulations provide that, if there is only one transferor to a qualified settlement fund, the transferor may make an election to treat the qualified settlement fund as a grantor trust, all of which is treated as owned by the transferor (a grantor trust election). The election may be revoked only for compelling circumstances upon consent of the Commissioner by private letter ruling.

Commentators recommended expanding the scope of the grantor trust election by allowing the election even if there are multiple transferors to a qualified settlement fund. Certain commentators suggested that this rule could be limited to situations in which all of the grantors are members of the same consolidated group. These comments were not adopted because they would result in undue complexity. For example, extending the grantor trust election to multiple-transferor trusts would require the allocation of items of income, deduction and credit (including capital gains and losses) among the various transferors. Although §1.671–3 of the Income Tax Regulations contains rules for making such allocations, the IRS and the Treasury Department do not believe that these rules address the complex sharing arrangements that may arise in a qualified settlement fund. Moreover, if some, but not all, of the transferors elected grantor trust treatment, another allocation method would be necessary to allocate the items of income, deduction, and credit (including capital gains and losses) between the grantor trust portion of the fund and the qualified settlement fund portion of the fund.

Commentators recommended allowing transferors to make the grantor trust election in taxable years after the taxable year in which the fund is established. This comment was not adopted because allowing a grantor trust election for a taxable year other than the taxable year in which the fund is established gives rise to complex issues regarding the tax treatment of the fund upon conversion to a grantor trust. For example, any deduction claimed by the transferor for amounts contributed to the qualified settlement fund would need to be recaptured. Further, adjustments would be necessary to take into account income previously taxed to the qualified settlement fund and differences in the accounting methods used by the transferor and the fund.

However, the final regulations allow a transferor to a qualified settlement fund to elect grantor trust treatment for the fund's first taxable year and all subsequent years if the fund was established on or before February 3, 2006, and the applicable period of limitations for filing an amended return has not expired for the qualified settlement fund's first and all subsequent taxable years, and for the transferor's corresponding taxable years. To make the grantor trust election, the qualified settlement fund and the transferor must amend all affected income tax returns.

2. *Treatment of Section 1031 Qualified Escrow Accounts and Qualified Trusts under §1.468B–6*

Section 1.468B–6 of the proposed regulations provides rules for the current taxation of income of a qualified escrow account or qualified trust used in a deferred exchange under section 1031. The proposed regulations provide that, in general, the taxpayer (the transferor of the property) is the owner of the assets in a qualified escrow account or qualified trust and must take into account all items of income, deduction, and credit (including capital gains and losses) of the qualified escrow account or qualified trust. However, if, under the facts and circumstances, a qualified intermediary or the transferee has the beneficial use and enjoyment of the assets, then the qualified intermediary or transferee is the owner of the assets in the qualified escrow account or qualified trust and must take into account all items of income, deduction, and credit (including capital gains and losses) of the qualified escrow account or qualified trust. In addition to other relevant facts and circumstances, the proposed regulations list three factors that will be considered in determining whether the qualified intermediary or transferee, rather than the taxpayer, has the beneficial use and enjoyment of assets of a qualified escrow account or qualified trust. The proposed regulations further

provide that, if a qualified intermediary or transferee is the owner of the assets transferred, section 7872 may apply if the deferred exchange involves a below-market loan from the taxpayer to the owner.

The comments reflected substantial disagreement on the proper rules for taxing these arrangements. For example, some commentators recommended that the facts and circumstances test be replaced by a *per se* rule requiring transferors to take into account the trust's or account's income in all cases. Other commentators urged that the ownership factors should apply in all circumstances. Commentators suggested that the rules of §1.468B–6 should apply to all funds held by qualified intermediaries as well as to funds held in a qualified escrow account or qualified trust, while other commentators argued that the rules should apply only to qualified escrow accounts and qualified trusts. Some commentators agreed that certain of these transactions create below-market loans, and other commentators asserted that the transactions do not create below-market loans.

The IRS and the Treasury Department have concluded that these issues merit further consideration. Therefore, a notice of proposed rulemaking published elsewhere in this issue of the Bulletin withdraws that portion of the notice of proposed rulemaking that relates to the current taxation of income of a qualified escrow account or qualified trust used in a deferred exchange under section 1031. This section has been omitted from the final regulations and is published as proposed regulations elsewhere in this issue of the Bulletin. The preamble to those proposed regulations more fully discusses the comments received.

3. *Pre-Closing Escrows under §1.468B–7*

Section 1.468B–7 provides rules for the taxation of income earned on certain escrows established in connection with the sale of property, or pre-closing escrows. The proposed regulations require the purchaser to take into account all items of income, deduction, and credit (including capital gains and losses) of the pre-closing escrow. The only comments received with respect to this section relate to reporting obligations of the escrow holder or trustee. Those comments are addressed later in this preamble. The final regulations adopt §1.468B–7 as proposed with minor changes to improve clarity.

4. *Contingent-at-Closing Escrows under §1.468B–8*

Section 1.468B–8 of the proposed regulations provides rules for taxing the income of a contingent-at-closing escrow, which is an escrow account, trust, or fund established in connection with the sale or exchange of real or personal property to account for contingencies existing at closing. The proposed regulations provide that, in computing taxable income, the purchaser must take into account all items of income, deduction, and credit (including capital gains and losses) of the escrow until the date on which specified events occur or fail to occur (the determination date). Beginning on the determination date, the purchaser and seller must each take into account the income, deductions, and credits of the escrow that correspond to their respective ownership interests in each asset of the escrow.

The IRS and the Treasury Department have concluded that this section requires further consideration. Therefore, this section has been omitted from the final regulations and will be published as separate regulations.

5. *Disputed Ownership Funds under §1.468B–9*

Section 1.468B–9 provides rules for the taxation of a disputed ownership fund (DOF). Under the proposed regulations, a DOF is an escrow account, trust, or fund that is not a QSF and that (1) is established to hold money or property subject to conflicting claims of ownership, (2) is subject to the continuing jurisdiction of a court, and (3) requires approval of the court to pay or distribute money or property to, or on behalf of, a claimant or transferor.

The final regulations specifically exclude bankruptcy estates under title 11 of the United States Code from the definition of disputed ownership funds to avoid conflict with section 1398, which provides rules for the taxation of bankruptcy estates in cases under chapters 7 and 11 of title 11 involving individual debtors, and section 1399, which provides that no separate taxable entity results from the commencement of a case under title 11 except in a case to which section 1398 applies.

The final regulations also exclude liquidating trusts from the definition of disputed ownership fund, although they may have a similar purpose, because liquidating trusts are taxed as grantor trusts. See §301.7701–4(d), which provides that a liquidating trust is organized for the primary purpose of liquidating and distributing assets. However, in the case of certain liquidating trusts established in connection with bankruptcy proceedings, it is uncertain who is properly taxable on income earned with respect to assets set aside to satisfy disputed claims of creditors. Therefore, the trustee of a liquidating trust established pursuant to a plan confirmed by the court in a case under title 11 of the United States Code may, in its first taxable year, elect to treat an escrow account, trust, or fund that holds assets of the liquidating trust that are subject to disputed claims as a disputed ownership fund. The trustee makes an election to treat this portion of the liquidating trust as a DOF by attaching an election statement to a timely filed Federal income tax return of the DOF for the taxable year for which the election becomes effective. The trustee may revoke the election only with the Commissioner's consent by private letter ruling. The regulations do not otherwise affect the rules for the taxation of liquidating trusts.

Under the proposed and final regulations, a DOF generally is taxable (1) as a QSF under §1.468B–2 if all the assets transferred to the fund are passive assets, or (2) as a C corporation in all other cases. The claimants to a DOF also may request a private letter ruling proposing an alternative method of taxation. These final regulations clarify that a DOF holding exclusively passive assets is taxable under §1.468B–2 as if it were a qualified settlement fund, but is not subject to all of the rules applicable to qualified settlement funds. Additionally, because the final regulations include certain rules that differ from, and apply in lieu of, the rules in §1.468B–2, the final regulations expressly identify the provisions of §1.468B–2 that do not apply.

The final regulations generally follow the substantive rules of the proposed regulations, but have been restructured for greater clarity. For example, the final regulations provide separate paragraphs for rules applicable to a transferor that is not a claimant to the DOF as well as rules ap-

plicable to a transferor that is a claimant (transferor-claimant).

Unless a grantor trust election is made, the transfer of money or property to a qualified settlement fund generally gives rise to economic performance. In contrast, under both the proposed regulations and the final regulations, the transfer of money or property to a DOF gives rise to economic performance only if the transferor does not claim ownership of any part of the property that is transferred to the DOF (the transferor is not a transferor-claimant). The transfer of property to the DOF is not treated as a transfer to the claimants for economic performance purposes if the transferor continues to claim ownership of some or all of the transferred property. Consistent with this approach, the proposed regulations provide that, if the transferor claims ownership of the transferred property after the transfer to the fund, then the transfer of property to the DOF is not treated as a sale or exchange under section 1001 and the transferor is not taxed on distributions that the transferor receives from the DOF.

The final regulations further provide that a distribution from the DOF to a transferor-claimant is not treated as a sale or exchange under section 1001(a). Distributions from the DOF to claimants other than the transferor-claimant are deemed to be made first to the transferor-claimant and then from the transferor-claimant to another claimant. These rules are intended to put the transferor-claimant in the same position for purposes of determining whether a deduction is allowable with respect to the transfer as it would have been in if the money or property had not been transferred first to a DOF.

A commentator requested that the final regulations exempt court registry funds from the rules for DOFs. The commentator asserted that complying with the DOF rules would impose an undue burden on courts. This comment was not adopted because an exemption for court registry funds would be inconsistent with section 468B(g), which requires current income taxation of escrow accounts, settlement funds, and similar funds. Because court registry funds are similar to escrow accounts and settlement funds, they fall within the plain meaning of the statute. The commentator also requested clarification of whether bail bonds or appellate bonds filed with a court are DOFs. The final regulations include an example to clarify that these types of surety bonds do not create DOFs.

6. *Information Reporting Requirements*

Generally, §§1.468B–6 through 1.468B–8 of the proposed regulations state that an escrow holder (escrow agent, trustee or other person responsible for administering the escrow) must report the income of an escrow account, trust, or fund on a Form 1099 "in accordance with" subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Code (currently, sections 6041 through 6050T). Several commentators expressed concern that these provisions expand the existing information reporting obligations in sections 6041 through 6050T.

The proposed regulations were not intended to create new information reporting requirements but merely to alert escrow holders and other responsible persons of the potential obligation to report. To clarify this intent, the final regulations provide that a payor must report to the extent required by sections 6041 through 6050T and these regulations.

Effect on Other Documents

Rev. Rul. 77–230, 1977–2 C.B. 214, is obsolete as of February 3, 2006.

Effective Date

The regulations apply to qualified settlement funds, pre-closing escrows, and disputed ownership funds created after February 3, 2006. A transferor to a qualified settlement fund, however, may make a grantor trust election for a qualified settlement fund created on or before February 3, 2006, if the applicable period of limitations on filing an amended return has not expired for the qualified settlement fund's first taxable year and all subsequent taxable years and for the transferor's corresponding taxable year or years. Additionally, for pre-closing escrows and disputed ownership funds established after August 16, 1986, but before February 3, 2006, the IRS will not challenge a reasonable, consistently applied method of taxation.

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. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Final Regulatory Flexibility Act Analysis

This final regulatory flexibility analysis has been prepared for this Treasury decision under 5 U.S.C. 604. The objective of the regulations is to ensure that the income of certain escrow accounts, trusts, and funds is subject to current taxation by identifying the proper party or parties subject to tax. Section 468B(g) provides the legal basis for the requirements of the regulations. The IRS and the Treasury Department are not aware of any Federal rules that may duplicate, overlap, or conflict with the regulations. An explanation is provided below of the burdens on small entities resulting from the requirements of the regulations. A description also is provided of alternative rules that were considered by the IRS and the Treasury Department but rejected as too burdensome.

1. *Grantor Trust Election*

Under §1.468B–1(k), a transferor to a qualified settlement fund may elect to have the qualified settlement fund treated as a grantor trust all of which is owned by the transferor (grantor trust election). The election is available only to a qualified settlement fund established after February 3, 2006. However, a transferor may make a grantor trust election under §1.468B–1(k) for a qualified settlement fund that was established on or before February 3, 2006, if the applicable period of limitations on filing an amended return has not expired for both the qualified settlement fund's first taxable year and all subsequent taxable years and the transferor's corresponding taxable year or years.

To make a grantor trust election, a transferor must attach a statement to a timely filed (including extensions) Form

1041, *"U.S. Income Tax Return for Estates and Trusts."* The statement must include the transferor's name, address, taxpayer identification number, and the legend, "§1.468B–1(k) Election."

Approximately 900 qualified settlement fund returns are filed each year. Only a small number of these returns are filed for newly created qualified settlement funds. Because a grantor trust election may be made only for a qualified settlement fund that has one transferor, the IRS and the Treasury Department believe that a very small number of grantor trust elections will be made each year.

Similarly, the IRS and the Treasury Department believe that a very small number of grantor trust elections will be made for past years. A retroactive grantor trust election may impose an additional burden on a taxpayer because the taxpayer may be required to file amended returns. However, this election is voluntary.

The alternatives to the regulations are (1) to limit the grantor trust election by permitting the elections only for QSFs established on or after the date the final regulations are published, or (2) to eliminate the opportunity to make a grantor trust election by retaining the current rules, which do not permit the election. These alternatives were rejected because they might result in a greater burden on small entities than that imposed by these regulations.

2. *Disputed Ownership Funds*

Section 1.468B–9(c)(1) provides that a disputed ownership fund is a separate taxable entity.

Section 1.468B–9(g) requires that a transferor provide to the IRS and the administrator of a disputed ownership fund a statement that itemizes the property other than cash transferred to the disputed ownership fund during the calendar year. The statement must indicate the basis and holding period of the property. This information is required to substantiate the transfer and to determine the proper tax consequences of the transfer to the fund and of a transfer of property from the fund to a claimant. To minimize the burden, no statement is required for transfers of cash and any two or more transferors may provide a combined statement. There are no known alternatives to these rules that are less burdensome to small entities and accomplish the purpose of the regulations.

The trustee of a liquidating trust established pursuant to a plan confirmed by the court in a case under title 11 of the United States Code may, in the liquidating trust's first taxable year, elect to treat an escrow account, trust, or fund that holds assets of the liquidating trust that are subject to disputed claims as a disputed ownership fund. The trustee makes an election by attaching an election statement to a timely filed Federal income tax return of the disputed ownership fund for the taxable year for which the election becomes effective. This election is voluntary. There are no known alternatives to this requirement that are less burdensome and accomplish the purpose of the regulations.

The IRS and the Treasury Department estimate that there are approximately 5,000 disputed ownership funds created annually. Many of these funds do not involve small entities.

Drafting Information

The principal authors of these regulations are Richard Shevak and A. Katharine Jacob Kiss of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by:

a. Removing the entries for "Section 1.468B" and "Sections 1.468B–0 through 1.468B–5."

b. Adding entries for §§1.468B–1 through 1.468B–9.

The additions read as follows:

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

Section 1.468B–1 also issued under 26 U.S.C. 461(h) and 468B(g).

Section 1.468B–2 also issued under 26 U.S.C. 461(h) and 468B(g).

Section 1.468B–3 also issued under 26 U.S.C. 461(h) and 468B(g).

Section 1.468B–4 also issued under 26 U.S.C. 461(h) and 468B(g).

Section 1.468B–5 also issued under 26 U.S.C. 461(h) and 468B(g).

Section 1.468B–7 also issued under 26 U.S.C. 461(h) and 468B(g).

Section 1.468B–9 also issued under 26 U.S.C. 461(h) and 468B(g).* * *

Par. 2. Section 1.468B–0 is amended by:

a. Revising the introductory text of §1.468B–0.

b. Revising the entries for §1.468B–1, paragraph (k).

c. Adding an entry for §1.468B–1, paragraph (l).

d. Revising the entry for the section heading for §1.468B–5.

e. Adding an entry for §1.468B–5, paragraph (c).

f. Adding entries for §§1.468B–6 through 1.468B–9.

The additions and revisions read as follows:

§1.468B–0 Table of contents.

This section lists the table of contents for §§1.468B–1 through 1.468B–9.

§1.468B–1 Qualified settlement funds.

* * * * *

(k) Election to treat a qualified settlement fund as a subpart E trust.

(1) In general.

(2) Manner of making grantor trust election.

(i) In general.

(ii) Requirements for election statement.

(3) Effect of making the election.

(l) Examples.

* * * * *

§1.468B–5 Effective dates and transition rules applicable to qualified settlement funds.

* * * * *

(c) Grantor trust elections under §1.468B–1(k).

(1) In general.

(2) Transition rules.

(3) Qualified settlement funds established by the U.S. government on or before February 3, 2006.

§1.468B–6 Escrow accounts, trusts, and other funds used in deferred exchanges of like-kind property under section 1031(a)(3). [Reserved].

§1.468B–7 Pre-closing escrows.

(a) Scope.
(b) Definitions.
(c) Taxation of pre-closing escrows.
(d) Reporting obligations of the administrator.
(e) Examples.
(f) Effective dates.
(1) In general.
(2) Transition rule.

§1.468B–8 Contingent-at-closing escrows. [Reserved].

§1.468B–9 Disputed ownership funds.

(a) Scope.
(b) Definitions.
(c) Taxation of a disputed ownership fund.
(1) In general.
(2) Exceptions.
(3) Property received by the disputed ownership fund.
(i) Generally excluded from income.
(ii) Basis and holding period.
(4) Property distributed by the disputed ownership fund.
(i) Computing gain or loss.
(ii) Denial of deduction.
(5) Taxable year and accounting method.
(6) Unused carryovers.
(d) Rules applicable to transferors that are not transferor-claimants.
(1) Transfer of property.
(2) Economic performance.
(i) In general.
(ii) Obligations of the transferor.
(3) Distributions to transferors.
(i) In general.
(ii) Exception.
(iii) Deemed distributions.
(e) Rules applicable to transferor-claimants.
(1) Transfer of property.
(2) Economic performance.
(i) In general.
(ii) Obligations of the transferor-claimant.
(3) Distributions to transferor-claimants.
(i) In general.
(ii) Deemed distributions.
(f) Distributions to claimants other than transferor-claimants.
(g) Statement to the disputed ownership fund and the Internal Revenue Service with respect to transfers of property other than cash.
(1) In general.
(2) Combined statements.
(3) Information required on the statement.
(h) Examples.
(i) [Reserved]
(j) Effective dates.
(1) In general.
(2) Transition rule.

Par. 3. Section 1.468B–1 is amended by redesignating paragraph (k) as paragraph (l) and adding a new paragraph (k) to read as follows:

§1.468B–1 Qualified settlement funds.

* * * * *

(k) *Election to treat a qualified settlement fund as a subpart E trust*—(1) *In general*. If a qualified settlement fund has only one transferor (as defined in paragraph (d)(1) of this section), the transferor may make an election (grantor trust election) to treat the qualified settlement fund as a trust all of which is owned by the transferor under section 671 and the regulations thereunder. A grantor trust election may be made whether or not the qualified settlement fund would be classified, in the absence of paragraph (b) of this section, as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder. A grantor trust election may be revoked only for compelling circumstances upon consent of the Commissioner by private letter ruling.

(2) *Manner of making grantor trust election*—(i) *In general*. To make a grantor trust election, a transferor must attach an election statement satisfying the requirements of paragraph (k)(2)(ii) of this section to a timely filed (including extensions) Form 1041, *"U.S. Income Tax Return for Estates and Trusts,"* that the administrator files on behalf of the qualified settlement fund for the taxable year in which the qualified settlement fund is established. However, if a Form 1041 is not otherwise required to be filed (for example, because the provisions of §1.671–4(b) apply), then the transferor makes a grantor trust election by attaching an election statement satisfying the requirements of paragraph (k)(2)(ii) of this section to a timely filed (including extensions) income tax return of the transferor for the taxable year in which the qualified settlement fund is established. See §1.468B–5(c)(2) for transition rules.

(ii) *Requirements for election statement*. The election statement must include a statement by the transferor that the transferor will treat the qualified settlement fund as a grantor trust. The election statement must include the transferor's name, address, taxpayer identification number, and the legend, "§1.468B–1(k) Election." The election statement and the statement described in §1.671–4(a) may be combined into a single statement.

(3) *Effect of making the election*. If a grantor trust election is made—

(i) Paragraph (b) of this section, and §§1.468B–2, 1.468B–3, and 1.468B–5(a) and (b) do not apply to the qualified settlement fund. However, this section (except for paragraph (b) of this section) and §1.468B–4 apply to the qualified settlement fund;

(ii) The qualified settlement fund is treated, for Federal income tax purposes, as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder;

(iii) The transferor must take into account in computing the transferor's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified settlement fund in accordance with §1.671–3(a)(1); and

(iv) The reporting obligations imposed by §1.671–4 on the trustee of a trust apply to the administrator.

* * * * *

Par. 4. Section 1.468B–5 is amended by revising the section heading and adding paragraph (c) to read as follows:

§1.468B–5 Effective dates and transition rules applicable to qualified settlement funds.

* * * * *

(c) *Grantor trust elections under §1.468B–1(k)*—(1) *In general*. A transferor may make a grantor trust election under §1.468B–1(k) if the qualified settlement fund is established after February 3, 2006.

(2) *Transition rules*. A transferor may make a grantor trust election under §1.468B–1(k) for a qualified settlement fund that was established on or before February 3, 2006, if the applicable period of limitation on filing an amended return has not expired for both the qualified settlement fund's first taxable year and all subsequent taxable years and the transferor's corresponding taxable year or years. A grantor trust election under this paragraph (c)(2) requires that the returns of the qualified settlement fund and the transferor for all affected taxable years are consistent with the grantor trust election. This requirement may be satisfied by timely filed original returns or amended returns filed before the applicable period of limitation expires.

(3) *Qualified settlement funds established by the U.S. government on or before February 3, 2006*. If the U.S. government, or any agency or instrumentality thereof, established a qualified settlement fund on or before February 3, 2006, and the fund would have been classified as a trust all of which is treated as owned by the U.S. government under section 671 and the regulations thereunder without regard to the regulations under section 468B, then the U.S. government is deemed to have made a grantor trust election under §1.468B–1(k), and the election is applicable for all taxable years of the fund.

Par. 5. Section 1.468B–6 is added and reserved to read as follows:

§1.468B–6 Escrow accounts, trusts, and other funds used in deferred exchanges of like-kind property under section 1031(a)(3). [Reserved].

Par. 6. Section 1.468B–7 is added to read as follows:

§1.468B–7 Pre-closing escrows.

(a) *Scope*. This section provides rules under section 468B(g) for the current taxation of income of a pre-closing escrow.

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

(1) A *pre-closing escrow* is an escrow account, trust, or fund—

(i) Established in connection with the sale or exchange of real or personal property;

(ii) Funded with a down payment, earnest money, or similar payment that is deposited into the escrow prior to the sale or exchange of the property;

(iii) Used to secure the obligation of the purchaser to pay the purchase price for the property;

(iv) The assets of which, including any income earned thereon, will be paid to the purchaser or otherwise distributed for the purchaser's benefit when the property is sold or exchanged (for example, by being distributed to the seller as a credit against the purchase price); and

(v) Which is not an escrow account or trust established in connection with a deferred exchange under section 1031(a)(3).

