Internal Revenue bulletin

Bulletin No. 2006-45
November 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. 2006–54, page 834.

2006 base period T-bill rate. The "base period T-bill rate" for the period ending September 30, 2006, is published as required by section 995(f) of the Code.

Rev. Rul. 2006–55, page 837.

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 November 2006.

T.D. 9289, page 827.

Final regulations under section 752 of the Code contain rules for taking into account certain obligations of a business entity that is disregarded as separate from its owner under section 856(i) or section 1361(b)(3), or regulations sections 301.7701–1 through 301.7701–3. The regulations clarify the existing regulations concerning when a partner may be treated as bearing the economic risk of loss for a partnership liability based upon an obligation of a disregarded entity.

Notice 2006–95, page 848.

This notice provides rules interpreting the reasonable mortality charge requirement contained in section 7702(c)(3)(B)(i) of the Code. Notice 88–128 supplemented. Notice 2004–61 modified and superseded.

TAX CONVENTIONS

Announcement 2006–80, page 840.

The United States recently exchanged instruments of ratification for a new income tax treaty with Bangladesh and a new protocol with Sweden. The tables in this announcement can be used to supplement the tables in Publications 515 and 901.

Announcement 2006–86, page 842.

The document describes how certain taxpayers may elect to use dual consolidated losses subject to section 1503(d) of the Code either in the United States or the United Kingdom, and contains background information for that election.

ADMINISTRATIVE

Rev. Proc. 2006–43, page 849.

This document provides procedures under which a taxpayer may use the automatic consent procedures of Rev. Proc. 2002–9 to request a change in method of accounting to comply with regulations sections 1.168(k)–1 or 1.1400L(b)–1. Rev. Proc. 2002–9 modified and amplified.

Rev. Proc. 2006–45, page 851.

This document provides the exclusive procedures for a corporation to obtain automatic approval from the Commissioner to change an annual accounting period under section 442 of the Code. Rev. Proc. 2002–37 clarified, modified, amplified, and superseded.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Rev. Proc. 2006–46, page 859.
This document provides the exclusive procedures for a partnership, S corporation, electing S corporation, personal service corporation, or trust to obtain automatic approval from the Commissioner to adopt, change, or retain an annual accounting period under section 442 of the Code. Rev. Proc. 2002–38 clarified, modified, amplified, and superseded.

Rev. Proc. 2006–47, page 869.
This document provides methods to determine the amount of "paragraph (e)(1) wages" for purposes of the limitation contained in section 199(b)(1) on the amount of the deduction provided by section 199(a)(1) for income attributable to domestic production activities. The procedure reflects changes in the definition of "W–2 wages" for purposes of section 199 made by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

Announcement 2006–84, page 873.
This document contains corrections to final and temporary regulations (T.D. 9281, 2006–39 I.R.B. 517) relating to the determination of the interest expense deduction of foreign corporations and applies to foreign corporations engaged in a trade or business within the United States.

Announcement 2006–85, page 873.
This document contains corrections to final regulations (T.D. 9276, 2006–37 I.R.B. 423) concerning the definition of supplemental wages for income tax withholding purposes and income tax requirements for employers making payments of supplemental wages to employees.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2006. See Rev. Rul. 2006-55, page 837.

Section 168.—Accelerated Cost Recovery System

26 CFR 1.168(k)–1: Additional first year depreciation deduction.

How does a taxpayer change its method of accounting to comply with § 1.168(k)–1 of the Income Tax Regulations? See Rev. Proc. 2006-43, page 849.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2006. See Rev. Rul. 2006-55, page 837.

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 November 2006. See Rev. Rul. 2006-55, page 837.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2006. See Rev. Rul. 2006-55, page 837.

Section 441.—Period for Computation of Taxable Income

26 CFR 1.441–1: Period for computation of taxable income.

This revenue procedure provides the exclusive procedures for a corporation to obtain the automatic approval of the Commissioner to change an annual accounting period. See Rev. Proc. 2006-45, page 851.

26 CFR 1.441–1: Period for computation of taxable income.
26 CFR 1.441–3: Taxable year of a personal service corporation.

This revenue procedure provides the exclusive procedures for a partnership, S corporation, electing S corporation, personal service corporation, or trust to obtain the automatic approval of the Commissioner to adopt, change, or retain an annual accounting period. See Rev. Proc. 2006-46, page 859.

Section 444.—Election of Taxable Year Other Than Required Taxable Year

This revenue procedure provides the exclusive procedures for a partnership, S corporation, electing S corporation, personal service corporation, or trust to obtain the automatic approval of the Commissioner to adopt, change, or retain an annual accounting period. See Rev. Proc. 2006-46, page 859.

Section 446.—General Rule for Methods of Accounting

If a taxpayer changes its method of computing depreciation to comply with § 1.168(k)–1 or § 1.1400L(b)–1 of the Income Tax Regulations, is this change a change in method of accounting under § 446(e) of the Internal Revenue Code? See Rev. Proc. 2006-43, page 849.

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 November 2006. See Rev. Rul. 2006-55, page 837.

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 November 2006. See Rev. Rul. 2006-55, page 837.

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 November 2006. See Rev. Rul. 2006-55, page 837.

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 November 2006. See Rev. Rul. 2006-55, page 837.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of November 2006. See Rev. Rul. 2006-55, page 837.

Section 706.—Taxable Years of Partner and Partnership

26 CFR 1.706–1: Taxable years of partner and partnership.

This revenue procedure provides the exclusive procedures that apply for a partnership to obtain the automatic approval of the Commissioner to adopt, change, or retain an annual accounting period. See Rev. Proc. 2006-46, page 859.

Section 752.—Treatment of Certain Liabilities

26 CFR 1.752–2: Partner's share of recourse liabilities.

T.D. 9289

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

Treatment of Disregarded Entities Under Section 752

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 752 for taking into account certain obligations of a business entity that is disregarded as separate from its owner under section 856(i) or section 1361(b)(3) of the Internal Revenue Code, or §§301.7701–1 through 301.7701–3 of the Procedure and Administration Regulations. These final regulations clarify the existing regulations concerning when a partner may be treated as bearing the economic risk of loss for a partnership liability based upon an obligation of a disregarded entity. The rules affect partnerships and their partners.

DATES: *Effective Date:* These regulations are effective on October 11, 2006.

Applicability Date: These regulations generally are applicable for liabilities incurred or assumed by a partnership on or after October 11, 2006.

FOR FURTHER INFORMATION CONTACT: Charlotte Chyr, 202–622–3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1905. Response to this collection of information 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.

The estimated annual burden per respondent varies from 6 minutes to 4 hours, depending on individual circumstances, with an estimated average of 2 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 Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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

Background

On August 12, 2004, the IRS and the Treasury Department issued proposed regulations under section 752 providing rules for taking into account certain obligations of disregarded entities (REG–128767–04, 2004–2 C.B. 534 [69 FR 49832]). Comments were received in response to the notice of proposed rulemaking, and a public hearing was scheduled. However, the public hearing was later cancelled when no one requested to speak. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision.

Summary of Comments and Explanation of Provisions

1. *Net Value Approach In General*

The proposed regulations provide that a payment obligation under §1.752–2(b)(1) (§1.752–2(b)(1) payment obligation) of a disregarded entity for which a partner is treated as bearing the economic risk of loss is taken into account only to the extent of the net value of the disregarded entity. Certain commentators disagreed with the approach taken in the proposed regulations, arguing that the regulations will result in inconsistent treatment of similar economic situations and unwarranted complexity.

Some commentators argued that the presumption of deemed satisfaction of §1.752–2(b)(1) payment obligations of partners and related persons that is provided in §1.752–2(b)(6) (presumption of deemed satisfaction) should be applied to disregarded entities that have §1.752–2(b)(1) payment obligations. Other commentators argued that the presumption of deemed satisfaction should apply only to certain disregarded entities, such as disregarded entities that comprise substantially all of the owner's assets, or disregarded entities that hold active trades or businesses.

The IRS and the Treasury Department believe that applying the presumption of deemed satisfaction to a disregarded entity that shields the federal tax partner from liability for the entity's obligations would, in many cases, cause partnership liabilities that are economically indistinguishable from nonrecourse liabilities to be classified as recourse for purposes of section 752. Applying the presumption of deemed satisfaction to disregarded entities would distort the allocation of partnership liabilities in those cases. Accordingly, these comments are not adopted in the final regulations.

One commentator suggested that §1.752–2 be amended to provide that, in addition to statutory and contractual obligations, statutory and contractual limitations should be taken into account in determining a partner's economic risk of loss. The IRS and the Treasury Department believe that such limitations are already taken into account under §1.752–2(b)(3). As a result, the comment is not adopted.

Another commentator suggested that the goal of the proposed regulation could be better achieved by adding an example to the current anti-abuse rule in §1.752–2(j) (or by publishing a revenue ruling) to illustrate a situation under which a partner's §1.752–2(b)(1) payment obligation is limited because the partner holds its interest in a partnership through a disregarded entity with a principal purpose to eliminate the partner's economic risk of loss with respect to the partnership's liabilities. The IRS and the Treasury Department agree that, in certain circumstances, the current anti-abuse rule under section 752 prevents allocation of partnership liabilities to a partner that is a disregarded entity. However, if a partner holds a partnership interest through a disregarded entity, and only the assets of the disregarded entity are available to satisfy §1.752–2(b)(1) payment obligations undertaken by the disregarded entity, the IRS and the Treasury Department believe that a partner should be treated as bearing the economic risk of loss for a partnership liability only to the extent of the net value of a disregarded entity's assets, whether or not the principal purpose of the arrangement is to

limit the partner's economic risk of loss. As a result, the comment is not adopted.

2. *Net Value Approach Not Extended To Other Entities*

The proposed regulations requested comments regarding whether the rules of the proposed regulations should be extended to the §1.752–2(b)(1) payment obligations of other entities, such as entities that are capitalized with nominal equity. Some commentators opposed expanding the approach of the proposed regulations to thinly capitalized entities as unnecessary. Other commentators suggested that the anti-abuse rule of §1.752–2(j) could be expanded to cover certain situations involving thinly capitalized entities. Specifically, a commentator suggested that the anti-abuse rule should apply if a substantially undercapitalized subsidiary of a consolidated group of corporations or a substantially undercapitalized passthrough entity (other than a disregarded entity) is utilized as the partner (or related obligor) for a principal purpose of limiting its owner's risk of loss in respect of existing partnership liabilities, and obtaining tax benefits for its owners (or other members of the consolidated group) that would not be available but for the additional tax basis in the partnership interest that results from the presumption of deemed satisfaction rule. The commentator also suggested that the regulations provide a safe harbor for determining entities that are not substantially undercapitalized.

Under the anti-abuse rule of §1.752–2(j), a §1.752–2(b)(1) payment obligation of a partner or a related person may be disregarded if the facts and circumstances indicate that a principal purpose of the arrangement between the parties is to eliminate the partner's economic risk of loss with respect to that obligation or to create the appearance of the economic risk of loss where the substance of the arrangement is otherwise. Thus, the anti-abuse rule of §1.752–2(j) can apply to abusive transactions involving thinly capitalized entities. Although these regulations do not modify the anti-abuse rule of §1.752–2(j) and do not extend the net value approach to thinly capitalized entities, the IRS and the Treasury Department may continue to study these issues in connection with future guidance projects.

3. *Calculating The Net Value of A Disregarded Entity*

Under the proposed regulations, the net value of a disregarded entity equals the fair market value of all assets owned by the disregarded entity that may be subject to creditors' claims under local law, including the disregarded entity's enforceable rights to contributions from its owner but excluding the disregarded entity's interest in the partnership for which the net value is being determined (if any) and the fair market value of property pledged to secure a partnership liability (which is already taken into account under §1.752–2(h)(1)), less obligations of the disregarded entity that do not constitute, and are senior or of equal priority to, §1.752–2(b)(1) payment obligations of the disregarded entity.

One commentator suggested that the final regulations should provide (or clarify) that the net value of a disregarded entity can vary depending upon the priority of the §1.752–2(b)(1) payment obligation for which the value is being computed. A commentator also suggested that obligations of the disregarded entity that are of equal priority to §1.752–2(b)(1) payment obligations of the disregarded entity should not be subtracted in their entirety. Instead, the commentator suggested that in determining the net value of the disregarded entity, the final regulations should subtract only the *pro rata* portion of the amount of any obligation of the disregarded entity that is not a §1.752–2(b)(1) payment obligation of the disregarded entity and that is of equal priority to the §1.752–2(b)(1) payment obligation of the disregarded entity. Other commentators suggested that prorating a disregarded entity's net value among equal priority obligations would add unnecessary complexity.

The comments illustrate the difficulty of taking into account priorities among obligations of the disregarded entity in determining the net value of the entity and the divergent views regarding the approach that best measures the economic risk of loss of a partner. The IRS and the Treasury Department believe that the regulations should provide clear and administrable rules that avoid unwarranted complexity. As a result, the final regulations provide that the net value of a disregarded entity is determined by subtracting all obligations (regardless of priority) of the disregarded entity that do not constitute §1.752–2(b)(1) payment obligations from the fair market value of the assets of the entity. That net value is reported by the owner to each partnership for which the disregarded entity may have one or more §1.752–2(b)(1) payment obligations. Each such partnership independently takes the net value of the disregarded entity into account under §1.752–2(k)(3) and allocates the net value among liabilities of that partnership in a reasonable and consistent manner, taking into account the relative priorities of those liabilities.

One commentator suggested that the final regulations clarify that a disregarded entity's interest in another partnership (other than the one for which the net value is being determined) is included as an asset to be valued for purposes of the net value calculation. This comment is adopted.

4. *Valuation Events*

Under the proposed regulations, after the net value of a disregarded entity is initially determined, the net value of the disregarded entity is not redetermined unless (1) the obligations of the disregarded entity that do not constitute, and are senior or of equal priority to, §1.752–2(b)(1) payment obligations of the disregarded entity change by more than a *de minimis* amount or (2) there is more than a *de minimis* contribution to or distribution from the disregarded entity, of property other than property pledged to secure a partnership liability under §1.752–2(h)(1). In the preamble to the proposed regulations, the IRS and the Treasury Department requested comments on whether other events (such as a sale of substantially all of a disregarded entity's assets) should be specified as valuation events.

One commentator suggested that the disposition of a non-*de minimis* asset should require an adjustment to the net value of the disregarded entity only to the extent such asset changed in value, without valuing other assets held by the disregarded entity. The final regulations adopt this suggestion.

A commentator suggested that the regulations provide that changes in the owner's legally enforceable obligation to contribute to the disregarded entity be

a valuation event. The final regulations adopt this comment.

Commentators suggested that certain events that would require the net value of a disregarded entity to be redetermined under the proposed regulations be eliminated as valuation events. For example, one commentator suggested that net value should not be redetermined if a disregarded entity refinances an obligation of the disregarded entity in the same amount. The IRS and the Treasury Department believe that the refinancing of a disregarded entity's obligation is an appropriate and administrable time to redetermine the net value of a disregarded entity. Accordingly, this suggestion is not adopted.

Another commentator suggested that the net value of a disregarded entity should not be redetermined with respect to a particular partnership in which the disregarded entity holds an interest if (1) a contribution by the owner of the disregarded entity to the disregarded entity corresponds to an equal contribution by the disregarded entity to the partnership or (2) a distribution from the partnership to the disregarded entity corresponds to an equal distribution by the disregarded entity to the owner of the disregarded entity. The IRS and the Treasury Department agree that these transfers to a disregarded entity, which remain in the disregarded entity only briefly, should not be valuation events. Accordingly, the final regulations adopt this comment.

5. *Timing Issues*

Commentators requested that the final regulations clarify the timing of the reallocation of partnership liabilities that may occur as a result of a change in the net value of a disregarded entity. The commentators suggested that, under the proposed regulations, a change in net value could result in a deemed distribution under section 752(b) that would require a determination of a partner's share of partnership liabilities for basis purposes under §§1.705–1(a) and 1.752–4(d).

The final regulations clarify when the net value of a disregarded entity initially must be determined if a partnership interest is held by a disregarded entity, and the partnership has or incurs a liability, all or a portion of which may be allocable to the owner of the disregarded entity under §1.752–2(k). The final regulations clarify that a disregarded entity's net value generally is determined as of the earlier of (A) the first date occurring on or after the date on which the requirement to determine the net value of a disregarded entity arises on which the partnership otherwise determines a partner's share of partnership liabilities under §§1.705–1(a) and 1.752–4(d), or (B) the end of the partnership's taxable year in which the requirement to determine the net value of a disregarded entity arises. For example, if a valuation event occurs during the partnership's taxable year, and subsequently, but before the end of the taxable year, the partnership makes a distribution that requires a determination of the distributee partner's basis in the partnership, the net value of the disregarded entity must be redetermined as of the date of the distribution.

Several commentators requested that the final regulations permit an election to redetermine the net value of a disregarded entity annually, regardless of the occurrence of a valuation event, and that if only one valuation event occurs during a partnership's taxable year, the owner have the option of using the net value of the disregarded entity as of the date of the valuation event rather than as of the date on which the partnership allocates liabilities under section 752. Because a change in the net value of a disregarded entity may require a shift of liabilities among partners, the IRS and the Treasury Department believe that valuations should be limited and should be required only as the result of a valuation event. Moreover, the timing of the net value determination should generally coincide with the date on which the partnership otherwise determines partners' shares of partnership liabilities. Accordingly, the final regulations do not adopt these comments.

6. *Value of Pledged Property*

Some commentators suggested that the final regulations conform the rules regarding the valuation of property pledged by partners as security for partnership liabilities with the rules regarding the determination of the net value of a disregarded entity. The commentators also suggested allowing, but not requiring, partners to revalue pledged property annually. In response to these comments, the final regulations provide that if additional property is made subject to a pledge, the addition is treated as a new pledge and the net fair market value of all of the pledged property must be determined at that time. The IRS and the Treasury Department may continue to study whether further modifications to the pledge rule are necessary.

7. *Compliance, Reporting, and Effective Date*

Some commentators asked that the regulations provide that the partnership may make certain assumptions if a partner does not provide the information required. The IRS and the Treasury Department believe that partnerships are responsible for obtaining the required information in order to allocate partnership liabilities correctly among the partners, and that the partnership agreement should require that partners comply with the reporting requirements in the regulations. Thus, the final regulations do not adopt this comment.

Some commentators suggested that the estimated burden of complying with the paperwork requirements in the proposed regulations was too low. The estimated number of respondents has been increased from 500 to 1,500, and the average estimated time per respondent has been increased from 1 hour to 2 hours.

A commentator also suggested certain grandfathering provisions for partnerships with existing liabilities as of the effective date of the regulations. The IRS and the Treasury Department believe that the same rules should apply to all partnership liabilities incurred or assumed by a partnership on or after the date the regulations are final. Accordingly, this comment is not adopted.

Effective Date

The final regulations apply to liabilities incurred or assumed by a partnership on or after October 11, 2006, other than liabilities incurred or assumed by a partnership pursuant to a written binding contract in effect prior to October 11, 2006.

Special Analyses

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

that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the amount of time necessary to report the required information will be minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Charlotte Chyr, Office of Associate Chief Counsel (Passthroughs and Special Industries).

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.704–2 is amended as follows:

1. The text of paragraph (f)(2), the first sentence of paragraph (g)(3), and the third sentence of paragraph (i)(4) are revised.

2. Paragraph (l)(1)(iv) is added.

The revisions and addition read as follows:

§1.704–2 Allocations attributable to nonrecourse liabilities.

* * * * *

(f) * * *

(2) * * * A partner is not subject to the minimum gain chargeback requirement to the extent the partner's share of the net decrease in partnership minimum gain is caused by a recharacterization of nonrecourse partnership debt as partially or wholly recourse debt or partner nonrecourse debt, and the partner bears the economic risk of loss (within the meaning of §1.752–2) for the liability.

* * * * *

(g) * * *

(3) * * * A partner's share of partnership minimum gain is increased to the extent provided in this paragraph (g)(3) if a recourse or partner nonrecourse liability becomes partially or wholly nonrecourse. * * *

* * * * *

(i) * * *

(4) * * * A partner is not subject to this minimum gain chargeback, however, to the extent the net decrease in partner nonrecourse debt minimum gain arises because a partner nonrecourse liability becomes partially or wholly a nonrecourse liability. * * *

* * * * *

(l) * * *

(1) * * *

(iv) Paragraph (f)(2), the first sentence of paragraph (g)(3), and the third sentence of paragraph (i)(4) of this section apply to liabilities incurred or assumed by a partnership on or after October 11, 2006, other than liabilities incurred or assumed by a partnership pursuant to a written binding contract in effect prior to October 11, 2006. The rules applicable to liabilities incurred or assumed (or subject to a binding contract in effect) prior to October 11, 2006, are contained in this section in effect prior to October 11, 2006 (see 26 CFR part 1 revised as of April 1, 2006).

* * * * *

Par. 3. Section 1.752–2 is amended as follows:

1. Paragraph (a), the last sentence of paragraph (b)(6), and paragraph (h)(3) are revised.

2. Paragraphs (k) and (l) are added.

The revisions and additions read as follows:

§1.752–2 Partner's share of recourse liabilities.

(a) * * * A partner's share of a recourse partnership liability equals the portion of that liability, if any, for which the partner or related person bears the economic risk of loss. The determination of the extent to which a partner bears the economic risk of loss for a partnership liability is made under the rules in paragraphs (b) through (k) of this section.

* * * * *

(b) * * *

(6) * * * See paragraphs (j) and (k) of this section.

* * * * *

(h) * * *

(3) *Valuation*. The extent to which a partner bears the economic risk of loss for a partnership liability as a result of a direct pledge described in paragraph (h)(1) of this section or an indirect pledge described in paragraph (h)(2) of this section is limited to the net fair market value of the property (pledged property) at the time of the pledge or contribution. If a partner provides additional pledged property, the addition is treated as a new pledge and the net fair market value of the pledged property (including but not limited to the additional property) must be determined at that time. For purposes of this paragraph (h), if pledged property is subject to one or more other obligations, those obligations must be taken into account in determining the net fair market value of pledged property at the time of the pledge or contribution.

* * * * *

(k) *Effect of a disregarded entity*—(1) *In general*. In determining the extent to which a partner bears the economic risk of loss for a partnership liability, an obligation under paragraph (b)(1) of this section (§1.752–2(b)(1) payment obligation) of a business entity that is disregarded as an entity separate from its owner under sections 856(i) or 1361(b)(3) or §§301.7701–1 through 301.7701–3 of this chapter (disregarded entity) is taken into account only to the extent of the net value of the disregarded entity as of the allocation date (as defined in paragraph (k)(2)(iv) of this section) that is allocated to the partnership liability as determined under the rules of this paragraph (k). The rules of this paragraph (k) do not apply to a §1.752–2(b)(1) payment obligation of a disregarded entity to the extent that the owner of the disregarded entity is otherwise required to make a payment (that satisfies the requirements of paragraph (b)(1) of this section) with respect to the obligation of the disregarded entity.

