Internal Revenue
bulletin

Bulletin No. 2006-46
November 13, 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. 2006–58, page 876.

Charitable remainder trust; real estate investment trust (REIT). This ruling illustrates the application of section 860E of the Code where a charitable remainder trust is a shareholder of a real estate investment trust (REIT) or a partner of a partnership, and the REIT or the partnership has excess inclusion income.

T.D. 9287, page 896.

Final regulations under section 7702 of the Code explain how to determine the attained age of an insured for purposes of testing whether a contract qualifies as a life insurance contract for federal income tax purposes.

T.D. 9290, page 879.

Final regulations under section 6320 of the Code relate to a taxpayer's right to a hearing after the filing of a notice of federal tax lien (NFTL). The regulations make certain clarifying changes in the way collection due process hearings are conducted and specify the period during which a taxpayer may request an equivalent hearing.

T.D. 9291, page 887.

Final regulations under section 6330 of the Code relate to a taxpayer's right to a hearing before or after levy. The regulations make certain clarifying changes in the way collection due process hearings are conducted and specify the period during which a taxpayer may request an equivalent hearing.

Notice 2006–96, page 902.

This notice provides transitional guidance on the new definitions of "qualified appraisal" and "qualified appraiser" in section 170(f)(11) of the Code for purposes of substantiating deductions for charitable contributions of property. The notice also provides guidance on complying with new section 6695A, regarding penalties for appraisals that result in substantial or gross valuation misstatements under section 6662.

Notice 2006–97, page 904.

This notice provides interim guidance (and requests comments and suggestions for further guidance) under sections 860E(d) and 7701(i)(3) of the Code, relating to the taxation and reporting of excess inclusion income of pass-through entities, including real estate investment trusts (REITs) that own taxable mortgage pools or residual interests in real estate mortgage investment conduits (REMICs).

Notice 2006–99, page 907.

This notice provides guidance on withholding and information reporting on foreign persons and includes guidance on certain book-entry systems in foreign countries. It also announces that the IRS and Treasury intend to issue regulations providing that regulations section 1.871–14(e), dealing with foreign targeted registered obligations, will not apply to obligations issued after December 31, 2006, except in limited circumstances. Finally, this notice announces that the IRS and Treasury intend to issue regulations retroactively removing the rule in regulations section 1.1441–1(b)(7)(iii) that purports to impose interest under section 6601 when no underlying tax liability has in fact been imposed.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Announcement 2006–88, page 910.
This announcement is a ministerial update to Notice 2006–27, 2006–11 I.R.B. 626, and Notice 2006–28, 2006–11 I.R.B. 628, and announces that taxpayers may use either RESNET Publication No. 05–001 or RESNET Publication No. 06–001 to determine whether a dwelling unit qualifies for the new energy efficient home credit. This announcement also provides for developers of software to submit applications to be included on a public list of software programs that may be used in calculating energy consumption for purposes of obtaining a section 45L certification by using standards prescribed in either RESNET publication. This change is effective for new energy efficient homes acquired after December 31, 2005. Notices 2006–27 and 2006–28 modified.

EMPLOYEE PLANS

Notice 2006–98, page 906.
2007 cost-of-living adjustments; retirement plans, etc. This notice sets forth certain cost-of-living adjustments effective January 1, 2007, applicable to the dollar limits on benefits under qualified defined benefit pension plans and to other provisions affecting (1) certain plans of deferred compensation and (2) "control employees." This notice restates the data in News Release IR–2006–162 issued October 18, 2006.

EXEMPT ORGANIZATIONS

Rev. Rul. 2006–58, page 876.
Charitable remainder trust; real estate investment trust (REIT). This ruling illustrates the application of section 860E of the Code where a charitable remainder trust is a shareholder of a real estate investment trust (REIT) or a partner of a partnership, and the REIT or the partnership has excess inclusion income.

Notice 2006–97, page 904.
This notice provides interim guidance (and requests comments and suggestions for further guidance) under sections 860E(d) and 7701(i)(3) of the Code, relating to the taxation and reporting of excess inclusion income of pass-through entities, including real estate investment trusts (REITs) that own taxable mortgage pools or residual interests in real estate mortgage investment conduits (REMICs).

EMPLOYMENT TAX

Rev. Rul. 2006–56, page 874.
Excess *per diem* allowances. This ruling provides that where an expense allowance arrangement has no mechanism or process to track allowances paid and routinely pays *per diem* allowances in excess of the federal *per diem* rates without requiring actual substantiation of all the expenses or repayment of the excess amount, all payments made under the arrangement will be treated as made under a nonaccountable plan.

Notice 2006–102, page 909.
2007 social security contribution and benefit base; domestic employee coverage threshold. The Commissioner of the Social Security Administration has announced (1) the OASDI contribution and benefit base for remuneration paid in 2007 and self-employment income earned in taxable years beginning in 2007, and (2) the domestic employee coverage threshold amount for 2007.

ADMINISTRATIVE

T.D. 9290, page 879.
Final regulations under section 6320 of the Code relate to a taxpayer's right to a hearing after the filing of a notice of federal tax lien (NFTL). The regulations make certain clarifying changes in the way collection due process hearings are conducted and specify the period during which a taxpayer may request an equivalent hearing.

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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 62(c).—Certain Arrangements Not Treated as Reimbursement Arrangements

26 CFR 1.62–2(k): Reimbursements and other expense allowance arrangements: Anti-abuse provision.

Excess *per diem* allowances. This ruling provides that where an expense allowance arrangement has no mechanism or process to track allowances paid and routinely pays *per diem* allowances in excess of the federal *per diem* rates without requiring actual substantiation of all the expenses or repayment of the excess amount, all payments made under the arrangement will be treated as made under a nonaccountable plan.

Rev. Rul. 2006–56

ISSUE

Whether, under an expense allowance arrangement which has no mechanism or process to determine when an allowance exceeds the amount that may be deemed substantiated and which routinely pays allowances in excess of the amount that may be deemed substantiated without requiring actual substantiation of all expenses or repayment of the excess amount, the failure to treat the excess allowances as wages for employment tax purposes causes all payments made under the expense allowance arrangement to be treated as made under a nonaccountable plan.

FACTS

Taxpayer is an employer of long-haul truck drivers in the transportation industry. Taxpayer uses a monthly payroll period and compensates its drivers for their services on a mileage basis. For 2006, Taxpayer pays its drivers compensation of X cents-per-mile driven during each month. Taxpayer reports the compensation on the drivers' Forms W–2 and treats the compensation as wages for Federal Insurance Contributions Act (FICA) tax, Federal Unemployment Tax Act (FUTA) tax, and Federal income tax withholding purposes (collectively, "employment taxes").

Taxpayer also reimburses its drivers for meal and incidental expenses (M&IE) paid or incurred while traveling away from home during the monthly payroll period. Taxpayer reimburses its drivers for these expenses through an allowance for each day the driver is away from home for Taxpayer's business. For 2006, the allowance is Y cents-per-mile driven. Taxpayer's industry commonly used this cents-per-mile driven method before December 12, 1989.