(2) *Purchaser* means, in the case of an exchange, the intended transferee of the property whose obligation to pay the purchase price is secured by the pre-closing escrow;

(3) *Purchase price* means, in the case of an exchange, the required consideration for the property; and

(4) *Administrator* means the escrow agent, escrow holder, trustee, or other person responsible for administering the pre-closing escrow.

(c) *Taxation of pre-closing escrows*. The purchaser must take into account in computing the purchaser's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the pre-closing escrow. In the case of an exchange with a single pre-closing escrow funded by two or more purchasers, each purchaser must take into account in computing the purchaser's income tax liability all items of income, deduction, and credit (including capital gains and losses) earned by the pre-closing escrow with respect to the money or property deposited in the pre-closing escrow by or on behalf of that purchaser.

(d) *Reporting obligations of the administrator*. For each calendar year (or portion thereof) that a pre-closing escrow is in existence, the administrator must report the income of the pre-closing escrow on Form 1099 to the extent required by the information reporting provisions of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code and the regulations thereunder. See §1.6041–1(f) for rules relating to the amount to be reported when fees, expenses, or commissions owed by a payee to a third party are deducted from a payment.

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

Example 1. P enters into a contract with S for the purchase of residential property owned by S for the price of $200,000. P is required to deposit $10,000 of earnest money into an escrow. At closing, the $10,000 and the interest earned thereon will be credited against the purchase price of the property. The escrow is a pre-closing escrow. P is taxable on the interest earned on the pre-closing escrow prior to closing.

Example 2. X and Y enter into a contract in which X agrees to exchange certain construction equipment for residential property owned by Y. The contract requires X and Y to each deposit $10,000 of earnest money into an escrow. At closing, $10,000 and the interest earned thereon will be paid to X and $10,000 and the interest earned thereon will be paid to Y. The escrow is a pre-closing escrow. X is taxable on the interest earned prior to closing on the $10,000 of funds X deposited in the pre-closing escrow. Similarly, Y is taxable on the interest earned prior to closing on the $10,000 of funds Y deposited in the pre-closing escrow.

(f) *Effective dates*—(1) *In general*. This section applies to pre-closing escrows established after February 3, 2006.

(2) *Transition rule*. With respect to a pre-closing escrow established after August 16, 1986, but on or before February 3, 2006, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the escrow or a reasonable, consistently applied method for reporting the income.

Par. 7. Section 1.468B–8 is added and reserved to read as follows:

§1.468B–8 Contingent-at-closing escrows. [Reserved].

Par. 8. Section 1.468B–9 is added to read as follows:

§1.468B–9 Disputed ownership funds.

(a) *Scope*. This section provides rules under section 468B(g) relating to the current taxation of income of a disputed ownership fund.

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

(1) *Disputed ownership fund* means an escrow account, trust, or fund that—

(i) Is established to hold money or property subject to conflicting claims of ownership;

(ii) Is subject to the continuing jurisdiction of a court;

(iii) Requires the approval of the court to pay or distribute money or property to, or on behalf of, a claimant, transferor, or transferor-claimant; and

(iv) Is not a qualified settlement fund under §1.468B–1, a bankruptcy estate (or part thereof) resulting from the commencement of a case under title 11 of the United States Code, or a liquidating trust under §301.7701–4(d) of this chapter (except as provided in paragraph (c)(2)(ii) of this section);

(2) *Administrator* means a person designated as such by a court having jurisdiction over a disputed ownership fund, however, if no person is designated, the administrator is the escrow agent, escrow holder, trustee, receiver, or other person responsible for administering the fund;

(3) *Claimant* means a person who claims ownership of, in whole or in part, or a legal or equitable interest in, money or property immediately before and immediately after that property is transferred to a disputed ownership fund;

(4) *Court* means a court of law or equity of the United States or of any state (including the District of Columbia), territory, possession, or political subdivision thereof;

(5) *Disputed property* means money or property held in a disputed ownership fund subject to the claimants' conflicting claims of ownership;

(6) *Related person* means any person that is related to a transferor within the meaning of section 267(b) or 707(b)(1);

(7) *Transferor* means, in general, a person that transfers disputed property to a disputed ownership fund, except that—

(i) If disputed property is transferred by an agent, fiduciary, or other person acting in a similar capacity, the transferor is the person on whose behalf the agent, fiduciary, or other person acts; and

(ii) A payor of interest or other income earned by a disputed ownership fund is not a transferor within the meaning of this section (unless the payor is also a claimant);

(8) *Transferor-claimant* means a transferor that claims ownership of, in whole or in part, or a legal or equitable interest in, the disputed property immediately before and immediately after that property is transferred to the disputed ownership fund. Because a transferor-claimant is both a transferor and a claimant, generally the terms *transferor* and *claimant* also include a transferor-claimant. See paragraph (d) of this section for rules applicable only to transferors that are not transferor-claimants and paragraph (e) of this section for rules applicable only to transferors that are also transferor-claimants.

(c) *Taxation of a disputed ownership fund*—(1) *In general*. For Federal income tax purposes, a disputed ownership fund is treated as the owner of all assets that it holds. A disputed ownership fund is treated as a C corporation for purposes of subtitle F of the Internal Revenue Code, and the administrator of the fund must obtain an employer identification number for the fund, make all required income tax and information returns, and deposit all tax payments. Except as otherwise provided in this section, a disputed ownership fund is taxable as—

(i) A C corporation, unless all the assets transferred to the fund by or on behalf of transferors are passive investment assets. For purposes of this section, passive investment assets are assets of the type that generate portfolio income within the meaning of §1.469–2T(c)(3)(i); or

(ii) A qualified settlement fund, if all the assets transferred to the fund by or on behalf of transferors are passive investment assets. A disputed ownership fund taxable as a qualified settlement fund under this section is subject to all the provisions contained in §1.468B–2, except that the rules contained in paragraphs (c)(3), (4), and (c)(5)(i) of this section apply in lieu of the rules in §1.468B–2(b)(1), (d), (e), (f) and (j).

(2) *Exceptions*. (i) The claimants to a disputed ownership fund may submit a private letter ruling request proposing a method of taxation different than the method provided in paragraph (c)(1) of this section.

(ii) The trustee of a liquidating trust established pursuant to a plan confirmed by the court in a case under title 11 of the United States Code may, in the liquidating trust's first taxable year, elect to treat an escrow account, trust, or fund that holds assets of the liquidating trust that are subject to disputed claims as a disputed ownership fund. Pursuant to this election, creditors holding disputed claims are not treated as transferors of the money or property transferred to the disputed ownership fund. A trustee makes the election by attaching a statement to the timely filed Federal income tax return of the disputed ownership fund for the taxable year for which the election becomes effective. The election statement must include a statement that the trustee will treat the escrow account, trust, or fund as a disputed ownership fund and must include a legend, "§1.468B–9(c) Election," at the top of the page. The election may be revoked only upon consent of the Commissioner by private letter ruling.

(3) *Property received by the disputed ownership fund*—(i) *Generally excluded from income*. In general, a disputed ownership fund does not include an amount in income on account of a transfer of disputed property to the disputed ownership fund. However, the accrual or receipt of income from the disputed property in a disputed ownership fund is not a transfer of disputed property to the fund. Therefore, a disputed ownership fund must include in income all income received or accrued from the disputed property, including items such as—

(A) Payments to a disputed ownership fund made in compensation for late or delayed transfers of money or property;

(B) Dividends on stock of a transferor (or a related person) held by the fund; and

(C) Interest on debt of a transferor (or a related person) held by the fund.

(ii) *Basis and holding period*. In general, the initial basis of property transferred by, or on behalf of, a transferor to a disputed ownership fund is the fair market value of the property on the date of transfer to the fund, and the fund's holding period begins on the date of the transfer. However, if the transferor is a transferor-claimant, the fund's initial basis in the property is the same as the basis of the transferor-claimant immediately before the transfer to the fund, and the fund's holding period for the property is determined under section 1223(2).

(4) *Property distributed by the disputed ownership fund*—(i) *Computing gain or loss*. Except in the case of a distribution or deemed distribution described in paragraph (e)(3) of this section, a disputed ownership fund must treat a distribution of disputed property as a sale or exchange of that property for purposes of section 1001(a). In computing gain or loss, the

amount realized by the disputed ownership fund is the fair market value of that property on the date of distribution.

(ii) *Denial of deduction*. A disputed ownership fund is not allowed a deduction for a distribution of disputed property or of the net after-tax income earned by the disputed ownership fund made to or on behalf of a transferor or claimant.

(5) *Taxable year and accounting method*. (i) A disputed ownership fund taxable as a C corporation under paragraph (c)(1)(i) of this section may compute taxable income under any accounting method allowable under section 446 and is not subject to the limitations contained in section 448. A disputed ownership fund taxable as a C corporation may use any taxable year allowable under section 441.

(ii) A disputed ownership fund taxable as a qualified settlement fund under paragraph (c)(1)(ii) of this section may compute taxable income under any accounting method allowable under section 446 and may use any taxable year allowable under section 441.

(iii) Appropriate adjustments must be made by a disputed ownership fund or transferors to the fund to prevent the fund and the transferors from taking into account the same item of income, deduction, gain, loss, or credit (including capital gains and losses) more than once or from omitting such items. For example, if a transferor that is not a transferor-claimant uses the cash receipts and disbursements method of accounting and transfers an account receivable to a disputed ownership fund that uses an accrual method of accounting, at the time of the transfer of the account receivable to the disputed ownership fund, the transferor must include in its gross income the value of the account receivable because, under paragraph (c)(3)(ii) of this section, the disputed ownership fund will take a fair market value basis in the receivable and will not include the fair market value in its income when received from the transferor or when paid by the customer. If the account receivable were transferred to the disputed ownership fund by a transferor-claimant using the cash receipts and disbursements method, however, the disputed ownership fund would take a basis in the receivable equal to the transferor's basis, or $0, and would be required to report the income upon collection of the account.

(6) *Unused carryovers*. Upon the termination of a disputed ownership fund, if the fund has an unused net operating loss carryover under section 172, an unused capital loss carryover under section 1212, or an unused tax credit carryover, or if the fund has, for its last taxable year, deductions in excess of gross income, the claimant to which the fund's net assets are distributable will succeed to and take into account the fund's unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year of the fund. If the fund's net assets are distributable to more than one claimant, the unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year must be allocated among the claimants in proportion to the value of the assets distributable to each claimant from the fund. Unused carryovers described in this paragraph (c)(6) are not money or other property for purposes of paragraph (e)(3)(ii) of this section and thus are not deemed transferred to a transferor-claimant before being transferred to the claimants described in this paragraph (c)(6).

(d) *Rules applicable to transferors that are not transferor-claimants*. The rules in this paragraph (d) apply to transferors (as defined in paragraph (b)(7) of this section) that are not transferor-claimants (as defined in paragraph (b)(8) of this section).

(1) *Transfer of property*. A transferor must treat a transfer of property to a disputed ownership fund as a sale or other disposition of that property for purposes of section 1001(a). In computing the gain or loss on the disposition, the amount realized by the transferor is the fair market value of the property on the date the transfer is made to the disputed ownership fund.

(2) *Economic performance*—(i) *In general*. For purposes of section 461(h), if a transferor using an accrual method of accounting has a liability for which economic performance would otherwise occur under §1.461–4(g) when the transferor makes payment to the claimant or claimants, economic performance occurs with respect to the liability when and to the extent that the transferor makes a transfer to a disputed ownership fund to resolve or satisfy that liability.

(ii) *Obligations of the transferor*. Economic performance does not occur when a transferor using an accrual method of accounting issues to a disputed ownership fund its debt (or provides the debt of a related person). Instead, economic performance occurs as the transferor (or related person) makes principal payments on the debt. Economic performance does not occur when the transferor provides to a disputed ownership fund its obligation (or the obligation of a related person) to provide property or services in the future or to make a payment described in §1.461–4(g)(1)(ii)(A). Instead, economic performance occurs with respect to such an obligation as property or services are provided or payments are made to the disputed ownership fund or a claimant. With regard to interest on a debt issued or provided to a disputed ownership fund, economic performance occurs as determined under §1.461–4(e).

(3) *Distributions to transferors*—(i) *In general*. Except as provided in section 111(a) and paragraph (d)(3)(ii) of this section, the transferor must include in gross income any distribution to the transferor (including a deemed distribution described in paragraph (d)(3)(iii) of this section) from the disputed ownership fund. If property is distributed, the amount includible in gross income and the basis in that property are generally the fair market value of the property on the date of distribution.

(ii) *Exception*. A transferor is not required to include in gross income a distribution of money or property that it previously transferred to the disputed ownership fund if the transferor did not take into account, for example, by deduction or capitalization, an amount with respect to the transfer either at the time of the transfer to, or while the money or property was held by, the disputed ownership fund. The transferor's gross income does not include a distribution of money from the disputed ownership fund equal to the net after-tax income earned on money or property transferred to the disputed ownership fund by the transferor while that money or property was held by the fund. Money distributed to a transferor by a disputed ownership fund will be deemed to be distributed first from the money or property transferred to the disputed ownership fund by that transferor, then from the net after-tax income of any

money or property transferred to the disputed ownership fund by that transferor, and then from other sources.

(iii) *Deemed distributions*. If a disputed ownership fund makes a distribution of money or property on behalf of a transferor to a person that is not a claimant, the distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to make a payment to the actual recipient.

(e) *Rules applicable to transferor-claimants*. The rules in this paragraph (e) apply to transferor-claimants (as defined in paragraph (b)(8) of this section).

(1) *Transfer of property*. A transfer of property by a transferor-claimant to a disputed ownership fund is not a sale or other disposition of the property for purposes of section 1001(a).

(2) *Economic performance*—(i) *In general*. For purposes of section 461(h), if a transferor-claimant using an accrual method of accounting has a liability for which economic performance would otherwise occur under §1.461–4(g) when the transferor-claimant makes payment to another claimant, economic performance occurs with respect to the liability when and to the extent that the disputed ownership fund transfers money or property to the other claimant to resolve or satisfy that liability.

(ii) *Obligations of the transferor-claimant*. Economic performance does not occur when a disputed ownership fund transfers the debt of a transferor-claimant (or of a person related to the transferor-claimant) to another claimant. Instead, economic performance occurs as principal payments on the debt are made to the other claimant. Economic performance does not occur when a disputed ownership fund transfers to another claimant the obligation of a transferor-claimant (or of a person related to the transferor-claimant) to provide property or services in the future or to make a payment described in §1.461–4(g)(1)(ii)(A). Instead, economic performance occurs with respect to such an obligation as property or services are provided or payments are made to the other claimant. With regard to interest on a debt issued or provided to a disputed ownership fund, economic performance occurs as determined under §1.461–4(e).

(3) *Distributions to transferor-claimants*—(i) *In general*. The gross income of a transferor-claimant does not include a distribution to the transferor-claimant (including a deemed distribution described in paragraph (e)(3)(ii) of this section) of money or property from a disputed ownership fund that the transferor-claimant previously transferred to the fund, or the net after-tax income earned on that money or property while it was held by the fund. If such property is distributed to the transferor-claimant by the disputed ownership fund, then the transferor-claimant's basis in the property is the same as the disputed ownership fund's basis in the property immediately before the distribution.

(ii) *Deemed distributions*. If a disputed ownership fund makes a distribution of money or property to a claimant or makes a distribution of money or property on behalf of a transferor-claimant to a person that is not a claimant, the distribution is deemed made by the fund to the transferor-claimant. The transferor-claimant, in turn, is deemed to make a payment to the actual recipient.

(f) *Distributions to claimants other than transferor-claimants*. Whether a claimant other than a transferor-claimant must include in gross income a distribution of money or property from a disputed ownership fund generally is determined by reference to the claim in respect of which the distribution is made.

(g) *Statement to the disputed ownership fund and the Internal Revenue Service with respect to transfers of property other than cash*—(1) *In general*. By February 15 of the year following each calendar year in which a transferor (or other person acting on behalf of a transferor) makes a transfer of property other than cash to a disputed ownership fund, the transferor must provide a statement to the administrator of the fund setting forth the information described in paragraph (g)(3) of this section. The transferor must attach a copy of this statement to its return for the taxable year of transfer.

(2) *Combined statements*. If a disputed ownership fund has more than one transferor, any two or more transferors may provide a combined statement to the administrator. If a combined statement is used, each transferor must attach a copy of the combined statement to its return and maintain with its books and records a schedule describing each asset that the transferor transferred to the disputed ownership fund.

(3) *Information required on the statement*. The statement required by paragraph (g)(1) of this section must include the following information—

(i) A legend, "§1.468B–9 Statement," at the top of the first page;

(ii) The transferor's name, address, and taxpayer identification number;

(iii) The disputed ownership fund's name, address, and employer identification number;

(iv) A statement declaring whether the transferor is a transferor-claimant;

(v) The date of each transfer;

(vi) A description of the property (other than cash) transferred; and

(vii) The disputed ownership fund's basis in the property and holding period on the date of transfer as determined under paragraph (c)(3)(ii) of this section.

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

Example 1. (i) X Corporation petitions the United States Tax Court in 2006 for a redetermination of its tax liability for the 2003 taxable year. In 2006, the Tax Court determines that X Corporation is liable for an income tax deficiency for the 2003 taxable year. X Corporation files an appellate bond in accordance with section 7485(a) and files a notice of appeal with the appropriate United States Court of Appeals. In 2006, the Court of Appeals affirms the decision of the Tax Court and the United States Supreme Court denies X Corporation's petition for a writ of certiorari.

(ii) The appellate bond that X Corporation files with the court for the purpose of staying assessment and collection of deficiencies pending appeal is not an escrow account, trust or fund established to hold property subject to conflicting claims of ownership. Although X Corporation was found liable for an income tax deficiency, ownership of the appellate bond is not disputed. Rather, the bond serves as security for a disputed liability. Therefore, the bond is not a disputed ownership fund.

Example 2. (i) The facts are the same as *Example 1*, except that X Corporation deposits United States Treasury bonds with the Tax Court in accordance with section 7845(c)(2) and 31 U.S.C. 9303.

(ii) The deposit of United States Treasury bonds with the court for the purpose of staying assessment and collection of deficiencies while X Corporation prosecutes an appeal does not create a disputed ownership fund because ownership of the bonds is not disputed.

Example 3. (i) Prior to A's death, A was the insured under a life insurance policy issued by X, an insurance company. X uses an accrual method of accounting. Both A's current spouse and A's former spouse claim to be the beneficiary under the policy and entitled to the policy proceeds ($1 million). In 2005, X files an interpleader action and deposits $1 million into the registry of the court. On June 1, 2006,

a final determination is made that A's current spouse is the beneficiary under the policy and entitled to the money held in the registry of the court. The interest earned on the registry account is $12,000. The money in the registry account is distributed to A's current spouse.

(ii) The money held in the registry of the court consisting of the policy proceeds and the earnings thereon are a disputed ownership fund taxable as if it were a qualified settlement fund. See paragraphs (b)(1) and (c)(1)(ii) of this section. The fund's gross income does not include the $1 million transferred to the fund by X, however, the $12,000 interest is included in the fund's gross income in accordance with its method of accounting. See paragraph (c)(3)(i) of this section. Under paragraph (c)(4)(ii) of this section, the fund is not allowed a deduction for a distribution to A's current spouse of the $1 million or the interest income earned by the fund.

(iii) X is a transferor that is not a transferor-claimant. See paragraphs (b)(7) and (b)(8) of this section.

(iv) Whether A's current spouse must include in income the $1 million insurance proceeds and the interest received from the fund is determined under other provisions of the Internal Revenue Code. See paragraph (f) of this section.

Example 4. (i) Corporation B and unrelated individual C claim ownership of certain rental property. B uses an accrual method of accounting. The rental property is property used in a trade or business. B claims to have purchased the property from C's father. However, C asserts that the purported sale to B was ineffective and that C acquired ownership of the property through intestate succession upon the death of C's father. For several years, B has maintained and received the rent from the property.

(ii) Pending the resolution of the title dispute between B and C, the title to the rental property is transferred to a court-supervised registry account on February 1, 2005. On that date the court appoints R as receiver for the property. R collects the rent earned on the property and hires employees necessary for the maintenance of the property. The rents paid to R cannot be distributed to B or C without the court's approval.

(iii) On June 1, 2006, the court makes a final determination that the rental property is owned by C. The court orders C to refund to B the purchase price paid by B to C's father plus interest on that amount from February 1, 2005. The court also orders that a distribution be made to C of all funds held in the court registry consisting of the rent collected by R and the income earned thereon. C takes title to the rental property.

(iv) The rental property and the funds held by the court registry are a disputed ownership fund under paragraph (b)(1) of this section. The fund is taxable as if it were a C corporation because the rental property is not a passive investment asset within the meaning of paragraph (c)(1)(i) of this section.

(v) The fund's gross income does not include the value of the rental property transferred to the fund by B. See paragraph (c)(3)(i) of this section. Under paragraph (c)(3)(ii) of this section, the fund's initial basis in the property is the same as B's adjusted basis immediately before the transfer to the fund and the fund's holding period is determined under section 1223(2). The fund's gross income includes the rents collected by R and any income earned thereon. For the period between February 1, 2005, and June 1, 2006, the fund may be allowed deductions for depreciation and for the costs of maintenance of the property because the fund is treated as owning the property during this period. See sections 162, 167, and 168. Under paragraph (c)(4)(ii) of this section, the fund may not deduct the distribution to C of the property, or the rents (or any income earned thereon) collected from the property while the fund holds the property. No gain or loss is recognized by the fund from this distribution or from the fund's transfer of the rental property to C pursuant to the court's determination that C owns the property. See paragraphs (c)(4)(i) and (e)(3) of this section.

(vi) B is the transferor to the fund. Under paragraphs (b)(8) and (e)(1) of this section, B is a transferor-claimant and does not recognize gain or loss under section 1001(a) on transfer of the property to the disputed ownership fund. The money and property distributed from the fund to C is deemed to be distributed first to B and then transferred from B to C. See paragraph (e)(3)(ii) of this section. Under paragraph (e)(2)(i) of this section, economic performance occurs when the disputed ownership fund transfers the property and any earnings thereon to C. The income tax consequences of the deemed transfer from B to C as well as the income tax consequences of C's refund to B of the purchase price paid to C's father and interest thereon are determined under other provisions of the Internal Revenue Code.

(i) [Reserved]

(j) *Effective dates*—(1) *In general.* This section applies to disputed ownership funds established after February 3, 2006.

(2) *Transition rule.* With respect to a disputed ownership fund established after August 16, 1986, but on or before February 3, 2006, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the fund, transfers to the fund, and distributions made by the fund.