(2) *Net value of a disregarded entity*—(i) *Definition*. For purposes of this

paragraph (k), the net value of a disregarded entity equals the following—

(A) The fair market value of all assets owned by the disregarded entity that may be subject to creditors' claims under local law (including the disregarded entity's enforceable rights to contributions from its owner and the fair market value of an interest in any partnership other than the partnership for which net value is being determined, but excluding the disregarded entity's interest in the partnership for which the net value is being determined and the net fair market value of property pledged to secure a liability of the partnership under paragraph (h)(1) of this section); less

(B) All obligations of the disregarded entity that do not constitute §1.752–2(b)(1) payment obligations of the disregarded entity.

(ii) *Timing of the net value determination*—(A) *Initial determination*. If a partnership interest is held by a disregarded entity, and the partnership has or incurs a liability, all or a portion of which may be allocable to the owner of the disregarded entity under this paragraph (k), the disregarded entity's net value must be initially determined on the allocation date described in paragraph (k)(2)(iv) of this section.

(B) *Other events*. If a partnership interest is held by a disregarded entity, and the partnership has or incurs a liability, all or a portion of which may be allocable to the owner of the disregarded entity under this paragraph (k), then, if one or more valuation events (as defined in paragraph (k)(2)(iii) of this section) occur during the partnership taxable year, except as provided in paragraph (k)(2)(iii)(E) of this section, the net value of the disregarded entity is determined on the allocation date described in paragraph (k)(2)(iv) of this section.

(iii) *Valuation events*. The following are valuation events for purposes of this paragraph (k):

(A) A more than *de minimis* contribution to a disregarded entity of property other than property pledged to secure a partnership liability under paragraph (h)(1) of this section, unless the contribution is followed immediately by a contribution of equal net value by the disregarded entity to the partnership for which the net value of the disregarded entity otherwise would be determined, taking into account any obligations assumed or taken subject to in connection with such contributions.

(B) A more than *de minimis* distribution from a disregarded entity of property other than property pledged to secure a partnership liability under paragraph (h)(1) of this section, unless the distribution immediately follows a distribution of equal net value to the disregarded entity by the partnership for which the net value of the disregarded entity otherwise would be determined, taking into account any obligations assumed or taken subject to in connection with such distributions.

(C) A change in the legally enforceable obligation of the owner of the disregarded entity to make contributions to the disregarded entity.

(D) The incurrence, refinancing, or assumption of an obligation of the disregarded entity that does not constitute a §1.752–2(b)(1) payment obligation of the disregarded entity.

(E) The sale or exchange of a non-*de minimis* asset of the disregarded entity (in a transaction that is not in the ordinary course of business). In this case, the net value of the disregarded entity may be adjusted only to reflect the difference, if any, between the fair market value of the asset at the time of the sale or exchange and the fair market value of the asset when the net value of the disregarded entity was last determined. The adjusted net value is taken into account for purposes of §1.752–2(k)(1) as of the allocation date.

(iv) *Allocation Date*. For purposes of this paragraph (k), the allocation date is the earlier of—

(A) The first date occurring on or after the date on which the requirement to determine the net value of a disregarded entity arises under paragraph (k)(2)(ii)(A) or (B) of this section on which the partnership otherwise determines a partner's share of partnership liabilities under §§1.705–1(a) and 1.752–4(d); or

(B) The end of the partnership's taxable year in which the requirement to determine the net value of a disregarded entity arises under paragraph (k)(2)(ii)(A) or (B) of this section.

(3) *Multiple liabilities*. If one or more disregarded entities have §1.752–2(b)(1) payment obligations with respect to one or more liabilities of a partnership, the partnership must allocate the net value of each disregarded entity among partnership liabilities in a reasonable and consistent manner, taking into account the relative priorities of those liabilities.

(4) *Reduction in net value of a disregarded entity*. For purposes of this paragraph (k), the net value of a disregarded entity is determined by taking into account a subsequent reduction in the net value of the disregarded entity if, at the time the net value of the disregarded entity is determined, it is anticipated that the net value of the disregarded entity will subsequently be reduced and the reduction is part of a plan that has as one of its principal purposes creating the appearance that a partner bears the economic risk of loss for a partnership liability.

(5) *Information to be provided by the owner of a disregarded entity*. A partner that may be treated as bearing the economic risk of loss for a partnership liability based upon a §1.752–2(b)(1) payment obligation of a disregarded entity must provide information to the partnership as to the entity's tax classification and the net value of the disregarded entity that is appropriately allocable to the partnership's liabilities on a timely basis.

(6) *Examples*. The following examples illustrate the rules of this paragraph (k):

Example 1. Disregarded entity with net value of zero. (i) In 2007, A forms a wholly owned domestic limited liability company, LLC, with a contribution of $100,000. A has no liability for LLC's debts, and LLC has no enforceable right to contribution from A. Under §301.7701–3(b)(1)(ii) of this chapter, LLC is a disregarded entity. Also in 2007, LLC contributes $100,000 to LP, a limited partnership with a calendar year taxable year, in exchange for a general partnership interest in LP, and B and C each contributes $100,000 to LP in exchange for a limited partnership interest in LP. The partnership agreement provides that only LLC is required to make up any deficit in its capital account. On January 1, 2008, LP borrows $300,000 from a bank and uses $600,000 to purchase nondepreciable property. The $300,000 debt is secured by the property and is also a general obligation of LP. LP makes payments of only interest on its $300,000 debt during 2008. LP has a net taxable loss in 2008, and under §§1.705–1(a) and 1.752–4(d), LP determines its partners' shares of the $300,000 debt at the end of its taxable year, December 31, 2008. As of that date, LLC holds no assets other than its interest in LP.

(ii) Because LLC is a disregarded entity, A is treated as the partner in LP for Federal tax purposes. Only LLC has an obligation to make a payment on account of the $300,000 debt if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, under this paragraph (k), A is treated as bearing the economic risk of loss for LP's $300,000 debt only to the extent of LLC's net value. Because that net value is $0 on December 31,

2008, when LP determines its partners' shares of its $300,000 debt, A is not treated as bearing the economic risk of loss for any portion of LP's $300,000 debt. As a result, LP's $300,000 debt is characterized as nonrecourse under §1.752–1(a) and is allocated as required by §1.752–3.

Example 2. Disregarded entity with positive net value. (i) The facts are the same as in *Example 1* except that on January 1, 2009, A contributes $250,000 to LLC. On January 5, 2009, LLC borrows $100,000 and LLC shortly thereafter uses the $350,000 to purchase unimproved land. LP makes payments of only interest on its $300,000 debt during 2009. As of December 31, 2009, LLC holds its interest in LP and the land, the value of which has declined to $275,000. LP has a net taxable loss in 2009, and under §§1.705–1(a) and 1.752–4(d), LP determines its partners' shares of the $300,000 debt at the end of its taxable year, December 31, 2009.

(ii) A's contribution of $250,000 to LLC on January 1, 2009, constitutes a more than *de minimis* contribution of property to LLC under paragraph (k)(2)(iii)(A) of this section and the debt incurred by LLC on January 5, 2009, is a valuation event under paragraph (k)(2)(iii)(D) of this section. Accordingly, under paragraph (k)(2)(ii) of this section, LLC's value must be redetermined as of the end of the partnership's taxable year. At that time LLC's net value is $175,000 ($275,000 land - $100,000 debt). Accordingly, $175,000 of LP's $300,000 debt will be recharacterized as recourse under §1.752–1(a) and allocated to A under this section, and the remaining $125,000 of LP's $300,000 debt will remain characterized as nonrecourse under §1.752–1(a) and is allocated as required by §1.752–3.

Example 3. Multiple partnership liabilities. (i) The facts are the same as in *Example 2* except that on January 1, 2010, A forms another wholly owned domestic limited liability company, LLC2, with a contribution of $120,000. Shortly thereafter, LLC2 uses the $120,000 to purchase stock in X corporation. A has no liability for LLC2's debts, and LLC2 has no enforceable right to contribution from A. Under §301.7701–3(b)(1)(ii) of this chapter, LLC2 is a disregarded entity. On July 1, 2010, LP borrows $100,000 from a bank and uses the $100,000 to purchase nondepreciable property. The $100,000 debt is secured by the property and is also a general obligation of LP. The $100,000 debt is senior in priority to LP's existing $300,000 debt. Also, on July 1, 2010, LLC2 agrees to guarantee both LP's $100,000 and $300,000 debts. LP makes payments of only interest on both its $100,000 and $300,000 debts during 2010. LP has a net taxable loss in 2010 and, under §§1.705–1(a) and 1.752–4(d), must determine its partners' shares of its $100,000 and $300,000 debts at the end of its taxable year, December 31, 2010. As of that date, LLC holds its interest in LP and the land, and LLC2 holds the X corporation stock which has appreciated in value to $140,000.

(ii) Both LLC and LLC2 have obligations to make a payment on account of LP's debts if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, under paragraph (k)(1) of this section, A is treated as bearing the economic risk of loss for LP's $100,000 and $300,000 debts only to the extent of the net values of LLC and LLC2, as allocated among those debts in a reasonable and consistent manner pursuant to paragraph (k)(3) of this section.

(iii) No events have occurred that would allow a valuation of LLC under paragraph (k)(2)(iii) of this section. Therefore, LLC's net value remains $175,000. LLC2's net value as of December 31, 2010, when LP determines its partners' shares of its liabilities, is $140,000. Under paragraph (k)(3) of this section, LP must allocate the net values of LLC and LLC2 between its $100,000 and $300,000 debts in a reasonable and consistent manner. Because the $100,000 debt is senior in priority to the $300,000 debt, LP first allocates the net values of LLC and LLC2, *pro rata*, to its $100,000 debt. Thus, LP allocates $56,000 of LLC's net value and $44,000 of LLC2's net value to its $100,000 debt, and A is treated as bearing the economic risk of loss for all of LP's $100,000 debt. As a result, all of LP's $100,000 debt is characterized as recourse under §1.752–1(a) and is allocated to A under this section. LP then allocates the remaining $119,000 of LLC's net value and LLC2's $96,000 net value to its $300,000 debt, and A is treated as bearing the economic risk of loss for a total of $215,000 of the $300,000 debt. As a result, $215,000 of LP's $300,000 debt is characterized as recourse under §1.752–1(a) and is allocated to A under this section, and the remaining $85,000 of LP's $300,000 debt is characterized as nonrecourse under §1.752–1(a) and is allocated as required by §1.752–3. This example illustrates one reasonable method of allocating net values of disregarded entities among multiple partnership liabilities.

Example 4. Disregarded entity with interests in two partnerships. (i) In 2007, B forms a wholly owned domestic limited liability company, LLC, with a contribution of $175,000. B has no liability for LLC's debts and LLC has no enforceable right to contribution from B. Under §301.7701–3(b)(1)(ii) of this chapter, LLC is a disregarded entity. LLC contributes $50,000 to LP1 in exchange for a general partnership interest in LP1, and $25,000 to LP2 in exchange for a general partnership interest in LP2. LLC retains the $100,000 in cash. Both LP1 and LP2 have taxable years that end on December 31 and, under both LP1's and LP2's partnership agreements, only LLC is required to make up any deficit in its capital account. During 2007, LP1 and LP2 incur partnership liabilities that are general obligations of the partnership. LP1 borrows $300,000 (Debt 1), and LP2 borrows $60,000 (Debt 2) and $40,000 (Debt 3). Debt 2 is senior in priority to Debt 3. LP1 and LP2 make payments of only interest on Debts 1, 2, and 3 during 2007. As of the end of taxable year 2007, LP1 and LP2 each have a net taxable loss and must determine its partners' shares of partnership liabilities under §§1.705–1(a) and 1.752–4(d) as of December 31, 2007. As of that date, LLC's interest in LP1 has a fair market value of $45,000, and LLC's interest in LP2 has a fair market value of $15,000.

(ii) Because LLC is a disregarded entity, B is treated as the partner in LP1 and LP2 for federal tax purposes. Only LLC has an obligation to make a payment on account of Debts 1, 2, and 3 if LP1 and LP2 were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, under this paragraph (k), B is treated as bearing the economic risk of loss for LP1's and LP2's liabilities only to the extent of LLC's net value as of the allocation date, December 31, 2007.

(iii) LLC's net value with respect to LP1 is $115,000 ($100,000 cash + $15,000 interest in LP2). Therefore, under paragraph (k)(1) of this section, B is treated as bearing the economic risk of loss for $115,000 of Debt 1. Accordingly, $115,000 of LP1's $300,000 debt is characterized as recourse under §1.752–1(a) and is allocated to B under this section. The balance of Debt 1 ($185,000) is characterized as nonrecourse under §1.752–1(a) and is allocated as required by §1.752–3.

(iv) LLC's net value with respect to LP2 is $145,000 ($100,000 cash + $45,000 interest in LP1). Therefore, under paragraph (k)(1) of this section, B is treated as bearing the economic risk of loss with respect to Debts 2 and 3 only to the extent of $145,000. Because Debt 2 is senior in priority to Debt 3, LP2 first allocates $60,000 of LLC's net value to Debt 2. LP2 then allocates $40,000 of LLC's net value to Debt 3. As a result, both Debts 2 and 3 are characterized as recourse under §1.752–1(a) and allocated to B. This example illustrates one reasonable method of allocating the net value of a disregarded entity among multiple partnership liabilities.

(l) *Effective dates*. Paragraph (a), the last sentence of paragraph (b)(6), and paragraphs (h)(3) and (k) of this section apply to liabilities incurred or assumed by a partnership on or after October 11, 2006, other than liabilities incurred or assumed by a partnership pursuant to a written binding contract in effect prior to that date. The rules applicable to liabilities incurred or assumed (or subject to a binding contract in effect) prior to October 11, 2006, are contained in §1.752–2 in effect prior to October 11, 2006 (see 26 CFR part 1 revised as of April 1, 2006).

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

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

Authority: 26 U.S.C. 7805.

Par. 5. Section 602.101 paragraph (b) is amended by adding a new entry to the table for "1.752–2" to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described		Current OMB control No.
* * * * *		
1.752–2	. . . .	1545–1905
* * * * *		

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

Approved June 30, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 10, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 11, 2006, 71 F.R. 59669)

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 November 2006. See Rev. Rul. 2006-55, page 837.

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 November 2006. See Rev. Rul. 2006-55, page 837.

Section 898.—Taxable Year of Certain Foreign Corporations

This revenue procedure provides the exclusive procedures for certain foreign corporations to obtain the automatic approval of the Commissioner to change an annual accounting period. See Rev. Proc. 2006-45, page 851.

Section 995.—Taxation of DISC Income to Shareholders

2006 base period T-bill rate. The "base period T-bill rate" for the period ending September 30, 2006, is published as required by section 995(f) of the Code.

Rev. Rul. 2006–54

Section 995(f)(1) of the Internal Revenue Code provides that a shareholder of a DISC shall pay interest each taxable year in an amount equal to the product of the shareholder's DISC-related deferred tax liability for the year and the "base period T-bill rate." Under section 995(f)(4), the base period T-bill rate is the annual rate of interest determined by the Secretary to be equivalent to the average of the 1-year constant maturity Treasury yields, as published by the Board of Governors of the Federal Reserve System, for the 1-year period ending on September 30 of the calendar year ending with (or of the most recent calendar year ending before) the close of the taxable year of the shareholder. The base period T-bill rate for the period ending September 30, 2006 is 4.76 percent.

Pursuant to section 6222 of the Code, interest must be compounded daily. The table below provides factors for compounding the base period T-bill rate daily for any number of days in the shareholder's taxable year (including a 52–53 week accounting period) for the 2006 base period T-bill rate. To compute the amount of the interest charge for the shareholder's taxable year, multiply the amount of the shareholder's DISC-related deferred tax liability (as defined in section 995(f)(2)) for that year by the base period T-bill rate factor corresponding to the number of days in the shareholder's taxable year for which the interest charge is being computed. Generally, one would use the factor for 365 days. One would use a different factor only if the shareholder's taxable year for which the interest charge being determined is a short taxable year, if the shareholder uses the 52–53 week taxable year, or if the shareholder's taxable year is a leap year.

For the base period T-bill rates for the periods ending in prior years, see Rev. Rul. 2005–70, 2005–45 I.R.B. 919, Rev. Rul. 2004–99, 2004–2 C.B. 720, Rev. Rul. 2003–111, 2003–2 C.B. 1009, Rev. Rul. 2002–68, 2002–2 C.B. 808, Rev. Rul. 2001–56, 2001–2 C.B. 500, and Rev. Rul. 2000–52, 2000–2 C.B. 516.

DRAFTING INFORMATION

The principal author of this revenue ruling is David Bergkuist of the Office of the Associate Chief Counsel (International). For further information about this revenue ruling, contact Mr. Bergkuist at (202) 622–3850 (not a toll-free call).

2006 ANNUAL RATE,
COMPOUNDED DAILY

4.760 PERCENT

DAYS	FACTOR
1	.000130411
2	.000260839
3	.000391284
4	.000521746
5	.000652225
6	.000782721
7	.000913234
8	.001043764
9	.001174311
10	.001304875
11	.001435456
12	.001566054
13	.001696670
14	.001827302
15	.001957951
16	.002088617
17	.002219301
18	.002350001
19	.002480719
20	.002611453
21	.002742205
22	.002872973
23	.003003759
24	.003134561
25	.003265381

2006 ANNUAL RATE, COMPOUNDED DAILY 4.760 PERCENT	
DAYS	FACTOR
26	.003396218
27	.003527072
28	.003657943
29	.003788831
30	.003919736
31	.004050658
32	.004181597
33	.004312553
34	.004443527
35	.004574517
36	.004705525
37	.004836549
38	.004967591
39	.005098650
40	.005229726
41	.005360819
42	.005491929
43	.005623056
44	.005754200
45	.005885362
46	.006016540
47	.006147736
48	.006278948
49	.006410178
50	.006541425
51	.006672689
52	.006803970
53	.006935269
54	.007066584
55	.007197916
56	.007329266
57	.007460633
58	.007592017
59	.007723418
60	.007854836
61	.007986271
62	.008117724
63	.008249193
64	.008380680
65	.008512184

2006 ANNUAL RATE, COMPOUNDED DAILY 4.760 PERCENT	
DAYS	FACTOR
66	.008643705
67	.008775243
68	.008906799
69	.009038371
70	.009169961
71	.009301568
72	.009433192
73	.009564833
74	.009696491
75	.009828167
76	.009959859
77	.010091569
78	.010223296
79	.010355040
80	.010486802
81	.010618580
82	.010750376
83	.010882189
84	.011014019
85	.011145866
86	.011277731
87	.011409612
88	.011541511
89	.011673427
90	.011805361
91	.011937311
92	.012069279
93	.012201264
94	.012333266
95	.012465285
96	.012597322
97	.012729376
98	.012861447
99	.012993535
100	.013125640
101	.013257763
102	.013389903
103	.013522060
104	.013654235
105	.013786426

2006 ANNUAL RATE, COMPOUNDED DAILY 4.760 PERCENT	
DAYS	FACTOR
106	.013918635
107	.014050861
108	.014183104
109	.014315365
110	.014447643
111	.014579938
112	.014712250
113	.014844580
114	.014976927
115	.015109291
116	.015241672
117	.015374071
118	.015506487
119	.015638920
120	.015771370
121	.015903838
122	.016036323
123	.016168825
124	.016301345
125	.016433882
126	.016566436
127	.016699007
128	.016831596
129	.016964202
130	.017096825
131	.017229466
132	.017362124
133	.017494799
134	.017627491
135	.017760201
136	.017892928
137	.018025673
138	.018158434
139	.018291213
140	.018424010
141	.018556823
142	.018689654
143	.018822503
144	.018955368
145	.019088251

2006 ANNUAL RATE, COMPOUNDED DAILY

4.760 PERCENT

DAYS	FACTOR
146	.019221151
147	.019354069
148	.019487004
149	.019619956
150	.019752926
151	.019885913
152	.020018917
153	.020151939
154	.020284978
155	.020418034
156	.020551108
157	.020684199
158	.020817307
159	.020950433
160	.021083576
161	.021216737
162	.021349914
163	.021483110
164	.021616322
165	.021749552
166	.021882800
167	.022016064
168	.022149346
169	.022282646
170	.022415963
171	.022549297
172	.022682649
173	.022816018
174	.022949404
175	.023082808
176	.023216229
177	.023349668
178	.023483124
179	.023616597
180	.023750088
181	.023883596
182	.024017122
183	.024150665
184	.024284225
185	.024417803
186	.024551399
187	.024685011
188	.024818641
189	.024952289
190	.025085954
191	.025219636
192	.025353336
193	.025487054
194	.025620788
195	.025754541
196	.025888310
197	.026022097
198	.026155902
199	.026289724
200	.026423563
201	.026557420
202	.026691294
203	.026825186
204	.026959096
205	.027093022
206	.027226966
207	.027360928
208	.027494907
209	.027628904
210	.027762918
211	.027896949
212	.028030998
213	.028165065
214	.028299149
215	.028433250
216	.028567369
217	.028701506
218	.028835660
219	.028969831
220	.029104020
221	.029238227
222	.029372451
223	.029506692
224	.029640951
225	.029775227
226	.029909521
227	.030043833
228	.030178162
229	.030312508
230	.030446872
231	.030581254
232	.030715653
233	.030850070
234	.030984504
235	.031118956
236	.031253425
237	.031387912
238	.031522416
239	.031656938
240	.031791477
241	.031926034
242	.032060608
243	.032195200
244	.032329810
245	.032464437
246	.032599082
247	.032733744
248	.032868424
249	.033003121
250	.033137836
251	.033272569
252	.033407319
253	.033542086
254	.033676871
255	.033811674
256	.033946495
257	.034081333
258	.034216188
259	.034351061
260	.034485952
261	.034620860
262	.034755786
263	.034890730
264	.035025691
265	.035160669

2006 ANNUAL RATE, COMPOUNDED DAILY

4.760 PERCENT

DAYS	FACTOR
266	.035295666
267	.035430680
268	.035565711
269	.035700760
270	.035835827
271	.035970911
272	.036106013
273	.036241133
274	.036376270
275	.036511425
276	.036646597
277	.036781787
278	.036916995
279	.037052221
280	.037187463
281	.037322724
282	.037458002
283	.037593298
284	.037728612
285	.037863943
286	.037999292
287	.038134658
288	.038270042
289	.038405444
290	.038540864
291	.038676301
292	.038811756
293	.038947228
294	.039082718
295	.039218226
296	.039353751
297	.039489294
298	.039624855
299	.039760434
300	.039896030
301	.040031644
302	.040167275
303	.040302924
304	.040438591
305	.040574276

2006 ANNUAL RATE, COMPOUNDED DAILY

4.760 PERCENT

DAYS	FACTOR
306	.040709978
307	.040845698
308	.040981436
309	.041117191
310	.041252964
311	.041388755
312	.041524564
313	.041660390
314	.041796234
315	.041932095
316	.042067975
317	.042203872
318	.042339787
319	.042475719
320	.042611669
321	.042747637
322	.042883623
323	.043019627
324	.043155648
325	.043291687
326	.043427743
327	.043563818
328	.043699910
329	.043836020
330	.043972148
331	.044108293
332	.044244456
333	.044380637
334	.044516836
335	.044653052
336	.044789286
337	.044925538
338	.045061808
339	.045198096
340	.045334401
341	.045470724
342	.045607065
343	.045743423
344	.045879800
345	.046016194

2006 ANNUAL RATE, COMPOUNDED DAILY

4.760 PERCENT

DAYS	FACTOR
346	.046152606
347	.046289036
348	.046425483
349	.046561949
350	.046698432
351	.046834933
352	.046971451
353	.047107988
354	.047244542
355	.047381115
356	.047517705
357	.047654312
358	.047790938
359	.047927581
360	.048064243
361	.048200922
362	.048337619
363	.048474333
364	.048611066
365	.048747816
366	.048884584
367	.049021370
368	.049158174
369	.049294996
370	.049431836
371	.049568693

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 November 2006.