Taxpayer establishes the Y cents-per-mile rate based on its expectation of the amount of daily M&IE that will be paid or incurred, and its expectation of the average number of daily miles driven during the payroll period. Taxpayer bases its expectations on reliable industry data and on Taxpayer's own data from recent years. Based on Taxpayer's specific methodology and data, Taxpayer's projected allowance is reasonably calculated not to exceed the drivers' anticipated daily M&IE.

Taxpayer requires its drivers to provide logs to substantiate the time, place, and business purpose of the travel away from home for each day (or partial day). Taxpayer does not require its drivers to substantiate the amount of actual M&IE. Instead, for its drivers' substantiation of the amount of M&IE paid or incurred by the drivers, Taxpayer relies on administrative guidance published annually by the Internal Revenue Service under which the amount of ordinary and necessary business expenses of an employee for M&IE paid or incurred while traveling away from home is deemed substantiated when the employer provides a *per diem* allowance to cover the expenses. The guidance applicable for *per diem* allowances paid to an employee on or after October 1, 2005, with respect to travel away from home on or after October 1, 2005, is Rev. Proc. 2005–67, 2005–2 C.B. 729. For 2006 Taxpayer elects to treat $52 per day as the federal M&IE rate for all localities of travel pursuant to section 4.04 of Rev. Proc. 2005–67. Thus, for 2006, $52 or less per day of M&IE paid or incurred by a driver while traveling away from home may be deemed substantiated. The allowances paid by Taxpayer to many of its drivers for M&IE incurred on travel away from home during the monthly payroll period routinely exceed $52 per day, even when computed on a monthly basis pursuant to the periodic rule provided in section 4.04 of Rev. Proc. 2005–67.

Taxpayer requires its drivers to return any amounts paid to them for M&IE with respect to days they were not away from home on business travel. Taxpayer does not require drivers to return the portion of the allowance paid for days they were away from home on business travel that exceeds the $52 per day that may be deemed substantiated.

Neither the policies nor actual practices of Taxpayer's expense allowance arrangement include any process for tracking the amount of the cents-per-mile M&IE allowance paid to each driver on a *per diem* basis, nor is there any mechanism in place to determine when the allowances exceed the amount of expenses that may be deemed substantiated under Rev. Proc. 2005–67. Taxpayer does not treat the excess allowances over $52 per day as wages for withholding or employment tax purposes and does not report the excess allowances as wages on the drivers' Forms W–2.

LAW AND ANALYSIS

Section 62(a)(2)(A) of the Internal Revenue Code provides that, for purposes of determining adjusted gross income, an employee may deduct certain business expenses paid by the employee in connection with the performance of services as an employee of the employer under a reimbursement or other expense allowance arrangement.

Section 62(c) provides that, for purposes of § 62(a)(2)(A), an arrangement will not be treated as a reimbursement or other expense allowance arrangement if (1) the arrangement does not require the employee to substantiate the expenses covered by the arrangement to the person providing the reimbursement, or (2) the arrangement provides the employee the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 1.62–2(c)(1) of the Income Tax Regulations provides that a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of substantiated expenses. If an arrangement meets these requirements, all amounts paid under the arrangement are treated as paid under an accountable plan. *See* § 1.62–2(c)(2). Amounts treated as paid under an accountable plan are excluded from the employee's gross income, are not reported as wages or other compensation on the employee's Form W–2, and are exempt from the withholding and payment of employment taxes. *See* § 1.62–(2)(c)(4). Conversely, if the arrangement fails any one of these requirements, amounts paid under the arrangement are treated as paid under a nonaccountable plan and are included in the employee's gross income, must be reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(3) and (5).

With regard to the business connection requirement, under § 1.62–2(d)(3)(ii) an arrangement providing a *per diem* allowance that is computed on a basis similar to that used in computing the employee's wages or other compensation (such as the number of hours worked, miles traveled, or pieces produced) meets the business connection requirement only if, on December 12, 1989, the *per diem* allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the *per diem* allowance, or a *per diem* allowance computed on that basis was commonly used in the industry in which the employee is employed.

With regard to the substantiation requirement, pursuant to Rev. Proc. 2005–67, the amount of M&IE that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for that day or the amount computed at the federal M&IE rate. *See* section 3.01(3) of Rev. Proc. 2005–67. Under these rules, employees must continue to actually substantiate the elements of time, place, and business purpose relating to the travel expenses. *See* section 7.01 of Rev. Proc. 2005–67. Section 4.04 of Rev. Proc. 2005–67 provides special rules for the transportation industry under which $52 per day may be treated as the federal M&IE rate and the amount deemed substantiated may be computed on a periodic basis (but not less frequently than monthly) rather than daily.

For purposes of the return of excess requirement, § 1.62–2(f)(2) permits the Commissioner to prescribe rules under which an arrangement that provides a *per diem* allowance is treated as satisfying the requirement of returning amounts in excess of expenses so long as the allowance is reasonably calculated not to exceed the amount of the employee's expenses and the employee is required to return any portion that relates to days of travel not substantiated. However, the portion of the allowance that exceeds the amount deemed substantiated will be treated as paid under a nonaccountable plan, must be reported as wages or other compensation, and is subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(5).

Section 1.62–2(h)(2)(i)(B)(*1*) provides that if a payor pays a *per diem* allowance that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to days of travel substantiated in accordance with § 1.62–2(e) and that exceeds the amount of the employee's expenses deemed substantiated for the travel pursuant to rules prescribed under § 274(d) and the relevant regulations is treated as paid under a nonaccountable plan. Such amount is wages subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(5). *See also* §§ 31.3121(a)–3(b)(1)(ii), 31.3306(b)–2(b)(1)(ii), and 31.3401(a)–4(b)(1)(ii) of the Employment Tax Regulations.

Section 1.62–2(k) provides that if a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments made under the arrangement are treated as made under a nonaccountable plan. Thus, these payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes. *See* § 1.62–2(c)(5), and (h)(2).

If an arrangement satisfies all three requirements of an accountable plan, but an allowance is paid under the arrangement that exceeds the amount that may be deemed substantiated, no actual substantiation is provided for the M&IE covered by the allowance, and the excess allowance is not returned, the excess allowance is treated as wages. *See* § 1.62–2(h)(2)(B)(*1*). However, if the facts and circumstances evidence a pattern of abuse of the rules of § 62(c) and the regulations thereunder, including the rule to treat excess allowances as wages, all payments made under the arrangement are treated as wages. *See* § 1.62–2(k).

Under the facts set forth above, the arrangement to reimburse Taxpayer's drivers for M&IE paid or incurred while traveling away from home meets the business connection requirement. Taxpayer is permitted to compute a *per diem* allowance based upon the number of miles driven during the payroll period as that method was commonly used in Taxpayer's industry before December 12, 1989.