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 9. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 10. In §602.101, paragraph (b) is amended by adding entries in numerical order to read, in part, as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.468B–1	1545–1631
1.468B–9	1545–1631
* * * * *	

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

Approved January 30, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 3, 2006, 8:45 a.m., and published in the issue of the Federal Register for February 7, 2006, 71 F.R. 6197)

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

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

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

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

Rev. Rul. 2006–10

This revenue ruling provides various prescribed rates for federal income tax purposes for March 2006 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2006–10 TABLE 1

Applicable Federal Rates (AFR) for March 2006

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.58%	4.53%	4.50%	4.49%
110% AFR	5.04%	4.98%	4.95%	4.93%
120% AFR	5.51%	5.44%	5.40%	5.38%
130% AFR	5.98%	5.89%	5.85%	5.82%
Mid-term				
AFR	4.51%	4.46%	4.44%	4.42%
110% AFR	4.97%	4.91%	4.88%	4.86%
120% AFR	5.42%	5.35%	5.31%	5.29%
130% AFR	5.88%	5.80%	5.76%	5.73%
150% AFR	6.80%	6.69%	6.63%	6.60%
175% AFR	7.96%	7.81%	7.74%	7.69%
Long-term				
AFR	4.68%	4.63%	4.60%	4.59%
110% AFR	5.15%	5.09%	5.06%	5.04%
120% AFR	5.64%	5.56%	5.52%	5.50%
130% AFR	6.11%	6.02%	5.98%	5.95%

REV. RUL. 2006–10 TABLE 2

Adjusted AFR for March 2006

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.15%	3.13%	3.12%	3.11%
Mid-term adjusted AFR	3.50%	3.47%	3.46%	3.45%
Long-term adjusted AFR	4.23%	4.19%	4.17%	4.15%

REV. RUL. 2006–10 TABLE 3

Rates Under Section 382 for March 2006

Adjusted federal long-term rate for the current month	4.23%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.36%

REV. RUL. 2006–10 TABLE 4

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

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

REV. RUL. 2006–10 TABLE 5

Rate Under Section 7520 for March 2006

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.4%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of March 2006. See Rev. Rul. 2006-10, page 557.

Part III. Administrative, Procedural, and Miscellaneous

Clean Renewable Energy Bonds

Notice 2006–7

SECTION 1. PURPOSE

This notice provides guidance with respect to facilities that may be financed with the proceeds of clean renewable energy bonds under § 54(a) of the Internal Revenue Code (the Code). In addition, this notice provides guidance with respect to the entities that may own facilities financed with the proceeds of clean renewable energy bonds and the entities that may issue clean renewable energy bonds. This notice supplements Notice 2005–98, 2005–52 I.R.B. 1211, which was published on December 27, 2005.

SECTION 2. BACKGROUND

Section 1303 of the Energy Tax Incentives Act of 2005, Pub. L. No. 109–58, added § 54 to the Code. In general, § 54 authorizes up to $800,000,000 of tax credit bonds to be issued by qualified issuers to finance certain renewable energy projects described in § 45(d) of the Code.

Section 54(a) provides that a taxpayer that holds a "clean renewable energy bond" on one or more credit allowance dates of the bond occurring during any taxable year is allowed as a nonrefundable credit against Federal income tax for the taxable year an amount equal to the sum of the credits determined under § 54(b) with respect to such dates. Section 54(d) provides that a "clean renewable energy bond" means any bond issued as part of an issue if: (1) the bond is issued by a qualified issuer pursuant to an allocation by the Secretary to the issuer of a portion of the national clean renewable energy bond limitation under § 54(f)(2); (2) 95 percent or more of the proceeds of the issue are to be used for capital expenditures incurred by qualified borrowers for one or more qualified projects; (3) the qualified issuer designates the bond for purposes of § 54 and the bond is in registered form; and (4) the issue meets certain requirements described in § 54(h) with respect to the expenditure of bond proceeds.

Section 54(j)(4) defines a "qualified issuer" as: (1) a clean renewable energy bond lender (as defined in § 54(j)(2)); (2) a cooperative electric company (as defined in § 54(j)(1)); or (3) a governmental body. Section 54(j)(3) defines the term "governmental body" as any State, territory, possession of the United States, the District of Columbia, Indian tribal government, or any political subdivision thereof. Section 54(j)(5) provides that a "qualified borrower" is: (1) a mutual or cooperative electric company described in § 501(c)(12) or § 1381(a)(2)(C); or (2) a governmental body. Section 54(d)(2)(A) defines the term "qualified project" as any of the qualified facilities described in §§ 45(d)(1) through (d)(9) (determined without regard to any placed in service date) owned by a qualified borrower.

Notice 2005–98 solicits applications for allocations of the $800,000,000 clean renewable energy bond limitation and provides guidance on certain other matters under § 54.

SECTION 3. TEMPORARY REGULATIONS

The Treasury Department and the Internal Revenue Service intend to issue temporary and proposed regulations (the "Temporary Regulations") under § 54 to provide guidance to holders and issuers of clean renewable energy bonds. It is anticipated that the Temporary Regulations will provide, in part, as follows:

1. For purposes of § 54, the term "qualified project" includes any facility owned by a qualified borrower that is functionally related and subordinate (as determined under § 1.103–8(a)(3) of the Income Tax Regulations) to any qualified facility described in §§ 45(d)(1) through (d)(9) (determined without regard to any placed in service date) and owned by such borrower.

2. For purposes of § 54, the term "political subdivision" will have the same meaning as in § 1.103–1.

3. A clean renewable energy bond may be issued on behalf of a State or political subdivision within the meaning of § 1.103–1(b) under rules similar to those for determining whether a bond issued on behalf of a State or political subdivision, constitutes an obligation of that State or political subdivision for purposes of § 103.

4. For purposes of § 54, the term "qualified borrower" includes an instrumentality of a State or political subdivision (as determined for purposes of § 103).

SECTION 4. DRAFTING INFORMATION

The principal authors of this notice are Timothy L. Jones and Aviva M. Roth of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding this notice, contact Timothy L. Jones or Aviva M. Roth at (202) 622–3980 (not a toll-free call).

Postponement of Deadline for Making an Election to Deduct Certain Losses Attributable to Hurricanes Katrina, Rita, and Wilma

Notice 2006–17

PURPOSE

This notice under § 7508A of the Internal Revenue Code postpones until October 16, 2006, the deadline to make an election under § 165(i) to deduct in the preceding taxable year losses attributable to Hurricane Katrina, Rita, or Wilma sustained in Presidentially declared disaster areas in Alabama, Louisiana, Florida, Mississippi, and Texas eligible for Public Assistance or Public Assistance and Individual Assistance.

BACKGROUND

Section 165(i) provides that if a taxpayer sustains a loss attributable to a disaster occurring in an area subsequently determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. §§ 5121–5206 (the Stafford Act), the taxpayer may elect to deduct that

loss on the taxpayer's return for the taxable year immediately preceding the taxable year in which the disaster occurred. For purposes of § 165(i), a disaster includes an event declared a major disaster that occurred in an area later determined by the Federal Emergency Management Agency (FEMA) to be eligible for Individual Assistance, Public Assistance, or both, under the Stafford Act.

Generally, § 1.165–11(e) of the Income Tax Regulations provides that a taxpayer must make the § 165(i) election by filing a return, an amended return, or a refund claim on or before the later of (1) the due date of the taxpayer's income tax return (determined without regard to any extension of time for filing the return) for the taxable year in which the disaster actually occurred, or (2) the due date of the taxpayer's income tax return (determined with regard to any extension of time for filing the return) for the immediately preceding taxable year. The election is irrevocable 90 days after it is made.

Section 7508A provides the Secretary with authority to postpone the time for performing certain acts under the internal revenue laws for up to one year for a taxpayer affected by a Presidentially declared disaster. Section 301.7508A–1(c)(1) of the Regulations on Procedure and Administration lists several specific acts performed by taxpayers for which § 7508A relief may apply, and § 301.7508A–1(c)(1)(vii) allows the Secretary to specify additional acts. Section 301.7508A–1(d)(1) describes several types of "affected taxpayers" eligible for relief under § 7508A. Section 301.7508A–1(d)(1)(vii) authorizes the Service to determine that any other person is affected by a Presidentially declared disaster and therefore eligible for relief. Under § 301.7508A–1(d)(2), the area of a Presidentially declared disaster for which the Service has determined that the postponement of one or more deadlines applies is referred to as a "covered disaster area."

AFFECTED TAXPAYERS FOR WHICH THE SECTION 165(i) DEADLINE IS POSTPONED

Under the authority of § 7508A and § 301.7508A–1(d)(2), the Service has determined that the counties and parishes that FEMA has determined to be eligible for Public Assistance or Public Assistance and Individual Assistance pursuant to the major disaster declarations issued in response to Hurricanes Katrina, Rita, and Wilma, are covered disaster areas. *See* Notice 2005–73, 2005–42 I.R.B. 723 (October 17, 2005) (Katrina); IRS News Release IR–2005–110 (Rita); IRS News Release IR–2005–128 (Wilma); and Publication 4492 for a list of counties and parishes constituting covered disaster areas.

Under the authority of § 301.7508A–1(d)(1)(vii), a taxpayer is an "affected taxpayer" to which the postponement of the deadline for making the § 165(i) election applies if (1) the taxpayer sustained a loss attributable to Hurricane Katrina, Rita, or Wilma; (2) the loss occurred in the covered disaster area for the hurricane (regardless of whether the taxpayer's principal residence or principal place of business is in one of the covered disaster areas); and (3) the deadline for the taxpayer to make a § 165(i) election for that loss, but for this notice, would be before October 16, 2006.

Affected taxpayers for purposes of this notice and the § 165(i) election are not affected taxpayers for purposes of other relief provided by the Service unless the taxpayer separately qualifies as an affected taxpayer under other guidance issued by the Service. *See* Notice 2005–73, IR–2005–110, and IR–2005–128 for the definition of an affected taxpayer for purposes of Hurricanes Katrina, Rita, and Wilma.

GRANT OF RELIEF

Under the authority of § 7508A, affected taxpayers, as defined above, are granted a postponement to October 16, 2006, to make an election under § 165(i) for losses attributable to Hurricane Katrina, Rita, or Wilma.

In order to assist the Service in identifying affected taxpayers to ensure that they receive the extension to make the § 165(i) election, affected taxpayers should mark "Hurricane Katrina," "Hurricane Rita," or "Hurricane Wilma" in red ink on the top of the return, amended return, or refund claim on which they are making the election. See Publication 4492 for special instructions on completing forms to make the § 165(i) election for a loss attributable to Hurricane Katrina, Rita, or Wilma.

This notice is limited to making of an election under § 165(i) and does not affect the application of any other section of the Code or the regulations.

DRAFTING INFORMATION

The principal author of this notice is Norma Rotunno of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Rotunno at (202) 622–7900 (not a toll-free call).

Additional Postponement of Deadlines for Certain Taxpayers Affected By Hurricane Katrina

Notice 2006–20

PURPOSE

This notice supplements Notice 2005–73, 2005–42 I.R.B. 723 (October 17, 2005); News Release IR–2005–112 (September 28, 2005); Notice 2005–81, 2005–47 I.R.B. 977 (November 21, 2005); and Notice 2005–66, 2005–40 I.R.B. 620 (October 3, 2005) which, under the authority of section 7508A, postponed until February 28, 2006, deadlines for certain taxpayers affected by Hurricane Katrina to perform the acts described in Notice 2005–73 (*e.g.*, filing returns and other documents, payment of taxes), and for the Internal Revenue Service (IRS) to perform the acts described in Notice 2005–81 (*e.g.*, assessment and collection of tax). This notice further postpones those deadlines through August 28, 2006, for the IRS and for affected taxpayers in the parishes in Louisiana and the counties in Mississippi and Alabama that the Federal Emergency Management Agency (FEMA) determined were eligible for Individual Assistance or Individual and Public Assistance.

Affected Parishes and Counties

On August 28, 2005 and August 29, 2005, the President issued four federal disaster declarations pertaining to Hurricane Katrina. The disaster declarations included the states of Louisiana, Mississippi, and Alabama. The Presidential declarations authorized FEMA, under the

Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. §§ 5121–5206, to provide assistance to counties and parishes in each state. Under that authority, FEMA determined that certain counties and parishes within those states were eligible for Individual Assistance or Individual and Public Assistance.

Both FEMA and the IRS have closely monitored the effects of Hurricane Katrina in the Gulf region and, due to continued widespread devastation from the hurricane and subsequent flooding, the IRS has determined that certain parishes and counties in Louisiana and Mississippi require additional disaster relief. These counties and parishes were hit the hardest by Hurricane Katrina and its aftermath and either remain uninhabitable or have a large number of displaced individuals and/or trailers in use as temporary housing. These include Cameron, Jefferson, Orleans, Plaquemines, St. Bernard, St. Charles, and St. Tammany parishes in Louisiana, and Hancock, Harrison, and Jackson counties in Mississippi. The Service will automatically provide the additional relief described below to affected taxpayers in these parishes and counties.

In addition, the IRS has determined that some affected taxpayers in other parishes and counties in Louisiana, Mississippi, and Alabama may require additional disaster relief. The parishes and counties identified by the IRS in which some taxpayers may require additional disaster relief are as follows: Alabama (Baldwin, Choctaw, Clarke, Greene, Hale, Marengo, Mobile, Pickens, Sumter, Tuscaloosa, and Washington); Mississippi (Adams, Amite, Attala, Claiborne, Choctaw, Clarke, Copiah, Covington, Franklin, Forrest, George, Greene, Hinds, Holmes, Humphreys, Jasper, Jefferson, Jefferson Davis, Jones, Kemper, Lamar, Lauderdale, Lawrence, Leake, Lincoln, Lowndes, Madison, Marion, Neshoba, Newton, Noxubee, Oktibbeha, Pearl River, Perry, Pike, Rankin, Scott, Simpson, Smith, Stone, Walthall, Warren, Wayne, Wilkinson, Winston, and Yazoo); Louisiana (Acadia, Ascension, Assumption, Calcasieu, East Baton Rouge, East Feliciana, Iberia, Iberville, Jefferson Davis, Lafayette, Lafourche, Livingston, Pointe Coupee, St. Helena, St. James, St. John the Baptist, St. Mary, St. Martin, Tangipahoa, Terrebonne, Vermilion, Washington, West Baton Rouge, and West Feliciana). In these counties and parishes, affected taxpayers can receive relief by identifying themselves to the IRS as discussed in the *Identifying Affected Taxpayers* section, *infra*. The counties and parishes in which taxpayers receive relief automatically or by self-identification constitute a "covered disaster area" within the meaning of section 301.7508A–1(d)(2) for purposes of the relief provided by this notice. This definition of covered disaster area differs from the covered disaster area for purposes of other relief provided by the IRS, including different counties and parishes.

Affected Taxpayers Whose Acts May be Postponed

Under the authority of section 301.7508A–1(d)(1), "affected taxpayers" eligible for the relief provided by this notice include: any individual whose principal residence, and any business entity whose principal place of business, is located (or was located on August 29, 2005) in the covered disaster area; any individual who is a relief worker affiliated with a recognized government or philanthropic organization and who is assisting in the covered disaster area; any individual whose principal residence, and any business entity whose principal place of business, is not located in the covered disaster area, but whose records necessary to meet a filing or payment deadline are maintained (or were maintained on August 29, 2005) in the covered disaster area; any estate or trust that has (or had as of August 29, 2005) tax records necessary to meet a filing or payment deadline in the covered disaster area; and any spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife.

Additionally, under section 301.7508A–1(d)(1)(vii), the IRS may determine that any other person is affected by a Presidentially-declared disaster and therefore eligible for relief. Accordingly, the IRS has determined that the following persons are also affected by Hurricane Katrina and its aftermath: (1) all workers assisting in the relief activities in the covered disaster areas, regardless of whether they are affiliated with recognized government or philanthropic organizations; (2) any individual whose principal residence, and any business entity whose principal place of business, is not located in the covered disaster area, but whose tax professional/practitioner's office is located (or was located as of August 29, 2005) in the covered disaster area; and (3) individuals, visiting the covered disaster area, who were killed or injured as a result of Hurricane Katrina and its aftermath. For purposes of (3) above, the estate of an individual visiting the covered disaster area who was killed as a result of the hurricane is also considered to be an affected taxpayer.

Extension of the Postponement Period

Section 7508A authorizes a postponement of deadlines for up to one year for taxpayers affected by a Presidentially-declared disaster. The IRS has determined that affected taxpayers as described in this notice in the parishes and counties identified by the IRS as eligible for additional relief shall receive a further postponement through August 28, 2006, of deadlines for the acts specified in Notice 2005–73 (including the acts listed in section 301.7508A–1(c)(1) and Rev. Proc. 2005–27, 2005–20 I.R.B. 1050). Thus, if the last day to perform one of the specified acts falls on or after August 29, 2005, and before August 28, 2006, then the last day for an affected taxpayer to timely perform the act is August 28, 2006. Furthermore, the IRS has concluded that some affected taxpayers as described in this notice may still have difficulty in making timely federal tax deposits in accordance with section 6302. Accordingly, for deposits required to be made by affected taxpayers on or after August 29, 2005, and before August 28, 2006, the IRS will waive the addition to tax under section 6656 for the failure to timely make any deposit of tax if the deposit is made on or before August 28, 2006. The relief from the failure to timely deposit addition to tax is intended for taxpayers who are unable to meet their deposit obligations because their (or their service provider's) records, computers, or other essential supporting services were damaged, or essential personnel were injured, by the hurricane or any subsequent flooding. Thus, although the waiver applies to all affected taxpayers, taxpayers that are reasonably able to make their deposits are encouraged to do so.

Likewise, the IRS is granted a further postponement through August 28, 2006, to perform the acts specified in Notice 2005–66 (including the acts listed in section 301.7508A–1(c)(2)), with respect to affected taxpayers as described in this notice in the parishes and counties identified by the IRS as eligible for additional relief. Thus, if the last day for the IRS to perform one of the specified acts falls on or after September 6, 2005, and before August 28, 2006, then the last day for the IRS to timely perform the act is August 28, 2006. The act of issuing a notice of final partnership administrative adjustment (FPAA) to the Tax Matters Partner under section 6223 with respect to the tax attributable to the partnership items of partners of any partnership that is an affected taxpayer was added to the list of items postponed for the IRS by Notice 2005–81. If the last date for issuance of the FPAA is on or after November 7, 2005, and before August 28, 2006, then there is a postponement through August 28, 2006.

Requests for Further Relief

Affected taxpayers described in this notice who receive relief under section 7508A until August 28, 2006, may request, if applicable, additional time to file and/or pay after August 28, 2006, under other provisions of the Internal Revenue Code and regulations thereunder.

Section 6081 provides that the Secretary may grant a reasonable extension of time (generally not to exceed six months) for filing any return, declaration, statement, or other document required by the Code or by regulations thereunder. Section 6161 provides that the Secretary may grant a reasonable extension of time (generally not to exceed six months) for paying the amount (or any installments) of tax shown or required to be shown on any return or declaration required by the Code or by regulations thereunder. To the extent that a taxpayer has not previously received a full six-month extension of time under section 6081, then the taxpayer will be entitled to request an extension of time to file under section 6081. For example, an affected individual income taxpayer's 2005 Federal income tax return (including any payment) is due on April 17, 2006. Under the relief provided by this notice, the taxpayer would be required to file the return (and pay) on or before August 28, 2006. As the postponement from April 17, 2006, through August 28, 2006, was under the authority of section 7508A, the taxpayer would be eligible to request a further extension of time, up through February 28, 2007, to file (and pay) under section 6081 and section 6161. The granting of the extension of time to file (and pay) would be based on the standards applicable to all taxpayers, not just affected taxpayers.

Except in the case of taxpayers who are abroad, a taxpayer who has previously received a full six-month extension of time under section 6081 will not be entitled to request an extension of time to file under section 6081. Although the taxpayer could not receive an extension beyond August 28, 2006, if the taxpayer is unable to file by that date, the taxpayer can request that the IRS grant relief from any penalty if the failure to file is due to reasonable cause and not due to willful neglect. The waiver of the penalty would be based on the standards applicable to all taxpayers, not just affected taxpayers.

Identifying Affected Taxpayers

In order to assist the IRS in identifying affected taxpayers as described in this notice, to ensure that they receive the relief to which they are entitled, affected taxpayers should mark "Hurricane Katrina" in red ink on the top of their returns and other documents for which the IRS has postponed the due dates. In addition, affected taxpayers may identify themselves as eligible for relief by calling the IRS Disaster Hotline at (866) 562–5227. In the three Mississippi counties and seven Louisiana parishes where relief is being granted automatically, affected taxpayers are nonetheless strongly encouraged to mark their returns and other documents or otherwise alert the IRS to the need for relief. In the other counties and parishes identified in this notice, and for other affected taxpayers (*e.g.*, relief workers), taxpayers must notify the Service in order to ensure that they receive the relief. Accordingly, these taxpayers need to mark their returns and documents, or otherwise alert the IRS to the need for relief. Affected taxpayers should also identify themselves as such if the IRS sends them a notice or makes any other direct contact, *e.g.*, telephone calls.

Taxpayers Not Receiving an Extension of the Postponement Period

The grant of relief provided by this notice applies only to affected taxpayers with respect to the counties and parishes listed in this notice. If an affected taxpayer described in Notice 2005–73 is not described as an affected taxpayer under this notice, and that taxpayer determines that additional time is needed, that taxpayer may request an extension under sections 6081 and 6161 (so long as the taxpayer has not previously received a full six-month extension of time to file or pay under those provisions for the specified act) and/or relief under any other provision providing for a waiver of a penalty for reasonable cause, such as sections 6651 and 6656.

DRAFTING INFORMATION

The principal author of this notice is Dillon Taylor of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, you may call (202) 622–4940 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Regulations Governing Practice Before the Internal Revenue Service

REG–122380–02

AGENCY: Office of the Secretary, Treasury.

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

SUMMARY: This document proposes modifications of the regulations governing practice before the IRS (Circular 230). These proposed regulations affect individuals who practice before the IRS. The proposed amendments modify the general standards of practice before the IRS. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written or electronically generated comments must be received by Friday, April 28, 2006. Outlines of topics to be discussed at the public hearing scheduled for Wednesday, June 21, 2006 at 10 a.m., in the auditorium of the Internal Revenue Service building at 1111 Constitution Avenue, NW, Washington, DC 20224, must be received by Friday, May 31, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–122380–02), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be hand delivered Monday through Friday between the hours of 8 am and 4 pm to: CC:PA:LPD:PR (REG–122380–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS and REG–122380–02). The public hearing will be held in auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning issues for comment, Brinton T. Warren at (202) 622–7800; concerning submissions of comments and the public hearing, Robin Jones at (202) 622–7180; (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate the practice of representatives before the Treasury Department. The Secretary is authorized, after notice and an opportunity for a proceeding, to censure, suspend or disbar from practice before the Treasury Department those representatives who are incompetent, disreputable, or who violate regulations prescribed under section 330 of title 31. The Secretary also is authorized to impose a monetary penalty against these individuals. Pursuant to section 330 of title 31, the Secretary has published the regulations in Circular 230 (31 CFR part 10). These regulations authorize the Director of the Office of Professional Responsibility to act upon applications for enrollment to practice before the IRS, to make inquiries with respect to matters under the Office of Professional Responsibility's jurisdiction, to institute proceedings to impose a monetary penalty or to censure, suspend or disbar a practitioner from practice before the IRS, to institute proceedings to disqualify appraisers, and to perform other duties necessary to carry out these functions.

Circular 230 has been amended periodically. For example, on June 20, 1994 (59 FR 31523), the regulations were amended to provide standards for tax return preparation by practitioners, to limit the use of contingent fees by practitioners in tax return or refund claim preparation and to provide expedited rules for suspension from practice before the IRS.

On December 19, 2002 (REG–122380–02, issued as Announcement 2003–5, 2003–1 C.B. 397 [67 FR 77724]), the Treasury Department and the IRS issued an advance notice of proposed rulemaking (2002 ANPRM) requesting comments on amendments to the regulations relating to the Office of Professional Responsibility, unenrolled practice, eligibility for enrollment, sanctions and disciplinary proceedings, contingent fees and confidentiality agreements. This document proposes amendments reflecting the Treasury Department and the IRS consideration of the comments received in response to the 2002 ANPRM and reflecting amendments to section 330 of title 31 made by the American Jobs Creation Act of 2004, Public Law 108–357 (118 Stat. 1418) (the Jobs Act). The proposed regulations include conforming amendments to reflect the final regulations relating to best practices, covered opinions and other written advice published as T.D. 9165, 2005–4 I.R.B. 357, on December 20, 2004 (69 FR 75839) and as T.D. 9201, 2005–23 I.R.B. 1153, on May 19, 2005 (70 FR 28824), but do not otherwise address those final regulations.