Rev. Rul. 2006–55

This revenue ruling provides various prescribed rates for federal income tax purposes for November 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. 2006–55 TABLE 1

Applicable Federal Rates (AFR) for November 2006

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	4.89%	4.83%	4.80%	4.78%
110% AFR	5.38%	5.31%	5.28%	5.25%
120% AFR	5.88%	5.80%	5.76%	5.73%
130% AFR	6.38%	6.28%	6.23%	6.20%
Mid-term				
AFR	4.69%	4.64%	4.61%	4.60%
110% AFR	5.17%	5.10%	5.07%	5.05%
120% AFR	5.65%	5.57%	5.53%	5.51%
130% AFR	6.12%	6.03%	5.99%	5.96%
150% AFR	7.08%	6.96%	6.90%	6.86%
175% AFR	8.28%	8.12%	8.04%	7.99%
Long-term				
AFR	4.90%	4.84%	4.81%	4.79%
110% AFR	5.39%	5.32%	5.29%	5.26%
120% AFR	5.89%	5.81%	5.77%	5.74%
130% AFR	6.39%	6.29%	6.24%	6.21%

REV. RUL. 2006–55 TABLE 2

Adjusted AFR for November 2006

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.40%	3.37%	3.36%	3.35%
Mid-term adjusted AFR	3.57%	3.54%	3.52%	3.51%
Long-term adjusted AFR	4.15%	4.11%	4.09%	4.08%

REV. RUL. 2006–55 TABLE 3

Rates Under Section 382 for November 2006

Adjusted federal long-term rate for the current month	4.15%
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.)	4.41%

REV. RUL. 2006–55 TABLE 4

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

Appropriate percentage for the 70% present value low-income housing credit	8.12%
Appropriate percentage for the 30% present value low-income housing credit	3.48%

REV. RUL. 2006–55 TABLE 5

Rate Under Section 7520 for November 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	5.6%

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 November 2006. See Rev. Rul. 2006-55, page 837.

Section 1378.—Taxable Year of S Corporation

26 CFR 1.1378–1: Taxable year of S corporation.

This revenue procedure provides the exclusive procedures that apply for an S corporation or electing S corporation to obtain the automatic approval of the Commissioner to adopt, change, or retain an annual accounting period. See Rev. Proc. 2006-46, page 859.

Section 1400L.—Tax Benefits for New York Liberty Zone

26 CFR 1.1400L(b)–1: Additional first year depreciation deduction for qualified New York Liberty Zone property.

How does a taxpayer change its method of accounting to comply with § 1.1400L(b)–1 of the Income Tax Regulations? See Rev. Proc. 2006-43, page 849.

Section 1502.—Regulations

26 CFR 1.1502–76: Taxable year of members of group.

This revenue procedure provides the exclusive procedures for members of a group to obtain the automatic approval of the Commissioner to change an annual accounting period. See Rev. Proc. 2006-45, page 851.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of November 2006. See Rev. Rul. 2006-55, page 837.

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 November 2006. See Rev. Rul. 2006-55, page 837.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions and Other Related Items

Supplemental Tables of Income Tax Rates Under New Income Tax Convention With Bangladesh and Protocol With Sweden

Announcement 2006–80

The United States recently exchanged instruments of ratification for a new income tax treaty with Bangladesh and a new protocol with Sweden.

Bangladesh. The provisions relating to withholding tax at source are effective for amounts paid or credited on or after October 1, 2006. For other taxes, the treaty is effective for tax periods beginning on or after January 1, 2007.

Sweden. The provisions relating to withholding tax at source are effective for amounts paid or credited on or after October 1, 2006. For other taxes, the protocol is effective for tax years beginning on or after January 1, 2007.

Tables 1 and 2. The following tables can be used to supplement Tables 1 and 2 in Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*, and Publication 901, *U.S. Tax Treaties*. The footnotes in those publications that relate to the column headings in these tables generally apply to these entries.

The protocol with Sweden affects only the footnotes in columns 6 and 7 of Table 1. These are the only columns shown for Sweden. The tables in Publication 515 and Publication 901 for Sweden can be used for the other columns of Table 1 and for Table 2.

Table 1. Withholding Tax Rates on Income Other Than Personal Service Income

Income code number		**1**	**2**	**3**	**6**	**7**	**9**	**10**	**11**	**12**	**13**	**14**	**21**
Country/Code													
Bangladesh	BG	10 a,g,i	10 a,f,g,i	10 a,g,i	15 a,j	10 a,b,j	0 a,h	10 a	10 a	10 a	30	0 c,d,e	30
Sweden	SW				15 a,k,l	5 a,b,k,l,m							

<u>Income Codes</u>

1	Interest paid by U.S. obligors — General	10	Industrial royalties
2	Interest on real property mortgages	11	Copyright royalties — Motion pictures and Television
3	Interest paid to controlling foreign corporations	12	Copyright royalties — Other
6	Dividends paid by U.S. corporations — General	13	Real property income and Natural resources royalties
7	Dividends qualifying for direct dividend rate	14	Pensions and annuities
9	Capital gains	21	Social security payment

<u>Footnotes</u>

a The reduction in rate does not apply if the recipient has a permanent establishment in the United States and the property giving rise to the income is effectively connected with this permanent establishment. The reduction in rate also does not apply if the property producing the income is effectively connected with a fixed base in the United States from which the recipient performs independent personal services.

b The reduced rate applies to dividends paid by a subsidiary to a foreign parent corporation that has the required percentage of stock ownership.

c Exemption does not apply to U.S. Government (federal, state, or local) pensions and annuities; a 30% rate applies to these pensions and annuities. U.S. Government pensions paid to an individual who is both a resident and national of Bangladesh are exempt from U.S. tax.

d Does not apply to an annuity received for services rendered.

e Includes alimony.

f Reduced rate does not apply to an excess inclusion for a residual interest in a real estate mortgage investment conduit (REMIC).

g The rate is 5% for interest (a) beneficially owned by a bank or other financial institution (including an insurance company) or (b) paid due to a sale on credit of any industrial, commercial, or scientific equipment, or of any merchandise to an enterprise.

h Exemption does not apply to gains on the sale of real property.

i The rate is 15% for contingent interest that does not qualify as portfolio interest.

j The rate in column 6 applies to dividends paid by a regulated investment company (RIC) or real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (a) an individual holding not more than a 10% interest in the REIT, (b) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (c) a person holding not more than a 10% interest in the REIT and the REIT is diversified.

k Amounts paid to a pension fund that are not derived from the carrying on of a business by the fund or through an associated enterprise are exempt. To be entitled to the exemption, the pension fund must not sell or make a contract to sell the holding from which such dividend is derived within two months of the date such pension fund acquired such holding.

l The rate in column 6 applies to dividends paid by a regulated investment company (RIC) or real estate investment trust (REIT). However, that rate applies to dividends paid by a REIT only if the beneficial owner of the dividends is (a) an individual or a pension fund holding not more than a 10% interest in the REIT, (b) a person holding not more than 5% of any class of the REIT's stock and the dividends are paid on stock that is publicly traded, or (c) a person holding not more than a 10% interest in the REIT and the REIT is diversified. Dividends paid to a pension fund from a RIC, or a REIT that meets the above conditions, are exempt if the pension fund satisfies the requirements described in footnote (k).

m Dividends paid by an 80%-owned corporate subsidiary are exempt if certain conditions are met.

Table 2. Compensation for Personal Services Performed in United States Exempt from Withholding and U.S. Income Tax Under Income Tax Treaties

Country	Code[1]	Category of Personal Services / Purpose	Maximum Presence in U.S.	Required Employer or Payer	Maximum Amount of Compensation	Treaty Article Citation
Bangladesh	15	Scholarship or fellowship grant[2]	2 years[5]	Any U.S. or foreign resident [3]	No limit	21(2)
	16	Independent personal services[6,8]	183 days	Any contractor	No limit	15
	20	Public entertainment[8]	No limit	Any contractor	$10,000[7]	18
	17	Dependent personal services[4]	183 days	Any foreign resident	No limit	16
	20	Public entertainment[8]	No limit	Any contractor	$10,000[7]	18
	18	Teaching or research[2]	2 years	Any U.S. or foreign resident	No limit	21(1)
	19	Studying and training:[2]				
		Remittances or allowances	2 years[5]	Any foreign resident	No limit	21(2)
		Compensation during study or training	2 years[5]	Any U.S. or foreign resident	$8,000 p.a.	21(2)

Footnotes

1 Refers to income code numbers under which the income is reported on Forms 1042–S. Personal services must be performed by a nonresident alien individual who is a resident of the specified treaty country.
2 Does not apply to compensation for research work primarily for private benefit.
3 Grant must be from a nonprofit organization. The exemption also applies to amounts from either the U.S. or foreign government.
4 The exemption does not apply if the employee's compensation is borne by a permanent establishment or a fixed base that the employer has in the United States.
5 The time limit pertains only to an apprentice or business trainee.
6 Exemption does not apply to the extent income is attributable to the recipient's fixed U.S. base.

7 Exemption does not apply if gross receipts, including reimbursements, exceed this amount during the year. Income is fully exempt if visit to the United States is substantially supported by public funds of the treaty country or its political subdivisions or local authorities.

8 Withholding at 30% may be required because the factors on which the treaty exemption is based may not be determinable until after the close of the tax year.

United Kingdom/United States Dual Consolidated Loss Competent Authority Agreement

Announcement 2006–86

The following is a copy of the Mutual Agreement entered into on October 6, 2006, by the Competent Authorities of the United States and the United Kingdom, regarding the elimination of double taxation as a result of the interaction of the UK non-resident company group relief rules and the U.S. dual consolidated loss rules. The agreement constitutes a Mutual Agreement in accordance with paragraph 3 Article 26 (Mutual Agreement Procedure) of the Convention Between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation with Respect to Taxes on Income signed at London on July 24, 2001.

For further information regarding this announcement, contact Kathleen Bellamy of the Office of the Deputy Commissioner (International), Large and Mid-Size Business at (202) 435–5040 (not a toll-free call) or Jeffrey Cowan of the Office of the Associate Chief Counsel (International) at (202) 622–3860 (not a toll-free call).

The text of the agreement is as follows:

United Kingdom/United States Dual Consolidated Loss Competent Authority Agreement

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND ON CAPITAL GAINS

BACKGROUND

Paragraph 3 of Article 26 of the Convention Between the Government of the United States of America and the Government of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains signed at London on July 24, 2001, and subsequently amended by a protocol signed July 19, 2002 ("Treaty") allows the competent authorities of the Contracting States to consult together for the elimination of double taxation in cases not provided for in the Treaty.

The competent authority of each Contracting State recognizes that in certain situations the interaction of domestic loss relief rules can lead to double taxation. Those rules are, in the case of the United States, section 1503(d) of the Internal Revenue Code (Code) and the regulations thereunder, including Treas. Reg. §1.1503–2(b) and (c)(15)(iv), and, in the case of the United Kingdom, S 403D(1)(c) when subject to 403D(6) ICTA88. These rules are discussed below.

The U.S. Rules

Section 1503(d) of the Code and the regulations thereunder provide that a dual consolidated loss of a corporation cannot reduce the taxable income of any other member of the affiliated group ("domestic affiliate"). A dual consolidated loss is a net operating loss of a domestic corporation that is subject to an income tax of a foreign country on its income without regard to the source of its income, or is subject to tax on a residence basis. Except as discussed below, when section 1503(d) of the Code applies, a dual consolidated loss may only be used to offset income earned by the domestic corporation.

Similar rules apply to any loss of a separate unit of a domestic corporation. A separate unit includes activities of a domestic corporation that constitute a permanent establishment under the terms of a treaty between the United States and the country in which the activities are conducted. For purposes of the dual consolidated loss rules, a separate unit is treated as a domestic corporation and therefore is a domestic affiliate.

Notwithstanding the general rule, a dual consolidated loss may offset income of a domestic affiliate, provided that a taxpayer makes an election and enters into an agreement pursuant to regulations ("(g)(2)(i) agreement") whereby the taxpayer certifies that, *inter alia*, no portion of the loss has been or will be used to offset the income of any other person under the income tax laws of a foreign country. This election is an annual election made separately with respect to dual consolidated losses incurred in each taxable year. If a (g)(2)(i) agreement is entered into, and a subsequent "triggering event" occurs (and no exception applies), the taxpayer must generally recapture and report as gross income the total amount of the dual consolidated loss on its U.S. Federal income tax return for the taxable year in which the triggering event occurs, plus an applicable interest charge. Triggering events include, but are not limited to, the use of any portion of the dual consolidated loss by any means to offset the income of any other person under the income tax laws of a foreign country.

The regulations under section 1503(d) of the Code also contain a "mirror legislation" rule that denies the ability to elect to use a dual consolidated loss to offset the income of a domestic affiliate in certain cases. The mirror legislation rule generally applies when a foreign jurisdiction has enacted legislation that operates in a manner similar to the U.S. dual consolidated loss rules and, as a result, prohibits the taxpayer from claiming the dual consolidated loss in the foreign jurisdiction. Section 403D(6) ICTA 88 is mirror legislation within the meaning of the regulations under section 1503(d) of the Code. The mirror legislation rule does not apply, however, to the extent an election is made under Treas. Reg. §1.1503–2(g)(1) to use the loss in the United States pursuant to an agreement entered into between the United

States and a foreign country that puts into place an elective procedure through which losses offset income in only one country. The competent authority agreement set forth in this document is an agreement described in Treas. Reg. §1.1503–2(g)(1).

The UK Rules

Section 403D ICTA1988 generally allows for the surrender of the trading losses of UK permanent establishments of foreign companies, but not where that loss is deductible or allowable in any period against profits that are outside the corporation tax jurisdiction of the United Kingdom. No surrender is possible other than in the circumstances permitted. (Section 403D(1)(c) ICTA1988).

The UK legislation also contains a rule (section 403D(6)) that requires any overseas rule which prevents that overseas deduction or allowance by virtue of relief that may be available in the United Kingdom to be disregarded in deciding whether a loss is 'deductible or allowable outside the United Kingdom'. The regulations under section 1503(d) of the Code constitute such a rule. So no surrender of the loss as group relief in the UK is possible.

Section 403D(6) is effective in relation to losses in accounting periods ending on or after April 1, 2000.

Interaction of the Contracting States' Rules

As mentioned, the interaction of the rules described above may result in no relief for a loss in either Contracting State, thereby producing double taxation inconsistent with the aims of Article 7 (Business Profits) and Article 24 (Relief of Double Taxation) of the Treaty and with the intentions of the Contracting States in passing domestic laws to prevent the same loss from being used more than once.

Therefore, to resolve the issue regarding the interaction of the legislation and regulations referred to above, the competent authorities of the Contracting States agree that certain taxpayers may, subject to the terms and conditions of the competent authority agreement set forth in this document, elect to use, or relieve, losses in either the United States or the United Kingdom to the extent permitted by the rules of the Contracting State, as modified by this agreement.

COMPETENT AUTHORITY AGREEMENT

1. The competent authorities of the United States of America and the United Kingdom hereby enter into the following agreement ("Agreement") regarding, in the case of the United States, dual consolidated losses under section 1503(d) of the Code and, in the case of the United Kingdom, trading losses disallowed under 403D(1)(c) ICTA1988 by the action of S403D(6) ICTA 88, under the Treaty. Except as provided in this paragraph 1, the Agreement applies in cases where a consolidated group of which a domestic owner is a member, or an unaffiliated domestic owner (as such terms are defined in Treas. Reg. §1.1503–2(c)(8), (9) and (11), respectively) ("Taxpayer"), has a permanent establishment in the United Kingdom as defined in Article 5 (Permanent Establishment) of the Treaty ("UK permanent establishment") that incurs losses which, for UK tax purposes, relate to accounting periods ending on or after April 1, 2000, and are otherwise subject to section 1503(d) of the Code and the regulations thereunder, including Treas. Reg. §1.1503–2(b) and (c)(15)(iv), and S403D(6) ICTA 88.[1] This agreement shall not apply where losses are incurred by:

i. A dual resident corporation within the meaning of Treas. Reg. §1.1503–2(c)(2) (other than to the extent a UK permanent establishment is treated as a dual resident corporation);

ii. A hybrid entity separate unit, within the meaning of Treas. Reg. §1.1503–2(c)(4); or

iii. A separate unit, within the meaning of Treas. Reg. §1.1503–2(c)(3), owned indirectly through a hybrid entity separate unit.

2. The Agreement is entered into under paragraph 3 of Article 26 (Mutual Agreement Procedure) of the Treaty.

3. With respect to the United States, and except as provided in paragraph 4 and Annex A of the Agreement, a dual consolidated loss of a UK permanent establishment cannot offset the taxable income of any domestic affiliate as provided under section 1503(d)(1) of the Code and Treas. Reg. §1.1503–2(b) and (c)(15)(iv). With respect to the United Kingdom, and except as provided in paragraph 4 and Annex B of the Agreement, no loss or other amount of a UK permanent establishment shall be treated as available for surrender by way of group relief pursuant to section 403D(1)(c) ICTA 1988.

4. Subject to the terms and conditions of the Agreement, a Taxpayer may elect to:

i. Use the dual consolidated loss attributable to a UK permanent establishment, within the meaning of Treas. Reg. §1.1503–2(d)(1)(ii), to offset the taxable income of a domestic affiliate, notwithstanding Treas. Reg. §1.1503–2(c)(15)(iv); or

ii. Surrender a loss of the UK permanent establishment as permitted by S402 ICTA88 and S403D ICTA1988 without the restriction provided by S403D(6),

but may not elect for both treatments. Further, and except as provided in paragraph 4 of each of Annex A and Annex B with respect to losses incurred in certain prior taxable years, no election may be made under this Agreement with respect to a loss unless both the statute of limitations (in the case of the United States) and the time limit for claimant company provided by paragraph 74 of Schedule 18 to FA1998 (in the case of the United Kingdom) have not closed or passed, respectively, with respect to the taxable year or taxable period, respectively, in which such loss was incurred.

5. The election must be made in accordance with the procedures and conditions set out in Annex A or Annex B, as applicable.

6. The use of a loss pursuant to an election under this Agreement must be consistent with the domestic law generally applicable to the relief of losses of the Contract-

[1] The dual consolidated loss rules do not apply to losses incurred by a U.S. permanent establishment of a foreign corporation. Accordingly, this Agreement does not apply to dual consolidated losses incurred by a permanent establishment of a UK corporation in the United States.

ing State in which relief for such loss is sought.

7. In the case of an election for a loss to be used in the United States pursuant to the Agreement and Annex A, the election shall only apply to dual consolidated losses within the meaning of section 1503(d)(2) of the Code and Treas. Reg. §1.1503–2(c)(5). The fact that a particular item taken into account in computing the dual consolidated loss is not taken into account in computing the Taxpayer's taxable income (or loss) in the United Kingdom shall not cause such item to be excluded from the calculation of the dual consolidated loss.

8. In the case of an election for a loss to be used in the United Kingdom, pursuant to the Agreement and Annex B, the election shall apply only to amounts within the terms of S403D ICTA 88. The fact that a particular item taken into account for the purposes of S403D is not taken into account in computing the Taxpayer's taxable income (or loss) in the United States shall not cause such item to be excluded from the calculation of the S403D amount.

9. The election provided under this Agreement is an annual election, applicable with respect to losses incurred in a specific taxable year. A Taxpayer may make only one election under this Agreement with respect to a loss incurred in a particular taxable year. Once made, an election may not be revoked. Taxable year for this purpose refers to the U.S. taxable year of the entity for which a UK permanent establishment exists and which is the subject of this Agreement. If for UK CT purposes, the accounting period of the UK permanent establishment is different from that of the U.S. taxable year for the entity, then an election for a taxable year shall correspond to each accounting period, or part of an accounting period, to which that tax year relates.

10. No part of a loss which has been relieved, used, or claimed in a Contracting State following an election under this Agreement may be utilized for loss relief purposes in the other Contracting State in a manner inconsistent with the domestic law of the first-mentioned Contracting State. Where a loss (or any item composing such loss) has been used in a manner inconsistent with the domestic law of the first-mentioned Contracting State, any loss relief given in the first-mentioned Contracting State will be recoverable or recaptured, where appropriate, in accordance with the domestic laws of the first-mentioned Contracting State and Annex A or Annex B, as applicable.

11. This Agreement shall be applied taking into account the domestic law of the Contracting States in effect on or before October 6, 2006. In addition, any reference to the domestic law of either Contracting State shall incorporate, when effective, any successor provision of domestic law provided such provision is not materially inconsistent with this Agreement. In the case of the United States, the proposed regulations contained in the notice of proposed rulemaking (REG–102144–04, 2005–25 I.R.B. 1297), that was published in the Federal Register on Tuesday, May 24, 2005 (70 FR 29868), shall, when finalized, be treated as a successor provision that is not materially inconsistent with this Agreement.

12. This Agreement may not be unilaterally terminated by the competent authority of either Contracting State until after December 31, 2011. Prior to such date, this Agreement may only be terminated by the joint agreement of the competent authorities. After December 31, 2011, this Agreement may be unilaterally terminated by the competent authority of either Contracting State providing written notice of such termination to the competent authority of the other Contracting State. If this Agreement is unilaterally terminated by the competent authority of a Contracting State, then such termination will take effect 3 months after the date of the notice of termination. In such event, any election made under this Agreement prior to such termination shall remain valid and in effect with respect to losses covered by such election.

13. It is understood that the competent authorities shall consult together at regular intervals regarding the terms and operation of the Agreement. In addition, the competent authorities may consult regarding the application of specific elections made in accordance with the Agreement. The Agreement will be reviewed in detail in parallel with the arrangements for the Treaty outlined in the Exchange of Notes of July 24, 2001.

Annex A

Election by Taxpayer to Use Losses in the United States

This Annex A provides rules and conditions that must be satisfied for a Taxpayer to use dual consolidated losses in the United States, with respect to which relief is available under the terms of this Agreement, to offset taxable income of a domestic affiliate. It also provides the time, place and manner for various filings and notification required under this Agreement and section 1503(d) of the Code and the regulations thereunder.

1. *Compliance with Section 1503(d) and the Regulations Thereunder*

The Taxpayer must comply with section 1503(d) of the Code and the regulations thereunder (other than Treas. Reg. §1.1503–2(c)(15)(iv)), as modified in this Agreement. For example, in order to use a dual consolidated loss of a UK permanent establishment to offset taxable income of a domestic affiliate pursuant to this Agreement, the Taxpayer must file an agreement described in Treas. Reg. §1.1503–2T(g)(2)(i), as modified below ("modified (g)(2)(i) agreement").