For purposes of satisfying the substantiation requirements of § 1.62–2(e) for 2006, Taxpayer relies on the deemed substantiation rules provided in Rev. Proc. 2005–67, including the special rules for the transportation industry found in section 4.04 of Rev. Proc. 2005–67.

With respect to the return of excess requirement, the regulations and Rev. Proc. 2005–67 permit Taxpayer to pay *per diem* allowances for M&IE paid or incurred while traveling away from home that exceed the deemed substantiated amount without requiring return of the excess. *See* § 1.62–2(f)(2) and section 7.02 of Rev. Proc. 2005–67. Under these rules, however, Taxpayer must take steps to ensure that the excess allowances are tracked and treated as wages subject to withholding and payment of employment taxes and reporting on Forms W–2.

In implementing its expense allowance arrangement for 2006, Taxpayer has not included any mechanism or process that tracks allowances and permits it to determine when the allowances paid to its drivers, computed on a *per diem* basis, exceed the $52 per day that may be deemed substantiated. Taxpayer does not receive actual substantiation for the M&IE covered by the allowances. Taxpayer neither requires repayment of the excess allowances nor treats the excess allowances as wages for purposes of withholding and

payment of employment taxes and reporting on Forms W–2.

As operated in 2006, Taxpayer's expense allowance arrangement routinely results in payment of excess allowances that are not repaid or treated as wages. Taxpayer's failure to track the excess allowances and its routine payment of excess allowances that are not repaid or treated as wages evidence a pattern of abuse under § 1.62–2(k). Although the excess allowances that have not been repaid or treated as wages may be small in comparison to the total allowance paid to an individual driver, to the amount that may be deemed substantiated for any given period of travel away from home, and to the aggregate allowances paid to all of Taxpayer's drivers, Taxpayer's arrangement is neither structured nor operated to meet the requirements of the accountable plan regulations for *per diem* allowance arrangements. As a result, Taxpayer has more than a failure to account for a particular driver's excess allowance or excess allowances paid to drivers for a particular period of travel. Taxpayer's arrangement evidences a pattern of abuse of the accountable plan rules.

Accordingly, even if Taxpayer's expense allowance arrangement otherwise meets the business connection, substantiation, and return of excess requirements of an accountable plan for the allowances paid to Taxpayer's drivers up to the amount that may be deemed substantiated, all payments made under Taxpayer's expense allowance arrangement are treated as paid under a nonaccountable plan. Taxpayer must include all amounts paid under the arrangement to reimburse drivers' M&IE, not just the excess allowances, in the drivers' wages on Forms W–2 and must treat all these amounts as wages for the withholding and payment of employment taxes.

HOLDING

Where an expense allowance arrangement has no mechanism or process to determine when an allowance exceeds the amount that may be deemed substantiated and the arrangement routinely pays allowances in excess of the amount that may be deemed substantiated without requiring actual substantiation of all the expenses or repayment of the excess amount, the failure of the arrangement to treat the excess allowances as wages for employment tax purposes causes all payments made under the arrangement to be treated as made under a nonaccountable plan.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ligeia M. Donis of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue ruling, contact Ligeia M. Donis at (202) 622–0047 (not a toll-free call).

Section 103.—Interest on State and Local Bonds

26 CFR 5f.103–1(c): Registered form.
26 CFR 5f.103–1(e): Special rules.

A notice interprets the rules regarding obligations held through book-entry systems. See Notice 2006-99, page 907.

Section 163.—Interest

26 CFR 1.163–5(c)(2)(i)(D):

A notice interprets the rules regarding certain obligations issued before January 1, 2007, in compliance with TEFRA D. See Notice 2006-99, page 907.

Section 664.—Charitable Remainder Trusts

Excess inclusion income allocated to a charitable remainder trust is not unrelated business taxable income to the charitable remainder trust and thus does not affect the charitable remainder trust's exemption from tax under section 664(c) for the taxable year. See Rev. Rul. 2006-58, page 876.

Section 860E.—Treatment of Income in Excess of Daily Accruals on Residual Interests

26 CFR 1.860E–2: Tax on transfers of residual interests to certain organizations.
(Also §§ 511, 664, 702; 1.664–1, 1.702–1, 1.860E–1.)

Charitable remainder trust; real estate investment trust (REIT). This ruling illustrates the application of section 860E of the Code where a charitable remainder trust is a shareholder of a real estate investment trust (REIT) or a partner of a partnership, and the REIT or the partnership has excess inclusion income.

Rev. Rul. 2006–58

ISSUES

If a charitable remainder annuity trust or a charitable remainder unitrust, as defined in section 664(d) of the Internal Revenue Code (collectively, charitable remainder trusts), is a partner in a partnership or a shareholder in a real estate investment trust (REIT), and if the partnership or the REIT has excess inclusion income from holding a residual interest in a real estate mortgage investment conduit (REMIC)—

(1) Does the charitable remainder trust have unrelated business taxable income (UBTI) as defined in section 512, causing the charitable remainder trust to lose its exemption from tax under section 664(c) for the taxable year?

(2) Is the charitable remainder trust a disqualified organization as defined in section 860E(e)(5)?

(3) Is the partnership (or REIT) subject to the pass-thru entity tax under section 860E(e)(6)?

FACTS

In the following situations, Trust *TR1* and Trust *TR2* meet all the requirements for exemption from tax under section 664(c) for the taxable year, except for the possible treatment of excess inclusion income as UBTI under section 860E(b).

Situation 1

Trust *TR1*, a charitable remainder trust, holds a ten percent partnership interest in Partnership *PRS*. Because *PRS* holds a residual interest in a REMIC, section 860C(a) requires *PRS* to take into account its daily portion of the REMIC's net income or net loss. For 2004, a portion of the REMIC net income taken into account by *PRS* was an excess inclusion, as defined in section 860E(c).

Situation 2

Trust *TR2*, a charitable remainder trust, holds a ten percent equity interest in Corporation *R*, which has elected, and is qualified, to be treated as a REIT under sub-

chapter M of the Code. Because *R* holds a residual interest in a REMIC, section 860C(a) requires *R* to take into account its daily portion of the REMIC's net income or net loss. For 2004, a portion of the REMIC net income taken into account by *R* was an excess inclusion, as defined in section 860E(c). *R*'s real estate investment trust taxable income (within the meaning of section 857(b)(2), excluding any net capital gain) was zero.

LAW

In general, section 702 requires each partner to take into account separately its distributive share of partnership items. Section 702(a)(7) requires a partner to take into account separately its distributive share of a partnership's "other items of income, gain, loss, deduction, or credit, to the extent provided in regulations prescribed by the Secretary." Section 1.702–1(a)(8)(ii) provides:

> Each partner must also take into account separately the partner's distributive share of any partnership item which, if separately taken into account by any partner, would result in an income tax liability for that partner, or for any other person, different from that which would result if that partner did not take the item into account separately.