Explanation of Provisions

Over 60 written comments were received in response to the 2002 ANPRM. All comments were considered and are available for public inspection upon request. A number of these comments are summarized below. Comments relating to matters about which the Treasury Department and the IRS declined to propose changes are not generally discussed. The scope of these regulations is limited to practice before the IRS. These regulations do not alter or supplant ethical standards that might otherwise be applicable to practitioners.

Director of the Office of Professional Responsibility

In the 2002 ANPRM, the Treasury Department and the IRS solicited comments relating to the name of the office and appointment of the Director. In January of 2003, the Office of Professional Responsibility was established and replaced the office of the Director of Practice. This change, which was supported by many commentators, reflects the office's commitment to ensuring the integrity of the tax system and recognition of tax professionals as an integral part of effective tax administration. The proposed regulations

change references to the Office of the Director of Practice to the Office of Professional Responsibility. The Director of the Office of Professional Responsibility is appointed by the Secretary, or his or her delegate. The text of the regulations also will be changed to eliminate references to the Office of the Secretary to reflect the prior transfer of the Office of Professional Responsibility to the IRS. See 47 FR 29918 (July 9, 1982).

Definitions — Practice Before the Internal Revenue Service

On October 22, 2004, the President signed the Jobs Act. Section 822(b) of the Act amends section 330 of title 31 of the United States Code by adding a provision that recognizes the Secretary's authority to impose standards for written advice rendered with respect to any entity, transaction plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion. Accordingly, §10.2(d) of the proposed regulations is modified to clarify that the rendering of this written advice is practice before the IRS subject to Circular 230 when it is provided by a practitioner.

Who may Practice

The Advisory Committee for Tax Exempt/Governmental Entities recently suggested that individuals who provide technical services to plan sponsors to maintain the tax qualified status of their retirement plans (retirement plan administrators) should be authorized to practice provided they demonstrate the competency to do so. The Treasury Department and the IRS are considering this proposal and invite public comments even though text is not proposed in this notice of proposed rulemaking. The Advisory Committee's proposal suggests limiting the practice by this group of individuals to representation relating to filing applications for determination letters, Forms 5500, employee plan audits, and negotiating with the IRS with respect to voluntary compliance matters.

In addition, the Advisory Committee proposes procedures for enrollment similar to the current Enrolled Agent program (see §§10.4–10.6), including an examination to determine competency, a renewal process and continuing professional education requirements. For more information relating to practice by retirement plan administrators, see *Establishing the Enrolled Retirement Plan Agent Under Circular 230*, Advisory Committee for Tax Exempt/Governmental Entities (June 2005). The Treasury Department and the IRS also invite comments on proposals relating to limited practice by other individuals that the public believes competent to represent taxpayers before the IRS, and whether the Director of the Office of Professional Responsibility should have the authority to regulate these individuals through IRS notice procedures.

Enrollment Procedures

Section 10.5 of the regulations sets forth the applicable procedures relating to the enrollment of an enrolled agent. The proposed regulations provide that applicants for enrollment must utilize forms and comply with procedures established and published by the Office of Professional Responsibility. The proposed regulations permit the Office of Professional Responsibility to change the "Application for Enrollment to Practice Before the IRS" and other requirements pertaining to the procedures to apply for enrollment.

Section 10.6 of the regulations sets forth the procedures for renewal of enrollment to practice before the IRS. Under the current regulations, the Director of the Office of Professional Responsibility must maintain a list of enrolled agents, including those who are active, inactive and sanctioned. This requirement is combined with the roster requirements of §10.90 in the proposed regulations to clarify that all rosters, including those related to enrolled agents, will be maintained and made available for public inspection in the time and manner prescribed by the Secretary.

The proposed regulations clarify the requirements to maintain active enrollment to practice before the IRS. An enrolled agent must apply for renewal of enrollment between November 1 and January 31 of the relevant period described in §10.6(d). The effective date of renewal is the first day of the third month following the close of the period for renewal, *i.e.*, April 1. An enrolled agent must complete 72 hours of continuing professional education during each enrollment cycle, with a minimum of 16 hours (including two hours of ethics) during each enrollment year. The enrollment year is each calendar year, *i.e.*, January 1 to December 31, in the enrollment cycle. The enrollment cycle is the three successive enrollment years preceding the April 1 effective date of renewal. Thus, an enrolled agent whose social security number ends with 0 must renew enrollment between November 1, 2006, and January 31, 2007. The enrolled agent must have completed 72 hours of continuing professional education between January 1, 2004, and December 31, 2006, with at least 16 hours (including two hours of ethics) during each calendar year. Similarly, the proposed regulations require sponsors of continuing education courses to renew their status as qualified sponsors every three years.

The proposed regulations require that a qualifying course enhance professional knowledge in Federal taxation or Federal tax related matters and be consistent with the Internal Revenue Code and effective tax administration.

Limited Practice Before the IRS

In the 2002 ANPRM, the Treasury Department and IRS solicited comments relating to limited practice by unenrolled return preparers. Most commentators opposed expanding the authority of the Director of the Office of Professional Responsibility to include the authority to modify the scope of limited practice by unenrolled preparers without further amendment to Circular 230. Most commentators agreed that the Director of the Office of Professional Responsibility should not be given the authority to determine the eligibility for limited practice by unenrolled preparers.

Section 10.7(c)(1)(viii) currently authorizes an individual, who is not otherwise a practitioner, to represent a taxpayer during an examination if that individual prepared the return for the taxable period under examination. The proposed regulations revoke this authorization because it is inconsistent with the requirement that all individuals permitted to practice before the IRS demonstrate their qualifications to advise and assist persons in presenting their cases to the IRS.

Under the proposed regulations, an unenrolled return preparer may not represent a taxpayer unless otherwise authorized by §10.7(c)(1)(i) – (vii). These individuals no

longer may negotiate with the IRS on behalf of a taxpayer during an examination and no longer may bind a taxpayer to a position during an examination. For example, an unenrolled return preparer may not sign a Form 872, "*Consent to Extend the Time to Assess Tax*," with regard to the tax return prepared for that individual. In addition, an unenrolled return preparer may not agree to any adjustment to the taxpayer's reported tax liability.

Individuals who are not eligible to practice and who prepare an original return may assist in the exchange of information with the IRS regarding a taxpayer's return if the taxpayer has specifically authorized the preparer to receive confidential tax information from the IRS. Revocation of the authority for limited practice will not preclude a return preparer from assisting a taxpayer in responding to questions regarding the taxpayer's return. The proposed regulations do not preclude an unenrolled return preparer from accompanying a taxpayer to an examination, provided the taxpayer authorizes the IRS to disclose confidential tax information to the unenrolled return preparer.

Practice by Former Government Employees, Their Partners and Their Associates

Section 10.25 sets forth rules governing practice by former government employees, their business partners and their associates. These rules were first promulgated in 1976 to address discrepancies between the Government-wide post-employment statute, 18 U.S.C. 207, its implementing regulations and the codes of professional responsibility (*e.g.*, ABA Model Rules of Professional Conduct, AICPA Code of Professional Conduct and individual state rules of professional conduct) applicable to practitioners who appear before the IRS.

Section 10.25 of the proposed regulations has been conformed with the terminology used in 18 U.S.C. 207, and 5 C.F.R. parts 2637 and 2641 (or superseding regulations), by eliminating the definitions of *official responsibility* in §10.25(a)(5), *participate or participation* in §10.25(a)(6), and *transaction* in §10.25(a)(8) and substituting the term *particular matter involving specific parties* in §10.25(a)(4) (formerly §10.25(a)(8)).

The proposed regulations also eliminate the prohibition in §10.25(b)(3) against assisting in the representation in matters in which the former employee had official responsibility during the former employee's last year of service. Existing statutes, regulations and codes of professional responsibility are adequate to protect against conflicts of interest and protect the integrity of the tax system, including the prohibition on representation in 18 U.S.C. 207.

Section 10.25(b)(2) of the proposed regulations continues to prohibit former employees who personally and substantially participated in a matter while in Government service from representing or assisting in the representation in the same matter while in private practice. In these matters, the former employee's firm may represent the taxpayer in the matter if the former employee is isolated from the matter and isolation statements are filed with the Office of Professional Responsibility in accordance with §10.25(c).

Contingent Fees

In the 2002 ANPRM, the Treasury Department and the IRS solicited comments relating to contingent fees. Most commentators opposed further limitations on contingent fees under §10.27. The Treasury Department and the IRS continue to believe that a rule restricting contingent fees for preparing tax returns supports voluntary compliance with the Federal tax laws by discouraging return positions that exploit the audit selection process. Additionally, a broader prohibition against contingent fee arrangements is appropriate in light of concerns regarding attorney and auditor independence. The recent shift toward even greater independence, including rules adopted by the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board, also support expanding the prohibition on contingent fees with respect to Federal tax matters.

Under section 10.27 of the proposed regulations, a practitioner generally is precluded from charging a contingent fee for services rendered in connection with any matter before the Service, including the preparation or filing of a tax return, amended tax return or claim for refund or credit. A practitioner may, however, charge a contingent fee for services rendered in connection with the IRS's examination of, or challenge to, an original tax return. Practitioners also may charge a contingent fee for services rendered in connection with the IRS's examination of, or challenge to, an amended return or claim for refund or credit filed prior to the taxpayer receiving notice of the examination of, or challenge to the original tax return. A written notice of examination would include the written notice furnished to taxpayers subject to the Coordinated Industry Case procedures requesting a statement showing additional tax due (or an adequate disclosure with respect to an item or position) to avoid the imposition of certain accuracy-related penalties if no other written notice of examination is received. Contingent fees also may be charged for services rendered in connection with a judicial proceeding arising under the Federal tax laws.

Conflicting Interests

Section 10.29 of the regulations prohibits a practitioner from representing conflicting interests before the IRS, except with the express consent of all directly interested parties after full disclosure. Section 10.29 is generally consistent with Rule 1.7 of the ABA Model Rules of Professional Conduct (Model Rules), which was amended just prior to the July 26, 2002 amendment to the regulations.

Section 10.29 of the proposed regulations clarifies that a practitioner is required to obtain consents in writing from each affected client in order to represent the conflicting interests. The written consent may vary in form. The practitioner may prepare a letter to the client outlining the conflict, as well as the possible implications of the conflict, and submit the letter to the client for the client to countersign. Unlike the Model Rules, which permit affected clients to provide informed consent orally if the consent is contemporaneously documented by the practitioner in writing, an oral consent followed by a confirmation letter authored by the practitioner will not satisfy §10.29 unless the confirmation letter is countersigned by the client.

Standards With Respect to Tax Returns and Documents, Affidavits and Other Papers

Section 10.34 sets forth standards applicable to advice with respect to tax return positions and applicable to preparing or signing returns. Section 10.34 of the proposed regulations sets forth standards applicable to practitioners who advise clients with respect to documents, affidavits and other papers submitted to the IRS. The proposed regulations also provide separate standards for papers that take a position with respect to Federal tax matters and standards for advising a client to file papers involving procedural or factual matters.

Under the proposed regulations, a practitioner may not advise a client to take a position on a submission to the IRS unless the position is not frivolous. A practitioner also may not advise a client to submit a document to the IRS that is meant primarily for delay; is frivolous or groundless; or contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation. With regard to factual matters, a practitioner may rely upon information furnished by the taxpayer with respect to tax returns and documents, affidavits and other papers, unless the information appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete. These standards would supplement the existing requirement in §10.22 that practitioners exercise due diligence in preparing, or assisting in the preparation of, tax returns and other documents relating to IRS matters.

Sanctions

In accordance with section 822(a) of the Jobs Act, proposed §10.50 authorizes the Secretary to impose a monetary penalty against a practitioner if the practitioner is shown to be incompetent or disreputable, fails to comply with any regulation in part 10, or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client.

Under the proposed regulations, the monetary penalty may be imposed in addition to, or in lieu of, any other sanction. If a practitioner acts on behalf of the practitioner's employer, firm or other entity and the employer, firm or other entity knew or should have known of the practitioner's conduct, the Secretary may impose a monetary penalty on the employer, firm or other entity. The Treasury Department and the IRS will issue procedures relating to the imposition of the monetary penalty through separate published guidance.

The proposed regulations also contain conforming amendments to other provisions relating to sanctions.

Incompetence and Disreputable Conduct

In the 2002 ANPRM, the Treasury Department and the IRS solicited comments relating to whether the definition of disreputable conduct should include the willful failure of a preparer who is a practitioner to sign a return. Many commentators supported expanding the definition of disreputable conduct to specifically include the willful failure of a practitioner who is a tax return preparer to sign a return.

Section 10.51 of the regulations defines disreputable conduct for which a practitioner may be sanctioned. Section 10.51 of the proposed regulations modifies the definition of disreputable conduct to include willful failure to sign a tax return prepared by the practitioner. The definition of disreputable conduct also includes the disclosure or use of returns or return information by practitioners in a manner not authorized by the Code, a court of competent jurisdiction, or an administrative law judge in a proceeding instituted under section 10.60.

Supplemental Charges

Section 10.65 provides that the Director of the Office of Professional Responsibility may file supplemental charges against a practitioner or appraiser. Section 10.65 of the proposed regulations provides that the Director may file supplemental charges against a practitioner by amending the complaint to reflect the additional charges if the practitioner is given notice and an opportunity to prepare a defense to the supplemental charges.

Hearings and Discovery

In the 2002 ANPRM, the Treasury Department and the IRS solicited comments relating to expanding discovery and providing greater procedural protections in disciplinary proceedings. Most commentators supported expanding the use of discovery in disciplinary proceedings. Most commentators also supported providing further procedural protections such as a guarantee of the right to cross-examine witnesses.

These proposed regulations redesignate the provisions relating to hearings, evidence and depositions and discovery. Proposed §10.71 addresses discovery, proposed §10.72 addresses hearings and proposed §10.73 addresses evidence.

1. *Motions and requests*

Section 10.68 of the regulations sets forth procedures for filing a motion or request with the Administrative Law Judge presiding over a disciplinary proceeding. The regulations provide that a party is not presumed to oppose a motion for decision by default for failure to file a timely answer or for failure to prosecute. The proposed regulations amend §10.68 to expressly allow a party to file a motion for summary adjudication if there is no genuine issue as to any material fact.

2. *Discovery in Disciplinary Proceedings*

Section 10.71 of the proposed regulations clarifies the discovery methods available to the parties in preparation for a disciplinary hearing. The Administrative Law Judge may authorize discovery if the party seeking discovery establishes that it is necessary and relevant. Discovery methods include depositions upon oral examination and requests for admission. The Administrative Law Judge should weigh factors such as the ultimate relevancy and anticipated costs to determine the least burdensome method in ordering discovery.

Discovery is not permitted if the information is privileged or the information relates to mental impressions, conclusions or legal theories of any attorney, party, or other representative of a party prepared in anticipation of a proceeding.

To address practitioners' due process rights without creating a formal court proceeding, the proposed regulations require the Director of the Office of Professional Responsibility to turn over the documentation used in support of a complaint filed with the Administrative Law Judge. Under §10.63(d) of the proposed regulations, this

information must be served on the practitioner or appraiser, or the representative, within 10 days of serving the complaint. This requirement, however, is only an initial disclosure of the evidence of record at the time of the complaint. Supplemental evidence developed during preparation for the hearing is not prohibited from being introduced.

Under §10.62(c) of the proposed regulations, the Director of the Office of Professional Responsibility must notify the practitioner or appraiser of the time for answering the complaint, which cannot be less than 30 days. When determining the time for answering the complaint, the Director will take into account the amount of the evidence in support of the complaint and the complexity of the charges to allow the practitioner or appraiser time to prepare an adequate answer in defense to the complaint.

3. *Hearings*

Section 10.72 of the regulations sets forth the procedures for an administrative hearing pursuant to Circular 230. The Administrative Law Judge should conduct the hearing within 180 days of the time for filing of the answer, absent circumstances requiring that, in the interest of justice, the hearing be held at a later date. The proposed regulations amend §10.72 to allow each party to a disciplinary proceeding, as may be required for a full and true disclosure of the facts, to question, in the presence of the Administrative Law Judge, a person whose statement is offered by the opposing party. The proposed regulations incorporate the requirements of the Administrative Procedure Act (5 U.S.C. 556(d)). The proposed regulations do not prohibit a party from presenting evidence contained in a deposition if all parties to the proceeding were given an opportunity for full examination and cross-examination of the witness under §10.71. The proposed regulations generally require pre-hearing memoranda. The Administrative Law Judge may determine that pre-hearing memoranda are not necessary or, by order, require other information with respect to the disciplinary proceeding.

4. *Publicity of Disciplinary Proceedings*

Currently, disciplinary proceedings brought pursuant to Circular 230 are closed to the public unless the Administrative Law Judge grants a practitioner's request that the proceedings be public. The proposed regulations amend §10.72(d) to provide that all hearings, reports, evidence and decisions in a disciplinary proceeding be available for public inspection. The proposed regulations mandate procedures to protect the identities of any third party taxpayers contained in returns and return information obtained pursuant to section 6103(l)(4) for use in an action or proceeding under subpart D. The procedures to protect the identities of third party taxpayers also must be observed with respect to discovery matters.

The Administrative Law Judge must issue a protective order in the event that redactions of taxpayer identifiers render documents unintelligible or may still permit indirect identification of the taxpayer. The Administrative Law Judge may, for good cause, order proceedings closed to the public or may order nondisclosure of materials associated with the proceeding, such as in the case in which disclosure is prohibited by 18 U.S.C. 1905 or section 6103. The Administrative Law Judge also may order limited access to materials which are confidential or sensitive in some other way.

The proposed regulations provide that, at the conclusion of a proceeding, the Secretary, or his or her delegate, shall ensure that all returns and return information, including the names, addresses or other identifying details of third party taxpayers, are redacted and replaced with the code assigned to the corresponding taxpayer in all documents prior to such documents being made available for further public inspection.

Decision of Administrative Law Judge

Section 10.76 of the regulations sets forth the requirements for the decision of the Administrative Law Judge. The proposed regulations amend §10.76 to provide that the Administrative Law Judge should render a decision within 180 days after the conclusion of the hearing. If a party files a motion for summary adjudication, the Administrative Law Judge should rule on the motion within 60 days after a written response to the motion for summary adjudication or, if no written response is filed, 90 days after the motion for summary adjudication is filed.

The proposed regulations provide that the decision of the Administrative Law Judge will become the final decision of the agency 45 days after the date the decision is served on the parties. The Secretary may, however, either in response to a petition for review filed by a party or on the Secretary's own initiative, intervene and order review of the Administrative Law Judge's decision before the decision becomes final. The petition for review must be filed within 30 days of the date the decision is served on the parties.

If the Secretary grants a petition or otherwise orders review, the Secretary must notify the parties within 45 days from the date the Administrative Law Judge's decision is served on the parties. The notice must state that (1) the decision is under review, (2) no final agency decision has been made, (3) any action of the Administrative Law Judge is inoperative, and (4) a final decision of the agency made by the Secretary is required before judicial review can be obtained. The Secretary will not review an interlocutory order or ruling, *e.g.*, a discovery request ruling, of the Administrative Law Judge prior to the rendering of a decision by the Administrative Law Judge that would dispose of the proceeding.

Expedited Suspension

Section 10.82 of the regulations authorizes the Director of the Office of Professional Responsibility to suspend immediately a practitioner who has engaged in certain conduct. The proposed regulations extend the expedited process to practitioners who are in egregious noncompliance with their tax obligations or have been adjudicated as having advanced arguments, relating to the practitioner's own tax obligations or the obligations of the client, primarily for delay.

The Treasury Department and the IRS are aware of a number of practitioners who are not in compliance with their own Federal tax obligations, but continue to represent taxpayers, and of situations in which practitioners advance frivolous or obstructionist positions relating to their own tax obligations and the obligations of their clients. Under the proposed regulations, a practitioner who is not compliant with the practitioner's own Federal tax

obligations may be subject to expedited disciplinary proceedings. In addition, a practitioner who has been found by a court of competent jurisdiction to have advanced frivolous arguments or advanced arguments primarily for delay, either relating to a taxpayer's tax liability or relating to the practitioner's own tax liability, will be subject to an expedited disciplinary proceeding.

Proposed Effective Date

These regulations are proposed to apply on the date that final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. The general requirements of these regulations are substantially the same as the requirements of the regulations that these regulations replace. Persons authorized to practice have long been required to comply with certain standards of conduct when practicing before the Internal Revenue Service. These regulations do not alter the basic nature of the obligations and responsibilities of these practitioners. These regulations clarify those obligations in response to public comments, replace certain terminology to conform with the terminology used in 18 U.S.C. 207, and 5 C.F.R. parts 2637 and 2641 (or superseding regulations), make modifications to reflect amendments to section 330 of title 31 made by the Jobs Act, and make other modifications to reflect concerns about greater independence, transparency and due process. 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 the regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The Treasury Department and IRS specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

The public hearing is scheduled for Wednesday, June 21, 2006 at 10:00 a.m., and will be held in the auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. 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 at the hearing must submit written or electronic comments by Friday, April 28, 2006, and an outline of the topics to be discussed and the time to be devoted to each topic by May 31, 2006. A period of 10 minutes will be allocated 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 Brinton T. Warren and Heather L. Dostaler of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Proposed Amendments to the Regulations

Paragraph 1. The authority citation for 31 CFR part 10 is amended to read as follows:

[Authority: 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 321; 31 U.S.C. 330, as amended by P.L. 108–357, Sec. 822]

Par. 2. In Part 10, remove the language "Director of Practice" and add, in its place, the language "Director of the Office of Professional Responsibility" in each of the following sections and paragraphs:

Section 10.4(a), (b) introductory text, (b)(1), (b)(2);

Section 10.5(c), (d), (e);

Section 10.6(b), (g)(2)(iii), (g)(2)(iv), (g)(4), (j)(1), (j)(2), (j)(4), (k)(1), (k)(2), (n);

Section 10.7(c)(2)(iii), (d);

Section 10.20(b), (c);

Section 10.62(a), (b);

Section 10.63(c);

Section 10.64(a);

Section 10.66;

Section 10.69(a)(1), (b);

Section 10.73(a);

Section 10.81;

Section 10.82(a), (c) introductory text, (c)(3), (d), (e), (f)(1), (g).

Par. 3. Section 10.1 is revised to read as follows:

§10.1 Director of the Office of Professional Responsibility.

(a) *Establishment of office*. The Office of Professional Responsibility is established in the Internal Revenue Service. The Director of the Office of Professional Responsibility is appointed by the Secretary of the Treasury, or his or her delegate.

(b) *Duties*. The Director of the Office of Professional Responsibility acts on applications for enrollment to practice before the Internal Revenue Service; makes inquiries with respect to matters under his or her jurisdiction; institutes and provides for the conduct of disciplinary proceedings relating to practitioners (and employers, firms or other entities, if applicable) and appraisers; and performs other duties as are necessary or appropriate to carry out his or her functions under this part or as are otherwise prescribed by the Secretary of the Treasury, or his or her delegate.

(c) *Acting Director of the Office of Professional Responsibility*. The Secretary of the Treasury, or his or her delegate, will designate an officer or employee of the Treasury Department to act as Director of the Office of Professional Responsibility in the absence of the Director or a vacancy in that office.