2. *Modified (g)(2)(i) Agreement*

The modified (g)(2)(i) agreement must contain the caption "Election under §1.1503–2(g)(1) to Use a Dual Consolidated Loss of a UK Permanent Establishment under US/UK Competent Authority Agreement" at the top of the page. In addition to the requirements described in Treas. Reg. §1.1503–2T(g)(2)(i)(A) through (F), the modified (g)(2)(i) agreement must contain the following information or representations in paragraphs labeled to correspond with the items set forth below:

(G) The name, address and identifying number of the Taxpayer;

(H) A representation that the dual consolidated loss of the Taxpayer's UK permanent establishment is eligible for relief under the Agreement; and

(I) A representation that if an event described in Treas. Reg. §1.1503–2(g)(2)(iii)(A) occurs, notification of such event will be provided to both the competent authority of the United States and the competent authority of the United Kingdom, as described below.

Except as otherwise provided in this Annex A, a modified (g)(2)(i) agreement must be filed in the same time, place, and manner as a (g)(2)(i) agreement. For example, the Taxpayer must attach the modified (g)(2)(i) agreement to its timely filed U.S. Federal income tax return for the taxable year in which the dual consolidated loss is incurred.

3. *Notification to the U.S. and UK Competent Authorities*

A copy of the modified (g)(2)(i) agreement must be provided to both the U.S. and UK competent authorities no later than the due date for filing the modified (g)(2)(i) agreement with the Taxpayer's U.S. Federal income tax return, as provided above.

The triggering event notification required under paragraph (I) of the modified (g)(2)(i) agreement must be provided to both the U.S. and UK competent authorities no later than the due date of the Taxpayer's timely filed U.S. Federal income tax return for the taxable year that includes the event giving rise to such notification (or, when the triggering event is a use of the loss for foreign purposes, the taxable year that includes the last day of the foreign tax year during which such use occurs).

4. *Election to Use Dual Consolidated Losses Incurred in Certain Prior Taxable Years*

This paragraph 4 of Annex A applies to an election by the Taxpayer to use dual consolidated losses eligible for relief under the Agreement that were incurred in an open taxable year for which the due date (including extensions) for the U.S. Federal income tax return for such year is on or before January 4, 2007. In such a case, and notwithstanding the general time, place and manner rules provided in this Annex A, all agreements, statements, requests, or other information related to such dual consolidated losses that should have been filed on or before January 4, 2007, shall be treated as having been timely filed, provided they are attached to a U.S. Federal income tax return amending the Taxpayer's U.S. Federal income tax return for the taxable year in which they should have been attached. The amended return described in the preceding sentence must be filed on or before the due date of the Taxpayer's U.S. Federal income tax return due for its first taxable year ending after January 4, 2007.

If the statute of limitations is open for a taxable year in which a dual consolidated loss described in this section 4 of Annex A was incurred, the Taxpayer may make an election under paragraph 4(i) of this Agreement, even if the time limit for claimant company provided by paragraph 74 of schedule 18 to FA1988 with respect to such taxable year has passed. However, such an election cannot be made for a dual consolidated loss that was incurred in a taxable year with respect to which the statute of limitations has closed. See paragraph 4 of Annex B for a similar rule with respect to losses elected to be relieved in the United Kingdom.

With respect to dual consolidated losses incurred in taxable years described in this paragraph 4 of Annex A, a copy of the modified (g)(2)(i) agreement must be provided to both the U.S. and UK competent authorities by the due date set forth above for the filing of the amended U.S. Federal income tax return that included the modified (g)(2)(i) agreement for such losses.

5. *Relief for Untimely Filings*

In the event that the Taxpayer fails to timely provide or file any agreements, statements, requests, or other information related to dual consolidated losses subject to the Agreement (including a copy of the modified (g)(2)(i) agreement required to be provided to the U.S. and UK competent authorities), relief for such failure shall be available to the extent provided under the general rules of section 1503(d) of the Code and the regulations thereunder, including Treas. Reg. §§301.9100–1 through 301.9100–3, and Notice 2006–13, 2006–8 I.R.B. 496. When applying the foregoing standards to any failure to provide notice to the competent authorities pursuant to this Annex A, relief shall not be given unless and until such notices have been provided.

Annex B

Election by Taxpayer to Use Losses in the United Kingdom

This Annex B provides rules and conditions that must be satisfied for a Taxpayer to apply Section 403D ICTA1988 for the purposes of claiming and surrendering group relief without the application of subsection (6) in respect of U.S. taxation law.

An election by a Taxpayer to use the losses in the UK generally must be made within the time limit for that company to file its Corporation Tax self assessment for the accounting period or accounting periods concerned. However, paragraph 4 contains a special rule pertaining to claim requirements for losses for prior years. If the election affects more than one accounting period, the time limit is the earliest filing date if more than one.

The consent to surrender

1. The company making the election must provide a consent, or as the case may be a modified consent, to surrender under paragraph 71 of Schedule 18 to FA1998.

2. In addition to the requirements which exist under United Kingdom domestic law for a notice of consent to surrender, the following information must be included in the notice of consent otherwise the notice is ineffective:

- Confirmation that an election has been made under this Agreement to elect to disregard 403D(6);
- Confirmation that the amount of relief to be surrendered is eligible for surrender under S403D and an agreement that if that should cease to be the case, to withdraw the consent in accordance with paragraph 75 of schedule 18 to FA1998;
- Confirmation that notification of the election in accordance with paragraph 4(ii) of this Agreement has been or will be provided to both the competent authority of the United Kingdom and the competent authority of the United States, as described below.

3. *Notification to the UK and U.S. Competent Authorities*

A copy of the consent or modified consent to surrender must be provided to both the UK and U.S. competent authorities no later than the due date for making the corporation tax self assessment for the UK permanent establishment. Where, notwithstanding an election under paragraph 4(ii) of this Agreement, a loss is not available for surrender by virtue of the operation of the UK rules, a notification of the amended consent to surrender and modified claim must be provided to both the UK and U.S. competent authorities no later than the due date for filing the amended claim.

4. *Election to Surrender Losses Incurred in Certain Prior Taxable Years*

This section 4 of Annex B applies to an election by the Taxpayer to surrender losses eligible for relief under the Agreement that were incurred in a taxable year for which the due date for Corporation Tax self assessment of the surrendering company for such year is on or before January 4, 2007. In such a case, and notwithstanding the general time, place and manner rules provided in this Annex B, all agreements, statements, requests, or other information related to the surrender of losses that should have been filed on or before January 4, 2007, shall be treated as having been timely filed, provided they are attached to a Corporation Tax self assessment amending its Corporation Tax self assessment for the taxable year in which they should have been attached. The amended claim described in the preceding sentence must be filed on or before the due date of the Taxpayer's Corporation Tax self assessment due for its first taxable year ending after January 4, 2007.

If the period for claimant relief and the Corporation Tax self assessment for such company was due on or before January 4, 2007, is open for a taxable year in which a loss described in this section 4 of Annex B was incurred, the Taxpayer may make an election under paragraph 4(ii) of this Agreement, even if the statute of limitations under United States law with respect to such taxable year has closed. However, losses that are otherwise eligible for relief under this Agreement, that were incurred in an accounting period for which relief was available under section 403D ICTA1988 but for which the time limit for claimant company provided by paragraph 74 of Schedule 18 to FA1998 has passed prior to the date on which this Agreement is entered into, will not be eligible for relief. See paragraph 4 of Annex A for losses elected to be used in the United States.

5. *Relief for Late Claims*

In the event that the Taxpayer fails to timely provide or file any agreements, statements, requests, or other information related to the surrender of such losses subject to the Agreement (including a copy of the modified consent to surrender to the UK and U.S. competent authorities), relief for such failure shall be available to the extent set out in Statement of practice 5/01. However any relief which the UK officer of the Board subsequently agrees to be available will not give rise to relief until such notices to the competent authorities pursuant to this Annex B have been provided.

Part III. Administrative, Procedural, and Miscellaneous

Guidance Concerning Use of 2001 CSO Tables Under Section 7702

Notice 2006–95

SECTION 1. PURPOSE

This notice provides rules interpreting the reasonable mortality charge requirement contained in § 7702(c)(3)(B)(i) of the Internal Revenue Code. Specifically, this notice supplements Notice 88–128, 1988–2 C.B. 540, and modifies and supersedes Notice 2004–61, 2004–2 C.B. 596, by providing safe harbors regarding the use by taxpayers of either the 1980 Commissioners' Standard Ordinary mortality and morbidity tables (1980 CSO tables) or the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables) to determine whether mortality charges are reasonable. These safe harbors are designed to assist taxpayers in complying with the requirements of § 7702(c)(3)(B)(i).

SECTION 2. BACKGROUND

Section 7702 of the Code defines the term "life insurance contract" for purposes of the Code. Section 7702(a) provides that a "life insurance contract" is any contract that is a life insurance contract under the applicable law, but only if such contract either (1) meets the cash value accumulation test of § 7702(b), or (2) both meets the guideline premium requirements of § 7702(c) and falls within the cash value corridor of § 7702(d).

Section 7702(c)(3)(B)(i) provides that the guideline single premium under § 7702(c) is determined on the basis of reasonable mortality charges that meet the requirements (if any) prescribed in regulations and that (except as provided in regulations) do not exceed the mortality charges specified in the prevailing commissioners' standard tables (as defined in § 807(d)(5)) as of the time the contract is issued. The mortality charges specified in § 7702(c)(3)(B)(i) are also used for determining the "net single premium" (*see* § 7702(b)(2)(B)), and the "guideline level premium" (*see* § 7702(c)(4)). The same reasonable mortality charge standard applies for purposes of determining whether a life insurance contract is a modified endowment contract under § 7702A (*see* § 7702A(c)(1)(B)).

Section 807(d)(5)(A) provides that the term "prevailing commissioners' standard tables" means, with respect to any contract, the most recent commissioners' standard tables prescribed by the National Association of Insurance Commissioners (NAIC) that are permitted to be used in computing reserves for that type of contract under the insurance laws of at least 26 states when the contract was issued. Section 807(d)(5)(B) provides a 3-year transition period during which an insurer may use either the newly prevailing CSO tables or those that were previously prevailing.

The 2001 CSO tables prescribed by the NAIC became the prevailing commissioners' standard tables within the meaning of § 807(d)(5) during calendar year 2004, and have now been adopted by all 50 states. The 1980 CSO tables may still be used in all states for contracts issued in calendar years through 2008. For contracts issued after 2008, use of the 2001 CSO tables will be mandatory.

Notice 88–128 was issued after § 7702 was amended to require that only "reasonable" mortality charges be taken into account for purposes of testing life insurance contract qualification under § 7702. Under Notice 88–128, interim safe harbors provided that the 1980 CSO tables (and, for certain previously issued contracts, the 1958 CSO tables) would satisfy the requirement that mortality charges be "reasonable" under § 7702(c)(3)(B)(i). Notice 2004–61 supplemented Notice 88–128 by providing additional safe harbors to account for the promulgation of the 2001 CSO tables. Neither Notice 88–128, Notice 2004–61, nor this notice addresses the reasonable mortality charge requirement in the case of substandard risk underwriting. *See* the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100–647 (1988 Act), § 5011(c)(2).

SECTION 3. PUBLIC COMMENTS AND MODIFICATIONS TO NOTICE 2004–61

Notice 2004–61 requested comments on the need for additional guidance on the adoption of the 2001 CSO tables. This notice modifies Notice 2004–61 in response to the comments that were received. First, the safe harbor for contracts issued based on the 1980 CSO tables (1980 CSO contracts) is modified to remove the requirement in Notice 2004–61 that mortality charges used to determine whether a contract qualifies as a life insurance contract under § 7702 not exceed the mortality charge specified in the contract at issuance. Second, the new rules for gender- or smoker-based tables are modified to apply only to contracts issued based upon the 2001 CSO tables (2001 CSO contracts). These two changes help to ensure that the notice does not subject 1980 CSO contracts to more stringent standards, retroactively, than applied under Notice 88–128. Third, the rule for determining the issue date of a contract that undergoes an increase or decrease in death benefit is simplified by eliminating the concept of "underwriting." This change broadens the grandfather rule of Notice 2004–61 to encompass many routine transactions, but does not wholly defer to an issuer's administrative practices and procedures. Fourth, additional examples are provided of changes, modifications, or exercises of contractual provisions that will not require a change from previous tables to the 2001 CSO tables. Except as described above, this notice does not modify the definition of "issue date" that was provided in Notice 2004–61.

SECTION 4. SAFE HARBORS UNDER SECTION 7702

The following safe harbors apply for purposes of determining reasonable mortality charges under § 7702:

.01 *Notice 88–128.* The interim rules described in Notice 88–128 remain in effect, except as otherwise modified by this notice.

.02 *1980 CSO tables.* A mortality charge with respect to a life insurance contract will satisfy the requirements of

§ 7702(c)(3)(B)(i) so long as (1) the mortality charge does not exceed 100 percent of the applicable mortality charge set forth in the 1980 CSO tables; (2) the contract is issued in a state that permits or requires the use of the 1980 CSO tables at the time the contract is issued; and (3) the contract is issued before January 1, 2009.

.03 *2001 CSO tables*. A mortality charge with respect to a life insurance contract will satisfy the requirements of § 7702(c)(3)(B)(i) so long as (1) the mortality charge does not exceed 100 percent of the applicable mortality charge set forth in the 2001 CSO tables; (2) the mortality charge does not exceed the mortality charge specified in the contract at issuance; and (3) either (a) the contract is issued after December 31, 2008, or (b) the contract is issued before January 1, 2009, in a state that permits or requires the use of the 2001 CSO tables at the time the contract is issued.

SECTION 5. ISSUE DATE OF CONTRACTS

.01 For purposes of this notice, the date on which a contract was issued generally is to be determined according to the standards that applied for purposes of the original effective date of § 7702. *See* H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1076 (1984), 1984–3 (Vol. 2) C.B. 330; *see also* 1 Staff of Senate Comm. on Finance, 98th Cong., 2d Sess., *Deficit Reduction Act of 1984, Explanation of Provisions Approved by the Committee on March 21, 1984*, at 579 (Comm. Print 1984). Thus, contracts received in exchange for existing contracts are to be considered new contracts issued on the date of the exchange. For these purposes, a change in an existing contract is not considered to result in an exchange if the terms of the resulting contract (that is, the amount and pattern of death benefit, the premium pattern, the rate or rates guaranteed on issuance of the contract, and mortality and expense charges) are the same as the terms of the contract prior to the change.

.02 Notwithstanding section 5.01, if a life insurance contract satisfied section 4.01 or 4.02 when originally issued, a change from previous tables to the 2001 CSO tables is not required if (1) the change, modification, or exercise of a right to modify, add or delete benefits is pursuant to the terms of the contract; (2) the state in which the contract is issued does not require use of the 2001 CSO tables for that contract under its standard valuation and minimum nonforfeiture laws; and (3) the contract continues upon the same policy form or blank.

.03 The changes, modifications, or exercises of contractual provisions referred to in section 5.02 include (1) the addition or removal of a rider; (2) the addition or removal of a qualified additional benefit (QAB); (3) an increase or decrease in death benefit (whether or not the change is underwritten); (4) a change in death benefit option (such as a change from an option 1 to option 2 contract or vice versa); (5) reinstatement of a policy within 90 days after its lapse; and (6) reconsideration of ratings based on rated condition, lifestyle or activity (such as a change from smoker to nonsmoker status).

SECTION 6. RULES FOR GENDER- OR SMOKER-BASED TABLES

For purposes of section 4.03 (the 2001 CSO safe harbor), mortality charges that do not exceed the applicable charges in gender- or smoker-based variations of the 2001 CSO tables will be treated as reasonable mortality charges, provided the following requirements are satisfied:

.01 *Unisex tables*. If a state permits minimum nonforfeiture values for all contracts issued under a plan of insurance to be determined using the 2001 CSO Gender-Blended Mortality tables ("unisex tables"), then the applicable mortality charges in those tables are treated as reasonable mortality charges for female insureds provided the same tables are used to determine mortality charges for male insureds.

.02 *Smoker/nonsmoker tables*. If a state permits minimum nonforfeiture values for all contracts issued under a plan of insurance to be determined using the 2001 CSO Smoker and Nonsmoker Mortality tables ("smoker/nonsmoker tables"), then the applicable mortality charges in those tables for smoker insureds are treated as reasonable mortality charges provided nonsmoker tables are used to determine nonsmoker mortality charges.

SECTION 7. EFFECT UPON OTHER PUBLICATIONS

This notice supplements Notice 88–128 and modifies and supersedes Notice 2004–61.

SECTION 8. EFFECTIVE DATE

This notice is effective October 12, 2006, except that the provisions of this notice will not be applied adversely to taxpayers who issued, changed or modified contracts in compliance with Notice 2004–61 (without regard to the modifications made by this notice).

SECTION 9. PROCEDURAL INFORMATION

This notice serves as an "administrative pronouncement" as that term is described in § 1.6661–3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or a revenue procedure.

DRAFTING INFORMATION

The principal author of this notice is Ann H. Logan of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Ann H. Logan at (202) 622–3970 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, §§ 168, 446, 1400L; 1.168(k)–1, 1.1400L(b)–1.)

Rev. Proc. 2006–43

SECTION 1. PURPOSE

This revenue procedure provides the exclusive administrative procedures under which a taxpayer described in section 3 of this revenue procedure may obtain automatic consent to change its method of accounting to comply with § 1.168(k)–1 or § 1.1400L(b)–1 of the Income Tax Regulations (the "final regulations").

SECTION 2. BACKGROUND

.01 On August 31, 2006, the Internal Revenue Service and Treasury Department published the final regulations in the Federal Register (T.D. 9283, 2006–41 I.R.B.

633 [71 FR 51727]). Section 1.168(k)–1 prescribes the requirements that must be met for depreciable property to qualify for the additional first year depreciation deduction provided by § 168(k) of the Internal Revenue Code ("bonus depreciation deduction"). Section 1.1400L(b)–1 prescribes the requirements that must be met for depreciable property to qualify for the additional first year depreciation deduction provided by § 1400L(b) ("Liberty Zone bonus depreciation deduction"). The final regulations under § 1.168(k)–1 generally apply to qualified property under § 168(k)(2) acquired by a taxpayer after September 10, 2001, and to 50-percent bonus depreciation property under § 168(k)(4) acquired by a taxpayer after May 5, 2003. The final regulations under § 1.1400L(b)–1 generally apply to qualified New York Liberty Zone property acquired by a taxpayer after September 10, 2001.

.02 Because of revisions made to T.D. 9091, 2003–2 C.B. 939 (68 FR 52986) by the final regulations, taxpayers may need to seek a change in method of accounting to comply with the final regulations. For example, § 1.1400L(b)–1T(b)(4) and (c)(2)(ii) disallowed certain depreciable property from qualifying for the Liberty Zone bonus depreciation deduction. Section 1.1400L(b)–1 amended § 1.1400L(b)–1T(b)(4) and (c)(2)(ii) and, as a result, more depreciable property may qualify for the Liberty Zone bonus depreciation deduction. Section 1.1400L(b)–1(g)(4)(iii) provides that if a taxpayer did not claim on a Federal tax return for a taxable year ending on or after September 11, 2001, and on or before September 1, 2006, any Liberty Zone bonus depreciation deduction for qualified New York Liberty Zone property because of the application of § 1.1400L(b)–1T(b)(4) or because the taxpayer made an election under § 1.168(k)–1T(e)(1) for a class of property that included such qualified New York Liberty Zone property, the taxpayer may claim the Liberty Zone bonus depreciation deduction for that qualified New York Liberty Zone property in accordance with the applicable administrative procedures issued under § 1.446–1(e)(3)(ii) for obtaining the Commissioner of Internal Revenue's consent to a change in method of accounting.

.03 The preamble to the final regulations states that the Service and Treasury intend to issue administrative guidance providing procedures for automatic consent for taxpayers that wish to seek a change in method of accounting to comply with the final regulations.

.04 Under §§ 446(e) and 1.446–1(e)(2)(i), a taxpayer generally must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. To obtain the Commissioner's consent to a change in method, § 1.446–1(e)(3)(i) generally requires a taxpayer to file Form 3115, *Application for Change in Accounting Method*, during the taxable year in which the taxpayer desires to make the proposed change. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting.

.05 Rev. Proc. 2002–9, 2002–1 C.B. 327 (as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432) provides procedures under §§ 446(e) and 1.446–1(e) for obtaining the automatic consent of the Commissioner to change a method of accounting described in the APPENDIX of Rev. Proc. 2002–9.

.06 Rev. Rul. 90–38, 1990–1 C.B. 57, provides that, if a taxpayer uses an erroneous method of accounting for two or more consecutive taxable years, the taxpayer has adopted a method of accounting. Rev. Rul. 90–38 further provides that a taxpayer may not, without the Commissioner's consent, retroactively change from an erroneous to a permissible method of accounting by filing an amended return.

.07 Section 1.446–1T(e)(2)(ii)(*d*) provides the changes in computing depreciation that are, and are not, a change in method of accounting under § 446(e). Sections 1.446–1T(e)(2)(ii)(*d*)(*2*)(*ii*), (*iii*), and (*iv*) provide the changes in computing depreciation with respect to the bonus depreciation deduction and the Liberty Zone bonus depreciation deduction that are a change in method of accounting. Section 1.446–1T(e)(2)(ii)(*d*)(*3*) provides the changes in computing depreciation that are not a change in method of accounting. Section 1.446–1T(e)(2)(ii)(*d*) applies to property placed in service by the taxpayer in taxable years ending on or after December 30, 2003.

.08 For property placed in service by the taxpayer in taxable years ending before December 30, 2003, Notice CC–2004–007 (January 28, 2004) provides that the Service generally will not assert that a change in computing depreciation for such property that is treated as a capital asset under the taxpayer's present and proposed methods of accounting is a change in method of accounting under § 446(e). Accordingly, the taxpayer may effect this change in computing depreciation by filing amended Federal tax returns or may treat this change in computing depreciation as a change in method of accounting by filing a Form 3115 in accordance with Rev. Proc. 2002–9.

.09 This revenue procedure applies either for a taxpayer's last taxable year ending before October 18, 2006 (if the taxpayer timely files its Federal income tax return after October 18, 2006, for that last taxable year), or for the taxpayer's first taxable year ending on or after October 18, 2006, for changes to methods of accounting provided in the final regulations. For subsequent taxable years, see the automatic change in method of accounting procedures in Rev. Proc. 2002–9 (or its successor), if applicable, or the advance consent change in method of accounting procedures in Rev. Proc. 97–27, 1997–1 C.B. 680 (as modified and amplified by Rev. Proc. 2002–19, and amplified, clarified, and modified by Rev. Proc. 2002–54) (or its successor). However, if a taxpayer is claiming the rehabilitation credit in accordance with § 1.168(k)–1(g)(6) or § 1.1400L(b)–1(g)(6), the resulting change in computing depreciation for the qualified rehabilitated building must be made by filing amended returns for its placed-in-service year and subsequent taxable years.

SECTION 3. SCOPE

.01 Except as provided in section 3.02, this revenue procedure applies to a taxpayer that seeks a change in method of accounting under § 1.446–1T(e)(2)(ii)(*d*)(*2*)(*ii*), (*iii*), or (*iv*)

to comply with the final regulations for either: (1) the taxpayer's last taxable year ending before October 18, 2006, if the taxpayer timely files (including extensions) its Federal income tax return after October 18, 2006, for that last taxable year; or (2) the taxpayer's first taxable year ending on or after October 18, 2006.