Section 702(b) provides:

> The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (7) of [section 702(a)] shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

Section 860E(d) requires REITs, regulated investment companies, common trust funds, and subchapter T cooperatives, to allocate excess inclusion income to the shareholders, participants, and patrons. Section 860E(d) provides:

> If a residual interest in a REMIC is held by a [REIT], under regulations prescribed by the Secretary—
>
> (1) any excess of—
>
> (A) the aggregate excess inclusions determined with respect to such interests, over
>
> (B) the real estate investment trust taxable income (within the meaning of section 857(b)(2), excluding any net capital gain),
>
> shall be allocated among the shareholders of such trust in proportion to the dividends received by such shareholders from such trust, and
>
> (2) any such amount allocated to a shareholder under paragraph (1) shall be treated as an excess inclusion with respect to a residual interest held by such shareholder.
>
> Rules similar to the rules of the preceding sentence shall apply also in the case of regulated investment companies, common trust funds, and organizations to which part I of subchapter T [(sections 1381–1383)] applies.

Section 664(c) provides that a charitable remainder trust "shall, for any taxable year, not be subject to any tax imposed by [subtitle A], unless such trust, for such year, has [UBTI] (within the meaning of section 512, determined as if part III of subchapter F [(unrelated business income tax (UBIT) provisions under sections 511–515)] applied to such trust)."

Section 1.664–1(c) provides:

> If a charitable remainder trust has any [UBTI] (within the meaning of section 512 and the regulations thereunder, determined as if part III, subchapter F, chapter 1, subtitle A of the Code applied to such trust) for any taxable year, the trust is subject to all of the taxes imposed by subtitle A of the Code for such taxable year. . . . The taxes imposed by subtitle A of the Code upon a nonexempt charitable remainder trust shall be computed under the rules prescribed by subparts A and C, part 1, subchapter J, chapter 1, subtitle A of the Code [(sections 641–646 and 661–664)] for trusts which may accumulate income or which distribute corpus.

Section 860E(b) provides, "If the holder of any residual interest in a REMIC is an organization subject to the tax imposed by section 511, the excess inclusion of such holder for any taxable year shall be treated as [UBTI] of such holder for purposes of section 511."

Section 860E(e)(6)(A) imposes a tax on certain REITs, partnerships and other pass-thru entities (as defined under section 860E(e)(6)(B)). Section 860E(e)(6)(A) provides, "If, at any time during any taxable year of a pass-thru entity, a disqualified organization is the record holder of an interest in such entity, there is hereby imposed on such entity for such taxable year a tax equal to the product of—(i) the amount of excess inclusions for such taxable year allocable to the interest held by such disqualified organization, multiplied by (ii) the highest rate of tax specified in section 11(b)(1)." For purposes of section 860E(e)(6), section 860E(e)(6)(B) defines the term "pass-thru entity" to include any REIT and any partnership. Section 860E(e)(5)(B) defines the term "disqualified organization" to include "any organization (other than a cooperative described in section 521) which is exempt from tax imposed by [chapter 1] unless such organization is subject to the tax imposed by section 511."

Section 1.860E–2(b) of the Income Tax Regulations contains rules relating to the application of the pass-thru entity tax under section 860E(e)(6)(A). Among other things, § 1.860E–2(b)(4) provides, "Dividends paid by a RIC or by a REIT are not preferential dividends within the meaning of section 562(c) solely because the tax expense incurred by the RIC or REIT under section 860E(e)(6) is allocated solely to the shares held by disqualified organizations."

ANALYSIS

1. *Effect of allocation of excess inclusion income to a charitable remainder trust on its eligibility for exemption from tax under section 664(c) for the taxable year.*

As a partner of *PRS*, *TR1* has a distributive share of the excess inclusion income of *PRS*, as determined under section 702(a) and (b). If section 860E(b) characterizes the excess inclusion income allocated to *TR1* as UBTI, *TR1* will lose its

exemption under section 664(c) for 2004. Section 860E(b) treats excess inclusion income as UBTI to the holder of a REMIC residual interest but only if the holder "is an organization subject to the tax imposed by section 511" (that is, subject to the UBIT). In the case of a charitable remainder trust, section 664(c) employs the definitional rules of section 512 and the other UBIT provisions to determine whether any of the trust's income is UBTI, but it does not subject the trust to section 511. (See the discussion below under Issue 2.)

Whether section 860E(b) characterizes the excess inclusion income of charitable remainder trusts as UBTI should be determined in light of the intent underlying section 860E and other REMIC provisions. A number of the REMIC provisions are comprehensive and complementary by design. If a tax-exempt entity holds the REMIC residual interest, the REMIC provisions ensure the taxation of excess inclusion income in all events, whether or not the tax-exempt holder of the REMIC residual interest is a disqualified organization. A disqualified organization (as defined in section 860E(e)(5)(B)) is a tax-exempt entity that is not subject to UBIT. Thus, a disqualified organization cannot be subject to a tax on any excess inclusion income allocable to it. But other tax exempt entities are generally subject to UBIT and could be subject to a tax on excess inclusion income, subject to other requirements.

With respect to disqualified organizations, a REMIC is required to have in place "reasonable arrangements designed to ensure that . . . residual interests in [the REMIC] are not [transferred to] disqualified organizations . . . ." Section 860D(a)(6). If an entity nonetheless transfers a REMIC residual interest to a disqualified organization, section 860E(e)(1) imposes a tax on the transferor. Further, if a pass-thru entity has a record equity owner that is a disqualified organization, the pass-thru entity must pay a tax on the amount of excess inclusion income that is allocable to the disqualified organization. Section 860E(e)(6)(A). With respect to other tax-exempt entities (which are not disqualified organizations), section 860E(b) generally provides that, if a tax-exempt entity that is subject to the UBIT holds a REMIC residual interest, the excess inclusion income of that holder is UBTI.

Sections 860E(e)(6)(A) and 860E(b) are complementary provisions that should be interpreted consistently. If a pass-thru entity (whose equity owners may be disqualified organizations or other tax-exempt entities) holds REMIC residual interests, the two sections ensure that the excess inclusion income is taxable either to the pass-thru entity (under section 860E(e)(6)(A)) or to its tax-exempt equity owner that is subject to UBIT (under section 860E(b)). Characterizing as UBTI only the excess inclusion income that is allocable to tax exempt entities that are actually subject to the UBIT causes the two sections to operate consistently.

As discussed below, a charitable remainder trust can never be subject to the UBIT. Accordingly, *TR1*'s distributive share of *PRS*'s excess inclusion income is not UBTI under section 860E(b).

2. *Status of a charitable remainder trust as a disqualified organization.*

TR1 and *TR2* are charitable remainder trusts. Under section 664(c), a charitable remainder trust is exempt from tax under subtitle A of the Code, including chapter 1, unless it has UBTI for the taxable year (determined as if UBIT applied to the charitable remainder trust). But if a charitable remainder trust has UBTI, it loses its section 664(c) tax exemption for the taxable year, and the resulting tax liability is determined under the trust tax provisions of the Code. *See* § 1.664–1(c). Thus, if a charitable remainder trust has UBTI, that trust becomes an organization subject to the tax imposed by sections 1 and 641 but *not* to the UBIT. Because a charitable remainder trust can never be subject to the UBIT, it is a disqualified organization, as defined in section 860E(e)(5). As charitable remainder trusts, *TR1* and *TR2* are disqualified organizations.