(d) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 4. Section 10.2 is amended to read as follows:

§10.2 Definitions.

(a) As used in this part, except where the text provides otherwise—

(1) *Attorney* means any person who is a member in good standing of the bar of the highest court of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia.

(2) *Certified public accountant* means any person who is duly qualified to practice as a certified public accountant in any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia.

(3) *Commissioner* refers to the Commissioner of Internal Revenue.

(4) *Practice before the Internal Revenue Service* comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion, and representing a client at conferences, hearings and meetings.

(5) *Practitioner* means any individual described in paragraphs (a), (b), (c), or (d) of §10.3.

(6) A *tax return* includes an amended tax return and a claim for refund.

(7) *Service* means the Internal Revenue Service.

(b) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 5. Section 10.5 is amended by revising paragraphs (a) and (b) and adding paragraph (f) to read as follows:

§10.5 Application for enrollment.

(a) *Form; address*. An applicant for enrollment must apply as required by forms or procedures established and published by the Office of Professional Responsibility, including proper execution of required forms under oath or affirmation. The address on the application will be the address under which a successful applicant is enrolled and is the address to which all correspondence concerning enrollment will be sent.

(b) *Fee*. The applicant must pay the fee established and published by the Office of Professional Responsibility. This fee will be reflected on applicable forms and will be retained regardless of whether the applicant is granted enrollment.

* * * * *

(f) *Effective date*. This section is applicable to enrollment applications received on or after the date that final regulations are published in the **Federal Register**.

Par. 6. Section 10.6 is amended by:

1. Removing paragraph (a).

2. Redesignating paragraph (c) as paragraph (a).

3. Adding a new paragraph (c).

4. Revising paragraphs (d) introductory text, (d)(5), (d)(6), (d)(7), (e), (f)(1), (f)(2)(iv)(A), (g)(5), (k)(7) and (l).

5. Adding a new paragraph (p).

The revisions and additions read as follows:

§10.6 Enrollment.

* * * * *

(c) *Change of address*. An enrolled agent must send notification of any change of address to the address specified by the Director of the Office of Professional Responsibility. This notification must include the enrolled agent's name, prior address, new address, social security number or tax identification number and the date.

(d) *Renewal of enrollment*. To maintain active enrollment to practice before the Internal Revenue Service, each individual is required to have his or her enrollment renewed. Failure to receive notification from the Director of the Office of Professional Responsibility of the renewal requirement will not be justification for the individual's failure to satisfy this requirement.

* * * * *

(5) The Director of the Office of Professional Responsibility will notify the individual of his or her renewal of enrollment and will issue the individual a card evidencing enrollment.

(6) A reasonable nonrefundable fee may be charged for each application for renewal of enrollment filed with the Director of the Office of Professional Responsibility.

(7) Forms required for renewal may be obtained by sending a written request to the Director of the Office of Professional Responsibility, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224 or from such other source as the Director of the Office of Professional Responsibility will publish in the Internal Revenue Bulletin (see 26 CFR §601.601(d)(2)) and on the Internal Revenue Service webpage (*www.irs.gov*).

(e) *Condition for renewal: continuing professional education*. In order to qualify for renewal of enrollment, an individual enrolled to practice before the Internal Revenue Service must certify, on the application for renewal form prescribed by the Director of the Office of Professional Responsibility, that he or she has satisfied the following continuing professional education requirements.

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

(i) *Enrollment year* means January 1 to December 31 of each year of an enrollment cycle.

(ii) *Enrollment cycle* means the three successive enrollment years preceding the effective date of renewal.

(iii) The *effective date of renewal* is the first day of the third month following the close of the period for renewal described in paragraph (d) of this section.

(2) *For renewed enrollment effective after December 31, 2006*—(i) *Requirements for enrollment cycle*. A minimum of 72 hours of continuing education credit must be completed during each enrollment cycle.

(ii) *Requirements for enrollment year*. A minimum of 16 hours of continuing education credit, including 2 hours of ethics or professional conduct, must be completed during each enrollment year of an enrollment cycle.

(iii) *Enrollment during enrollment cycle*—(A) *In general*. Subject to paragraph (2)(iii)(B) of this section, an individual who receives initial enrollment during an enrollment cycle must complete 2 hours of qualifying continuing education credit for each month enrolled during the enrollment cycle. Enrollment for any part of a month is considered enrollment for the entire month.

(B) *Ethics*. An individual who receives initial enrollment during an enrollment cycle must complete 2 hours of ethics or professional conduct for each enrollment year during the enrollment cycle. Enrollment for any part of an enrollment year is considered enrollment for the entire year.

(f) *Qualifying continuing education*—(1) *General*. To qualify for continuing education credit, a course of learning must—

(i) Be a qualifying program designed to enhance professional knowledge in Federal taxation or Federal tax related matters, *i.e.*, programs comprised of current subject matter in Federal taxation or Federal tax related matters, including accounting, tax preparation software and taxation or ethics;

(ii) Be a qualifying program consistent with the Internal Revenue Code and effective tax administration; and

(iii) Be sponsored by a qualifying sponsor.

(2) * * *

(iv) *Credit for published articles, books, etc*. (A) Continuing education credit will be awarded for publications on Federal taxation or Federal tax related matters, including accounting, tax preparation software, and taxation or ethics, provided the content of such publications is current and designed for the enhancement of the professional knowledge of an individual enrolled to practice before the Internal Revenue Service. The publication must be consistent with the Internal Revenue Code and effective tax administration.

* * * * *

(g) * * *

(5) *Sponsor renewal*—(i) *In general*. A sponsor maintains its status as a qualified sponsor during the sponsor enrollment cycle.

(ii) *Renewal period*. Each sponsor must file an application to renew its status as a qualified sponsor between May 1 and July 31, 2008. Thereafter, applications for renewal will be required between May 1 and July 31 of every subsequent third year.

(iii) *Effective date of renewal*. The effective date of renewal is the first day of the third month following the close of the renewal period.

(iv) *Sponsor enrollment cycle*. The sponsor enrollment cycle is the three successive calendar years preceding the effective date of renewal.

* * * * *

(k) * * *

(7) Inactive enrollment status is not available to an individual who is the subject of a disciplinary matter in the Office of Professional Responsibility.

(l) *Inactive retirement status*. An individual who no longer practices before the Internal Revenue Service may request being placed in an inactive retirement status at any time and such individual will be placed in an inactive retirement status. The individual will be ineligible to practice before the Internal Revenue Service. Such individual must file a timely application for renewal of enrollment at each applicable renewal or enrollment period as provided in this section. An individual who is placed in an inactive retirement status may be reinstated to an active enrollment status by filing an application for renewal of enrollment and providing evidence of the completion of the required continuing professional education hours for the enrollment cycle. Inactive retirement status is not available to an individual who is the subject of a disciplinary matter in the Office of Professional Responsibility.

* * * * *

(p) *Effective date*. This section is applicable to enrollment effective on or after the date that final regulations are published in the **Federal Register**.

Par. 7. Section 10.7 is amended by:

1. Removing paragraph (c)(1)(viii).

2. Revising paragraph (c)(2)(ii).

3. And adding paragraph (g).

The revisions and additions read as follows:

§10.7 Representing oneself; participating in rulemaking; limited practice; special appearances; and return preparation.

* * * * *

(c) * * *

(2) * * *

(ii) The Director, after notice and opportunity for a conference, may deny eligibility to engage in limited practice before the Internal Revenue Service under paragraph (c)(1) of this section to any individual who has engaged in conduct that would justify a sanction under §10.50.

* * * * *

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

Par. 8. Section 10.22 is amended by revising paragraph (b) and adding paragraph (c) to read as follows:

§10.22 Diligence as to accuracy.

* * * * *

(b) *Reliance on others*. Except as provided in §§10.34 and 10.35, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

(c) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 9. Section 10.25 is revised to read as follows:

§10.25 Practice by former Government employees, their partners and their associates.

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

(1) *Assist* means to act in such a way as to advise, furnish information to, or otherwise aid another person, directly, or indirectly.

(2) *Government employee* is an officer or employee of the United States or any agency of the United States, including a special government employee as defined in 18 U.S.C. 202(a), or of the District of Columbia, or of any State, or a member of Congress or of any State legislature.

(3) *Member of a firm* is a sole practitioner or an employee or associate thereof, or a partner, stockholder, associate, affiliate or employee of a partnership, joint venture, corporation, professional association or other affiliation of two or more practitioners who represent nongovernmental parties.

(4) *Particular matter involving specific parties* is defined at 5 CFR 2637.201(c), or superseding post-employment regulations issued by the U.S. Office of Government Ethics.

(5) *Practitioner* includes any individual described in §10.2(a)(5).

(6) *Rule* includes Treasury regulations, whether issued or under preparation for issuance as notices of proposed rulemaking or as Treasury decisions; revenue rulings; and revenue procedures published in the Internal Revenue Bulletin (see 26 CFR §601.601(d)(2)).

(b) *General rules*. (1) No former Government employee may, subsequent to his or her Government employment, represent anyone in any matter administered by the Internal Revenue Service if the representation would violate 18 U.S.C. 207 or any other laws of the United States.

(2) No former Government employee who personally and substantially participated in a particular matter involving specific parties may, subsequent to his or her Government employment, represent or knowingly assist, in that particular matter, any person who is or was a specific party to that particular matter.

(3) A former Government employee who within a period of one year prior to the termination of Government employment had official responsibility for a particular matter involving specific parties may not, within two years after his or her Government employment is ended, represent in that particular matter any person who is or was a specific party to that particular matter.

(4) No former Government employee may, within one year after his or her Government employment is ended, appear before any employee of the Treasury Department in connection with the publication, withdrawal, amendment, modification, or interpretation of a rule the development of which the former Government employee participated or for which, within a period of one year prior to the termination of his or her Government employment, the former government employee had official direct responsibility. This paragraph (b)(4) does not, however, preclude such former employee from appearing on his or her own behalf or from representing a taxpayer before the Internal Revenue Service in connection with a particular matter involving specific parties involving the application or interpretation of such a rule with respect to that particular matter, provided that such former employee does not utilize or disclose any confidential information acquired by the former employee in the development of the rule.

(c) *Firm representation*. (1) No member of a firm of which a former Government employee is a member may represent or knowingly assist a person who was or is a specific party in any particular matter with respect to which the restrictions of paragraph (b)(2) of this section apply to the former Government employee, in that particular matter, unless the firm isolates the former Government employee in such a way to ensure that the former Government employee cannot assist in the representation.

(2) When isolation of a former Government employee is required under paragraph (c)(1) of this section, a statement affirming the fact of such isolation must be executed under oath by the former Government employee and by another member of the firm acting on behalf of the firm. The statement must clearly identify the firm, the former Government employee, and the particular matter(s) requiring isolation. The statement must be retained by the firm and, upon request, provided to the Director of the Office of Professional Responsibility.

(d) *Pending representation*. The provisions of this regulation will govern practice by former Government employees, their partners and associates with respect to representation in particular matters involving specific parties where actual representation commenced before the effective date of this regulation.

(e) This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 10. Section 10.27 is revised to read as follows:

§10.27 Fees.

(a) *In general*. A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

(b) *Contingent fees*. (1) Except as provided in paragraphs (b)(2) and (3) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service's examination of, or challenge to—

(i) An original tax return; or

(ii) An amended return or claim for refund or credit filed prior to the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return.

(3) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.

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

(1) *Contingent fee* is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client's fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) *Matter before the Internal Revenue Service* includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations ad-

ministered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.

(d) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 11. Section 10.29 is revised to read as follows:

§10.29 Conflicting interests.

(a) Except as provided by paragraph (b) of this section, a practitioner shall not represent a client in his or her practice before the Internal Revenue Service if the representation involves a conflict of interest. A conflict of interest exists if—

(1) The representation of one client will be directly adverse to another client; or

(2) There is a significant risk that the representation of one or more clients will be materially limited by the practitioner's responsibilities to another client, a former client or a third person or by a personal interest of the practitioner.

(b) Notwithstanding the existence of a conflict of interest under paragraph (a) of this section, the practitioner may represent a client if—

(1) The practitioner reasonably believes that the practitioner will be able to provide competent and diligent representation to each affected client;

(2) The representation is not prohibited by law; and

(3) Each affected client waives the conflict of interest and gives informed consent, confirmed in writing by the affected client, at the time the existence of the conflict of interest is known by the practitioner.

(c) Copies of the written consents must be retained by the practitioner for at least 36 months from the date of the conclusion of the representation of the affected clients, and the written consents must be provided to any officer or employee of the Internal Revenue Service on request.

(d) This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 12. Section 10.34 is revised to read as follows:

§10.34 Standards with respect to tax returns and documents, affidavits and other papers.

(a) *Tax returns*. A practitioner may not sign a tax return as a preparer if the practitioner determines that the tax return contains a position that does not have a realistic possibility of being sustained on its merits (the realistic possibility standard) unless the position is not frivolous and is adequately disclosed to the Internal Revenue Service. A practitioner may not advise a client to take a position on a tax return, or prepare the portion of a tax return on which a position is taken, unless—

(1) The practitioner determines that the position satisfies the realistic possibility standard; or

(2) The position is not frivolous.

(b) *Documents, affidavits and other papers*. (1) A practitioner may not advise a client to take a position on a document, affidavit or other paper submitted to the Internal Revenue Service unless the position is not frivolous.

(2) A practitioner may not advise a client to submit a document, affidavit or other paper to the Internal Revenue Service—

(i) The purpose of which is to delay or impede the administration of the Federal tax laws;

(ii) That is frivolous or groundless; or

(iii) That contains or omits information in a manner that demonstrates an intentional disregard of a rule or regulation.

(c) *Advising clients on potential penalties*. (1) A practitioner must inform a client of any penalties that are reasonably likely to apply to the client with respect to—

(i) A position taken on a tax return if—

(A) The practitioner advised the client with respect to the position; or

(B) The practitioner prepared or signed the tax return; and

(ii) Any document, affidavit or other paper submitted to the Internal Revenue Service.

(2) The practitioner also must inform the client of any opportunity to avoid any such penalties by disclosure, if relevant, and of the requirements for adequate disclosure.

(3) This paragraph (c) applies even if the practitioner is not subject to a penalty under the Internal Revenue Code with respect to the position or with respect to the document, affidavit or other paper submitted.

(d) *Relying on information furnished by clients*. A practitioner advising a client to take a position on a tax return, document, affidavit or other paper submitted to the Internal Revenue Service, or preparing or signing a tax return as a preparer, generally may rely in good faith without verification upon information furnished by the client. The practitioner may not, however, ignore the implications of information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.

(e) *Definitions*. For purposes of this section:

(1) *Realistic possibility*. A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis of the law and the facts by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits. The authorities described in 26 CFR 1.6662–4(d)(3)(iii), or any successor provision, of the substantial understatement penalty regulations may be taken into account for purposes of this analysis. The possibility that a tax return will not be audited, that an issue will not be raised on audit, or that an issue will be settled may not be taken into account.

(2) *Frivolous*. A position is frivolous if it is patently improper.

(f) *Effective date*. This section is applicable to tax returns, documents, affidavits and other papers filed on or after the date that final regulations are published in the **Federal Register**.

Par. 13. In §10.35(b)(1) remove the language "§10.2(e)" and add the language "§10.2(a)(5)" in its place.

Par. 14. Section 10.50 is amended by revising paragraph (a) and adding paragraphs (c) and (d) to read as follows:

§10.50 Sanctions.

(a) *Authority to censure, suspend, or disbar.* The Secretary of the Treasury, or his or her delegate, after notice and an opportunity for a proceeding, may censure, suspend, or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable (within the meaning of §10.51), fails to comply with any regulation in this part (under the prohibited conduct standards of §10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

* * * * *

(c) *Authority to impose monetary penalty*—(1) *In general.* (i) The Secretary of the Treasury, or his or her delegate, after notice and an opportunity for a proceeding, may impose a monetary penalty on any practitioner who engages in conduct subject to sanction under paragraph (a) of this section.

(ii) If the practitioner described in paragraph (c)(1)(i) of this section was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to the penalty, the Secretary of the Treasury, or his or her delegate, may impose a monetary penalty on the employer, firm, or entity if it knew, or reasonably should have known, of such conduct.

(2) *Amount of penalty.* The amount of the penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty.

(3) *Coordination with other sanctions.* Subject to paragraph (c)(2) of this section—

(i) Any monetary penalty imposed on a practitioner under this paragraph (c) may be in addition to or in lieu of any suspension, disbarment or censure and may be in addition to a penalty imposed on an employer, firm or other entity under paragraph (c)(1)(ii) of this section.

(ii) Any monetary penalty imposed on an employer, firm or other entity may be in addition to penalties imposed under paragraph (c)(1)(i) of this section.

(d) *Effective date.* This section is applicable to conduct occurring on or after the date that final regulations are published in the **Federal Register**.

Par. 15. Section 10.51 is revised to read as follows:

§10.51 Incompetence and disreputable conduct.

(a) *Incompetence and disreputable conduct.* Incompetence and disreputable conduct for which a practitioner may be sanctioned under §10.50 includes, but is not limited to:

(1) Conviction of any criminal offense under the Federal tax laws.

(2) Conviction of any criminal offense involving dishonesty or breach of trust.

(3) Conviction of any felony under Federal or State law for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(4) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing such information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, or any other document or statement, written or oral, are included in the term *information*.

(5) Solicitation of employment as prohibited under §10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or officer or employee thereof.

(6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.

(7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

(8) Misappropriation of, or failure properly or promptly to remit funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(9) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage or by the bestowing of any gift, favor or thing of value.

(10) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant or actuary by any duly constituted authority of any State, territory, possession of the United States, including a Commonwealth, or the District of Columbia, any Federal court of record or any Federal agency, body or board.

(11) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment or ineligibility of such other person.

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations or statements, knowing them to be false or circulating or publishing malicious or libel matter.

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph (13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should

observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

(14) Willfully failing to sign a tax return prepared by the practitioner when such signature is required by the Federal tax laws.

(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under section 10.60.

(b) *Effective date*. This section is applicable to conduct occurring on or after the date that final regulations are published in the **Federal Register**.

Par. 16. Section 10.52 is revised to read as follows:

§10.52 Violations subject to sanction.

(a) A practitioner may be sanctioned under §10.50 if the practitioner—

(1) Willfully violates any of the regulations (other than §10.33) contained in this part; or

(2) Recklessly or through gross incompetence (within the meaning of §10.51(a)(13)) violates §10.34, 10.35, 10.36 or 10.37.

(b) This section is applicable to conduct occurring on or after the date that final regulations are published in the **Federal Register**.

Par. 17. Section 10.60 is amended by revising paragraph (a) and adding paragraph (d) to read as follows:

§10.60 Institution of proceeding.

(a) Whenever the Director of the Office of Professional Responsibility determines that a practitioner (or employer, firm or other entity, if applicable) violated any provision of the laws governing practice before the Internal Revenue Service or the regulations in this part, the Director of the Office of Professional Responsibility may reprimand the practitioner or, in accordance with §10.62, institute a proceeding for a sanction described in §10.50. A proceeding is instituted by the filing of a complaint, the contents of which are more fully described in §10.62.

* * * * *

(d) This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 18. Section 10.61 is revised to read as follows:

§10.61 Conferences.

(a) *In general*. The Director of the Office of Professional Responsibility may confer with a practitioner, employer, firm or other entity, or an appraiser concerning allegations of misconduct irrespective of whether a proceeding has been instituted. If the conference results in a stipulation in connection with an ongoing proceeding in which the practitioner, employer, firm or other entity, or appraiser is the respondent, the stipulation may be entered in the record by either party to the proceeding.

(b) *Resignation or voluntary sanction*—(1) *In general*. In lieu of a proceeding being instituted or continued under §10.60(a), a practitioner or appraiser (or employer, firm or other entity, if applicable) may offer a consent to be sanctioned under §10.50.

(2) *Discretion; acceptance or declination*. The Director of the Office of Professional Responsibility may, in his or her discretion, accept or decline the offer described in paragraph (b)(1) of this section. In any declination, the Director of the Office of Professional Responsibility may state that he or she would accept the offer described in paragraph (b)(1) of this section if it contained different terms. The Director of the Office of Professional Responsibility may, in his or her discretion, accept or reject a revised offer submitted in response to the declination or may counteroffer and act upon any accepted counteroffer.

(c) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 19. Section 10.62 is amended by revising paragraph (c) and adding paragraph (d) to read as follows:

§10.62 Contents of complaint.

* * * * *

(c) *Demand for answer*. The Director of the Office of Professional Responsibility must, in the complaint or in a separate paper attached to the complaint, notify the respondent of the time for answering the complaint, which may not be less than 30 days from the date of service of the complaint, the name and address of the Administrative Law Judge with whom the answer must be filed, the name and address of the person representing the Director of the Office of Professional Responsibility to whom a copy of the answer must be served, and that a decision by default may be rendered against the respondent in the event an answer is not filed as required.

(d) *Effective date*. This section is applicable to complaints brought on or after the date that final regulations are published in the **Federal Register**.

Par. 20. Section 10.63 is amended by:

1. Revising paragraph (a)(4).

2. Redesignating paragraph (d) as paragraph (e).

3. Adding new paragraphs (d) and (f).

The revisions and additions read as follows:

§10.63 Service of complaint; service of other papers; service of evidence in support of complaint; filing of papers.

(a) * * *

(4) For purposes of this section, "respondent" means the practitioner, employer, firm or other entity, or appraiser named in the complaint or any other person having the authority to accept mail on behalf of the practitioner, employer, firm or other entity, or appraiser.

* * * * *

(d) *Service of evidence in support of complaint*. Within 10 days of serving the complaint, copies of the evidence in support of the complaint must be served on the respondent in any manner described in paragraphs (a)(2) and (3) of this section.

* * * * *

(f) *Effective date*. This section is applicable to complaints brought on or after the date that final regulations are published in the **Federal Register**.

Par. 21. Section 10.65 is revised to read as follows:

§10.65 Supplemental charges.

(a) *In general*. The Director of the Office of Professional Responsibility may file supplemental charges, by amending the complaint, against the respondent, if, for example—

(1) It appears that the respondent, in the answer, falsely and in bad faith, denies a material allegation of fact in the complaint or states that the respondent has insufficient knowledge to form a belief, when the respondent possesses such information; or

(2) It appears that the respondent has knowingly introduced false testimony during the proceedings against the respondent.

(b) *Hearing*. The supplemental charges may be heard with other charges in the case, provided the respondent is given due notice of the charges and is afforded a reasonable opportunity to prepare a defense to the supplemental charges.

(c) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 22. Section 10.68 is revised to read as follows:

§10.68 Motions and requests.

(a) *Motions*—(1) *In general*. At any time after the filing of the complaint, any party may file a motion with the Administrative Law Judge. Unless otherwise ordered by the Administrative Law Judge, motions must be in writing and must be served on the opposing party as provided in §10.63(b). A motion must concisely specify its grounds and the relief sought, and, if appropriate, must contain a memorandum of facts and law in support.

(2) *Summary adjudication*. Either party may move for a summary adjudication upon all or any part of the legal issues in controversy. If the non-moving party opposes summary adjudication in the moving party's favor, the non-moving party must file a written response within 30 days unless ordered otherwise by the Administrative Law Judge.

(3) *Good Faith*. A party filing a motion for extension of time, a motion for postponement of a hearing, or any other non-dispositive or procedural motion must first contact the other party to determine whether there is any objection to the motion, and must state in the motion whether the other party has an objection.