.02 This revenue procedure does not apply to:

(1) A change in computing depreciation resulting from a taxpayer claiming the rehabilitation credit in accordance with § 1.168(k)–1(g)(6) or § 1.1400L(b)–1(g)(6);

(2) A change in computing depreciation that is not a change in method of accounting under § 1.446–1T(e)(2)(ii)(*d*)(*3*). However if, in accordance with § 1.1400L(b)–1(g)(4)(iii), a taxpayer is changing its computation of depreciation for qualified New York Liberty Zone property because of the amendment made to § 1.1400L(b)–1T(c)(2)(ii) by the final regulations under § 1400L(b) and the taxpayer made an election under § 1.168(k)–1T(e)(1) for the class of property that included such qualified New York Liberty Zone property, § 1.1400L(b)–1(g)(4)(iii) expressly provides that this change in computing depreciation is a change in method of accounting and, thus, § 1.446–1T(e)(2)(ii)(*d*)(*3*)(*iii*) does not apply to such change in computing depreciation.

(3) A change in computing depreciation that is due to a posting error, mathematical error, or a change in underlying facts;

(4) A change in computing depreciation for depreciable property that is placed in service by a taxpayer in a taxable year ending before December 30, 2003, that is a capital asset under the taxpayer's present and proposed methods of accountings, and for which the taxpayer wants to effect the change in computing depreciation to comply with the final regulations by filing amended Federal tax returns in accordance with Notice CC–2004–007 (January 28, 2004);

(5) A change in the treatment of property from a non-capital asset (for example, inventory, materials and supplies) to a capital, depreciable asset (or vice versa); or

(6) A change from expensing the cost of depreciable property to capitalizing and depreciating that cost (or vice versa).

SECTION 4. APPLICATION

.01 A taxpayer within the scope of this revenue procedure is, in accordance with section 6.01 of Rev. Proc. 2002–9, granted the consent of the Commissioner to change to a method of accounting within the scope of this revenue procedure to comply with the final regulations provided the taxpayer follows the automatic change in method of accounting procedures in Rev. Proc. 2002–9 (or its successor) with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply for the taxpayer's first taxable year ending on or after October 18, 2006, or, if applicable, for the taxpayer's last taxable year ending before October 18, 2006, if the taxpayer timely files its Federal income tax return after October 18, 2006, for that last taxable year; and

(2) For purposes of section 6.02(4)(a) of Rev. Proc. 2002–9, the taxpayer must include on line 1a of the Form 3115 the designated automatic accounting method change number 105.

.02 A change in method of accounting within the scope of this revenue procedure results in a § 481(a) adjustment.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include the automatic change in method of accounting provided in section 4 of this revenue procedure in section 2 of the APPENDIX of Rev. Proc. 2002–9.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective October 18, 2006.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Douglas Kim of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Douglas Kim at (202) 622–3110 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 441, 442, 898, 1502; 1.441–1, 1.442–1, 1.1502–76.)

Rev. Proc. 2006–45

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SECTION 1. PURPOSE

This revenue procedure provides the exclusive procedures for a corporation (as defined in section 5.01 of this revenue procedure) within its scope to obtain automatic approval to change its annual accounting period under § 442 of the Internal Revenue Code and § 1.442–1(b) of the Income Tax Regulations. This revenue procedure clarifies, modifies, amplifies, and supersedes Rev. Proc. 2002–37, 2002–1 C.B. 1030. A corporation complying with all the applicable provisions of this revenue procedure will be deemed to have established a business purpose and obtained the approval of the Commissioner of Internal Revenue to change its annual accounting period under § 442 and the regulations thereunder.

SECTION 2. BACKGROUND

.01 *Taxable Year Defined.*

(1) *In general.* Section 441(b) and § 1.441–1(b)(1) provide that the term "taxable year" generally means the taxpayer's annual accounting period, if it is a calendar or fiscal year, or, if applicable, the taxpayer's required taxable year.

(2) *Annual accounting period.* Section 441(c) and § 1.441–1(b)(3) provide that the term "annual accounting period" means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes its income in keeping its books.

(3) *Required taxable year.* Section 1.441–1(b)(2) provides that certain taxpayers must use the particular taxable year that is required under the Code and the regulations thereunder. See § 1.441–1(b)(2) for examples of taxpayers, including certain corporations, with required taxable years.

.02 *Change in Taxable Year.*

(1) *In general.* Section 1.442–1(a)(1) generally provides that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain the approval of the Commissioner.

(2) *Annualization of short period return.* Section 443(b) and § 1.443–1(b)(1)(i) generally provide that if a return is made for a short period resulting from a change of an annual accounting period, the taxable income for the short period must be placed on an annual basis by multiplying the income by 12 and dividing the result by the number of months in the short period. Unless § 443(b)(2) and § 1.443–1(b)(2) apply, the tax for the short period generally is the same part of the tax computed on an annual basis as the number of months in the short period is of 12 months. But see, for example, §§ 1.852–3(e), 1.857–2(a)(4), and 1.1502–76 for exceptions to this general rule for a regulated investment company (RIC), a real estate investment trust (REIT), and a subsidiary corporation ceasing to be a member of a consolidated group, respectively.

(3) *No retroactive change in annual accounting period.* Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in annual accounting period, regardless of whether the change is to a required taxable year.

.03 *Approval of a Change.* Section 1.442–1(b) provides, in part, that in order to secure the approval of the Commissioner to change an annual accounting period, a taxpayer must file an application, generally on Form 1128, "*Application To Adopt, Change, or Retain a Tax Year*," with the Commissioner within such time and in such manner as is provided in administrative procedures published by the Commissioner. In general, a change in annual accounting period will be approved if the taxpayer establishes a business purpose for the requested annual accounting period and agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the change.

SECTION 3. SIGNIFICANT CHANGES

Significant changes to Rev. Proc. 2002–37 made by this revenue procedure include:

.01 Sections 4.01(2), 4.01(3), and 4.01(4) of Rev. Proc. 2002–37 are removed from the applicability section and are reinserted, where appropriate, in the relevant inapplicability subsections under section 4.02 of this revenue procedure.

.02 Section 4.02(2) of this revenue procedure removes section 4.02(2)(b) of Rev. Proc. 2002–37 because the entities formerly described by section 4.02(2)(b) of Rev. Proc. 2002–37 are included in section 4.02(2)(a) of this revenue procedure.

.03 Section 4.02(2)(e) of this revenue procedure provides that an interest in a pass-through entity that does not have a required taxable year is disregarded solely for purposes of section 4.02(2). Thus, having an interest in a pass-through entity that does not have a required taxable year does not make a corporation ineligible for use of this revenue procedure.

.04 Section 4.02(5) of this revenue procedure excludes from the scope an S or terminated S corporation. See Rev. Proc. 2006–46, 2006–45 I.R.B. 859, for procedures to follow for certain automatic changes in the annual accounting period of an S corporation.

.05 Section 4.02(8) of this revenue procedure excludes from the scope certain controlled foreign corporations (CFCs).

.06 Section 4.02(13) of this revenue procedure excludes from the scope a corporation that exits a consolidated group in its first effective year.

.07 Section 4.02(14) of this revenue procedure excludes from the scope certain changes to (or from) a 52–53 week taxable year by a member of a consolidated group.

.08 Section 6.02 of this revenue procedure provides that only certain short periods are exempt from the financial statement conformity requirement and incorporates the clarification in Notice 2002–72, 2002–2 C.B. 843, of the record keeping/book conformity term and condition with regard to CFCs.

.09 Section 6.03(1) of this revenue procedure provides that certain CFCs are not required to file a first effective year tax return.

.10 Sections 6.05 (changes in natural business year for an electing S corporation) and 6.06 (changes in ownership taxable year for an electing S corporation) of Rev. Proc. 2002–37 are not included in this revenue procedure because this revenue procedure does not apply to S corporations. The removal of these sections from the terms and conditions of this revenue procedure is not intended to imply that a corporation that elects to be an S corporation is not required to conform to the requirements for accounting periods for S corporations. See § 1378 and § 1.1378–1(a) for the permitted years of an S Corporation and see Rev. Proc. 2006–46 for procedures to follow for certain automatic changes in the annual accounting period of an S corporation.

.11 Section 6.06 of this revenue procedure incorporates the modified carryback term and condition of section 4.01 of Rev. Proc. 2003–34, 2003–1 C.B. 856.

.12 Section 6.08 of this revenue procedure clarifies that in the case of a change in annual accounting period by the common parent of a consolidated group, the consolidated return rules will apply (*e.g.*, § 1.1502–21) unless this revenue procedure specifically provides otherwise.

.13 Section 6.09 of this revenue procedure incorporates the clarification in Notice 2002–72, that certain entities with required taxable years that must concurrently change their annual accounting period as a term and condition for the approval of a related taxpayer's change of annual accounting period must do so under the applicable automatic approval procedures notwithstanding any limitations in those procedures to the contrary or any conflicting testing date provisions.

.14 Section 6.10 of this revenue procedure provides that a CFC that revokes its one month deferral election under § 898 is not eligible to make another change in taxable year for a period of 48 months following the first day of the first effective year.

.15 Sections 7.02(1)(b), 7.02(2)(b), and 7.02(4)(b) of this revenue procedure provide the filing requirements for certain CFCs and noncontrolled section 902 corporations.

.16 Section 7.02(2) of this revenue procedure provides that the Form 1128 or Form 5471, *Information Return of U.S. Persons With Respect To Certain Foreign Corporations*, must be filed no earlier than the day following the end of the first effective year.

.17 Section 7.02(7) of this revenue procedure provides that, for purposes of a change in annual accounting period, a consolidated group consists of the parent and any subsidiary that is a member of the group on the last day of the short period.

SECTION 4. SCOPE

.01 *Applicability*. Except as provided in section 4.02, this revenue procedure is the exclusive procedure for a corporation within its scope to secure the Commissioner's approval and applies to a corporation requesting approval to change its annual accounting period, including a corporation that wants to change to (or from) a 52–53-week taxable year.

.02 *Inapplicability*. This revenue procedure does not apply to the following corporations:

(1) *Prior change*. A corporation that has changed its annual accounting period within the most recent 48-month period ending with the last month of the requested taxable year, unless:

(a) the prior change was made in order to comply with the common taxable year requirement of either § 1.1502–75(d)(3)(v) or 1.1502–76(a)(1) (see § 1.442–1(c));

(b) the prior change was made by a corporation that either was acquired within the preceding 12 months by a new majority shareholder using a different taxable year, or whose majority shareholder changed its taxable year within the preceding 12 months, if that corporation does not file consolidated income tax returns with its majority shareholder and seeks to change to the taxable year of that shareholder in order to file consolidated financial statements. For purposes of this section 4.02(1)(b), "majority shareholder" means ownership that satisfies the test of § 1504(a)(2), substituting "more than 50 percent" for "at least 80 percent;"

(c) except in the case of a CFC, the prior change was from a 52–53-week taxable year that references a particular month to a non-52–53-week taxable year that ends on the last day of that month, and vice versa;

(d) the prior change was to a required taxable year (as defined in section 5.03 of this revenue procedure) or was a concurrent change required by either this revenue procedure or Rev. Proc. 2002–39 (or any successor);

(e) the corporation wants to change from a 52–53-week taxable year to a non-52–53-week taxable year that ends with reference to the same month, and vice versa; or

(f) the corporation is a CFC that wants to revoke its one month deferral election under § 898(c)(1)(B) and change its taxable year to the majority U.S. shareholder year (as defined in § 898(c)(1)(C)).

(2) *Interest in a pass-through entity or a CFC*. A corporation that has an interest in a pass-through entity (as defined in section 5.02 of this revenue procedure) or a CFC as of the end of the first effective year (as defined in section 5.05 of this revenue procedure). However, an interest in a pass-through entity or CFC will be disregarded for this purpose if any of the following conditions are met:

(a) the pass-through entity or CFC would be required under the Code or regulations to change its taxable year to the new taxable year of the corporation (or, in the case of a CFC, to a taxable year that is described in section 4.02(8)(b)). See section 6.09 of this revenue procedure for a special term and condition related to this exception;

(b) the new taxable year of the corporation would result in no change in or less deferral (as described in § 1.706–1(b)(3)) from the pass-through entity or CFC than the present taxable year of the corporation. If the entity is a partnership or a CFC, the

corporation should compare the existing deferral period (between the pass-through entity's and the corporation's current taxable years) with the new deferral period (between the new required taxable year of the pass-through entity or CFC and the corporation's new taxable year). See section 4.04 of this revenue procedure for an example of this rule;

(c) the pass-through entity or CFC in which the corporation has an interest has been in existence for at least 3 taxable years and the interest is *de minimis*. For this purpose, an interest is *de minimis* if:

(i) for each of the prior 3 taxable years of the corporation, the amount of income (including ordinary income or loss, capital gains or losses, rents, royalties, interest, dividends and deduction equivalents of credits) from *de minimis* interest in a pass-through entity or CFC is less than or equal to (A) 5 percent of the corporation's gross receipts (or, in the case of a member of a consolidated group, the consolidated group's gross receipts) for each of those taxable years, and (B) $500,000; and

(ii) the amount of income from all *de minimis* interest in pass-through entities and CFCs in the aggregate is less than or equal to the amounts described in (A) and (B) of (c)(i) above. See section 4.04 of this revenue procedure for an example of this rule;

(d) the corporation wants to change from a 52–53-week taxable year to a non-52–53-week taxable year that ends with reference to the same month, and vice versa;

(e) the pass-through entity or CFC does not have a required year;

(f) the corporation wants to change to a natural business year (as defined in section 5.04 of this revenue procedure) that satisfies the 25-percent gross receipts test described in that section; or

(g) the corporation is a CFC that wants to revoke its one month deferral election under § 898(c)(1)(B) and change its taxable year to the majority U.S. shareholder year (as defined in § 898(c)(1)(C)).

(3) *Shareholder of certain FSCs or IC-DISCs*. A corporation that is a shareholder of a foreign sales corporation (FSC) or interest charge domestic international sales corporation (IC-DISC), as of the end of the short period (as defined in section 5.06 of this revenue procedure). However, an interest in a FSC or IC-DISC is disregarded if any of the following conditions is met:

(a) the FSC or IC-DISC in which the corporation is the principal shareholder (*i.e.*, the shareholder with the highest percentage of voting power as defined in § 441(h)) would be required to change its taxable year pursuant to §§ 1.921–1T(b)(4) and (6) to the new taxable year of the corporation. See section 6.09 of this revenue procedure for a special term and condition related to this exception;

(b) the new taxable year of the corporation would result in no change in or less deferral of income (as determined under the principles of § 1.706–1(a)(3)) from the FSC or IC-DISC than the present taxable year of the corporation;

(c) the corporation wants to change from a 52–53-week taxable year to a non-52–53-week taxable year that ends with reference to the same month, and vice versa;

(d) the corporation wants to change to a natural business year that satisfies the 25-percent gross receipts test described in section 5.04 of this revenue procedure; or

(e) the corporation is a CFC that wants to revoke its one month deferral election under § 898(c)(1)(B) and change its taxable year to the majority U.S. shareholder year (as defined in § 898(c)(1)(C));

(4) *FSC and IC-DISC*. A corporation that is a FSC or an IC-DISC. See § 1.921–1T(b)(4) for rules regarding automatic changes of the annual accounting period of a FSC or IC-DISC to the taxable year of its principal shareholder;

(5) *S or terminated S corporation*. A corporation that either is an S corporation (as defined in § 1361) or a corporation that is requesting a change in annual accounting period that is within an S termination year (as defined in § 1362(e)(4)). See Rev. Proc. 2006–46 for procedures to follow for certain automatic changes in the annual accounting period of an S corporation;

(6) *Electing S corporation*. A corporation that attempts to make an S corporation election for the taxable year immediately following the short period, unless the change is to a permitted taxable year, or from a 52–53-week taxable year to a non-52–53-week taxable year that ends with reference to the same month, and vice versa;

(7) *PSC*. A corporation that is a personal service corporation (PSC) (as defined in § 441(i)). See Rev. Proc. 2006–46 for procedures to follow for certain automatic changes in the annual accounting period of a PSC;

(8) *CFC*. A corporation that is a controlled foreign corporation as defined in § 957, including a CFC that also is a passive foreign investment company (PFIC) as defined in § 1297(a), unless:

(a) the CFC does not have a required taxable year under § 898;

(b) the CFC is changing to its required taxable year under § 898, to a 52–53-week taxable year that references that year, or, if the CFC has a majority U.S. shareholder year (as defined in § 898(c)(3)), to a one-month deferral year described in § 898(c)(2) or to a 52–53-week taxable year that references such one-month deferral year; or

(c) with respect to the CFC's taxable years beginning after July 10, 1989, no U.S. shareholder has been required to include in gross income an amount described in § 951(a) (subpart F inclusion).

(9) *Tax-exempt organization*. A corporation that is a tax-exempt organization, other than an organization exempt from federal income tax under § 521, 526, 527, or 528. See Rev. Proc. 85–58, 1985–2 C.B. 740, for procedures to follow in changing an annual accounting period of a tax-exempt organization that is not within the scope of this revenue procedure;

(10) *Possessions corporation*. A corporation that has in effect an election under § 936;

(11) *Cooperative association*. A corporation that is a cooperative association (within the meaning of § 1381(a)) with a loss in the short period required to effect the change of annual accounting period, unless it is changing from a 52–53-week taxable year to a non-52–53-week taxable year that ends with reference to the same month, and vice versa, or the patrons of the cooperative association are substantially the same in the year before the change of annual accounting period, in the short period required to effect the change, and in the year following the change. For purposes of this subsection, "substantially the same" means that ownership of more than 90 percent of the cooperative association's stock is owned by the same members; or

(12) *Corporation with a required taxable year*. A corporation that has a required taxable year (*e.g.*, a REIT, or a Qualified Settlement Fund or Designated Settlement Fund as defined in § 1.468B), unless the corporation is changing to their required taxable year.

(13) *Corporation that exits a consolidated group*. A corporation that ceases to be a member of a consolidated group during the consolidated group's first effective year.

(14) *Certain members of a consolidated group*. A corporation that is a member of a consolidated group requesting to change to (or from) a 52–53-week taxable year unless the requested taxable year is identical to the taxable year of the consolidated group.

.03 *Nonautomatic Changes*. A corporation that is unable to obtain automatic approval for a change in accounting period under this or any other applicable revenue procedure, or under a regulation, must secure prior approval from the Commissioner for a change in an accounting period pursuant to § 442 and the regulations thereunder. See Rev. Proc. 2002–39 (or any successor).

.04 *Examples*.

(1) *Example 1*. (a) Corporations V, W, X, Y, and Z hold equal 20 percent interests in the capital and profits of partnership ABC. V and W are calendar year taxpayers. X and Y have taxable years ending June 30, and Z has a taxable year ending September 30. ABC does not have a business purpose for a particular taxable year, and thus, pursuant to § 1.706–1, ABC is required to use a taxable year ending June 30 because that taxable year results in the least aggregate deferral of income to its partners. Z currently has a 3-month deferral period (the number of months from the end of ABC's taxable year to the end of Z's taxable year). Z wants to change its taxable year to a calendar year.

(b) If Z changes its taxable year to a calendar year, ABC would be required to change its taxable year under § 706 to its majority interest taxable year, which would be the calendar year. As a result of Z's new taxable year and ABC's new taxable year, Z's deferral period would be eliminated. Because Z's new taxable year would reduce Z's deferral, Z may disregard its interest in ABC under section 4.02(2)(b) of this revenue procedure.

(2) *Example 2*. (a) Corporation X, a calendar year taxpayer, wants to change its taxable year to a year ending June 30. X has interests in five partnerships, ABC, DEF, GHI, JKL, and MNO. All of the partnerships have been in existence for over three taxable years. X's interests in each of ABC and DEF is greater than 50 percent. X's interest in GHI, JKL, and MNO is 15 percent, 10 percent, and 5 percent, respectively. GHI uses the majority interest taxable year ending May 31 and JKL and MNO each use their respective majority interest taxable year ending December 31. X's distributive share of income/(loss) from JKL for the prior three taxable years is $300,000, $(100,000), and $200,000, respectively, and from MNO is $300,000, $200,000, and $100,000, respectively. X's gross receipts for each of those same taxable years was $15,000,000.

(b) X's interests in its pass-through entities will be disregarded for purposes of section 4.02(2) of this revenue procedure only if each pass-through entity satisfies one of the exceptions enumerated under section 4.02(2) of this revenue procedure. In the instant case, X's interests in ABC and DEF each meet the exception in section 4.02(2)(a) because X is the majority interest partner in each partnership. X's interest in GHI meets the exception in section 4.02(2)(b) because X's new taxable year would result in less deferral than its old taxable year (the deferral between May 31 and June 30 of 1 month as compared to the deferral between May 31 and December 31 of 7 months). Because X is not the majority interest partner in JKL and MNO and because its new taxable year would not result in less deferral from these partnerships, X's interests in JKL and MNO may be disregarded only if they satisfy the *de minimis* exception in section 4.02(2)(c). Although the income from JKL and MNO for each of the prior three taxable years is less than 5 percent of X's gross receipts and $500,000, the income for year 1 from JKL and MNO, in the aggregate ($300,000 and $300,000), exceeds the $500,000 amount specified in section 4.02(2)(c)(ii). Consequently, JKL and MNO fail to satisfy the *de minimis* exception in section 4.02(2)(c). Because X's interests in all of its pass-through entities will not be disregarded, X is not within the scope of this revenue procedure.

SECTION 5. DEFINITIONS

The following definitions apply solely for the purpose of this revenue procedure:

.01 *Corporation*. The term "corporation" includes associations, joint-stock companies, and insurance companies, as provided in § 7701(a)(3) and the regulations thereunder, and includes each member of a consolidated group that is a member of the group on the last day of the first effective year.

.02 *Pass-through Entity*. The term "pass-through entity" means a partnership (as defined in § 7701(a)(2) and the regulations thereunder); a trust (as defined in § 301.7701–4); an estate; a common trust fund (as defined in § 584); a PFIC that the corporation has elected to treat as a qualified electing fund (as defined in § 1295); and a closely-held REIT (as defined in § 6655(e)(5)(B)), but only to the extent the corporation is described in § 6655(e)(5)(A).

.03 *Required Taxable Year*. The "required taxable year" is the particular taxable year that certain taxpayers are required to use under the Code and the regulations thereunder. See § 1.441–1(b)(2) for examples of taxpayers, including certain corporations, with required taxable years.

.04 *Natural Business Year*. A "natural business year" is a year for which a corporation satisfies the following "25-percent gross receipts test":

(1) *25-percent gross receipts test*. Except as provided in (2) below, the 25-percent gross receipts test is satisfied if each of the results described in (a) and (b) below equals or exceeds 25-percent:

(a) Gross receipts from sales and services for the most recent 12-month period that ends with the last month of the requested annual accounting period are totaled and then divided into the amount of gross receipts from sales and services for the last 2 months of this 12-month period.

(b) The same computation as in (1)(a) above is made for the two preceding 12-month periods ending with the last month of the requested annual accounting period.