3. *Application of the pass-thru entity tax under section 860E(e)(6)(A).*

PRS and *R* are pass-thru entities, as defined in section 860E(e)(6)(B). For purposes of section 860E(e)(6)(A), *PRS* is treated as having allocated excess inclusion income to *TR1*, a disqualified organization, equal to its distributive share of the excess inclusion income of *PRS* determined under section 702. Because *R*'s real estate investment trust income is zero, all of *R*'s excess inclusion income is allocable to its shareholders. *R*'s excess inclusion income is allocable to *TR2*, also a disqualified organization, in proportion to the dividends paid to *TR2* (determined without regard to any special allocation to *TR2* of the expense for the tax under section 860E(e)(6)). *See* § 1.860E–2(b)(4) (providing an exception to the preference dividend rule in section 562(c)).

PRS and *R* have record equity owners that are disqualified organizations, to which excess inclusion income is allocable. Thus, *PRS* and *R* are subject to a tax under section 860E(e)(6)(A) on the amount of the excess inclusion income allocable to *TR1* and *TR2*, respectively, at the highest rate specified in section 11(b)(1).

HOLDINGS

(1) Excess inclusion income allocated to a charitable remainder trust is not UBTI to the charitable remainder trust and thus does not affect the charitable remainder trust's exemption from tax under section 664(c) for the taxable year.

(2) A charitable remainder trust is a disqualified organization for purposes of section 860E.

(3) A pass-thru entity that has excess inclusion income allocable to a charitable remainder trust is subject to the pass-thru entity tax under section 860E(e)(6)(A).

DRAFTING INFORMATION

The principal author of this revenue ruling is Anna Kim of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Anna Kim at 202–622–3735.

Section 871.—Tax on Nonresident Alien Individuals

26 CFR 1.871–14: Rules relating to repeal of tax on interest of nonresident alien individuals and foreign corporations received from certain portfolio debt instruments.

A notice provides that for purposes of determining the application of the portfolio interest exception, the conditions for an obligation to be in registered form are identical to the conditions described in

Treas. Reg. § 5f.103–1. See Notice 2006-99, page 907.

Section 1441.—Withholding of Tax on Nonresident Aliens

26 CFR 1.1441–1(b)(7)(iii): Liability for interest and penalties.

A notice provides relief from interest and penalties imposed when no underlying tax is imposed. See Notice 2006-99, page 907.

Section 6320.—Notice and Opportunity for Hearing Upon Filing of Notice of Lien

26 CFR 301.6320–1: Notice and opportunity for hearing upon filing of notice of Federal tax lien.

T.D. 9290

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Miscellaneous Changes to Collection Due Process Procedures Relating to Notice and Opportunity for Hearing Upon Filing of Notice of Federal Tax Lien

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations amending the regulations relating to a taxpayer's right to a hearing under section 6320 of the Internal Revenue Code of 1986 after the filing of a notice of Federal tax lien (NFTL). The final regulations make certain clarifying changes in the way collection due process (CDP) hearings are held and specify the period during which a taxpayer may request an equivalent hearing. The final regulations affect taxpayers against whose property or rights to property the Internal Revenue Service (IRS) files a NFTL.

DATES: *Effective Date:* These regulations are effective on November 16, 2006.

Applicability Date: These regulations apply to requests for CDP or equivalent hearings on or after November 16, 2006.

FOR FURTHER INFORMATION CONTACT: Laurence K. Williams, 202–622–3600 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Regulations on Procedure and Administration (26 CFR part 301) relating to the provision of notice under section 6320 of the Internal Revenue Code to taxpayers of a right to a CDP hearing (CDP Notice) after the IRS files a NFTL. Final regulations (T.D. 8979, 2002–1 C.B. 466) were published on January 18, 2002, in the **Federal Register** (67 FR 2558) (the 2002 final regulations). The 2002 final regulations implemented certain changes made by section 3401 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206, 112 Stat. 685) (RRA 1998), including the addition of section 6320 to the Internal Revenue Code.

Section 3401 of RRA 1998 also added section 6330 to the Internal Revenue Code. That statute provides for notice to taxpayers of a right to a hearing before or, in limited cases, after levy. A number of the provisions in section 6330 concerning the conduct and judicial review of a CDP hearing are incorporated by reference in section 6320. On January 18, 2002, final regulations (T.D. 8980, 2002–1 C.B. 477) under section 6330 were published in the **Federal Register** (67 FR 2549) along with the 2002 final regulations under section 6320.

On September 16, 2005, the IRS and the Treasury Department published in the **Federal Register** (70 FR 54681) a notice of proposed rulemaking and notice of public hearing (REG–150088–02, 2005–43 I.R.B. 774). The IRS received one set of written comments responding to the notice of proposed rulemaking. Because no one requested to speak at the public hearing, the hearing was cancelled. After considering each of the comments, the proposed regulations are adopted as amended by this Treasury decision.

On August 17, 2006, the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780 (the PPA), was enacted. Section 855 of the PPA amended section 6330(d) of the Internal Revenue Code to withdraw judicial review of CDP notices of determination from United States district court jurisdiction, leaving review solely in the United States Tax Court. Section 6330(d) is made applicable to section 6320 hearings by section 6320(c). The amendment to section 6330(d), effective for notices of determination issued on or after October 17, 2006, requires the removal of references to district court review in the 2002 final regulations. This Treasury decision removes those references.

The IRS and the Treasury Department have determined that a notice of proposed rulemaking and solicitation of public comments are not required to amend the regulations to implement the modification to section 6330(d). These amendments are made solely to conform the regulations to a statutory change enacted by Congress. Because the amendments do not involve any exercise of discretion or interpretation, the notice and public comment procedures are unnecessary.

The comments and changes to the proposed regulations, and the amendments required by the Congressional modification to section 6330(d), are discussed below.

Summary of Comments and Explanation of Changes

The comments suggested that the IRS be required to contact taxpayers who timely file an incomplete request for CDP hearing to give them the opportunity to perfect the request within a reasonable time period and further recommended that such contact be in writing and identify the infirmity requiring perfection. The comments also recommended that the final regulations establish a specific time period during which taxpayers may, by right, amend or perfect their previously-filed yet incomplete CDP hearing request. The request, according to the comments, should be considered timely if it is perfected within the applicable time period.

Currently, the practice of the IRS is to contact taxpayers whose hearing requests fail to satisfy the requirements specified by the existing regulations and ask these taxpayers to perfect their requests within a specified period of time. The IRS consid-

ers requests perfected within the time specified to be timely. The intention of the IRS and the Treasury Department is to incorporate this administrative procedure into the proposed regulations. The final regulations more clearly state that the IRS will make a reasonable attempt to contact taxpayers to give them a reasonable period of time to perfect incomplete requests. However, the timeframe in which to respond to the request, and the method of delivery of the request (*i.e.*, orally or in writing) are more appropriately addressed in the Internal Revenue Manual. The final regulations make clear that requests perfected within the time period specified by the IRS will be considered timely.