(b) *Response*. Unless otherwise ordered by the Administrative Law Judge, the nonmoving party is not required to file a response to a motion. If the Administrative Law Judge does not order the nonmoving party to file a response, and the nonmoving party files no response, the nonmoving party is deemed to oppose the motion. If a nonmoving party does not respond within 30 days of the filing of a motion for decision by default for failure to file a timely answer or for failure to prosecute, the nonmoving party is deemed not to oppose the motion.

(c) *Oral motions; oral argument*. (1) The Administrative Law Judge may, for good cause and with notice to the parties, permit oral motions and oral opposition to motions.

(2) The Administrative Law Judge may, within his or her discretion, permit oral argument on any motion.

(d) *Orders*. The Administrative Law Judge should issue written orders disposing of any motion or request and any response thereto.

(e) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 23. Section 10.70 is amended by revising paragraphs (a) and (b)(6) and adding paragraph (c) to read as follows:

§10.70 Administrative Law Judge.

(a) *Appointment*. Proceedings on complaints for the sanction (as described in §10.50) of a practitioner, employer, firm or other entity, or appraiser will be conducted by an Administrative Law Judge appointed as provided by 5 U.S.C. 3105.

(b) * * *

(6) Take or authorize the taking of depositions or answers to requests for admission;

* * * * *

(c) This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 24. Section 10.73 is removed.

§10.73 **[Removed]**

Par. 25. Section 10.72 is redesignated as §10.73.

§10.72 **[Redesignated as §10.73]**

Par. 26. Section 10.71 is redesignated as §10.72.

§10.71 **[Redesignated as §10.72]**

Par. 27. New §10.71 is added to read as follows:

§10.71 Discovery.

(a) *In general*. Discovery may be permitted, at the discretion of the Administrative Law Judge, only upon written motion demonstrating the relevance, materiality and reasonableness of the requested discovery and subject to the requirements of §10.72(d)(2) and (3). Within 10 days of receipt of the answer, the Administrative Law Judge will notify the parties of the right to request discovery and the timeframes for filing a request. A request for discovery, and objections, must be filed in accordance with §10.68. In response to a request for discovery, the Administrative Law Judge may order:

(1) Depositions upon oral examination; or

(2) Answers to requests for admission.

(b) *Depositions upon oral examination*. (1) A deposition must be taken before an officer duly authorized to administer an oath for general purposes or before an officer or employee of the Internal Revenue Service who is authorized to administer an oath in Federal tax law matters.

(2) In ordering a deposition, the Administrative Law Judge will require reasonable notice to the opposing party as to the time and place of the deposition. The opposing party, if attending, will be provided the opportunity for full examination and cross-examination of any witness.

(3) Expenses in the reporting of depositions shall be borne by the party at whose instance the deposition is taken. Travel expenses of the deponent shall be borne by the party requesting the deposition, unless otherwise authorized by Federal law or regulation.

(c) *Requests for admission*. Any party may serve on any other party a written request for admission of the truth of any matters which are not privileged and are relevant to the subject matter of this proceeding. Requests for admission shall not exceed a total of 30 (including any subparts within a specific request) without

the approval from the Administrative Law Judge.

(d) *Limitations*. Discovery shall not be authorized if—

(1) The request fails to meet any requirement set forth in paragraph (a) of this section;

(2) It will unduly delay the proceeding;

(3) It will place an undue burden on the party required to produce the discovery sought;

(4) It is frivolous or abusive;

(5) It is cumulative or duplicative;

(6) It is privileged or otherwise protected from disclosure by law;

(7) It relates to mental impressions, conclusions, or legal theories of any party, attorney, or other representative, of a party prepared in anticipation of a proceeding; or

(8) It is available generally to the public, equally to the parties, or to the party seeking the discovery through another source.

(e) *Failure to comply*. Where a party fails to comply with an order of the Administrative Law Judge under this section, the Administrative Law Judge may, among other things, infer that the information would be adverse to the party failing to provide it, exclude the information from evidence or issue a decision by default.

(f) *Other discovery*. No discovery other than that specifically provided for in this section is permitted.

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

Par. 28. Newly designated §10.72 is amended by:

1. Revising paragraph (a).

2. Redesignating paragraphs (b), (c) and (d) as paragraphs (d), (e) and (f), respectively.

3. Adding new paragraphs (b) and (c).

4. Revising newly designated paragraph (d).

5. Adding a new paragraph (g).

The additions and revisions read as follows:

§10.72 Hearings.

(a) *In general*—(1) *Presiding officer*. An Administrative Law Judge will preside at the hearing on a complaint filed under §10.60 for the sanction of a practitioner, employer, firm or other entity, or appraiser.

(2) *Time for hearing*. Absent a determination by the Administrative Law Judge that, in the interest of justice, a hearing must be held at a later time, the Administrative Law Judge should, on notice sufficient to allow proper preparation, schedule the hearing to occur no later than 180 days after the time for filing the answer.

(3) *Procedural requirements*. (i) Hearings will be stenographically recorded and transcribed and the testimony of witnesses will be taken under oath or affirmation.

(ii) Hearings will be conducted pursuant to 5 U.S.C. 556.

(iii) A hearing in a proceeding requested under §10.82(g) will be conducted *de novo*.

(iv) An evidentiary hearing must be held in all proceedings prior to the issuance of a decision by the Administrative Law Judge unless—

(A) The Director of the Office of Professional Responsibility withdraws the complaint;

(B) A decision is issued by default pursuant to §10.64(d);

(C) A decision is issued under §10.82(e);

(D) The respondent requests a decision on the written record without a hearing; or

(E) The Administrative Law Judge issues a decision under §10.68(d) or by virtue of ruling on another motion that disposes of the case prior to the hearing.

(b) *Cross-examination*. A party is entitled to present his or her case or defense by oral or documentary evidence, to submit rebuttal evidence, and to conduct cross-examination, in the presence of the Administrative Law Judge, as may be required for a full and true disclosure of the facts. This paragraph (b) does not limit a party from presenting evidence contained within a deposition when the Administrative Law Judge determines that the deposition has been obtained in compliance with the rules of this subpart D.

(c) *Prehearing memorandum*. Unless otherwise ordered by the Administrative Law Judge, each party shall file, and serve on the opposing party or the opposing party's representative, prior to any hearing, a prehearing memorandum containing—

(1) A list (together with a copy) of all proposed exhibits to be used in the party's case in chief;

(2) A list of proposed witnesses, including a synopsis of their expected testimony, or a statement that no witnesses will be called;

(3) Identification of any proposed expert witnesses, including a synopsis of their expected testimony and a copy of any report prepared by the expert or at his or her direction; and

(4) A list of undisputed facts.

(d) *Publicity of proceedings*—(1) *In general*. Except as provided in paragraph (d)(3) of this section, all hearings before the Administrative Law Judge, all pleadings filed with the Administrative Law Judge, all evidence received by the Administrative Law Judge, and all reports and decisions of the Administrative Law Judge in a proceeding under Subpart D will, subject to paragraph (d)(3) of this section, be public and open to inspection. Copies of these documents may, at the Secretary's discretion, be made publicly available on the Internal Revenue Service webpage (*www.irs.gov*) or through other means.

(2) *Returns and return information*—(i) *Disclosure to practitioner or appraiser*. Pursuant to section 6103(l)(4)(A) of the Internal Revenue Code, the Secretary, or his or her delegate, may disclose returns and return information, upon written request, to any practitioner or appraiser, or to the authorized representative of such practitioner or appraiser, whose rights are or may be affected by an administrative action or proceeding under subpart D, but solely for use in such action or proceeding and only to the extent that the Secretary, or his or her delegate, determines that such returns or return information are or may be relevant and material to the action or proceeding.

(ii) *Disclosure to officers and employees of the Department of Treasury*. Pursuant to section 6103(l)(4)(B) of the Internal Revenue Code, the Secretary may disclose returns and return information to officers and employees of the Department of the Treasury for use in any action or proceeding under subpart D, to the extent necessary to advance or protect the interests of the United States.

(iii) *Use of returns and return information*. Recipients of returns and return

information under this paragraph (d)(2) may use such returns or return information solely in the action or proceeding, or in preparation for the action or proceeding, with respect to which the disclosure was made.

(iv) *Procedures for disclosure of returns and return information*—(A) *Requests for information*. The practitioner or appraiser, or his or her authorized representative, may request returns or return information for use in the action or proceeding, or preparation for such action or proceeding in accordance with the requirements of section 6103(l)(4)(A) of the Internal Revenue Code. The practitioner or appraiser, or his or her authorized representative, may not obtain returns or return information from the Internal Revenue Service for use in a disciplinary proceeding under subpart D through any other process or procedure.

(B) *Responding to requests for information*. The Secretary will respond to a properly constituted written request for returns or return information made pursuant to paragraph (d)(2)(iv)(A) of this section by providing—

(*1*) To the extent authorized by section 6103(l)(4)(A) of the Internal Revenue Code, returns or return information requested by the practitioner or appraiser, coded for identifying all third party taxpayers;

(*2*) A key to the coded information;

(*3*) A letter informing the practitioner or appraiser, and his or her authorized representative, of the restrictions on the use and disclosure of the returns and return information, the applicable damages remedy under section 7431 of the Internal Revenue Code, and that unauthorized disclosure of information provided by the Internal Revenue Service under this paragraph (d)(2) is also a violation of this part.

(C) *Filing documents*. The parties must redact from all documents filed with the Administrative Law Judge (including attachments and exhibits) any names, addresses or other identifying details of third party taxpayers and replace such information with the code assigned to the corresponding taxpayer.

(D) *Oral testimony*. The parties shall provide a key to the coded third party returns and return information described in paragraph (d)(2)(iv)(B) of this section to each person giving oral testimony before the Administrative Law Judge, but only to the extent relevant to the person's testimony. The Administrative Law Judge should direct all persons giving oral testimony to use the code during such testimony, or, if impractical, issue a protective order in accordance with paragraph (d)(3) of this section.

(3) *Protective measures*—(i) *Mandatory protective order*. If redaction of names, addresses, and other identifying information of third parties would render documents unintelligible for use in the proceeding or may still permit indirect identification of any third party taxpayer, the Administrative Law Judge will issue a protective order to ensure that such identifying information is available to the parties and the Administrative Law Judge for purposes of the proceeding, but is not disclosed to, or open to inspection by, the public.

(ii) *Authorized orders*. (A) Upon motion by a party or any other affected person, and for good cause shown, the Administrative Law Judge may make any order which justice requires to protect any person in the event disclosure of information is prohibited by law, privileged, confidential, or sensitive in some other way, including, but not limited to, one or more of the following—

(*1*) That disclosure of information be made only on specified terms and conditions, including a designation of the time or place;

(*2*) That certain matters not be inquired into, or that the inquiry be limited to certain matters or to any other extent;

(*3*) That the hearing or deposition be conducted with no one present except persons designated by the Administrative Law Judge;

(*4*) That a deposition or any written materials be sealed, and be opened only by order of the Administrative Law Judge;

(*5*) That a trade secret or other information not be disclosed, or be disclosed only in a designated way; and

(*6*) That the parties simultaneously file specified documents or information enclosed in sealed envelopes to be opened only as directed by the Administrative Law Judge.

(B) If a discovery request has been made, then the movant shall attach as an exhibit to a motion for a protective order under this section a copy of any discovery request in respect of which the motion is filed.

(iii) *Denials*. If a motion for a protective order is denied in whole or in part, then the Administrative Law Judge may, on such terms or conditions as he or she deems just, order any party or person to comply with, or respond in accordance with, the procedure involved.

(iv) *Conclusion of Proceedings*. At the conclusion of a proceeding the Secretary, or his or her delegate, shall ensure that all returns and return information, including the names, addresses or other identifying details of third party taxpayers, are redacted and replaced with the code assigned to the corresponding taxpayer in all documents prior to such documents being made available for further public inspection.

* * * * *

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

Par. 29. Newly designated §10.73 is amended by:

1. Revising paragraph (b).

2. Redesignating paragraphs (c), (d), and (e) as paragraphs (d), (e), and (f), respectively.

3. Adding new paragraphs (c) and (g).

4. Revising newly designated paragraph (d).

The revisions and additions read as follows:

§10.73 Evidence.

* * * * *

(b) *Depositions*. The deposition of any witness taken pursuant to §10.71 may be admitted into evidence in any proceeding instituted under §10.60.

(c) *Requests for admission*. Any matter admitted in response to a request for admission under §10.71 is conclusively established unless the Administrative Law Judge on motion permits withdrawal or modification of the admission. Any admission made by a party is for the purposes of the pending action only and is not an admission by such party for any other purpose, nor may it be used against such party in any other proceeding.

(d) *Proof of documents*. Official documents, records, and papers of the Internal Revenue Service and the Office of Professional Responsibility are admissible in ev-

idence without the production of an officer or employee to authenticate them. Any such documents, records, and papers may be evidenced by a copy attested or identified by an officer or employee of the Internal Revenue Service or the Treasury Department, as the case may be.

* * * * *

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

Par. 30. Section 10.76 is revised to read as follows:

§10.76 Decision of Administrative Law Judge.

(a) *In general*—(1) *Hearings*. Within 180 days after the conclusion of a hearing and the receipt of any proposed findings and conclusions timely submitted by the parties, the Administrative Law Judge should enter a decision in the case. The decision must include a statement of findings and conclusions, as well as the reasons or basis for making such findings and conclusions, and an order of censure, suspension, disbarment, monetary penalty, disqualification, or dismissal of the complaint.

(2) *Summary adjudication*. In the event that a motion for summary adjudication is filed, the Administrative Law Judge should rule on the motion for summary adjudication within 60 days after the party in opposition files a written response, or if no written response is filed, within 90 days after the motion for summary adjudication is filed. A decision shall thereafter be rendered if the pleadings, depositions, admissions, and any other admissible evidence show that there is no genuine issue of material fact and that a decision may be rendered as a matter of law. The decision must include a statement of conclusions, as well as the reasons or basis for making such conclusions, and an order of censure, suspension, disbarment, monetary penalty, disqualification, or dismissal of the complaint.

(3) *Returns and return information*. In the decision, the Administrative Law Judge should use the code assigned to third party taxpayers (described in §10.72(d)).

(b) *Standard of proof*. If the sanction is censure or a suspension of less than six months' duration, the Administrative Law Judge, in rendering findings and conclusions, will consider an allegation of fact to be proven if it is established by the party who is alleging the fact by a preponderance of the evidence in the record. If the sanction is a monetary penalty, disbarment or a suspension of six months or longer duration, an allegation of fact that is necessary for a finding against the practitioner must be proven by clear and convincing evidence in the record. An allegation of fact that is necessary for a finding of disqualification against an appraiser must be proven by clear and convincing evidence in the record.

(c) *Copy of decision*. The Administrative Law Judge will provide the decision to the Director of the Office of Professional Responsibility, with a copy to the Director's authorized representative, and a copy of the decision to the respondent or the respondent's authorized representative.

(d) *When final*. The decision of the Administrative Law Judge will become the final decision of the agency 45 days after the date the Administrative Law Judge's decision is served on the parties unless, either in response to a petition for review to the Secretary, or his or her delegate, filed by a party, or on his or her own initiative, the Secretary, or his or her delegate, provides the written notice described in §10.77(e) to the parties.

(e) *Effective date*. This section is applicable to proceedings initiated on or after the date that final regulations are published in the **Federal Register**.

Par. 31. Section 10.77 is revised to read as follows:

§10.77 Petition for review of decision of Administrative Law Judge.

(a) *Petition for review*. Any party to the proceeding under subpart D may file a petition for review of the decision of the Administrative Law Judge with the Secretary, or his or her delegate.

(1) *Briefs*. The petition must include a brief that states exceptions to the decision of the Administrative Law Judge and supporting reasons for such exceptions.

(2) *Publicity of review*—(i) *In general*. All petitions and briefs, any responses thereto, filed with the Secretary, or his or her delegate, and all decisions of the Secretary, or his or her delegate, will be public and open to inspection. Copies of these documents may, at the Secretary's discretion, be made publicly available on the Internal Revenue Service webpage (*www.irs.gov*) or through other means.

(ii) *Returns and return information*. The parties must delete from all documents filed with the Secretary, or his or her delegate, (including attachments and exhibits) and the Secretary, or his or her delegate, will delete from the decision any names, addresses or other identifying details of third party taxpayers and replace the information with the code assigned to third party taxpayers in accordance with §10.72(d).

(b) *Time and place for filing of petition for review*. The petition for review, and brief, must be filed, in duplicate, with the Director of the Office of Professional Responsibility within 30 days of the date that the decision of the Administrative Law Judge is served on the parties. The Director of the Office of Professional Responsibility will immediately furnish a copy of the petition to the Secretary or his or her delegate who decides appeals. A copy of the petition for review must be sent to any non-petitioning party. If the Director of the Office of Professional Responsibility files a petition for review, he or she shall certify to the respondent that the petition has been filed along with a copy of the petition.

(c) *Discretionary review*. In determining whether to grant review of the decision of the Administrative Law Judge, the Secretary, or his or her delegate, may consider whether the petition for review shows that—

(1) A prejudicial error was likely committed in the conduct of the proceeding; or

(2) The decision—

(i) Likely contains a finding or conclusion of material fact or conclusion of law that is clearly erroneous; or

(ii) The Secretary, or his or her delegate, determines that such error should be reviewed.

(d) *Secretary review other than pursuant to a petition for review*. The Secretary, or his or her delegate, may, on his or her own initiative, order review of any Administrative Law Judge decision within 45 days of the date of the decision.

(e) *Notice of review*. If the Secretary, or his or her delegate, grants a petition for review or orders review on his or her own initiative, the Secretary, or his or her delegate, will notify the parties, within 45 days from the date the decision of the Adminis-

trative Law Judge is served on the parties, that—

(1) The decision of the Administrative Law Judge has been taken under review by the Secretary, or his or her delegate;

(2) No final agency decision has been made;

(3) The action of the Administrative Law Judge, including the decision and order, is inoperative pending review by the Secretary, or his or her delegate; and

(4) A final decision of the agency to be made by the Secretary is required before judicial review can be obtained.

(f) *Deemed denial*. A petition for review will be deemed to be denied where the Secretary, or his or her delegate, issues no notice of review.

(g) *Interlocutory review*. The Secretary will not review an Administrative Law Judge's ruling prior to the Administrative Law Judge rendering a decision that would dispose of the entire proceeding.

(h) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 32. Section 10.78 is revised to read as follows:

§10.78 Decision on review.

(a) *Scope of review*. If the Secretary, or his or her delegate, provides written notice to the parties pursuant to §10.77 that a decision of the Administrative Law Judge is under review, the Secretary, or his or her delegate, may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, the decision by the Administrative Law Judge and may make any findings and conclusions that in his or her judgment are proper and on the basis of the record. The decision of the Administrative Law Judge will not be reversed unless it is established that the decision is clearly erroneous in light of the evidence in the record and applicable law. Issues that are exclusively matters of law will be reviewed *de novo*. In the event that the Secretary, or his or her delegate, determines that there are unresolved issues raised by the record, the case may be remanded to the Administrative Law Judge to elicit additional testimony or evidence. A copy of the agency decision will be provided by the Secretary, or his or her delegate, contemporaneously to the Director of the Office of Professional Responsibility and the respondent or their authorized representatives.

(b) *Record on review*. The Director of the Office of Professional Responsibility must provide the entire record, including copies of any petition for review, brief, and any reply brief, to the Secretary, or his or her delegate, within 30 days of the date the Secretary, or his or her delegate, provides written notice to the parties pursuant to §10.77 that a decision of the Administrative Law Judge is under review. The Director of the Office of Professional Responsibility shall certify to the respondent that such documents have been so provided.

(c) *Reply and supplemental briefs*. The Secretary, or his or her delegate, may order the filing of a reply brief that responds to the petition for review, either before the period for notice of review expires or after a notice of review is issued. The Secretary, or his or her delegate, may order the parties to file supplemental briefs on any or all issues.

(d) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 33. Section 10.82 is amended by revising paragraph (b) and adding paragraph (h) to read as follows:

§10.82 Expedited suspension.

* * * * *

(b) *To whom applicable*. This section applies to any practitioner who, within five years of the date a complaint instituting a proceeding under this section is served:

(1) Has had his or her license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause (not including failure to pay a professional licensing fee) by any authority or court, agency, body, or board described in §10.51(a)(11).

(2) Has, irrespective of whether an appeal has been taken, been convicted of any crime under title 26 of the United States Code, any crime involving dishonesty or breach of trust, or any felony for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(3) Has violated conditions imposed on the practitioner pursuant to §10.79(d).

(4) Has demonstrated a pattern of egregious conduct by—

(i) Failing to file a return or pay a tax, required annually by the Internal Revenue Code, during three of the five immediately proceeding taxable years; or

(ii) Failing to file a return or pay a tax, required more frequently than annually by the Internal Revenue Code, during four of the seven immediately proceeding tax periods; and

(iii) Is not in compliance with his or her Federal tax obligations at the time the notice of suspension is issued under paragraph (f) of this section.

(5) Has been sanctioned by a court of competent jurisdiction, whether in a civil or criminal proceeding (including suits for injunctive relief), relating to a taxpayer's tax liability or relating to the practitioner's own tax liability, for—

(i) Instituting or maintaining proceedings primarily for delay;

(ii) Advancing frivolous or groundless arguments; or

(iii) Failing to pursue available administrative remedies.

* * * * *

(h) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 34. Section 10.90 is revised to read as follows:

§10.90 Records.

(a) *Roster*. The Director of the Office of Professional Responsibility will maintain, and may make available for public inspection in the time and manner prescribed by the Secretary, or his or her delegate, rosters of—

(1) Enrolled agents, including individuals—

(i) Granted active enrollment to practice;

(ii) Whose enrollment has been placed in inactive status for failure to meet the requirements for renewal of enrollment;

(iii) Whose enrollment has been placed in inactive retirement status; and

(iv) Whose offer of consent to resign from enrollment has been accepted by the Director of the Office of Professional Responsibility under §10.61;

(2) Individuals (and employers, firms or other entities, if applicable) censured, suspended, or disbarred from practice before the Internal Revenue Service or upon

whom a monetary penalty was imposed; and

(3) Disqualified appraisers.

(b) *Other records*. Other records of the Director of the Office of Professional Responsibility may be disclosed upon specific request, in accordance with the applicable disclosure rules of the Internal Revenue Service and the Treasury Department.

(b) *Effective date*. This section is applicable on the date that final regulations are published in the **Federal Register**.

Par. 35. Section 10.91 is revised to read as follows:

§10.91 Saving provision.

Any proceeding instituted under this part prior to July 26, 2002, for which a final decision has not been reached or for which judicial review is still available will not be affected by these revisions. Any proceeding under this part based on conduct engaged in prior to the effective dates of these revisions, which is instituted after that date, shall apply subpart D and E or this part as revised, but the conduct engaged in prior to the effective date of these revisions shall be judged by the regulations in effect at the time the conduct occurred.

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

Approved February 2, 2006.

Arnold I. Havens,
General Counsel,
Office of the Secretary.