(2) *Exception*. The corporation must determine whether any annual accounting period other than the requested annual accounting period also meets the 25-percent gross receipts test described in (1). If one or more other annual accounting periods produce higher averages of the three percentages (rounded to 1/100 of a percent) described in (1) than the requested annual accounting period, then the requested annual accounting period will not qualify as the corporation's natural business year.

(3) *Special rules*.

(a) To apply the 25-percent gross receipts test for any particular year, the corporation must compute its gross receipts under the method of accounting used to prepare its federal income tax return for such taxable year.

(b) Regardless of the corporation's method of accounting, the corporation's share of taxable income from a pass-through entity generally must be reported as gross receipts from sales and services in the month that the pass-through entity's taxable year ends.

(c) If a corporation has a predecessor organization and is continuing the same business as its predecessor, the corporation must use the gross receipts from sales and services of its predecessor for purposes of

computing the 25-percent gross receipts test.

(d) If the corporation (including any predecessor organization) does not have a 47-month period of gross receipts (36-month period for requested taxable year plus additional 11-month period for comparing requested taxable year with other potential taxable years), then it cannot establish a natural business year under this revenue procedure.

(e) If the requested taxable year is a 52–53-week taxable year, the calendar month ending nearest to the last day of the 52–53-week taxable year is treated as the last month of the requested taxable year for purposes of computing the 25-percent gross receipts test.

.05 *First Effective Year*. The "first effective year" is the first taxable year for which a change in annual accounting period is effective. The first effective year generally is the short period required to effect the change. In the case of a short period of 6 days or less, the first effective year is the taxable year that includes such short period under § 1.441–2(b)(2)(ii). The first effective year also is the first taxable year for complying with all the terms and conditions set forth in this revenue procedure necessary to effect the change in annual accounting period.

.06 *Short Period*. In the case of a change in annual accounting period, a corporation's "short period" is the period beginning with the day following the close of the old taxable year and ending with the day preceding the first day of the new taxable year.

SECTION 6. TERMS AND CONDITIONS OF CHANGE

.01 *In General*. A change in annual accounting period filed under this revenue procedure must be made pursuant to the terms and conditions provided in this revenue procedure.

.02 *Record Keeping/Book Conformity*.

(1) *In general*. The corporation must compute its income and keep its books and records (including financial statements and reports to creditors) on the basis of the requested taxable year. The books and records of the corporation must be closed as of the last day of the first effective year and the corporation must conform the accounting period used for financial statement purposes and reports to creditors concurrently.

(2) *Certain short periods exempt from financial statement conformity*. If the corporation is not required to issue financial statements for the short period required to effect the change, the corporation will be deemed to have met the financial statement conformity requirement for the first effective year provided the corporation's accounting period used for financial statement purposes already conforms to the requested taxable year or the corporation makes the change in accounting period used for financial statement purposes and reports to creditors concurrently.

(3) Foreign law books and records. The terms and conditions in section 6.02(1) of this revenue procedure do not apply to require a corporation to close and conform books and records that are required to be maintained for foreign law purposes (*e.g.*, foreign tax reporting purposes) on the basis of a different taxable year than the requested taxable year. In addition, the terms and conditions in section 6.02(1) of this revenue procedure do not apply to require a noncontrolled section 902 corporation to close and conform any books and records that are maintained for foreign law purposes, regardless of whether foreign law requires such books and records to be maintained on the basis of a different taxable year than the requested taxable year.

.03 *First Effective Year Tax Return*.

(1) *When to file*. The corporation generally must file a federal income tax return for the first effective year by the due date of that return, including extensions pursuant to § 1.443–1(a). A CFC or a noncontrolled section 902 corporation that is not required to file Form 1120F (because it is not engaged in United States trade or business) need not file a first effective year tax return (or have its U.S. shareholder file such a return on its behalf).

(2) *Annualization*. The corporation's taxable income for the short period must be annualized and the tax must be computed in accordance with the provisions of § 443(b) and § 1.443–1(b). However, for changes to (or from) a 52–53-week taxable year referencing the same month as the current (or requested) taxable year, see special rules in § 1.441–2.

.04 *Subsequent Year Tax Returns*. Returns for subsequent taxable years generally must be made on the basis of a full 12 months (or on a 52–53-week basis) ending on the last day of the requested taxable year, unless the corporation secures the approval of the Commissioner to change that taxable year.

.05 *52–53-week Taxable Years*. If applicable, the corporation must comply with § 1.441–2(e) (relating to the timing of taking items into account in those cases where the taxable year of a pass-through entity ends with reference to the same calendar month as one or more of its owners).

.06 *Creation of Net Operating Loss or Capital Loss*. If the corporation generates a net operating loss (NOL) or capital loss (CL) in the short period required to effect a change in annual accounting period, the corporation may not carry the NOL or CL back, but must carry it over in accordance with the provisions of §§ 172 and 1212, respectively, beginning with the first taxable year after the short period. However, except as otherwise provided in the Code or regulations, the short period NOL or CL is carried back or carried over in accordance with § 172 or 1212, respectively, if it is either: (a) $50,000 or less, or (b) less than the NOL or CL, respectively, generated for the full 12-month period beginning with the first day of the short period. The corporation must wait until this 12-month period has expired to determine whether it qualifies for the exception in (b) above.

.07 *Creation of General Business Credits*. If there is an unused general business credit or any other unused credit generated in the short period, the corporation must carry that unused credit forward. An unused credit from the short period may not be carried back.

.08 *Consolidated Groups*. In the case of a change in annual accounting period by the common parent of a consolidated group, the consolidated return rules will apply (*e.g.*, § 1.1502–21) unless this revenue procedure specifically provides otherwise. In addition, every member of the consolidated group must meet all the requirements and meet and comply with all the terms and conditions of this revenue procedure.

.09 *Concurrent Change for Related Entities*. If a corporation's interest in a pass-through entity, FSC, or IC-DISC (related

entity) is disregarded pursuant to section 4.02(2)(a) or 4.02(3)(a) of this revenue procedure because the related entity is required to change its taxable year to the corporation's new taxable year (or, in the case of a CFC, because it does not have a required year under § 898), the related entity must change its taxable year concurrently with the corporation's change in taxable year, either under this revenue procedure, Rev. Proc. 2006–46, or Rev. Proc. 2002–39 (or any successor), whichever is applicable. If the related entity that is required to change is a corporation, such as a CFC, it is deemed to be within section 4.01 of this revenue procedure and if the related entity is a pass-through entity, such as a partnership, it is deemed to be within section 4.01(1) of Rev. Proc. 2006–46. The preceding sentence applies notwithstanding any conflicting testing date provisions under the Code (*e.g.*, § 706(b)(4)(A)(ii), § 898(c)(3)(B), § 1.921–1T(b)(6), and the special provision in § 706(b)(4)(B)) or regulations, or any other limitation under sections 4.02 and 7.02(2) of this revenue procedure or sections 4.02 and 7.02(2) of Rev. Proc. 2006–46.

.10 *CFCs*. In the case of a CFC that revokes its one month deferral election under § 898, the CFC shall not be eligible to change its taxable year during a 48-month period following the first day of the first effective year unless the change is necessary to conform to a new required taxable year under § 898.

SECTION 7. GENERAL APPLICATION PROCEDURES

.01 *Approval*. Approval is hereby granted to any corporation within the scope of this revenue procedure to change its annual accounting period, provided the corporation complies with all the applicable provisions of this revenue procedure. Approval is granted beginning with the first effective year. A corporation granted approval under this revenue procedure to change its annual accounting period is deemed to have established a business purpose for the change to the satisfaction of the Commissioner.

.02 *Filing Requirements*.

(1) *Where to file*.

(a) *In general*. Any corporation (including the common parent of a consolidated group) that wants to change its annual accounting period pursuant to the provisions of this revenue procedure must complete and file an application (*i.e.*, a current Form 1128) with the Director, Internal Revenue Service Center, Attention: ENTITY CONTROL, where the corporation files its federal income tax return. No copies of Form 1128 should be sent to the national office. The corporation also should attach a copy of the Form 1128 to the federal income tax return filed for the first effective year.

(b) *Certain foreign corporations*. In the case of a CFC or a noncontrolled section 902 corporation that is not required to file a federal income tax return, the controlling domestic shareholders (as defined in § 1.964–1T(c)(5)) that want to change the foreign corporation's accounting period on behalf of the foreign corporation pursuant to the provisions of this revenue procedure must satisfy the requirements set forth in § 1.964–1T(c)(3), and, except as provided in section 7.02(1)(c) of this revenue procedure, the designated shareholder who retains the jointly executed consent described in § 1.964–1T(c)(3)(ii) must complete and file a current Form 1128 on behalf of the foreign corporation with its federal income tax return for its taxable year with or within which ends the first effective year of the foreign corporation. Each other controlling domestic shareholder (or its common parent) should also attach a copy of the Form 1128 to its federal income tax return filed for its taxable year with or within which ends such taxable year of the designated shareholder. No copies of Form 1128 should be sent to the national office.

(c) *Taxable years under section 898*. In the case of a taxable year described in section 4.02(8)(b) of this revenue procedure, in lieu of filing Form 1128, the CFC's controlling domestic shareholders must indicate the change in taxable year on the Form 5471 filed with respect to the CFC's first effective year.

(2) *When to file*. (a) *In general*. The Form 1128 must be filed no earlier than the day following the end of the first effective year and no later than the due date (including extensions) for filing the federal income tax return for the first effective year.

(b) *Certain foreign corporations*. An application that is filed by a controlling domestic shareholder (or its common parent) on behalf of a CFC or a noncontrolled section 902 corporation is due no later than the due date (including extensions) of such shareholder's (or its common parent's) federal income tax return for its tax year with or within which ends the first effective year of the foreign corporation.

(3) *Label*. In order to assist in the processing of the change in annual accounting period, reference to this revenue procedure should be made a part of the Form 1128 or Form 5471 by either typing or legibly printing the following statement at the top of page 1 of the Form 1128 or Form 5471: "FILED UNDER REV. PROC. 2006–45."

(4) *Signature requirements*.

(a) *In general*. Form 1128 must be signed on behalf of the corporation requesting the change of annual accounting period by an individual with authority to bind the corporation in such matters. If the corporation is a member of a consolidated group, the Form 1128 must be signed by a duly authorized officer of the common parent. If an agent is authorized to represent the corporation before the Service, to receive the original or a copy of correspondence concerning the application, or to perform any other act(s) regarding the application on behalf of the corporation, a power of attorney reflecting such authorization(s) should be attached to the application. A corporation's representative without a power of attorney to represent the corporation will not be given any information about the application.

(b) *Certain foreign corporations*. An application that is filed on behalf of a CFC or a noncontrolled section 902 corporation need not be signed. However, the controlling domestic shareholders must satisfy the requirement set forth in § 1.964–1T(c)(3) and the designated shareholder must retain the jointly executed consent described in § 1.964–1T(c)(3)(ii).

(5) *No user fee*. A user fee is not required for an application filed under this revenue procedure and, except as provided in section 8.01 of this revenue procedure, the receipt of an application filed under this revenue procedure generally will not be acknowledged.

(6) *Additional information*. In the case of a corporation changing to a natural business year that satisfies the 25-percent gross receipts test described in section

5.06 of this revenue procedure, the corporation must supply the gross receipts from sales and services for the most recent 47 months for itself (or any predecessor) in compliance with the instructions to Form 1128.

(7) *Consolidated application*. A common parent must file a single application to change the annual accounting period of its consolidated group, which consists of the parent and any subsidiary that is a member of the group on the last day of the short period.

SECTION 8. REVIEW OF APPLICATION

.01 *Service Center Review*. A Service Center may deny a change of annual accounting period under this revenue procedure only if: (a) the Form 1128 is not filed timely, or (b) the corporation fails to meet the scope or any term and condition of this revenue procedure. If the change is denied, the Service Center will return the Form 1128 with an explanation for the denial.

.02 *Review of Director*. The appropriate director may ascertain if the change in annual accounting period was made in compliance with all the applicable provisions of this revenue procedure. Corporations changing their annual accounting period pursuant to this revenue procedure without complying with all the provisions (including the terms and conditions) of this revenue procedure ordinarily will be deemed to have initiated the change in annual accounting period without the approval of the Commissioner. Upon examination, a corporation that has initiated an unauthorized change of annual accounting period may be denied the change. For example, the corporation may be required to recompute its taxable income or loss in accordance with its former (or required, if applicable) taxable year.

SECTION 9. EFFECTIVE DATE

This revenue procedure generally is effective for all changes in annual accounting periods for which the first effective year ends on or after October 18, 2006. However, if the time period for filing Form 1128 or Form 5471 with respect to a taxable year set forth in section 7.02(2) of this revenue procedure has not yet expired, a corporation within the scope of this revenue procedure may elect early application of the revenue procedure by providing the notification set forth in section 7.02(3) on the top of page 1 of Form 1128 or Form 5471 and by satisfying the other procedural requirements of section 7.

SECTION 10. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–37 is clarified, modified, amplified, and superseded.

SECTION 11. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1786. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is found in section 7. The information in section 7 is required in order to determine whether the corporation properly obtained automatic approval to change its annual accounting period. The likely respondents are corporations. The estimated total annual reporting burden for the requirements contained in section 7 of this revenue procedure is reflected in the burden estimates for Forms 1128 and 5471.

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.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Roy A. Hirschhorn and Jeffrey Marshall of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Marshall at (202) 622–4960 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, §§ 441, 442, 444, 706, 1378; 1.441–1, 1.441–3, 1.442–1, 1.706–1, 1.1378–1.)

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SECTION 1. PURPOSE

This revenue procedure provides the exclusive procedures for a partnership (as defined in section 5.02 of this revenue procedure), S corporation, electing S corporation (as defined in section 5.03 of this revenue procedure), personal service corporation (PSC) (as defined in section 5.04 of this revenue procedure), or trust within its scope — to obtain automatic approval to adopt, change, or retain its annual accounting period under § 442 of the Internal Revenue Code and § 1.442–1(b) of the Income Tax Regulations. This revenue procedure clarifies, modifies, amplifies, and supersedes Rev. Proc. 2002–38, 2002–1 C.B. 1037. A partnership, S corporation, electing S corporation, PSC, or trust complying with the applicable provisions of this revenue procedure will be deemed to have established a business purpose and obtained the approval of the Commissioner of Internal Revenue to adopt, change, or retain its annual accounting period under § 442 and the regulations thereunder.

SECTION 2. BACKGROUND

.01 *Taxable Year Defined.*

(1) *In general.* Section 441(b) and § 1.441–1(b)(1) provide that the term "taxable year" generally means the taxpayer's annual accounting period, if it is a calendar year or fiscal year, or, if applicable, the taxpayer's required taxable year.

(2) *Annual accounting period.* Section 441(c) and § 1.441–1(b)(3) provide that the term "annual accounting period" means the annual period (calendar year or fiscal year) on the basis of which the taxpayer regularly computes its income in keeping its books.

(3) *Required taxable year.*

(a) *In general.* Section 1.441–1(b)(2) provides that certain taxpayers must use the particular taxable year that is required under the Code or regulations thereunder. Exceptions to the required taxable year are provided for certain taxpayers, including a partnership, S corporation, or PSC, that make an election under § 444, elect to use a 52–53-week taxable year that ends with reference to its required taxable year or a taxable year elected under § 444, or estab-

lish a business purpose for having a different taxable year and obtain approval under § 442.

(b) *Partnerships*. Section 706(b) and § 1.706–1(b)(2) generally provide that a partnership's taxable year must be its required taxable year. However, a partnership may have a taxable year other than its required taxable year if it makes an election under § 444, elects to use a 52–53-week taxable year that ends with reference to its required taxable year or a taxable year elected under § 444, or establishes a business purpose for having a different taxable year and obtains the approval of the Commissioner under § 442. The required taxable year for a partnership is:

(i) the taxable year of one or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent;

(ii) if there is no taxable year described in clause (i), the taxable year of all the principal partners of the partnership (*i.e.*, all the partners having an interest of 5 percent or more in partnership profits or capital); or

(iii) if there is no taxable year described in clause (i) or (ii), the taxable year that results in the least aggregate deferral of income to the partners.

(c) *S corporations*. Section 1378 and § 1.1378–1(a) provide that the taxable year of an S corporation must be a permitted year. The term "permitted year" means (1) the required taxable year (*i.e.*, a taxable year ending on December 31), (2) a taxable year elected under § 444, (3) a 52–53-week taxable year ending with reference to the required taxable year or a taxable year elected under § 444, or (4) any other accounting period for which the corporation establishes to the satisfaction of the Commissioner a business purpose.

(d) *PSCs*. Section 441(i)(1) and § 1.441–3 provide that the taxable year of a PSC must be the calendar year unless the PSC makes an election under § 444, elects to use a 52–53-week taxable year that ends with reference to the calendar year or a taxable year elected under § 444, or establishes, to the satisfaction of the Commissioner, a business purpose for having a different period for its taxable year.

(e) *Trusts*. Section 644(a) provides that the taxable year of any trust generally must be the calendar year.

.02 *Adoption of a Taxable Year*. A newly-formed partnership, S corporation, or PSC may adopt its required taxable year, a taxable year elected under § 444, or a 52–53-week taxable year ending with reference to its required taxable year or a taxable year elected under § 444 without the approval of the Commissioner pursuant to § 441. If, however, a partnership, S corporation, or PSC wants to adopt any other taxable year, it must establish a business purpose and obtain approval under § 442. See § 1.441–1(c).

.03 *Change in Taxable Year.*

(1) *In general*. Section 1.442–1(a) generally provides that a taxpayer that wants to change its annual accounting period and use a new taxable year must obtain the approval of the Commissioner.

(2) *Annualization of short period return*. Section 443(b) and § 1.443–1(b)(1)(i) generally provide that if a return is made for a short period resulting from a change of an annual accounting period, the taxable income for the short period must be placed on an annual basis by multiplying the income by 12 and dividing the result by the number of months in the short period. Unless § 443(b)(2) and § 1.443–1(b)(2) apply, the tax for the short period generally is the same part of the tax computed on an annual basis as the number of months in the short period is of 12 months. But see §§ 1.706–1(b)(8)(i)(B) and 1.1378–1(c)(2) for exceptions to this general rule for partnerships and S corporations, respectively.

(3) *No retroactive change in annual accounting period*. Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in annual accounting period, regardless of whether the change is to a required taxable year.

.04 *Retention of a Taxable Year.* In certain cases, a partnership, S corporation, electing S corporation, or PSC will be required to change its taxable year unless it establishes a business purpose and obtains the approval of the Commissioner under § 442, or makes an election under § 444, to retain its current taxable year. *See* § 1.441–1(d). For example, a corporation on a June 30 fiscal year that either becomes a PSC or elects to be an S corporation, and as a result is required to use the calendar year, must obtain the approval of the Commissioner to retain its current fiscal year. Similarly, a partnership using a taxable year that corresponds to its required taxable year generally must obtain the approval of the Commissioner to retain that taxable year if its required taxable year changes as a result of a change in ownership. *But see* § 706(b)(4)(B). However, a partnership that previously has established a business purpose to the satisfaction of the Commissioner to use a particular fiscal year is not required to obtain the approval of the Commissioner to retain such fiscal year if its required taxable year changes provided such fiscal year currently qualifies as a permitted taxable year.

.05 *Approval of an Adoption, Change, or Retention.* Section 1.442–1(b) provides, in part, that in order to secure the approval of the Commissioner to adopt, change, or retain an annual accounting period, a taxpayer must file an application, generally on Form 1128, "*Application To Adopt, Change, or Retain a Tax Year*," with the Commissioner within such time and in such manner as is provided in administrative procedures published by the Commissioner. In general, an adoption, change, or retention in annual accounting period will be approved if the taxpayer establishes a business purpose for the requested annual accounting period and agrees to the Commissioner's prescribed terms, conditions, and adjustments for effecting the adoption, change, or retention.

.06 *Business Purpose.*

(1) *Sufficient business purposes*. Section 1.442–1(b)(2) provides that the requirement of a business purpose generally will be satisfied, and adjustments to neutralize any tax consequences will not be required, if the requested annual accounting period coincides with the taxpayer's required taxable year, ownership taxable year, or natural business year. Section 1.442–1(b)(2) also provides that, in the case of a partnership, S corporation, electing S corporation, or PSC, deferral of income to partners, shareholders, or employee-owners will not be treated as a business purpose.

(2) *Natural business year*. A taxpayer is deemed to have established a natural business year if it satisfies the "25-percent gross receipts test" described in section 5.07 of this revenue procedure.

.07 *Section 444 Elections.* A partnership, S corporation, electing S corporation, or PSC generally can elect under § 444 to use a taxable year other than its required taxable year, but only if the deferral period of the taxable year elected is not longer than the shorter of 3 months or the deferral period of the taxable year being changed. A partnership and an S corporation with a § 444 election must make required payments under § 7519 that approximate the amount of deferral benefit and a PSC with a § 444 election is subject to the minimum distribution requirements of § 280H. A taxpayer may automatically adopt, change to, or retain a taxable year permitted under § 444 by filing a Form 8716, "*Election To Have a Tax Year Other Than a Required Tax Year*." A taxpayer that wants to terminate its § 444 election must follow the automatic procedures under § 1.444–1T(a)(5) to change to its required taxable year or establish a business purpose for using a different taxable year pursuant to § 442, the regulations thereunder, Rev. Proc. 2002–39, 2002–1 C.B. 1046 (or any successor), or this revenue procedure (whichever is applicable).

SECTION 3. SIGNIFICANT CHANGES

Significant changes to Rev. Proc. 2002–38 made by this revenue procedure include:

.01 Section 4.01 of this revenue procedure removes from the scope a partnership that has a minor, temporary percentage change in ownership.

.02 Section 4.01(1) of this revenue procedure adds to the scope a trust that wants to change to its required taxable year.

.03 Section 4.01(5) of this revenue procedure clarifies that a taxpayer that is required to make a concurrent change as a term and condition for the approval of a related taxpayer's change of accounting period is included in the scope notwithstanding any limitation in this revenue procedure to the contrary.

.04 Section 4.02(6) of this revenue procedure excludes from the scope a terminated S corporation.

.05 Section 4.02(7) of this revenue procedure excludes from the scope a partnership, S corporation, electing S corporation, or PSC that makes or terminates a § 444 election. A taxpayer that makes or terminates a § 444 election must follow the procedures in § 444 and the regulations thereunder.

.06 Section 5.05 of this revenue procedure adds a trust to the definition of a required taxable year.

.07 Section 5.08 of this revenue procedure clarifies that, for taxable years beginning after December 31, 2002, a shareholder that is tax-exempt under § 501(a) generally is disregarded for purposes of determining the ownership taxable year of an S or electing S corporation.

.08 Section 5.10 of this revenue procedure modifies the definition of first effective year to include a short period of 6 days or less.

.09 Section 6.02(1) of this revenue procedure provides that only certain short periods are exempt from the financial statement conformity requirement and incorporates the clarification in Notice 2002–72, 2002–2 C.B. 843, of the recordkeeping/book conformity term and condition with regard to certain taxpayers changing to their required taxable year.

.10 Section 6.08 of this revenue procedure incorporates the modified carryback term and condition of section 4.01 of Rev. Proc. 2003–34, 2003–1 C.B. 856.