The final regulations do not adopt the suggestion to establish a period of time during which a taxpayer is allowed to perfect an incomplete request, without regard to a perfection request from the IRS. The IRS and Treasury Department believe that the procedure incorporated into the final regulations is sufficient to permit taxpayers to ensure their requests are complete.

The comments recommended that the IRS Office of Appeals (Appeals) be given the discretion to permit a taxpayer to amend an imperfect hearing request after the period for perfecting the request has expired, if the taxpayer can demonstrate that such amendment furthers an alternative to collection. This change to the regulations is unnecessary because Appeals is already empowered to exercise this discretion. Neither the current regulations nor the proposed amendments limits Appeals from exercising this discretion. Accordingly, the final regulations do not adopt this recommendation. Further clarification, however, will be provided in the Internal Revenue Manual.

The comments suggested that where a taxpayer fails to perfect a CDP hearing request until after the time period specified by the IRS, the perfected request should be automatically treated as a request for an equivalent hearing. Treating untimely perfected requests as equivalent hearing requests may unduly prolong the process in cases in which a taxpayer does not want an equivalent hearing. Accordingly, the final regulations do not adopt this suggestion. The final regulations, however, provide that Appeals will determine the timeliness of CDP hearing requests. The final regulations also add to the proposed regulations that taxpayers making an untimely request will be provided the opportunity to have the request for CDP hearing treated as a request for equivalent hearing, without submitting an additional request.

The comments requested that the final regulations give taxpayers whose hearing requests might be construed as making a frivolous argument the right to amend their hearing requests to raise relevant, non-frivolous issues. The comments further recommended that all taxpayers be given the right to supplement the hearing request prior to the conference conducted by Appeals.

These comments indicate concern that taxpayers may be unable to articulate reasons for disagreeing with the collection action that are satisfactory to Appeals. The reasons for disagreeing with the collection action need not be detailed. To assist taxpayers in articulating reasons, the IRS is revising Form 12153, "*Request for a Collection Due Process Hearing,*" to add examples of the most common reasons taxpayers give for requesting a hearing, including requests for collection alternatives. In any event, the informal nature of the CDP hearing permits taxpayers and Appeals to discuss collection alternatives and issues not listed in the hearing request if such discussion will help resolve the case. Accordingly, the final regulations do not adopt these recommendations.

The comments urged that the final regulations guarantee a face-to-face conference for each taxpayer who presents a relevant, non-frivolous reason for disagreement with the collection action. If this recommendation is not adopted, the comments suggest that the regulations address and provide examples of when a face-to-face conference will not be granted. The final regulations do not adopt the recommendation to guarantee a face-to-face conference for each taxpayer raising a relevant, non-frivolous issue. The IRS and the Treasury Department agree with the comments that a face-to-face conference can be a useful forum for resolving a taxpayer's issues. The final regulations recognize the importance of a face-to-face meeting by providing that taxpayers will ordinarily be offered an opportunity for a face-to-face conference. There will be instances, however, when a face-to-face conference is not practical. The final regulations identify typical situations in which a face-to-face conference will be neither necessary nor productive. Except for these situations, the IRS and the Treasury Department anticipate that Appeals will afford a face-to-face meeting to taxpayers who request one. Nonetheless, unanticipated circumstances may arise in which granting a face-to-face conference will not be appropriate. The final regulations give Appeals the flexibility needed to respond to unanticipated circumstances.

Adoption of the comment requesting guidance on when a face-to-face conference will not be granted is unnecessary. The final regulations retain descriptions of situations in which a face-to-face conference will not be granted, as illustrated in the proposed regulations. Further guidance on granting face-to-face conferences will be provided in the Internal Revenue Manual.

The comments suggested that a taxpayer who appears to be presenting only frivolous reasons be given an opportunity to provide relevant, non-frivolous reasons in order to obtain a face-to-face conference. Adoption of this recommendation is unnecessary. Correspondence sent by Appeals to taxpayers who make only frivolous arguments invites them to submit relevant, non-frivolous reasons. Appeals offers face-to-face conferences to taxpayers who respond by providing such reasons.

The comments also suggested that the regulations define relevant and frivolous. The IRS and the Treasury Department believe that any attempt to define these terms is unnecessary and could result in underinclusive definitions. For example, the comments suggest that a frivolous issue be defined as an issue that is the same or substantially similar to an issue identified as frivolous by the IRS in published guidance. It is not possible to anticipate or keep pace with the evolution of frivolous arguments through published guidance. Instead, taxpayers are advised to consult the lists of examples of frivolous arguments in IRS Publication 2105, "*Why Do I Have to Pay Taxes*" and on the IRS website in a document entitled "The Truth about Frivolous Tax Arguments." The names and web addresses of these documents, and a toll-free number to order Publication 2105, will be added to the instructions to Form 12153 to help taxpayers avoid making these arguments.

The comments recommended clarification of the proposed rule that a face-to-face conference concerning a collection alternative will not be granted unless the alternative would be available to other taxpayers in similar circumstances. According to the comments, a taxpayer should not be denied a face-to-face conference because the requested collection alternative cannot be accepted, for example, because it appears from financial information that the taxpayer can pay the liabilities in full. This proposed rule was not intended to deny a face-to-face conference because the requested collection alternative would not be accepted. The intention of this rule is to permit the denial of a face-to-face conference to discuss a collection alternative for which the taxpayer is not eligible. A lack of eligibility under IRS policy is tied to a taxpayer's compliance with the Federal tax laws, not to the taxpayer's financial circumstances or ability to request the most appropriate alternative. For example, if the taxpayer has not filed all required tax returns, the taxpayer is not eligible for an offer to compromise or an installment agreement.

In response to the concerns expressed in the comments, the final regulations amplify the rule that a face-to-face conference to discuss a collection alternative will not be granted unless other taxpayers would be eligible for the alternative in similar circumstances. The final regulations provide in A–D8 that Appeals in its discretion may grant a face-to-face conference if Appeals determines that a face-to-face conference is appropriate to explain to the taxpayer the requirements for becoming eligible for a collection alternative. The final regulations also provide that taxpayers will be given an opportunity to demonstrate they are eligible for a collection alternative in order to obtain a face-to-face conference to discuss the alternative. Taxpayers will also be given an opportunity to become eligible for a collection alternative in order to obtain a face-to-face conference. For example, under the final regulations, if a taxpayer appears to have failed to file all required returns (and thus appears not to be eligible for an offer to compromise or an installment agreement), the taxpayer will be given an opportunity to demonstrate the inapplicability of the filing requirements or to file delinquent returns, in order to obtain a face-to-face conference. The final regulations further provide that a taxpayer's eligibility for a collection alternative does not include the taxpayer's ability to pay the unpaid tax.