(Filed by the Office of the Federal Register on February 3, 2006, 11:01 a.m., and published in the issue of the Federal Register for February 8, 2006, 71 F.R. 6421)

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

Escrow Accounts, Trusts, and Other Funds Used During Deferred Exchanges of Like-Kind Property

REG–113365–04 and REG–209619–93

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document withdraws in part a notice of proposed rulemaking under section 468B of the Internal Revenue Code (Code) relating to the taxation and reporting of income earned on qualified settlement funds and certain other funds, trusts, and escrow accounts. This document also contains proposed regulations under section 468B regarding the taxation of the income earned on escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property, and proposed regulations under section 7872 regarding below-market loans to facilitators of these exchanges. The proposed regulations affect taxpayers that engage in deferred like-kind exchanges and escrow holders, trustees, qualified intermediaries, and others that hold funds during deferred like-kind exchanges. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by May 8, 2006. Outlines of topics to be discussed at the public hearing scheduled for June 6, 2006, at 10 a.m. must be received by May 16, 2006.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–113365–04), 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–113365–04), courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–113365–04). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations under section 468B, A. Katharine Jacob Kiss, (202) 622–4930; concerning the proposed regulations under section 7872, David Silber, (202) 622–3930; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett, (202) 622–3401 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document withdraws §1.468B–6 of a notice of proposed rulemaking (REG–209619–93, 1999–1 C.B. 689) relating to the taxation of qualified settlement funds and certain other escrow accounts, trusts, and funds under section 468B(g) that was published in the **Federal Register** (64 FR 4801) on February 1, 1999 (the 1999 proposed regulations). This document contains new proposed regulations that provide rules under sections 468B(g) and 7872 regarding the taxation of qualified escrow accounts, qualified trusts, and other escrow accounts, trusts, or funds used during section 1031 deferred exchanges of like-kind property.

Section 468B was added by section 1807(a)(7)(A) of the Tax Reform Act of 1986 (Public Law 99–514, 100 Stat. 2814) and was amended by section 1018(f) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100–647, 102 Stat. 3582). Section 468B(g) provides that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax and that the Secretary shall prescribe regulations providing for the taxation of such accounts or funds whether as a grantor trust or otherwise.

Section 7872 was added to the Internal Revenue Code by the Tax Reform Act of 1984 (Public Law No. 98–369, 98 Stat. 494). Section 7872 provides rules for certain direct and indirect below-market loans enumerated in section 7872(c)(1). The legislative history of section 7872 states that the term loan is to be interpreted broadly for purposes of section 7872, potentially encompassing any transfer of money that provides the transferor with a right to repayment. See H.R. Rep. 98–861, 98th Cong., 2d Sess. 1018 (1984).

In general, section 7872 recharacterizes a below-market loan (a loan in which the interest rate charged is less than the applicable Federal rate (AFR)) as an arm's-length transaction in which the lender makes a loan to the borrower at the AFR, coupled with an imputed payment or payments to the borrower sufficient to fund all or part of the interest that the borrower is treated as paying on that loan. The amount, timing, and characterization of the imputed payments to the borrower under a below-market loan depend on the relationship between the borrower and the lender and whether the loan is characterized as a demand loan or a term loan.

Written comments responding to the 1999 proposed regulations under section 468B were received. A public hearing was held on May 12, 1999. After consideration of all the comments, portions of the 1999 proposed regulations are adopted in a Treasury decision (T.D. 9249) published elsewhere in this issue of the Bulletin. The rules relating to the taxation of qualified escrow accounts, qualified trusts, and other escrow accounts, trusts, or funds used during deferred exchanges of like-kind property under section 1031 have been substantially revised and are reproposed in this notice of proposed rulemaking. All comments received in connection with the 1999 proposed regulations will continue to be considered in finalizing these proposed regulations.

Explanation of Provisions and Summary of Comments

1. *Overview*

Section 1.468B–6 of the 1999 proposed regulations provides rules for the current taxation of income of a qualified escrow account or qualified trust used in a section 1031 deferred exchange of like-kind property. The 1999 proposed regulations provide that, in general, the taxpayer (the transferor of the property) is the owner of the assets in a qualified escrow account or qualified trust and must take into account all items of income, deduction, and credit (including capital gains and losses) of the qualified escrow account or qualified trust. However, if, under the facts and circumstances, a qualified intermediary or transferee has the beneficial use and enjoyment of the assets, then the qualified intermediary or transferee is the owner of the assets in the qualified escrow account or qualified trust and must take into account all items of income, deduction, and credit (including capital gains and losses) of the qualified escrow account or qualified trust. The 1999 proposed regulations further provide that, if a qualified intermediary or transferee is the owner of the assets transferred, the transaction may be characterized as a below-market loan from the taxpayer to the owner to which section 7872 may apply.

The comments received reflect differing interpretations of the 1999 proposed regulations and disagreement on the proper rules for taxing these transactions. The comments address three major issues (1) whether §1.468B–6 should apply to all funds and accounts maintained by qualified intermediaries to facilitate deferred like-kind exchanges as well as to qualified escrow accounts and qualified trusts (the scope of the rules); (2) whether the regulations should adopt a *per se* rule in place of the facts and circumstances ownership test; and (3) whether these arrangements may be properly characterized as loans. Other comments requested clarification of the information reporting provisions.

2. *Scope of the Rule*

Section 1.1031(k)–1(g) of the Income Tax Regulations provides safe harbors that allow taxpayers to engage in deferred exchanges of like-kind property and to avoid being determined to be in actual or constructive receipt of the proceeds from the sale of the taxpayers' relinquished property during the exchange period. The proceeds may be held in a qualified escrow account or qualified trust or may be held by a qualified intermediary. The 1999 proposed regulations address the treatment of only qualified escrow accounts and qualified trusts whether or not used by a qualified intermediary, and do not address accounts or funds used by a qualified intermediary that are not qualified escrow accounts or qualified trusts.

Commentators on the 1999 proposed regulations stated that qualified intermediaries may maintain funds in accounts that are not qualified escrow accounts or qualified trusts, including accounts in which the proceeds of a disposition of relinquished property are commingled with other assets, such as the proceeds from deferred like-kind exchanges entered into by other taxpayers. Some commentators recommended applying the rules of §1.468B–6 to income earned on amounts held in any escrow account, trust, or other account or fund used by a qualified intermediary in connection with a deferred like-kind exchange. They suggested that the limited scope of the 1999 proposed regulations may result in uncertainty and inconsistent treatment of the different types of accounts that may be used for similar purposes in deferred like-kind exchanges.

Other commentators took the contrary position, that is, that applying the rules proposed in 1999 to accounts other than qualified escrow accounts or qualified trusts is inappropriate. One commentator stated that at least one party (either the taxpayer or the qualified intermediary) is taxed on the income earned on every account used by a qualified intermediary. Therefore, the commentator reasoned, because there are no instances of homeless income (income that is not currently being taxed because the identity of the taxpayer has yet to be determined), applying the proposed regulations to escrow accounts or funds that are not qualified escrow accounts or qualified trusts would not advance the purpose of the statute. Another commentator opined that section 468B was intended to apply only to segregated accounts.

Other commentators urged that the 1999 proposed regulations be finalized without change or that the appropriate rules for taxation of accounts used in deferred like-kind exchanges other than qualified escrow accounts and qualified trusts should be considered at a later time.

The IRS and the Treasury Department have concluded that the same rules should apply to all escrow accounts, trusts, and

funds used during deferred exchanges to provide certainty and consistency of treatment. Additionally, the IRS and the Treasury Department have concluded that the rules should apply equally to escrow accounts, trusts, and funds used during exchanges that are intended to qualify as like-kind but fail to satisfy a requirement of section 1031. Therefore, these regulations propose to apply to *exchange funds*, defined as the relinquished property (if held in kind), cash, or cash equivalent that secures an obligation of a transferee to transfer replacement property, or the proceeds from a transfer of relinquished property, held in a qualified escrow account, qualified trust, or other escrow account, trust, or fund during a deferred exchange.

3. *Facts and Circumstances Ownership Test*

Under the 1999 proposed regulations, the taxpayer generally is treated as the owner of a qualified escrow account or qualified trust and is taxed on the income. If, under the facts and circumstances, however, a qualified intermediary or transferee has the beneficial use and enjoyment of the assets in the account, the qualified intermediary or transferee is the owner and is taxed on the income. The 1999 proposed regulations provide three factors that will be considered in addition to other relevant facts and circumstances in determining whether the transferee or qualified intermediary, rather than the taxpayer, has the beneficial use and enjoyment of the assets of the account or trust (1) who enjoys the use of the earnings of the account or trust; (2) who receives the benefit from appreciation in the value of the assets; and (3) who bears any risk of loss from a decline in the value of the assets. The 1999 proposed regulations include two examples that conclude that the taxpayer is the owner of the assets if the income from a qualified escrow account or qualified trust is paid to the qualified intermediary or transferee as compensation for services performed for the taxpayer. See *Old Colony Trust v. Commissioner*, 279 U.S. 716 (1929).

Some commentators recommended that the facts and circumstances test be eliminated and that the regulations provide a *per se* rule that the taxpayer must always take into account all items of income, deduction, and credit (including capital gains and losses) of the exchange funds in computing the taxpayer's income tax liability. They suggested that the taxpayer always owns the exchange funds and any income earned on the funds that is retained by the qualified intermediary constitutes compensation to the qualified intermediary for services rendered to the taxpayer in facilitating the deferred like-kind exchange. Therefore, consistent with the principles of *Old Colony Trust*, the taxpayer should be taxed on all the earnings in all cases.

Other commentators urged that the facts and circumstances test should be retained. They stated that like-kind exchanges are often structured so that a qualified intermediary has all the benefits and burdens of ownership of the exchange funds and that, in those circumstances, a qualified intermediary is the owner of the assets under general tax principles. These commentators explained that qualified intermediaries frequently charge separately stated fees that are the same if the earnings are paid to the taxpayer or retained by the qualified intermediary, indicating, they asserted, that the qualified intermediary's retention of the income is not properly characterized as compensation for services. These commentators further suggested, therefore, that in appropriate cases the qualified intermediary is the actual owner of the assets and the *Old Colony Trust* doctrine is inapplicable. These commentators also recommended that the rules should be sufficiently broad to permit parties to deferred like-kind exchanges flexibility in structuring the transactions, for example in the disposition of the income earned and in the use of commingled rather than segregated accounts.

A commentator recommended modifying the ownership rule to allow the allocation of the tax liability among the parties to the exchange and the qualified intermediary to the extent that those parties actually share the income earned on a qualified escrow account or qualified trust.

To enhance administrability, provide greater certainty, and ensure consistent treatment of taxpayers, these proposed regulations eliminate the facts and circumstances ownership test and propose specific rules that determine whether the income of an escrow account, trust, or fund used in a deferred like-kind exchange is taxed to the taxpayer or to an exchange facilitator, which is a qualified intermediary, transferee, or other party that holds the exchange funds. These rules are discussed further below.

Because the ownership test has been eliminated, these proposed regulations also eliminate the requirement in the 1999 proposed regulations that the parties provide a statement to the escrow holder or trustee when the taxpayer is not the owner of the assets.

4. *Loan Treatment*

One commentator argued that the treatment of a qualified intermediary as acquiring the relinquished property under the section 1031 regulations applies solely for purposes of section 1031. This commentator suggested that proceeds from the sale of the relinquished property in a deferred exchange are properly characterized in one of only two ways: (1) the taxpayer owns the funds and is taxed on the earnings; or (2) under section 7872, the taxpayer is treated as lending the funds to the qualified intermediary, in which case the qualified intermediary (or exchange facilitator) owns the funds and is treated as paying interest on the loan. The commentator also urged that, for reasons of administrative convenience, the parties should be permitted to elect either characterization and the rules should apply prospectively.

Other commentators stated that, if a qualified intermediary has the benefits and burdens of ownership, the funds are owned by the qualified intermediary and not the taxpayer, and therefore could not be loaned by the taxpayer. Because the taxpayer is deemed not to have actual or constructive receipt of the exchange funds under the rules of §1.1031(k)–1, these commentators reasoned that a taxpayer cannot lend assets it does not possess.

The IRS and the Treasury Department agree with the comment that exchange funds held by exchange facilitators in connection with deferred like-kind exchanges are properly characterized either as the taxpayer's funds or as loans from the taxpayer to the qualified intermediary or other exchange facilitator. Characterizing the exchange funds as having been loaned is consistent with the broad definition of the term loan in the legislative history of section 7872. The provisions of §1.1031(k)–1 stating that the taxpayer

is deemed to not have actual or constructive receipt of the exchange funds if the safe harbors apply do not preclude loan treatment. These rules permit taxpayers to engage in like-kind exchanges on a deferred basis but are not statements of general tax principles. See §1.1031–1(n).

Therefore, these proposed regulations provide that exchange funds are treated, as a general rule, as loaned by a taxpayer to an exchange facilitator, and the exchange facilitator takes into account all items of income, deduction, and credit (including capital gains and losses). If, however, the escrow agreement, trust agreement, or exchange agreement specifies that all the earnings attributable to exchange funds are payable to the taxpayer, the exchange funds are not treated as loaned from the taxpayer to the exchange facilitator, and the taxpayer takes into account all items of income, deduction, and credit (including capital gains and losses). If an exchange facilitator commingles exchange funds with other funds (for example, for investment purposes), all the earnings attributable to the exchange funds are treated as paid to the taxpayer if the exchange facilitator pays the taxpayer all the earnings of the commingled account that are allocable on a *pro-rata* basis (using a reasonable method that takes into account the time that the exchange funds are in the commingled account, actual rate or rates of return, and the respective principal balances) to the taxpayer's exchange funds. Payments from the exchange funds, or from the earnings attributable to the exchange funds, for the taxpayer's transactional expenses are treated as first paid to the taxpayer and then paid by the taxpayer to the recipient. Transactional expenses include the costs of land surveys, appraisals, title examinations, termite inspections, transfer taxes, and recording fees. An exchange facilitator's fee is a transactional expense only if the escrow agreement, trust agreement, or exchange agreement, as applicable, provides that (1) the amount of the fee payable to the exchange facilitator is fixed on or before the date of the transfer of the relinquished property by the taxpayer (either by stating the fee as a fixed dollar amount in the agreement or determining the fee by a formula, the result of which is known on or before the transfer of the relinquished property by the taxpayer), and (2) the amount of the fee is payable by the taxpayer regardless of whether the earnings attributable to the exchange funds are sufficient to pay the fee.

5. *Treatment under Section 7872 of Loans to Exchange Facilitators*

The 1999 proposed regulations provide that if a qualified intermediary or transferee is the owner of the assets transferred, section 7872 may apply "if the deferred exchange involves a below-market loan from the taxpayer to the owner."

Several commentators did not agree that section 7872 could apply to exchange funds and suggested that the reference should be deleted. Commentators also suggested that, even if a transfer of the exchange funds from the taxpayer to an exchange facilitator is a loan, it would constitute a loan given in consideration for the sale or exchange of property (within the meaning of section 1274(c)(1)) or a deferred payment on account of a sale or exchange of property (within the meaning of section 483) and would be exempt from section 7872 under the rules contained in §1.7872–2(a)(2)(ii) of the proposed regulations that were published in the **Federal Register** (LR–165–84, 1985–2 C.B. 812 [50 FR 33553]) on August 20, 1985 (the 1985 proposed regulations). These commentators further argued that exchange facilitator loans should be exempted from section 7872 because those loans must be repaid within six months. These commentators argued that the section 1274 exclusion of debt instruments payable within six months evidences Congress' intent that burdensome reporting and recordkeeping requirements should not apply to short-term loans.

Having considered the comments received, the IRS and the Treasury Department conclude that section 7872, rather than sections 1274 or 483, applies to loans from taxpayers to exchange facilitators. Therefore, these proposed regulations provide special rules under section 7872 for the treatment of exchange facilitator loans. Under these proposed regulations, an *exchange facilitator loan* is a transaction that, under §1.468B–6(c)(1), is treated as a loan from the taxpayer to an exchange facilitator in connection with a section 1031 deferred exchange. Below-market exchange facilitator loans are treated as compensation-related loans under section 7872(c)(1)(B) and are treated as demand loans for purposes of section 7872.

A commentator suggested that, if section 7872 applies to these transactions, interest should be tested and imputed at an alternative rate (similar to the alternative rate in §1.1274–4(a)(iii)) rather than at the short-term AFR. These proposed regulations provide an alternative rate (the 182-day rate) for exchange facilitator loans for purposes of section 7872. This rate is equal to the investment rate on a 182-day Treasury bill determined on the auction date that most closely precedes the date that the exchange facilitator loan is made. This rate is based on semi-annual compounding and may be found at *wwws.publicdebt.treas.gov/AI/OFBills*. The IRS and the Treasury Department request comments regarding alternative rates for exchange facilitator loans under section 7872, including whether the 182-day Treasury bill rate is an appropriate rate. Notwithstanding §1.7872–13 of the 1985 proposed regulations, the taxpayer and exchange facilitator may use the approximate method to determine the amount of forgone interest on an exchange facilitator loan.

One commentator urged that a *de minimis* exception for loans of exchange funds under $10,000,000 should be added under §1.7872–5T because these loans are without significant tax effect. Several other commentators opined that §1.7872–5T(b)(14) should exempt loans of exchange funds from section 7872 because they are loans without significant tax effect. However, the proposed regulations provide that exchange facilitator loans are not eligible for the exemptions listed in §1.7872–5T(b), including §1.7872–5T(b)(14). An exchange facilitator loan may be excepted from the application of section 7872 only if the loan qualifies for the $10,000 *de minimis* exception in section 7872(c)(3) for compensation-related loans.

6. *Information Reporting*

The 1999 proposed regulations state that an escrow holder or trustee must report the income of the escrow, trust, or fund on Form 1099 in accordance with subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Code (currently, sections 6041 through 6050T), and provide

rules for identifying the payee. Several commentators expressed concern that these provisions expand the existing information reporting obligations in sections 6041 through 6050T. The 1999 proposed regulations were not intended to create new information reporting requirements but merely to alert responsible persons of the potential obligation to report. To clarify this intent, these proposed regulations provide that a payor must report to the extent required by sections 6041 through 6050T and these regulations.

To enhance compliance, a commentator recommended that payors should be required to furnish Forms 1099 to corporate payees involved in deferred like-kind exchanges. This suggestion was not adopted because it would be inconsistent with provisions of sections 6041 through 6050T and the regulations thereunder that exempt payments to corporations from the information reporting requirements.

7. *Effective Dates*

Sections 1.468B–6 and 1.7872–16 apply, respectively, to transfers of property made by taxpayers and to exchange facilitator loans issued after the date these regulations are published as final regulations in the **Federal Register**. Section 1.468B–6 of these proposed regulations incorporates a transition rule similar to the transition rule in the 1999 proposed regulations. The transition rule provides that, with respect to transfers of property made by taxpayers after August 16, 1986, but on or before the date these regulations are published as final regulations in the **Federal Register**, the IRS will not challenge a reasonable, consistently applied method of taxation for income attributable to exchange funds.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. An initial regulatory flexibility analysis has been prepared for this notice of proposed rulemaking under 5 U.S.C. 603. The analysis is set forth below under the heading "Initial Regulatory Flexibility Analysis." Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Initial Regulatory Flexibility Analysis

The reasons for promulgation of these rules, and their legal basis, are set forth in this preamble under the heading "Background."

These rules impact exchange facilitators that hold exchange funds for taxpayers engaging in deferred exchanges of like-kind property. Exchange facilitators may be individuals, large entities such as banks, or small businesses. The IRS and the Treasury Department estimate that nationwide there are approximately 325 small businesses providing services as exchange facilitators, primarily as qualified intermediaries. For this purpose, a small business is defined as a business with annual receipts of up to $1.5 million, as provided in the Small Business Administration size standards set forth at 13 CFR 121.201 for NAICS code 531390 (other activities related to real estate).

Section 1.468B–6(c)(2) provides that exchange funds are not treated as loaned to an exchange facilitator if all the earnings attributable to the exchange funds are paid to a taxpayer. If the exchange facilitator commingles the exchange funds, the exchange facilitator will be required to account for the earnings attributable to the taxpayer's exchange funds.

As an alternative to these rules, retaining the facts and circumstances test of the 1999 proposed regulations was considered but rejected because the test lacks administrability and is subject to abuse. Other alternatives were considered and rejected as inconsistent with the statutory requirements of section 7872.

The number of transactions involving small entities that will be impacted by these regulations, and the full extent of the economic impact, cannot be precisely determined. Exchange facilitators may simplify the accounting for the earnings attributable to each taxpayer's exchange funds held in a commingled account by depositing each taxpayer's exchange funds in a segregated account and paying the taxpayer all the earnings of that account.

Comments are requested on the nature and extent of the economic burden imposed on small entities by these rules and on alternatives that would be less burdensome to small entities.

The IRS and the Treasury Department are not aware of any duplicative, overlapping, or conflicting federal rules.

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 the Treasury Department specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 6, 2006, at 10 a.m., in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of topics to be discussed and the time devoted to each topic (signed original and eight (8) copies) by May 16, 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 A. Katharine Jacob Kiss of the Office of Associate Chief Counsel (Income Tax & Accounting) and Rebecca Asta of the Office of Associate Chief Counsel (Financial Institutions &

Products). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Withdrawal of Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, §§1.468B–6 and 1.1031(k)–1(g)(3)(i) and (h)(2) of a notice of proposed rulemaking (REG–209619–93) amending 26 CFR part 1 that was published in the **Federal Register** (64 FR 4801) on February 1, 1999, are withdrawn.

Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.468B–6 also issued under 26 U.S.C. 468B(g).* * *

Section 1.7872–16 also issued under 26 U.S.C. 7872.* * *

Par. 2. Section 1.468B–0 is amended by revising the entries for §1.468B–6 to read as follows:

§1.468B–0 Table of contents.

* * * * *

§1.468B–6 Escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property under section 1031(a)(3).

(a) Scope.

(b) Definitions.

(1) In general.

(2) Exchange funds.

(3) Exchange facilitator.

(4) Transactional expenses.

(i) In general.

(ii) Special rule for certain fees for exchange facilitator services.

(c) Taxation of exchange funds.

(1) Exchange funds generally treated as loaned to an exchange facilitator.

(2) Exchange funds not treated as loaned to an exchange facilitator.

(i) Scope.

(ii) Treatment of the taxpayer.

(d) Information reporting requirements.

(e) Examples.

(f) Effective dates.

(1) In general.

(2) Transition rule.

* * * * *

Par. 3. Section 1.468B–6 is added to read as follows:

§1.468B–6 Escrow accounts, trusts, and other funds used during deferred exchanges of like-kind property under section 1031(a)(3).

(a) *Scope*. This section provides rules under section 468B(g) relating to the current taxation of escrow accounts, trusts, and other funds used during deferred exchanges.

(b) *Definitions*. The definitions in this paragraph (b) apply for purposes of this section.

(1) *In general*. *Deferred exchange*, *escrow agreement*, *escrow holder*, *exchange agreement*, *exchange period*, *qualified escrow account*, *qualified intermediary*, *qualified trust*, *relinquished property*, *replacement property*, *taxpayer*, *trust agreement*, and *trustee* have the same meanings as in §1.1031(k)–1; *deferred exchange* also includes any exchange intended to qualify as a deferred exchange, and *qualified intermediary* also includes any person or entity intended by a taxpayer to be a qualified intermediary within the meaning of §1.1031(k)–1(g)(4).

(2) *Exchange funds*. *Exchange funds* means relinquished property, cash, or cash equivalent, that secures an obligation of a transferee to transfer replacement property, or proceeds from a transfer of relinquished property, held in a qualified escrow account, qualified trust, or other escrow account, trust, or fund during an exchange period.

(3) *Exchange facilitator*. *Exchange facilitator* means a qualified intermediary, transferee, escrow holder, trustee, or other party that holds exchange funds for a taxpayer during an exchange period.