.11 Section 9.02 of this revenue procedure clarifies that, for a taxpayer that must change to a required year, failure to comply with all the applicable provisions of this revenue procedure does not relieve the taxpayer from any applicable penalties or interest if the taxpayer fails to make the change.

SECTION 4. SCOPE

.01 *Applicability.* Except as provided in section 4.02, this revenue procedure, which is the exclusive procedure for a taxpayer (as defined in section 5.01 of this revenue procedure) within its scope to secure the Commissioner's approval, applies to:

(1) *Required taxable year*. A partnership, S corporation, electing S corporation, PSC, or trust that wants to change to its required taxable year (as defined in section 5.05 of this revenue procedure), or a partnership, S corporation, electing S corporation, or PSC that wants to change to a 52–53-week taxable year ending with reference to such required taxable year;

(2) *Natural business year*. A partnership, S corporation, electing S corporation, or PSC (other than a member of a tiered structure as defined in § 444 and § 1.444–2T) that wants to change to or retain a natural business year that satisfies the 25-percent gross receipts test described in section 5.07 of this revenue procedure, or to a 52–53-week taxable year ending with reference to such taxable year;

(3) *Ownership taxable year*. An S corporation or electing S corporation that wants to adopt, change to, or retain its ownership taxable year (as defined in section 5.08 of this revenue procedure), or to a 52–53-week taxable year ending with reference to such taxable year;

(4) *Certain 52–53-week taxable years*. A partnership, S corporation, electing S corporation, or PSC that wants to change from a 52–53-week taxable year that references a particular calendar month to a non-52–53-week taxable year that ends on the last day of the same calendar month that is a permitted taxable year, and vice versa;

(5) *Certain taxpayers that are required to make concurrent changes*. Notwithstanding any limitation in this revenue procedure to the contrary (including any limitations in section 4.02 of this revenue procedure) or any conflicting testing date provisions, this revenue procedure applies to a taxpayer that is required to concurrently change its annual accounting period as a term and condition for the approval of a related taxpayer's change of annual accounting period.

.02 *Inapplicability.* Except as provided in section 4.01(5) of this revenue procedure, this revenue procedure does not apply to:

(1) *Under examination*. A change or retention in annual accounting period if the taxpayer is under examination (as defined in section 5.13 of this revenue procedure), unless it obtains consent of the appropriate director as provided in section 7.03(1) of this revenue procedure;

(2) *Before an area office*. A change or retention in annual accounting period if the taxpayer is before an area office with respect to any income tax issue and its annual accounting period is an issue under consideration (as defined in section 5.14 of this revenue procedure) by the area office;

(3) *Before a federal court*. A change or retention in annual accounting period if the taxpayer is before a federal court with respect to any income tax issue and its annual accounting period is an issue under consideration by the federal court;

(4) *Issue under consideration in connection with partner or shareholder return*. A change or retention in annual accounting period by a partnership or S corporation if, on the date the taxpayer otherwise would file its application with the Service Center, the taxpayer's annual accounting period is an issue under consideration in the examination of a partner's or shareholder's federal income tax return or an issue under consideration by an area office or by a federal court with respect to a partner's or shareholder's federal income tax return; or

(5) *Prior change*. A change to, or retention of, a natural business year as described in section 4.01(2) of this revenue procedure if the taxpayer has changed its annual accounting period at any time within the most recent 48-month period ending with the last month of the requested taxable year. For this purpose, the following changes are not considered prior changes in annual accounting period:

(a) a change to a required taxable year or ownership taxable year;

(b) a change from a 52–53-week taxable year to a non-52–53-week taxable year that ends with reference to the same calendar month, and vice versa; or

(c) a change in accounting period by an S corporation, electing S corporation, or PSC, in order to comply with the common taxable year requirements of §§ 1.1502–75(d)(3)(v) and 1.1502–76(a)(1).

(6) *Terminated S corporation*. A corporation that is requesting a change in a taxable year that is within an S termination year (as defined in § 1362(e)(4)).

(7) *Section 444 election*. A partnership, S corporation, electing S corporation, or PSC that makes or terminates a § 444 election.

.03 *Nonautomatic Changes.* Any taxpayer that wants to adopt, change to, or retain an annual accounting period that cannot do so automatically under this revenue procedure (because the requested taxable year is not described in section 4.01 or because of any application of section 4.02) or pursuant to a provision in the Code, regulations, or other published administrative procedures, must obtain the approval of the Commissioner. *See* § 1.442–1(b) and Rev. Proc. 2002–39 (or any successor) for rules relating to nonautomatic changes of annual accounting periods by partnerships, S corporations, electing S corporations, PSCs, and trusts.

SECTION 5. DEFINITIONS

The following definitions apply solely for purposes of this revenue procedure:

.01 *Taxpayer.* The term "taxpayer" has the same meaning as the term "person" as defined in § 7701(a)(1) (*e.g.*, an individual, trust, estate, partnership, association, or corporation) rather than the meaning of the term "taxpayer" as defined in § 7701(a)(14) (any person subject to tax).

.02 *Partnership.* A partnership is any entity classified as a partnership for purposes of § 7701(a)(3) or the regulations thereunder.

.03 *Electing S Corporation.* An "electing S corporation" is a corporation attempting to make an S corporation election for the short period (as defined in section 5.11 of this revenue procedure). See Rev. Proc. 2006–45, 2006–45 I.R.B. 851, for procedures for automatic approval to change an annual accounting period by corporations attempting to make an S corporation election for the taxable year immediately following the first effective year (as defined in section 5.10 of this revenue procedure).

.04 *PSC.* A PSC is a personal service corporation as defined in § 441(i)(2). For purposes of this revenue procedure, a PSC does not include a corporation that has a required taxable year under a provision of the Code other than § 441(i) (*e.g.*, a specified foreign corporation as defined in § 898(b)(1)).

.05 *Required Taxable Year.* The "required taxable year" is the taxable year determined under § 706(b) in the case of a partnership, § 644 in the case of a trust, § 1378 in the case of an S corporation or an electing S corporation, or § 441(i) in the case of a PSC, without taking into account any taxable year that is allowable by reason of a business purpose (including a grandfathered fiscal year as defined in section 5.09 of this revenue procedure) or a § 444 election.

.06 *Permitted Taxable Year.* A "permitted taxable year" is the required taxable year; a natural business year; the ownership taxable year; a taxable year elected under § 444; a 52–53-week taxable year that references the required taxable year, natural business year, ownership taxable year, or a taxable year elected under § 444; or any other taxable year for which the taxpayer establishes a business purpose to the satisfaction of the Commissioner.

.07 *Natural Business Year.* A "natural business year" is a year for which a partnership, S corporation, electing S corporation, or PSC satisfies the following "25-percent gross receipts test":

(1) *25-percent gross receipts test*. Except as provided in (2) below, the 25-percent gross receipts test is satisfied if each of the results described in (a) and (b) below equals or exceeds 25-percent:

(a) Gross receipts from sales and services for the most recent 12-month period that ends with the last month of the requested annual accounting period are totaled and then divided into the amount of gross receipts from sales and services for the last 2 months of this 12-month period.

(b) The same computation as in (1)(a) above is made for the two preceding 12-month periods ending with the last month of the requested annual accounting period.

(2) *Exception*. The taxpayer must determine whether any annual accounting period other than the requested annual accounting period also meets the 25-percent test described in (1). If one or more other annual accounting periods produce higher averages of the three percentages (rounded to 1/100 of a percent) described in (1) than the requested annual accounting period, then the requested annual accounting period will not qualify as the taxpayer's natural business year.

(3) *Special rules*.

(a) To apply the 25-percent gross receipts tests for any particular taxable year, the taxpayer must compute its gross receipts from sales and services under the method of accounting used to prepare its federal income tax returns for such taxable year.

(b) If a taxpayer has a predecessor organization and is continuing the same busi-

ness as its predecessor, the taxpayer must use the gross receipts from sales and services of its predecessor for purposes of computing the 25-percent gross receipts test.

(c) If the taxpayer (including any predecessor organization) does not have a 47-month period of gross receipts (36-month period for requested taxable year plus additional 11-month period for comparing requested taxable year with other potential taxable years), then it cannot establish a natural business year under this revenue procedure.

(d) If the requested taxable year is a 52–53-week taxable year, the calendar month ending nearest to the last day of the 52–53-week taxable year is treated as the last month of the requested taxable year for purposes of computing the 25-percent gross receipts test.

.08 *Ownership Taxable Year.* For an S corporation or electing S corporation, an "ownership taxable year" is the taxable year (if any) that, as of the first day of the first effective year, constitutes the taxable year of one or more shareholders (including any shareholder that concurrently changes to such taxable year) holding more than 50-percent of the corporation's issued and outstanding shares of stock. Under principles similar to § 1.706–1(b)(5) for determining the taxable year of a partnership, a shareholder that is tax-exempt under § 501(a) is disregarded if such shareholder is not subject to tax on any income attributable to the S corporation. Tax-exempt shareholders are not disregarded, however, if the S corporation is wholly-owned by such tax-exempt entities. A shareholder in an S corporation or electing S corporation that wants to concurrently change its taxable year must follow the instructions generally applicable to taxpayers changing their taxable years contained in § 1.442–1(b), Rev. Proc. 2002–39 (or any successor), or any other applicable administrative procedure published by the Commissioner.

.09 *Grandfathered Fiscal Year.* A "grandfathered fiscal year" is a fiscal year (other than a year that resulted in a three-month or less deferral of income) that a partnership or an S corporation received permission to use on or after July 1, 1974, by a letter ruling (*i.e.*, not by automatic approval).

.10 *First Effective Year.* The "first effective year" is the first taxable year for which an adoption, change, or retention in annual accounting period is effective. The first effective year generally is the short period required to effect the change. In the case of a short period of 6 days or less, the first effective year is the taxable year that includes such short period under § 1.441–2(b)(2)(ii). The first effective year is also the first taxable year for complying with all the terms and conditions set forth in this revenue procedure necessary to effect the adoption, change, or retention in annual accounting period.

.11 *Short Period.* In the case of a change in annual accounting period, a taxpayer's "short period" is the period beginning with the day following the close of the old taxable year and ending with the day preceding the first day of the new taxable year.

.12 *Field Office, Area Office, Director.* The terms "field office," "area office," and "director" have the same meaning as those terms have in Rev. Proc. 2006–1, 2006–1 I.R.B. 1 (or any successor).

.13 *Under Examination.*

(1) *In general.*

(a) Except as provided in section 5.13(2) of this revenue procedure, an examination of a taxpayer with respect to a federal income tax return begins on the date the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling any type of examination of the return. An examination ends:

(i) in a case in which the Service accepts the return as filed, on the date of the "no change" letter sent to the taxpayer;

(ii) in a fully agreed case, on the earliest of the date the taxpayer executes a waiver of restrictions on assessment or acceptance of overassessment (for example, Form 870, 4549, or 4605), the date the taxpayer makes a payment of tax that equals or exceeds the proposed deficiency, or the date of the "closing" letter (for example, Letter 891(IN) or 987(DO)) sent to the taxpayer; or

(iii) in an unagreed or a partially agreed case, on the earliest of the date the taxpayer (or its representative) is notified by an area officer that the case has been referred to an area office from a field office, the date the taxpayer files a petition in the Tax Court, the date on which the period for filing a petition with the Tax Court expires, or the date of the notice of claim disallowance.

(b) An examination does not end as a result of the early referral of an issue to an area office under the provisions of Rev. Proc. 99–28, 1999–2 C.B. 109.

(c) An examination resumes on the date the taxpayer (or its representative) is notified by an appeals officer (or otherwise) that the case has been referred to a field office for reconsideration.

(2) *Partnerships and S corporations subject to TEFRA*. For a partnership or S corporation that is subject to the TEFRA unified audit and litigation provisions (note that an S corporation is not subject to the TEFRA unified audit and litigation provisions for taxable years beginning after December 31, 1996; see Small Business Job Protection Act of 1996, Pub. L. No. 104–188, § 1317(a), 110 Stat. 1755, 1787 (1996)), an examination begins on the date that the notice of the beginning of an administrative proceeding is sent or personally delivered to the Tax Matters Partner/Tax Matters Person (TMP). An examination ends:

(a) in a case in which the Service accepts the partnership or S corporation return as filed, on the date of the "no adjustments" letter or the "no change" notice of final administrative adjustment sent to the TMP;

(b) in a case in which no formal notice is given, the period of limitations on assessment has expired for all partners with respect to the partnership items of the partnership;

(c) in a fully agreed case, when all the partners or shareholders execute a Form 870–P, 870–L, 870–S, or any variation thereof; or

(d) in an unagreed or a partially agreed case, on the earliest of the date the TMP (or its representative) is notified by an appeals officer that the case has been referred to an area office from a field office, the date the TMP (or a partner, member, or shareholder) requests judicial review, or the date on which the period for requesting judicial review expires.

.14 *Issue Under Consideration.*

(1) *During an examination*. A taxpayer's annual accounting period is an issue under consideration for the taxable years under examination if the taxpayer receives written notification (for example,

by examination plan, information document request (IDR), or notification of proposed adjustments or income tax examination changes) from the examining agent(s) specifically citing the taxpayer's annual accounting period as an issue under consideration. For example, a taxpayer's annual accounting period is an issue under consideration as a result of an examination plan that identifies the propriety of the taxpayer's annual accounting period as a matter to be examined. The question of whether the taxpayer's annual accounting period is an issue under consideration may be referred to the national office as a request for technical advice under the provisions of Rev. Proc. 2006–2, 2006–1 I.R.B. 89 (or any successor).

(2) *Before an area office*. A taxpayer's annual accounting period is an issue under consideration for the taxable years before an area office if the taxpayer's annual accounting period is included as an item of adjustment in the examination report referred to the area office or is specifically identified in writing to the taxpayer by the area office.

(3) *Before a federal court*. A taxpayer's annual accounting period is an issue under consideration for the taxable years before a federal court if the taxpayer's annual accounting period is an item included in the statutory notice of deficiency, the notice of claim disallowance, the notice of final administrative adjustment, the pleadings (for example, the petition, complaint, or answer) or amendments thereto, or is specifically identified in writing to the taxpayer by the government counsel.

SECTION 6. TERMS AND CONDITIONS OF CHANGE

.01 *In General.* An adoption, change, or retention in annual accounting period filed under this revenue procedure must be made pursuant to the terms and conditions provided in this revenue procedure.

.02 *Record Keeping/Book Conformity.*

(1) *In general*. The taxpayer must compute its income and keep its books and records (including financial statements and reports to creditors) on the basis of the requested taxable year. The books and records of the taxpayer must be closed as of the last day of the first effective year and the taxpayer must conform the accounting period used for financial statement purposes and reports to creditors concurrently.

(2) *Certain short periods exempt from financial statement conformity*. If the taxpayer is not required to issue financial statements for the short period required to effect the change, the taxpayer will be deemed to have met the financial statement conformity requirement for the first effective year provided the taxpayer's accounting period used for financial statement purposes already conforms to the requested taxable year or the taxpayer makes the change in accounting period used for financial statement purposes and reports to creditors concurrently.

(3) *Certain taxpayers using required year exempt from financial statement conformity*. If the requested taxable year is the taxpayer's required taxable year, the taxpayer must compute its income and keep its books and records for U.S. federal income tax purposes on the basis of the required taxable year, but is not required to conform its financial statements and reports to creditors on the basis of the required taxable year. The books and records of the taxpayer must be closed as of the last day of the first effective year.

.03 *First Effective Year Tax Return.*

(1) *When to file*. The taxpayer generally must file a federal income tax return for the first effective year by the due date of that return, including extensions, in accordance with § 1.443–1(a).

(2) *Annualization*. If the taxpayer is a PSC or a trust, the taxpayer's taxable income for the short period must be annualized and the tax must be computed in accordance with the provisions of § 443(b) and § 1.443–1(b). However, for changes to (or from) a 52–53-week taxable year referencing the same month as the current (or requested) taxable year, see special rules in § 1.441–2.

.04 *Subsequent Year Tax Returns.* Returns for subsequent taxable years generally must be made on the basis of a full 12 months (or on a 52–53-week basis) ending on the last day of the requested taxable year, unless the taxpayer secures the approval of the Commissioner to change that taxable year.

.05 *Changes in Natural Business Year.* If a partnership, S corporation, electing S corporation, or PSC changes to or retains a natural business year and that year no longer qualifies as a permitted taxable year, the taxpayer is using an impermissible annual accounting period and must change to a permitted taxable year. Taxpayers qualifying under section 4 of this revenue procedure may request automatic approval for the change under the provisions of this revenue procedure. Other taxpayers must request approval under Rev. Proc. 2002–39 (or any successor).

.06 *Changes in Ownership Taxable Year.* An S corporation or electing S corporation that adopts, changes to, or retains an ownership taxable year under this revenue procedure must change to a permitted taxable year, or request approval to retain its current taxable year, if, as of the first day of any taxable year, its ownership taxable year changes. S corporations qualifying under section 4 of this revenue procedure may request automatic approval for the change or retention under the provisions of this revenue procedure. Other taxpayers must request approval under Rev. Proc. 2002–39 (or any successor).

.07 *52–53-week Taxable Years.* If applicable, the taxpayer must comply with § 1.441–2(e) (relating to the timing of taking items into account in those cases where the taxable year of a pass-through entity or PSC ends with reference to the same calendar month as one or more of its partners, shareholders, or employee-owners).

.08 *Creation of Net Operating Loss or Capital Loss.* In the case of a PSC changing its annual accounting period, if the PSC generates a net operating loss (NOL) or capital loss (CL) in the short period required to effect the change in annual accounting period, the PSC may not carry the NOL or CL back, but must carry it over in accordance with the provisions of §§ 172 and 1212, respectively, beginning with the first taxable year after the short period. However, except as provided in § 280H and the regulations thereunder, the short period NOL or CL must be carried back or carried over in accordance with § 172 or 1212, respectively, if it is either (a) $50,000 or less; or (b) less than the NOL or CL, respectively, generated for the full 12-month period beginning with the first day of the short period. The taxpayer must wait until this 12-month period has expired

to determine whether the taxpayer qualifies for the exception in (b) above.

.09 *Creation of General Business Credits.* In the case of a PSC changing its annual accounting period, if there is an unused general business credit or any other unused credit generated in the short period, the PSC must carry that unused credit forward. An unused credit from the short period may not be carried back.

SECTION 7. GENERAL APPLICATION PROCEDURES

.01 *Approval.* Approval is hereby granted to any taxpayer within the scope of this revenue procedure to adopt, change, or retain its annual accounting period, provided the taxpayer complies with all the applicable provisions of this revenue procedure. Approval is granted beginning with the first effective year. A taxpayer granted approval under this revenue procedure to adopt, change to, or retain an annual accounting period other than its required year is deemed to have established a business purpose for the adoption, change, or retention to the satisfaction of the Commissioner.

.02 *Filing Requirements.*

(1) *Where to file*. A taxpayer within the scope of this revenue procedure that wants to adopt, change, or retain its annual accounting period under this revenue procedure must complete and file an application (*i.e.*, a current Form 1128 or, in the case of an electing S corporation, a current Form 2553, *Election by a Small Business Corporation*) with the Director, Internal Revenue Service Center, Attention: ENTITY CONTROL, where the taxpayer files its federal income tax return. No copies of Form 1128 (or Form 2553) should be sent to the national office. The taxpayer also must attach a copy of the Form 1128 (or Form 2553) to the federal income tax return filed for the first effective year.

(2) *When to file*. The Form 1128 must be filed no earlier than the day following the end of the first effective year and no later than the due date (including extensions) for filing the federal income tax return for the first effective year. For electing S corporations, the Form 2553 must be filed when the election to be an S corporation is filed pursuant to § 1362(b) and § 1.1362–6. Generally, such election must be filed at any time during (a) the taxable year that immediately precedes the taxable year for which the election is to be effective, or (b) the taxable year for which the election is to be effective, provided the election is made before the 16th day of the third month of the taxable year.

(3) *Label*. In order to assist in the processing of the adoption, change, or retention in annual accounting period, taxpayers should write at the top of page 1 of the Form 1128 (or Form 2553): "FILED UNDER REV. PROC. 2006–46."

(4) *Signature requirements*. In the case of a partnership, the Form 1128 must be signed on behalf of the partnership by a general partner. In the case of a limited liability company that elects to be treated as a partnership, the Form 1128 must be signed by a member-manager who has personal knowledge of the facts set forth on the form. In all other cases, the Form 1128 (or Form 2553) must be signed by an authorized corporate officer. If an agent is authorized to represent the taxpayer before the Service, to receive the original or a copy of correspondence concerning the application, or to perform any other act(s) regarding the application on behalf of the taxpayer, a Form 2848, *Power of Attorney and Declaration of Representative*, reflecting such authorization(s) should be attached to the application. A taxpayer's representative without a power of attorney to represent the taxpayer will not be given any information about the application.

(5) *No user fee*. A user fee is not required for applications filed under this revenue procedure and, except as provided in section 9.01 of this revenue procedure, the receipt of an application filed under this revenue procedure may not be acknowledged.

(6) *Additional information*. In the case of a taxpayer changing to a natural business year that satisfies the 25-percent gross receipts test described in section 5.07 of this revenue procedure, the taxpayer must supply the gross receipts from sales and services for the most recent 47 months for itself (or any predecessor) in compliance with the instructions to Form 1128 (or Form 2553).

.03 *Additional Procedures If Under Examination, Before an Area Office, or Before a Federal Court.*

(1) *Taxpayer under examination*.

(a) A taxpayer under examination may request approval to change or retain its annual accounting period under this revenue procedure only if the appropriate director consents to the change or retention. The director will consent to the change or retention unless, in the opinion of the director, the taxpayer's annual accounting period ordinarily would be included as an item of adjustment in the year(s) for which the taxpayer is under examination. For example, the director will consent to a change if the taxpayer is using a permissible annual accounting period. The director also will consent to a change from an impermissible annual accounting period if the period became impermissible (*e.g.*, due to a change in ownership or a change in the taxpayer's business) subsequent to the years under examination. The question of whether the taxpayer's annual accounting period from which the taxpayer is changing is permissible or became impermissible subsequent to the years under examination may be referred to the national office as a request for technical advice under the provisions of 2006–2, 2006–1 I.R.B. 89 (or any successor).

(b) A taxpayer changing or retaining an annual accounting period under this revenue procedure with the consent of the appropriate director must attach to the application a statement from the director consenting to the change or retention. The taxpayer must provide a copy of the application to the director at the same time it files the application with the Service Center. The application must contain the name(s) and telephone number(s) of the examining agent(s).

(2) *Taxpayer before an area office*. A taxpayer that is before an area office must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the area office. The taxpayer must provide a copy of the application to the appeals officer at the same time it files the application with the Service Center. The application must contain the name and telephone number of the appeals officer.

(3) *Taxpayer before a federal court*. A taxpayer that is before a federal court must attach to the application a separate statement signed by the taxpayer certifying that, to the best of the taxpayer's knowledge, the taxpayer's annual accounting period is not an issue under consideration by the federal court. The taxpayer must provide a copy of the application to the government counsel at the same time it files the application with the Service Center. The application must contain the name and telephone number of the government counsel.