The comments expressed concern that the amendment providing a face-to-face conference at an Appeals office other than an office in which all officers or employees had prior involvement could be construed as giving Appeals the discretion to deny a face-to-face conference even if the taxpayer would have been granted a face-to-face conference at the original location. The relevant sentence in A–D8 in the final regulations has been rewritten to make clear that Appeals does not have discretion to deny a face-to-face conference at an alternate location if the taxpayer would have been granted a face-to-face conference but for the disqualification of the Appeals employees at the original location.

The comments suggested that the regulations permit face-to-face conferences to be held not only at the Appeals office closest to the taxpayer's residence or, for a business taxpayer, the taxpayer's principal place of business, but also at the Appeals office closest to the taxpayer's school or place of employment, the authorized representative's place of business, or some other location convenient to the taxpayer or the taxpayer's representative. The IRS and Treasury Department believe the rules for CDP hearings should be consistent with the treatment of other proceedings in Appeals. The long-standing practice of Appeals in cases not docketed in the Tax Court is to grant face-to-face conferences in the Appeals office closest to the taxpayer's residence or principal place of business. The practice is retained in the final regulations. Appeals will, however, attempt to accommodate reasonable requests to hold the face-to-face conference at an Appeals office more convenient to the taxpayer.

The comments expressed concern that the definition of prior involvement under section 6320(b)(3) or 6330(b)(3) in the proposed regulations could be construed too narrowly in two ways. First, the definition of prior involvement as involvement in a prior hearing or proceeding could be read to exclude involvement in some informal settings, *e.g.*, the Appeals officer's participation in a mediation session. In order to clarify that no such limitation is intended, the final regulations substitute matter for hearing or proceeding in A–D4 of paragraph (d)(2). Second, defining prior involvement to exist when the Appeals officer previously considered the same tax liability could be construed as excluding from the definition instances in which the Appeals officer previously considered questions bearing only on collection issues. The final regulations adopt the suggestion in the comments to remove the word liability in A–D4 in order to eliminate the potential interpretation that there is a distinction between liability and collection issues in determining prior involvement.

The comments also requested that a mediation example be added to paragraph (d)(3). The IRS and the Treasury Department believe that the change made to A–D4 adequately clarifies the definition of prior involvement. This example and others will be added to the Internal Revenue Manual to ensure the proper administration of sections 6320(b)(3) and 6330(b)(3).

The comments recommended that the regulations address the treatment of *ex parte* communications during CDP hearings. The rules applicable to *ex parte* communications during CDP hearings and other Appeals proceedings are provided in Rev. Proc. 2000–43, 2000–2 C.B. 404. Therefore, these rules are not duplicated in the regulations under sections 6320 and 6330.

The comments recommended that the regulations be amended to provide that self-reported tax liabilities may be disputed in a CDP hearing. The final regulations adopt this recommendation. See also *Montgomery v. Commissioner*, 122 T.C. 1 (2004), *acq*. 2005–51 I.R.B. 1152.

The comments also requested changes in the existing regulations' interpretation of preclusive events under section 6330(c)(2)(B). Under section 6330(c)(2)(B), during a CDP hearing, a taxpayer may challenge the existence or amount of the underlying tax liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability. Section 6330(c)(2)(B) is made applicable to section 6320 hearings by section 6320(c). According to the comments, the only opportunity to dispute the tax liability that is sufficient to prevent the taxpayer

from challenging the liability in a CDP hearing is the prior opportunity to dispute the liability in a judicial forum. The IRS and the Treasury Department believe that the existing regulations correctly include an opportunity for an Appeals conference as a preclusive prior opportunity. The text of section 6330(c)(2)(B) does not contain language limiting prior opportunities to judicial proceedings. Moreover, it is consistent for a taxpayer who has had an opportunity to obtain a determination of liability by Appeals in one administrative hearing to be precluded from obtaining an Appeals determination in a subsequent CDP administrative hearing with respect to the same liability. This interpretation of section 6330(c)(2)(B) has been upheld by the courts. See, *e.g.*, *Pelliccio v. United States*, 253 F. Supp. 2d 258, 261–62 (D. Conn. 2003). Accordingly, the final regulations do not adopt this suggestion.

Alternatively, the comments also recommended that the regulations specify that a pre-CDP Appeals conference is not a prior opportunity to dispute liability under section 6330(c)(2)(B) if the receipt of the conference was conditioned upon the taxpayer's agreement to extend the assessment statute of limitations with respect to the liability and the taxpayer declined to extend the statute. The IRS and Treasury Department believe this addition is unnecessary. For taxes subject to deficiency procedures, the relevant, pre-assessment "prior opportunity" is the receipt of the notice of deficiency. The offer of an Appeals conference prior to receipt of the notice of deficiency does not constitute an opportunity to dispute liability under section 6330(c)(2)(B). This interpretation of section 6330(c)(2)(B) has been added to paragraph (e)(3) A–E2 to remove any uncertainty about this matter. For liabilities not subject to deficiency procedures, the offer of an Appeals conference prior to assessment constitutes an opportunity to dispute the liability under section 6330(c)(2)(B). Appeals conferences to consider these types of liabilities are rarely conditioned upon an extension of the assessment statute of limitations. The IRS generally makes conditional offers of a conference only when a taxpayer makes an untimely request for review of a proposed Trust Fund Recovery Penalty pursuant to a Letter 1153 and less than one year remains on the assessment statute of limitations. In this circumstance, however, the opportunity for an Appeals conference offered in the Letter 1153 constitutes the opportunity to dispute the liability under section 6330(c)(2)(B). The conditional offer made after the expiration of the prior opportunity provided in the Letter 1153 is irrelevant. For these reasons, the final regulations do not adopt this comment.

The comments objected to the addition of a definition of administrative record to the regulations as an attempt to overrule the Tax Court's decision in *Robinette v. Commissioner*, 123 T.C. 85 (2004), *rev'd*, 439 F.3d 455 (8th Cir. 2006). The assumption that *Robinette* eliminated any role for an administrative record in CDP court proceedings is not supported by the Court's opinion. While the Tax Court held in *Robinette* that it was not required to limit its abuse-of-discretion review to the administrative record, it did not reject the utility of an administrative record. Subsequent to the submission of the comments, the United States Court of Appeals for the Eighth Circuit reversed the Tax Court and held that abuse-of-discretion review in CDP cases is limited to the administrative record. *Robinette v. Commissioner*, 439 F.3d 455 (8th Cir. 2006). For these reasons, it is important that taxpayers and the IRS have a common understanding of the scope of the administrative record. The definition is retained in the final regulations.