(4) *Transactional expenses*—(i) *In general*. *Transactional expenses* means the usual and customary expenses paid or incurred in connection with a deferred exchange. For example, the costs of land surveys, appraisals, title examinations, termite inspections, transfer taxes, and recording fees are transactional expenses. Except as provided in paragraph (b)(4)(ii) of this section, the fee for the services of an exchange facilitator is not treated as a transactional expense.

(ii) *Special rule for certain fees for exchange facilitator services*. The fee for the services of an exchange facilitator will be treated as a transactional expense if the escrow agreement, trust agreement, or exchange agreement, as applicable, provides that—

(A) The amount of the fee payable to the exchange facilitator is fixed on or before the date of the transfer of the relinquished property by the taxpayer (either by stating the fee as a fixed dollar amount in the agreement or determining the fee by a formula, the result of which is known on or before the transfer of the relinquished property by the taxpayer); and

(B) The amount of the fee is payable by the taxpayer regardless of whether the earnings attributable to the exchange funds are sufficient to pay the fee.

(c) *Taxation of exchange funds*—(1) *Exchange funds generally treated as loaned to an exchange facilitator*. Except as provided in paragraph (c)(2) of this section, exchange funds are treated as loaned from a taxpayer to an exchange facilitator. The exchange facilitator must take into account all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds. See §1.7872–16 to determine if a loan from a taxpayer to an exchange facilitator is a below-market loan for purposes of section 7872.

(2) *Exchange funds not treated as loaned to an exchange facilitator*—(i) *Scope*. This paragraph (c)(2) applies if, in accordance with an escrow agreement, trust agreement, or exchange agreement, as applicable, all the earnings attributable to a taxpayer's exchange funds are paid to the taxpayer. For purposes of this paragraph (c)(2)—

(A) Any payment from the taxpayer's exchange funds, or from the earnings attributable to the taxpayer's exchange funds, for a transactional expense of the taxpayer (as defined in paragraph (b)(4) of

this section) is treated as first paid to the taxpayer and then paid by the taxpayer to the recipient; and

(B) If an exchange facilitator commingles (for investment or otherwise) the taxpayer's exchange funds with other funds or assets (whether or not the taxpayer's funds are in a segregated account), all the earnings attributable to the taxpayer's exchange funds are paid to the taxpayer if all of the earnings of the commingled funds or assets that are allocable on a *pro-rata* basis (using a reasonable method that takes into account the time that the exchange funds are in the commingled account, actual rate or rates of return, and the respective account balances) to the taxpayer's exchange funds either are paid to the taxpayer or are treated as paid to the taxpayer under paragraph (c)(2)(i)(A) of this section.

(ii) *Treatment of the taxpayer*. If this paragraph (c)(2) applies, exchange funds are not treated as loaned from a taxpayer to an exchange facilitator. The taxpayer must take into account all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds.

(d) *Information reporting requirements*. A payor (as defined in §1.6041–1) must report the income attributable to exchange funds on Form 1099 to the extent required by the information reporting provisions of subpart B, Part III, subchapter A, chapter 61, Subtitle F of the Internal Revenue Code, and the regulations thereunder. See §1.6041–1(f) for rules relating to the amount to be reported when fees, expenses or commissions owed by a payee to a third party are deducted from a payment.

(e) *Examples*. The provisions of this section are illustrated by the following examples in which T is a taxpayer that uses a calendar taxable year and the cash receipts and disbursements method of accounting. The examples are as follows:

Example 1. All earnings attributable to exchange funds paid to taxpayer. (i) T enters into a deferred exchange with R. The sales agreement provides that T will transfer property (the relinquished property) to R and R will transfer replacement property to T. R's obligation to transfer replacement property to T is secured by cash equal to the fair market value of the relinquished property that R will deposit into a qualified escrow account that T establishes with B, a financial institution. T enters into an escrow agreement with B that provides that all the earnings attributable to the exchange funds will be paid to T.

(ii) On February 1, 2006, T transfers property with a fair market value of $100,000 to R and R deposits $100,000 in T's qualified escrow account with B. Between February 1 and June 1, 2006, T's exchange funds earn $750. On June 1, 2006, R transfers replacement property worth $100,000 to T and B pays $100,000 from the qualified escrow account to R. Additionally, on June 1, B credits the qualified escrow account with $750 of earnings and pays the earnings to T.

(iii) Under paragraph (b) of this section, the $100,000 deposited with B are exchange funds and B is an exchange facilitator. Because all the earnings attributable to the exchange funds are paid to T in accordance with the escrow agreement, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B, and T must take into account in computing T's income tax liability for 2006 the $750 of earnings credited to the qualified escrow account.

Example 2. Payment of transactional expenses from earnings. (i) The facts are the same as in *Example 1*, except that the escrow agreement provides that, prior to paying the earnings to T, B may deduct any amounts B has paid to third parties for T's transactional expenses. B pays a third party $350 on behalf of T for a survey of the replacement property. After deducting $350 from the earnings attributable to T's qualified escrow account, B pays T the remainder ($400) of the earnings.

(ii) Under paragraph (b)(4) of this section, the cost of the survey is a transactional expense. Under paragraph (c)(2)(i)(A) of this section, the $350 that B pays for the survey is treated as first paid to T and then from T to the third party. Therefore, all the earnings attributable to T's exchange funds are paid or treated as paid to T in accordance with the escrow agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B, and T must take into account in computing T's income tax liability for 2006 the $750 of earnings credited to the qualified escrow account.

Example 3. Earnings retained by exchange facilitator as compensation for services. (i) The facts are the same as in *Example 1*, except that the escrow agreement provides that B also may deduct any outstanding fees owed by T for B's services in facilitating the deferred exchange. In accordance with paragraph (b)(4)(ii) of this section, the escrow agreement provides for a fixed fee of $200 for B's services, which is payable by T regardless of the amount of earnings attributable to the exchange funds. Because the earnings on the exchange funds in this case exceed $200, B retains $200 as the unpaid portion of its fee and pays T the remainder ($550) of the earnings.

(ii) Under paragraph (b)(4) of this section, B's fee is treated as a transactional expense. Under paragraph (c)(2)(i)(A) of this section, the $200 that B retains for its fee is treated as first paid to T and then from T to B. Therefore, all the earnings attributable to T's exchange funds are paid or treated as paid to T in accordance with the escrow agreement, and paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to B, and T must take into account in computing T's income tax liability for 2006 the $750 of earnings credited to the qualified escrow account.

Example 4. Stated rate of interest on account less than earnings attributable to exchange funds. (i) The facts are the same as in *Example 1*, except that the escrow agreement provides that the qualified escrow account will earn a stated rate of interest. B invests the exchange funds and earns $750, but credits $500 to the qualified escrow account at the stated rate. B pays to T the $500 of interest earned at the stated rate on the qualified escrow account.

(ii) Paragraph (c)(1) of this section applies and the exchange funds are treated as loaned from T to B. B must take into account in computing B's income tax liability all items of income, deduction, and credit (including capital gains and losses) attributable to the exchange funds. Paragraph (c)(2) of this section does not apply because B does not pay all the earnings attributable to the exchange funds to T. See §1.7872–16 for rules relating to exchange facilitator loans.

Example 5. Exchange funds deposited by exchange facilitator with financial institution in account in taxpayer's name. (i) The facts are the same as in *Example 1*, except that, instead of entering into an escrow agreement, T enters into an exchange agreement with QI, a qualified intermediary. The exchange agreement provides that R will pay $100,000 to QI, QI will deposit $100,000 into an account with a financial institution under T's name and taxpayer identification number (TIN), and all the earnings attributable to the account will be paid to T.

(ii) On February 1, 2006, T transfers property with a fair market value of $100,000 to R, R delivers $100,000 to QI, and QI deposits $100,000 into a money market account with B, a financial institution unrelated to QI, under T's name and TIN. Between February 1 and June 1, 2006, the account earns $500 of interest at the stated rate established by B. On June 1, 2006, QI uses $100,000 of the funds in the account to purchase replacement property identified by T and transfers the replacement property to T. B pays to T the $500 of interest earned on the money market account.

(iii) Under paragraph (b) of this section, the $100,000 QI receives from R for the relinquished property are exchange funds and QI is an exchange facilitator. B is not an exchange facilitator. T has no direct relationship with B, and QI, not B, holds the exchange funds on behalf of T. Because all the earnings attributable to the exchange funds held by QI are paid to T in accordance with the exchange agreement, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI, and T must take into account in computing T's income tax liability for 2006 the $500 of interest earned on the money market account.

Example 6. All earnings attributable to commingled exchange funds paid to taxpayer. (i) The facts are the same as in *Example 5*, except that the exchange agreement does not specify how the $100,000 QI receives from R must be invested.

(ii) On February 1, 2006, QI deposits the $100,000 with B, a financial institution, in a pre-existing interest-bearing account under QI's name and TIN. The account has a total balance of $275,000 immediately thereafter. On the last day of each month between February and June, 2006, the account earns interest as follows: $690 in February, $920 in March, $516 in April, and $986 in May. On April 11, 2006, QI deposits $50,000 in the account. On May 15, 2006, QI withdraws $175,000 from the account.

(iii) QI calculates T's *pro-rata* share of the earnings allocable to the $100,000 based on the actual return, the average daily principal balances, and a 30-day month convention, as follows:

Month	Account's Avg. Daily Bal.	T's Avg. Daily Bal.	T's Share*	Monthly Interest	T's End. Bal.**
February	$275,000	$100,000	36.4%	$690	$100,251
March	$275,690	$100,251	36.4%	$920	$100,586
April	$309,943	$100,586	32.5%	$516	$100,754
May	$236,626	$100,754	42.6%	$986	$101,174

* T's Average Daily Balance ÷ Account's Average Daily Balance

**T's beginning balance + [(T's share)(Monthly Interest)]

(iv) On June 1, 2006, QI uses $100,000 of the funds to purchase replacement property identified by T and transfers the property to T. QI pays $1,174, the earnings of the account allocated to T's exchange funds, to T.

(v) Under paragraph (b) of this section, the $100,000 from the sale of the relinquished property are exchange funds and QI is an exchange facilitator. Because QI uses a reasonable method to calculate the *pro-rata* share of account earnings allocable to T's exchange funds and pays all those earnings to T, paragraph (c)(2) of this section applies. The exchange funds are not treated as loaned from T to QI. T must take into account in computing T's income tax liability for 2006 the $1,174 of earnings attributable to T's exchange funds.

(f) *Effective dates*—(1) *In general*. This section applies to transfers of property made by taxpayers after the date these regulations are published as final regulations in the **Federal Register**.

(2) *Transition rule*. With respect to transfers of property made by taxpayers after August 16, 1986, but on or before the date these regulations are published as final regulations in the **Federal Register**, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income attributable to exchange funds.

Par. 4. Section 1.1031(k)–1 is amended by adding a sentence at the end of paragraph (h)(2) to read as follows:

§1.1031(k)–1 Treatment of deferred exchanges .

* * * * *

(h) * * *

(2) * * * For rules under section 468B(g) relating to the current taxation of qualified escrow accounts, qualified trusts, and other escrow accounts, trusts, and funds used during deferred exchanges of like-kind property, see §1.468B–6.

* * * * *

Par. 5. Section 1.7872–16 is added to read as follows:

§1.7872–16 Loans to an exchange facilitator under §1.468B–6.

(a) *Special rules applicable to loans made to an exchange facilitator under §1.468B–6*—(1) *Scope*. This section applies to a transaction that, under §1.468B–6(c)(1), is treated as a loan to an exchange facilitator in connection with a deferred exchange (exchange facilitator loan). For purposes of this section, the terms *deferred exchange*, *exchange agreement*, *exchange facilitator*, *exchange funds*, *qualified intermediary*, *replacement property*, and *taxpayer* have the same meanings as in §1.468B–6(b).

(2) *Treatment as compensation-related loans*. If an exchange facilitator loan is a below-market loan, the loan is treated as a compensation-related loan under section 7872(c)(1)(B).

(3) *Treatment of exchange facilitator loan as a demand loan*. For purposes of section 7872, exchange facilitator loans are treated as demand loans.

(4) *182-day rate for exchange facilitator loans*. For purposes of section 7872(f)(2), in lieu of the applicable Federal rate (AFR) provided under section 1274(d)(1), the taxpayer and the exchange facilitator must use the 182-day rate for an exchange facilitator loan. For purposes of the preceding sentence, the 182-day rate is equal to the investment rate on a 182-day Treasury bill determined on the auction date that most closely precedes the date that the exchange facilitator loan is made.

(5) *Use of approximate method permitted*. The taxpayer and exchange facilitator may use the approximate method under §1.7872–13(b)(2) to determine the amount of forgone interest on any exchange facilitator loan.

(b) *No exemption for below-market exchange facilitator loans*. If an exchange facilitator loan is a below-market loan, the loan is not eligible for the exemptions listed under §1.7872–5T(b), including §1.7872–5T(b)(14) (relating to loans without significant-tax effect).

(c) *Example*. The provisions of this section are illustrated by the following example.

Example. (i) T enters into a deferred exchange with QI, a qualified intermediary. The exchange is governed by an exchange agreement. The exchange funds held by QI pursuant to the exchange agreement are treated as loaned to QI under §1.468B–6(c)(1). Under paragraph (a)(1) of this section, the loan between T and QI is an exchange facilitator loan. The exchange agreement between T and QI provides that no earnings will be paid to T. On December 1, 2006, T transfers property with a fair market value of $1,000,000 to QI and QI deposits $1,000,000 in a money market account. On March 1, 2007, QI uses $1,000,000 of the funds in the account to purchase replacement property identified by T, and transfers the replacement property to T. The amount loaned for purposes of section 7872 is $1,000,000 and the loan is outstanding for three months. The 182-day rate under paragraph (a)(4) of this section is 1 percent, compounded semi-annually.

(ii) Under paragraph (a) of this section, the loan from T to QI is treated as a compensation-related demand loan. Because there is no interest payable on the loan from T to QI, the loan is a below-market loan under section 7872. Under section 7872(e)(2), the amount of forgone interest on the loan for 2006 is $833 ($1,000,000*.01/2*1/6). Under section 7872(e)(2), the forgone interest for 2007 is $1667 ($1,000,000*.01/2*2/6). The $833 for 2006 is deemed transferred as compensation by T to QI and retransferred as interest by QI to T on December 31, 2006. The $1667 for 2007 is deemed transferred as compensation by T to QI and retransferred as interest by QI to T on March 1, 2007.

(d) *Effective date*. This section applies to exchange facilitator loans issued after the date these regulations are published as final regulations in the **Federal Register**.

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

(Filed by the Office of the Federal Register on February 3, 2006, 8:45 a.m., and published in the issue of the Federal Register for February 7, 2006, 71 F.R. 6231)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

Numerical Finding List[1]

Bulletin 2006–1 through 2006–10

Announcements:

2006-1, 2006-1 I.R.B. *260*
2006-2, 2006-2 I.R.B. *300*
2006-3, 2006-3 I.R.B. *327*
2006-4, 2006-3 I.R.B. *328*
2006-5, 2006-4 I.R.B. *378*
2006-6, 2006-4 I.R.B. *340*
2006-7, 2006-4 I.R.B. *342*
2006-8, 2006-4 I.R.B. *344*
2006-9, 2006-5 I.R.B. *392*
2006-10, 2006-5 I.R.B. *393*
2006-11, 2006-6 I.R.B. *420*
2006-12, 2006-6 I.R.B. *421*
2006-13, 2006-7 I.R.B. *462*
2006-14, 2006-8 I.R.B. *516*

Notices:

2006-1, 2006-4 I.R.B. *347*
2006-2, 2006-2 I.R.B. *278*
2006-3, 2006-3 I.R.B. *306*
2006-4, 2006-3 I.R.B. *307*
2006-5, 2006-4 I.R.B. *348*
2006-6, 2006-5 I.R.B. *385*
2006-7, 2006-10 I.R.B. *559*
2006-8, 2006-5 I.R.B. *386*
2006-9, 2006-6 I.R.B. *413*
2006-10, 2006-5 I.R.B. *386*
2006-11, 2006-7 I.R.B. *457*
2006-12, 2006-7 I.R.B. *458*
2006-13, 2006-8 I.R.B. *496*
2006-14, 2006-8 I.R.B. *498*
2006-15, 2006-8 I.R.B. *501*
2006-16, 2006-9 I.R.B. *538*
2006-17, 2006-10 I.R.B. *559*
2006-18, 2006-8 I.R.B. *502*
2006-19, 2006-9 I.R.B. *539*
2006-20, 2006-10 I.R.B. *560*

Proposed Regulations:

REG-107722-00, 2006-4 I.R.B. *354*
REG-104385-01, 2006-5 I.R.B. *389*
REG-122380-02, 2006-10 I.R.B. *563*
REG-137243-02, 2006-3 I.R.B. *317*
REG-133446-03, 2006-2 I.R.B. *299*
REG-113365-04, 2006-10 I.R.B. *580*
REG-148568-04, 2006-6 I.R.B. *417*
REG-106418-05, 2006-7 I.R.B. *461*
REG-138879-05, 2006-8 I.R.B. *503*
REG-143244-05, 2006-6 I.R.B. *419*
REG-146459-05, 2006-8 I.R.B. *504*

Revenue Procedures:

2006-1, 2006-1 I.R.B. *1*
2006-2, 2006-1 I.R.B. *89*
2006-3, 2006-1 I.R.B. *122*
2006-4, 2006-1 I.R.B. *132*
2006-5, 2006-1 I.R.B. *174*
2006-6, 2006-1 I.R.B. *204*
2006-7, 2006-1 I.R.B. *242*
2006-8, 2006-1 I.R.B. *245*
2006-9, 2006-2 I.R.B. *278*
2006-10, 2006-2 I.R.B. *293*
2006-11, 2006-3 I.R.B. *309*
2006-12, 2006-3 I.R.B. *310*
2006-13, 2006-3 I.R.B. *315*
2006-14, 2006-4 I.R.B. *350*
2006-15, 2006-5 I.R.B. *387*
2006-16, 2006-9 I.R.B. *539*

Revenue Rulings:

2006-1, 2006-2 I.R.B. *261*
2006-2, 2006-2 I.R.B. *261*
2006-3, 2006-2 I.R.B. *276*
2006-4, 2006-2 I.R.B. *264*
2006-5, 2006-3 I.R.B. *302*
2006-6, 2006-5 I.R.B. *381*
2006-7, 2006-6 I.R.B. *399*
2006-8, 2006-9 I.R.B. *520*
2006-9, 2006-9 I.R.B. *519*
2006-10, 2006-10 I.R.B. *557*

Tax Conventions:

2006-6, 2006-4 I.R.B. *340*
2006-7, 2006-4 I.R.B. *342*
2006-8, 2006-4 I.R.B. *344*

Treasury Decisions:

9231, 2006-2 I.R.B. *272*
9232, 2006-2 I.R.B. *266*
9233, 2006-3 I.R.B. *303*
9234, 2006-4 I.R.B. *329*
9235, 2006-4 I.R.B. *338*
9236, 2006-5 I.R.B. *382*
9237, 2006-6 I.R.B. *394*
9238, 2006-6 I.R.B. *408*
9239, 2006-6 I.R.B. *401*
9240, 2006-7 I.R.B. *454*
9241, 2006-7 I.R.B. *427*
9242, 2006-7 I.R.B. *422*
9243, 2006-8 I.R.B. *475*
9244, 2006-8 I.R.B. *463*
9246, 2006-9 I.R.B. *534*
9247, 2006-9 I.R.B. *521*
9248, 2006-9 I.R.B. *524*
9249, 2006-10 I.R.B. *546*

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

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2006–1 through 2006–10

Notices:

2002-35
Clarified and modified by
Notice 2006-16, 2006-9 I.R.B. *538*

2005-44
Supplemented by
Notice 2006-1, 2006-4 I.R.B. *347*

2005-66
Supplemented by
Notice 2006-20, 2006-10 I.R.B. *560*

2005-73
Supplemented by
Notice 2006-20, 2006-10 I.R.B. *560*

2005-81
Supplemented by
Notice 2006-20, 2006-10 I.R.B. *560*

2005-98
Supplemented by
Notice 2006-7, 2006-10 I.R.B. *559*

Proposed Regulations:

REG-131739-03
Corrected by
Ann. 2006-10, 2006-5 I.R.B. *393*

REG-138647-04
Corrected by
Ann. 2006-4, 2006-3 I.R.B. *328*

REG-158080-04
Corrected by
Ann. 2006-11, 2006-6 I.R.B. *420*

Revenue Procedures:

96-52
Superseded by
Rev. Proc. 2006-10, 2006-2 I.R.B. *293*

97-27
Modified by
Rev. Proc. 2006-11, 2006-3 I.R.B. *309*
Modified and amplified by
Rev. Proc. 2006-12, 2006-3 I.R.B. *310*

2002-9
Modified by
Rev. Proc. 2006-11, 2006-3 I.R.B. *309*
Modified and amplified by
Rev. Proc. 2006-12, 2006-3 I.R.B. *310*
Rev. Proc. 2006-14, 2006-4 I.R.B. *350*
Rev. Proc. 2006-16, 2006-9 I.R.B. *539*

Revenue Procedures— Continued:

2002-17
Modified by
Rev. Proc. 2006-14, 2006-4 I.R.B. *350*

2003-38
Modified by
Rev. Proc. 2006-16, 2006-9 I.R.B. *539*

2004-23
Superseded for certain taxable years by
Rev. Proc. 2006-12, 2006-3 I.R.B. *310*

2004-40
Superseded by
Rev. Proc. 2006-9, 2006-2 I.R.B. *278*

2005-1
Superseded by
Rev. Proc. 2006-1, 2006-1 I.R.B. *1*

2005-2
Superseded by
Rev. Proc. 2006-2, 2006-1 I.R.B. *89*

2005-3
Superseded by
Rev. Proc. 2006-3, 2006-1 I.R.B. *122*

2005-4
Superseded by
Rev. Proc. 2006-4, 2006-1 I.R.B. *132*

2005-5
Superseded by
Rev. Proc. 2006-5, 2006-1 I.R.B. *174*

2005-6
Superseded by
Rev. Proc. 2006-6, 2006-1 I.R.B. *204*

2005-7
Superseded by
Rev. Proc. 2006-7, 2006-1 I.R.B. *242*

2005-8
Superseded by
Rev. Proc. 2006-8, 2006-1 I.R.B. *245*

2005-9
Superseded for certain taxable years by
Rev. Proc. 2006-12, 2006-3 I.R.B. *310*

2005-12
Section 10 modified and superseded by
Rev. Proc. 2006-1, 2006-1 I.R.B. *1*

2005-24
Modified by
Notice 2006-15, 2006-8 I.R.B. *501*

2005-61
Superseded by
Rev. Proc. 2006-3, 2006-1 I.R.B. *122*

Revenue Procedures— Continued:

2005-68
Superseded by
Rev. Proc. 2006-1, 2006-1 I.R.B. *1*
Rev. Proc. 2006-3, 2006-1 I.R.B. *122*

Revenue Rulings:

55-355
Obsoleted by
T.D. 9244, 2006-8 I.R.B. *463*

74-503
Revoked by
Rev. Rul. 2006-2, 2006-2 I.R.B. *261*

77-230
Obsoleted by
T.D. 9249, 2006-10 I.R.B. *546*

Treasury Decisions:

9203
Corrected by
Ann. 2006-12, 2006-6 I.R.B. *421*

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

U.S. GPO: 2006—320–797/20047