SECTION 8. EFFECT OF APPROVAL

.01 *Audit Protection.*

(1) *In general*. Except as provided in section 8.01(2) of this revenue procedure, a taxpayer that files an application in compliance with all the applicable provisions of this revenue procedure will not be required by the Service to change its annual accounting period for a taxable year prior to the first effective year.

(2) *Exceptions*. The Service may change a taxpayer's annual accounting period for a prior taxable year if:

(a) the taxpayer fails to implement the change;

(b) the taxpayer implements the change but does not comply with all the applicable provisions of this revenue procedure; or

(c) there was a misstatement or omission of material facts.

.02 *Subsequently Required Changes.*

(1) *In general*. A taxpayer that adopts, changes, or retains its annual accounting period pursuant to this revenue procedure may be required to subsequently change its annual accounting period for the following reasons:

(a) the enactment of legislation;

(b) a decision of the United States Supreme Court;

(c) the issuance of temporary or final regulations;

(d) the issuance of a revenue ruling, revenue procedure, notice, or other statement published in the Internal Revenue Bulletin;

(e) the issuance of written notice to the taxpayer that the change in annual accounting period was not in compliance with all the applicable provisions of this revenue procedure or is not in accord with the current view of the Service; or

(f) a change in the material facts on which the approval was granted.

(2) *Retroactive change*. Except in rare circumstances, if a taxpayer that adopts, changes, or retains its annual accounting period under this revenue procedure is subsequently required under section 8.02(1) of this revenue procedure to change that annual accounting period, the required change will not be applied retroactively, provided that:

(a) the taxpayer complied with the applicable provisions of this revenue procedure;

(b) there has been no misstatement or omission of material facts;

(c) there has been no change in the material facts on which the approval was based;

(d) there has been no change in the applicable law; and

(e) the taxpayer to which the approval was granted acted in good faith in relying on the approval, and applying the change retroactively would be to the taxpayer's detriment.

SECTION 9. REVIEW OF APPLICATION

.01 *Service Center Review.* A Service Center may deny an adoption, change, or retention of an annual accounting period under this revenue procedure only if: (1) the Form 1128 (or Form 2553) is not filed timely, or (2) the taxpayer fails to meet the scope or any term and condition of this revenue procedure. If the application is denied, the Service Center will return the application with an explanation for the denial. In the case of a denial of an accounting period request filed on Form 2553, the taxpayer will be required to use the calendar year or, if applicable, make a § 444 election, if it chooses to be an S corporation.

.02 *Review of Director.* The appropriate director may ascertain if the adoption, change, or retention of annual accounting period was made in compliance with all the applicable provisions of this revenue procedure. Taxpayers adopting, changing, or retaining their annual accounting period pursuant to this revenue procedure without complying with all the provisions (including the terms and conditions) of this revenue procedure ordinarily will be deemed to have initiated the adoption, change, or retention of annual accounting period without the approval of the Commissioner. Upon examination, a taxpayer that has initiated an unauthorized adoption, change, or retention of annual accounting period may be denied the adoption, change, or retention. For example, the taxpayer may be required to recompute its taxable income or loss in accordance with its former (or required, if applicable) taxable year. For a taxpayer that must change to a required year, failure to comply with all the applicable provisions of this revenue procedure does not relieve the taxpayer from the requirement to change to the required year and, if the taxpayer does not change to the required year, does not prevent the imposition of any applicable penalty or addition of any amount to tax.

SECTION 10. EFFECTIVE DATE

This revenue procedure generally is effective for adoptions, changes, or retentions of annual accounting periods for which the first effective year ends on or after October 18, 2006. However, if the time period for filing Form 1128 (or Form 2553) with respect to a taxable year set forth in section 7.02(2) of this revenue procedure has not yet expired, a taxpayer within the scope of this revenue procedure may elect early application of the revenue procedure by providing the notification set forth in section 7.02(3) on the top of page 1 of Form 1128 (or Form 2553) and by satisfying the other procedural requirements of section 7.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–38 is clarified, modified, amplified, and superseded.

SECTION 12. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1786. An agency may not conduct or sponsor, and a person is not required to

respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is found in section 7. The information in section 7 is required in order to determine whether the taxpayer properly obtained automatic approval to adopt, change, or retain its annual accounting period. The likely respondents are the following: partnerships, S corporations, electing S corporations, PSCs, and trusts. The estimated total annual burden for the requirements contained in section 7 of this revenue procedure is reflected in the burden estimates for Forms 1128 and 2553.

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.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Jeffrey S. Marshall and Roy A. Hirschhorn of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Marshall at (202) 622–4960 (not a toll-free call).

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26 CFR 1.199–2: Wage Limitation.
(Also: 26 CFR 1.199–2T.)

Methods of Determining Paragraph (e)(1) Wages for Purposes of the § 199(b)(1) Wage Limitation on the § 199 Deduction

Rev. Proc. 2006–47

SECTION 1. PURPOSE

This revenue procedure provides methods used as part of calculating W–2 wages for purposes of § 199(b)(1) of the Internal Revenue Code, which limits the amount of the § 199 deduction for income attributable to domestic production activities to 50 percent of the W–2 wages of the taxpayer for the taxable year.

Section 514(a) of the Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109–222) (TIPRA) imposes a new limitation on W–2 wages for purposes of § 199 for taxable years beginning after May 17, 2006. Under the change made by TIPRA, W–2 wages, for purposes of § 199, include *only* amounts that are properly allocable to domestic production gross receipts (DPGR) for purposes of § 199(c)(1). Thus, to determine such W–2 wages for taxable years beginning after May 17, 2006, it is necessary to determine the amount that would have been W–2 wages for purposes of § 199 before the amendment by TIPRA and then to determine the portion of that amount properly allocable to DPGR.

This revenue procedure provides methods for calculating the amount of wages described in § 1.199–2(e)(1) of the Income Tax Regulations ("paragraph (e)(1) wages"). Section 1.199–2T(e)(2) of the temporary Income Tax Regulations provides that the term W–2 wages includes only paragraph (e)(1) wages that are properly allocable to DPGR for purposes of § 199(c)(1). Thus, for taxable years covered by this revenue procedure, a taxpayer first determines the amount of paragraph (e)(1) wages under this revenue procedure and then applies § 1.199–2T(e)(2) to determine the amount of W–2 wages.

Section 1.199–2(e)(3) of the regulations provides the Internal Revenue Service with authority to issue guidance providing the methods that may be used to calculate W–2 wages. Section 1.199–2(e)(3) is effective for taxable years beginning on or after June 1, 2006. In Rev. Proc. 2006–22, 2006–23 I.R.B. 1033, the Internal Revenue Service provided methods for calculating W–2 wages for taxpayers who choose to apply the final regulations to taxable years beginning before June 1, 2006, but only for taxable years beginning on or after January 1, 2005, and on or before May 17, 2006. For taxable years covered by this revenue procedure, this revenue procedure provides methods to determine paragraph (e)(1) wages, but taxpayers must then subject such wages to the limitation contained in § 1.199–2T(e)(2) of the temporary regulations to determine W–2 wages.

SECTION 2. BACKGROUND

Section 199(a) provides a deduction for an amount equal to a percentage of the lesser of (A) the qualified production activities income of the taxpayer for the taxable year, or (B) taxable income (determined without regard to § 199) for the taxable year (or, in the case of an individual, adjusted gross income).

Section 199(b)(1) provides that the amount of the deduction allowable under § 199(a) for any taxable year shall not exceed 50 percent of the W–2 wages of the taxpayer for the taxable year. For this purpose, § 199(b)(2)(A) defines the term "W–2 wages" to mean, with respect to any person for any taxable year of such person, the sum of the amounts described in § 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. Section 199(b)(2)(C) provides that W–2 wages shall not include any amount that is not properly included in a return filed with the Social Security Administration (SSA) on or before the 60th day after the due date (including extensions) for such return.

Section 514(a) of TIPRA added § 199(b)(2)(B) to exclude from the term W–2 wages any amount that is not properly allocable to domestic production gross receipts for purposes of § 199(c)(1). Section 199(b)(2)(B) is effective with respect to taxable years beginning after the date of enactment, May 17, 2006. Temporary and final regulations have been issued to reflect the changes in the definition of W–2 wages made by TIPRA. Section 1.199–2T(e)(2) of the temporary regulations provides rules for applying the TIPRA limitation on W–2 wages under § 199(b)(2)(B).

This revenue procedure provides three methods for calculating paragraph (e)(1) wages. These methods for calculating paragraph (e)(1) wages are generally similar to the methods used to calculate W–2 wages before the amendment made by TIPRA as set forth in Rev. Proc. 2006–22, § 1.199–2 of the proposed regulations that were published in the **Federal Register** on November 4, 2005 (REG–105847–05, 2005–47 I.R.B. 987 [70 FR 67220]), and section 4.02 of Notice 2005–14, 2005–1 C.B. 498, 514. The first method (the unmodified Box method) allows for a sim-

plified calculation while the second and third methods (the modified Box 1 method and the tracking wages method) provide greater accuracy. After paragraph (e)(1) wages are determined under one of these methods, the amount of W–2 wages is then determined by applying § 1.199–2T(e)(2) of the temporary regulations.

SECTION 3. RULES OF APPLICATION

.01 *In general*. Except as provided in section 3.03 and section 6.01 of this revenue procedure, the Forms W–2, "*Wage and Tax Statement*," used in determining the amount of paragraph (e)(1) wages are those issued for the calendar year ending during the taxpayer's taxable year for wages paid to employees (or former employees) of the taxpayer for employment by the taxpayer. For this purpose, employees of the taxpayer are limited to employees of the taxpayer as defined in § 3121(d)(1) and (2) (that is, officers of a corporate taxpayer and employees of the taxpayer under common law rules). See § 1.199–2(a)(1) of the regulations.

.02 *Wages paid by entity other than common law employer*. In determining paragraph (e)(1) wages, a taxpayer may take into account wages paid by another entity and reported by the other entity on Forms W–2 with the other entity as the employer listed in Box c of the Forms W–2, provided that the wages were paid to employees of the taxpayer for employment by the taxpayer. If the taxpayer is treated as an employer described in § 3401(d)(1) because of control of the payment of wages (that is, the taxpayer is not the common law employer of the payee of the wages), the payment of wages may not be included in determining paragraph (e)(1) wages of the taxpayer. If the taxpayer is paying wages as an agent of another entity to individuals who are not employees of the taxpayer, the wages may not be included in determining the paragraph (e)(1) wages of the taxpayer. See § 1.199–2(a)(2) of the regulations.

.03 *Requirement that wages must be reported on return filed with Social Security Administration*. Paragraph (e)(1) wages shall not include any amount that is not properly included in a return filed with SSA on or before the 60th day after the due date (including extensions) for such return. For this purpose, if a Form W–2c (or corrected return) is filed to correct a Form W–2 that was not filed with SSA on or before the 60th day after the due date (including extensions) of the Form W–2 (or to correct a Form W–2c relating to a Form W–2 that had not been filed with SSA on or before the 60th day after the due date (including extensions) of the Form W–2), then such Form W–2c (or corrected return) shall not be considered to have been filed with SSA on or before the 60th day after the due date (including extensions) for such Form W–2c (or corrected return), regardless of when such Form W–2c (or corrected return) is filed. See § 1.199–2(a)(3) of the regulations for further guidance related to this requirement.

.04 *No application in determining whether amounts are wages for employment tax purposes*. The discussions of "wages" in this revenue procedure and in the regulations under § 199 are for purposes of § 199 only and have no application in determining whether amounts are wages under § 3121(a) for purposes of the Federal Insurance Contributions Act, under § 3306(b) for purposes of the Federal Unemployment Tax Act, or under § 3401(a) for purposes of the Collection of Income Tax at Source on Wages (federal income tax withholding), or any other wage-related determination. See § 1.199–2(a)(1) of the regulations.

.05 *Application for a taxpayer with a short taxable year*. Subject to the other rules of application of the regulations and of this revenue procedure, paragraph (e)(1) wages of the taxpayer for a short taxable year shall include those wages paid during the short taxable year to employees of the taxpayer as determined under the tracking wages method described in section 5.03 of this revenue procedure. See section 6 of this revenue procedure.

.06 *Acquisition or disposition of a trade or business (or major portion)*. If a taxpayer (a successor) acquires a trade or business, the major portion of a trade or business, or the major portion of a separate unit of a trade or business from another taxpayer (a predecessor), then, for purposes of computing the respective section 199 deduction of the successor and of the predecessor, paragraph (e)(1) wages paid for that calendar year shall be allocated between the successor and the predecessor based on whether the wages are for employment by the successor or for employment by the predecessor. Thus, in this situation, paragraph (e)(1) wages are allocated based on whether the wages are for employment for a period during which the employee was employed by the predecessor or for employment for a period during which the employee was employed by the successor, regardless of which permissible method for Form W–2 reporting is used. See § 1.199–2(c) of the regulations.

.07 *Non-duplication rules*. Amounts that are treated as paragraph (e)(1) wages for a taxable year under any method of calculating paragraph (e)(1) wages shall not be treated as paragraph (e)(1) wages for any other taxable year. Thus, for example, an amount of nonqualified deferred compensation that is treated as paragraph (e)(1) wages under the Unmodified Box Method described in section 5.01 of this revenue procedure shall not be treated as paragraph (e)(1) wages in any other taxable year. Also, an amount shall not be treated as paragraph (e)(1) wages by more than one taxpayer. See section 1.199–2(d) of the regulations.

.08 *Trade or business requirement*. Pursuant to § 1.199–8(c)(1), the term paragraph (e)(1) wages only includes those wages paid to employees of the taxpayer that are attributable to the actual conduct of a trade or business of the taxpayer. For example, remuneration paid to an employee for domestic service performed in the private home of the taxpayer is not included in paragraph (e)(1) wages of the taxpayer.

SECTION 4. DEFINITION OF PARAGRAPH (e)(1) WAGES AND CORRELATION WITH BOXES ON FORM W–2

.01 *Definition of paragraph (e)(1) wages*. Paragraph (e)(1) wages means, with respect to any person for any taxable year of such person, the sum of the amounts described in § 6051(a)(3) and (8) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year. See § 1.199–1(e)(1) of the regulations. Thus, paragraph (e)(1) wages include: (i) the total amount of wages as defined in § 3401(a); (ii) the total amount of elective deferrals (within the meaning of § 402(g)(3)); (iii) the compensation deferred under § 457; and (iv) for tax years beginning after December

31, 2005, the amount of designated Roth contributions (as defined in § 402A).

.02 *Correlation with Form W–2*. Under the 2006 Forms W–2, the elective deferrals under § 402(g)(3) and the amounts deferred under § 457 directly correlate to coded items reported in Box 12 on Form W–2. Box 12, Code D is for elective deferrals to a § 401(k) cash or deferred arrangement (plan); Box 12, Code E is for elective deferrals under a § 403(b) salary reduction agreement; Box 12, Code F is for elective deferrals under a § 408(k)(6) salary reduction Simplified Employee Pension (SEP); Box 12, Code G is for elective deferrals and employer contributions (including nonelective deferrals) to any governmental or nongovernmental § 457(b) deferred compensation plan; Box 12, Code S is for employee salary reduction contributions under a § 408(p) SIMPLE (simple retirement account); Box 12, Code AA is for designated Roth contributions (as defined in section 402A) to a section 401(k) plan; and Box 12, Code BB is for designated Roth contributions (as defined in section 402A) under a section 403(b) salary reduction agreement. However, designated Roth contributions are also reported in Box 1, Wages, tips, other compensation, and Box 5, Medicare wages and tips, and are subject to income tax withholding.

SECTION 5. METHODS FOR CALCULATING PARAGRAPH (e)(1) WAGES

For any taxable year, a taxpayer must calculate paragraph (e)(1) wages for purposes of § 199(b)(1) using one of the three methods described in section 5.01, 5.02, and 5.03 of this revenue procedure. These three methods are subject to the non-duplication rules provided in § 1.199–2(d) and in section 3.07 of this revenue procedure. For a taxpayer with a short taxable year, see Section 6 of this revenue procedure. In calculating paragraph (e)(1) wages for a taxable year under the methods below, the taxpayer includes only those Forms W–2 that are for the calendar year ending with or within the taxable year of the taxpayer and that meet the rules of application described in section 3 of this revenue procedure.

.01 *Unmodified box method*. Under the unmodified box method, paragraph (e)(1) wages are calculated by taking, without modification, the lesser of—

(A) The total entries in Box 1 of all Forms W–2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer; or

(B) The total entries in Box 5 of all Forms W–2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer.

.02 *Modified Box 1 method*. Under the Modified Box 1 method, the taxpayer makes modifications to the total entries in Box 1 of Forms W–2 filed with respect to employees of the taxpayer. Paragraph (e)(1) wages under this method are calculated as follows—

(A) Total the amounts in Box 1 of all Forms W–2 filed with SSA by the taxpayer with respect to employees of the taxpayer for employment by the taxpayer;

(B) Subtract from the total in paragraph .02(A) of this section amounts included in Box 1 of Forms W–2 that are not wages for Federal income tax withholding purposes and amounts included in Box 1 of Forms W–2 that are treated as wages for purposes of income tax withholding under § 3402(o) (for example, supplemental unemployment compensation benefits); and

(C) Add to the amount obtained after paragraph .02(B) of this section the total of the amounts that are reported in Box 12 of Forms W–2 with respect to employees of the taxpayer for employment by the taxpayer and that are properly coded D, E, F, G, and S.

.03 *Tracking wages method*. Under the tracking wages method, the taxpayer actually tracks total wages subject to Federal income tax withholding and makes appropriate modifications. Paragraph (e)(1) wages under this method are calculated as follows—

(A) Total the amounts of wages subject to Federal income tax withholding that are paid to employees of the taxpayer for employment by the taxpayer and that are reported on Forms W–2 filed with SSA by the taxpayer for the calendar year;

(B) Subtract from the total in paragraph .03(A) of this section the supplemental unemployment compensation benefits (as defined in § 3402(o)(2)(A)) that were included in the total in paragraph .03(A) of this section; and

(C) Add to the amount obtained after paragraph .03(B) of this section the total of the amounts that are reported in Box 12 of Forms W–2 with respect to employees of the taxpayer for employment by the taxpayer and that are properly coded D, E, F, G, and S.

SECTION 6. APPLICATION IN CASE OF SHORT TAXABLE YEAR

.01 *Special rule for taxpayers with a short taxable year*. In the case of a taxpayer with a short taxable year, subject to the rules of § 1.199–2(a), the paragraph (e)(1) wages of the taxpayer for the short taxable year shall include only those wages paid during the short taxable year to employees of the taxpayer, only those elective deferrals (within the meaning of § 402(g)(3)) made during the short taxable year by employees of the taxpayer, and only compensation actually deferred under § 457 during the short taxable year with respect to employees of the taxpayer. See § 1.199–2(b) of the regulations.

.02 *Method required for a short taxable year and modifications required in application of method*. The paragraph (e)(1) wages of a taxpayer with a short taxable year shall be determined under the tracking wages method described in section 5.03 of this revenue procedure. In applying the tracking wages method in the case of a short taxable year, the taxpayer must apply the method as follows—

(A) For purposes of section 5.03(A), the total amount of wages subject to Federal income tax withholding and reported on Form W–2 must include only those wages subject to Federal income tax withholding that are actually paid to employees during the short taxable year and reported on Form W–2 for the calendar year ending with or within that short taxable year;

(B) For purposes of section 5.03(B), only the supplemental unemployment compensation benefits paid during the short taxable year that were included in the total in section 5.03(A) as modified by section 6.02(A) are required to be deducted; and

(C) For purposes of section 5.03(C), only the portion of the total amounts

reported in Box 12, Codes D, E, F, G, and S on Forms W–2, that are actually deferred or contributed during the short taxable year are included in paragraph (e)(1) wages.

SECTION 7. EFFECTIVE DATE

This revenue procedure applies to taxpayers with taxable years beginning on or after October 19, 2006. A taxpayer may apply this revenue procedure to taxable years beginning after May 17, 2006, and before October 19, 2006. For taxable years beginning after May 17, 2006, a taxpayer may not apply any guidance under section 199 in a manner inconsistent with amendments made to section 199 by section 514 of TIPRA.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Alfred G. Kelley of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue procedure, contact Mr. Kelley at (202) 622–6040 (not a toll-free call).

Part IV. Items of General Interest

Determination of Interest Expense Deduction of Foreign Corporations; Correction

Announcement 2006–84

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains a correction to final and temporary regulations (T.D. 9281, 2006–39 I.R.B. 517), that were published in the **Federal Register** on Thursday, August 17, 2006 (71 FR 47443). This regulation revised the Income Tax Regulations relating to the determination of the interest expense deduction of foreign corporations and applies to foreign corporations engaged in a trade or business within the United States.

DATES: This correction is effective August 17, 2006.

FOR FURTHER INFORMATION CONTACT: Gregory Spring or Paul Epstein, (202) 622–3870 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final and temporary regulations (T.D. 9281) that is the subject of this correction are under sections 882 and 884 of the Internal Revenue Code.

Need for Correction

As published, T.D. 9281 contains errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 1 is corrected by making the following correcting amendment:

PART 1—INCOME TAXES

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

Authority: 26 USC 7805 * * *

Par. 2. Section 1.882–5 paragraph (a)(7) is revised to read as follows:

§ 1.882–5 Determination of interest deduction.

* * * * *

(a)(7) through (a)(7)(iii) [Reserved]. For further guidance, see entry in § 1.882–5T(a)(7) through (a)(7)(iii).

* * * * *

Par. 3. Section 1.882–5T is amended by revising the last sentence of paragraph (c)(2)(iv) to read as follows:

§ 1.882–5T Determination of interest deduction (temporary).

* * * * *

(c) * * *

(2) * * *

(iv)* * * The rules of § 1.882–5(b)(3) apply in determining the total value of applicable worldwide assets for the taxable year, except that the minimum number of determination dates are those stated in § 1.882–5(c)(2)(i).

* * * * *

Cynthia E. Grigsby,
Senior Federal Register Liaison Officer,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on September 27, 2006, 8:45 a.m., and published in the issue of the Federal Register for September 28, 2006, 71 F.R. 56868)

Flat Rate Supplemental Wage Withholding; Correction

Announcement 2006–85

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains a correction to final regulations (T.D. 9276, 2006–37 I.R.B. 432), that were published in the **Federal Register** on Tuesday, July 25, 2006 (71 FR 142). These regulations apply to all employers and others making supplemental wage payments to employees.

DATES: This correction is effective January 1, 2007.

FOR FURTHER INFORMATION CONTACT: A. G. Kelley, (202) 622–6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations (T.D. 9276) that is the subject of this correction are under sections 3401 and 3402 of the Internal Revenue Code.

Need for Correction

As published, T.D. 9276 contains language that is repetitious.

* * * * *

Correction of Publication

Accordingly, 26 CFR part 31 is corrected by making the following correcting amendment:

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

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

Authority: 26 USC 7805 * * *

§ 31.3402(g)–1 [Corrected]

Par. 2. Section 31.3402(g)–1 is amended by removing the last sentence from paragraph (a)(8), *Example 4* (i).

Cynthia E. Grigsby,
Senior Federal Register Liaison Officer,
Publications and Regulations Branch,
Legal Processing Division,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on October 2, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 3, 2006, 71 F.R. 58276)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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