The comments suggested that the proposed definition of the administrative record permits Appeals officers and employees to exclude from the record for judicial review issues, arguments, and evidence presented orally by the taxpayer, and to exclude written communications and documents. The administrative record definition is not intended to suggest that the reviewing court is not permitted to determine the contents of the administrative record or the record's adequacy in an individual case. The reviewing court has the authority to receive evidence concerning what happened during the CDP hearing. The definition is provided to establish for the benefit of the IRS and taxpayers a baseline description of what each administrative record should contain to ensure a record sufficient for judicial review. The final regulations have not been changed in this regard. The final regulations, however, adopt the suggestion that the description of the case file in A–D7 and in the definition of administrative record in A–F6 of the proposed regulations (redesignated as A–F4 in the final regulations) be made consistent.

The comments recommended that the final regulations require each Appeals officer to include in the notice of determination a list of the documents the Appeals officer believes are included in the administrative record. The justification for this proposed requirement is that the list would assist the taxpayer in deciding whether to seek judicial review. The list of documents, according to the comments, will also assist the court and taxpayers seeking review to more efficiently ascertain whether there was an abuse of discretion.

The final regulations do not adopt this recommendation. Requiring Appeals officers to prepare a list of documents constituting the administrative record in each of the thousands of cases handled each year would impose a heavy burden on Appeals without a commensurate benefit to taxpayers. The notice of determination issued in each case describes the facts and reasons supporting the Appeals officer's determination and should provide an adequate basis for the taxpayer's decision whether to seek judicial review.

The IRS and the Treasury Department acknowledge that disputes have arisen with respect to the contents of the administrative record in CDP cases and that there are no special rules in place to resolve these disputes. An appropriate solution could involve the Tax Court's development of rules governing the preparation and submission of the administrative record for abuse-of-discretion review, particularly now that the recently-enacted Pension Protection Act of 2006 requires all CDP cases to be litigated in the Tax Court.

The comments suggested removal of the limitation in the existing regulations that a taxpayer is precluded from obtaining judicial review of an issue not raised with Appeals during the CDP hearing. As an alternative, the comments recommended that a taxpayer only be prevented from raising those issues the taxpayer could have, but failed to raise during the CDP hearing. The limitation in the existing regulations implements a basic principle of administrative law that those seeking review of an issue must first give the agency

the opportunity to evaluate and respond to the issue. This limitation has been upheld in the courts. See *Robinette v. Commissioner*, 123 T.C. 85, 101–102 (2004), *rev'd on other grounds*, 439 F.3d 455 (8th Cir. 2006); *Magana v. Commissioner*, 118 T.C. 488, 493 (2002); *Abu-Awad v. United States*, 294 F. Supp. 2d 879, 889 (S.D. Tex. 2003). Accordingly, the final regulations do not adopt either of these recommendations.

The comments recommended that if the limitation on the taxpayer's ability to raise new issues during judicial review is retained, then the amendment to A–F5 (redesignated as A–F3 in the final regulations) should clarify that a taxpayer need not provide the evidence specified by Appeals with respect to an issue in order to present "any evidence" necessary to properly raise the issue. The IRS and the Treasury Department believe this change is unnecessary. The revision to A–F5 (redesignated as A–F3) does not suggest that the "any evidence" needed to avoid preclusion must be the evidence specified by Appeals. The revised language simply requires that the taxpayer submit some evidentiary support. This suggestion is not adopted in the final regulations.

The comments also suggested adding that a taxpayer need not provide any evidence to avoid preclusion if the case file already contains evidence with respect to that issue. This addition is not necessary. If the case file contains all the information needed for a decision on an issue, an Appeals officer will not request any additional evidence and the revised language in A–F5 (redesignated as A–F3 in the final regulations) will not apply. In the unlikely event that an Appeals officer making a determination on an issue requested information already in the file, a reviewing court should find the taxpayer's failure to provide any evidence does not prevent the issue from being raised. The final regulations do not adopt this recommendation.

The comments urged that the regulations make clear that the authority of Appeals officers to determine the validity, sufficiency and timeliness of a CDP notice does not alter or limit the authority of the reviewing court to make the same determination. The IRS and the Treasury Department believe this clarification is unnecessary. It is well-settled that reviewing courts have the authority to determine the validity, sufficiency and timeliness of a CDP notice. See, *e.g.*, *Kennedy v. Commissioner*, 116 T.C. 255 (2001). This clarification is not adopted in the final regulations.

The comments recommended that administrative rules similar to those developed under section 6015 be added to the regulations. The regulations state that a spousal defense raised under section 66 or 6015 is governed by section 66 or 6015 and the regulations and procedures thereunder. See Treas. Reg. § 301.6320–1(e)(2). To the extent it is determined that further guidance is necessary, such guidance will be in the form of additions to the Internal Revenue Manual. The final regulations do not adopt this recommendation.

The final regulations include amendments to the existing regulations to remove references to judicial review by United States district courts. The Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780, § 855 amended section 6330(d) to eliminate the jurisdiction of the district courts to review notices of determination, leaving the Tax Court with sole jurisdiction. Section 6330(d) is made applicable to section 6320 hearings by section 6320(c). To make clear in the regulations that judicial review is available only in the Tax Court, Q&A–F3 and Q&A–F4 in the existing regulations are removed by the final regulations and Q&A–F5 and Q&A–F6 in the proposed regulations are redesignated as Q&A–F3 and Q&A–F4 in the final regulations. In addition, only the Tax Court is now mentioned in A–E11, paragraph (f)(1), A–F1, redesignated Q&A–F3 and Q&A–F4, *Example 1* of paragraph (g)(3), Q&A–H2 and redesignated Q–I6.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In particular, the IRS and the Treasury Department find for good cause that a notice of proposed rulemaking and solicitation of public comments are unnecessary to amend the existing regulations to implement the modification of section 6330(d) by the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780. These amendments are made solely to conform the regulations to the statutory change enacted by Congress. The amendments do not involve any exercise of discretion or interpretation by the IRS or Treasury Department and the removal of United States district court jurisdiction would become effective even if the amendments were not made. Accordingly, the notice and public comment procedures do not apply. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations were 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 Laurence K. Williams, Office of Associate Chief Counsel, Procedure and Administration (Collection, Bankruptcy and Summonses Division).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6320–1 is amended as follows:

1. Paragraph (c)(2) A–C1, Q&A–C6 and A–C7 are revised.

2. Paragraph (d)(2) A–D4 and A–D7 are revised.

3. Paragraph (d)(2) Q&A–D8 is added.

4. Paragraph (d)(3) is added.

5. Paragraph (e)(1) is revised.

6. Paragraph (e)(3) A–E2, A–E6, A–E7 and A–E11 are revised.

7. Paragraph (f)(1) is revised.

8. Paragraph (f)(2) A–F1 is revised.

9. Paragraph (f)(2) Q&A–F3 is removed.

10. Paragraph (f)(2) Q&A–F5 is revised and redesignated Q&A–F3.

11. Paragraph (f)(2) Q&A–F4 is revised.

12. Paragraph (g)(3) *Example 1* is revised.

13. Paragraph (h)(2) Q&A–H2 is revised.

14. Paragraph (i)(2) Q–I5 is revised and redesignated Q–I6.

15. Paragraph (i)(2) A–I5 is redesignated A–I6.

16. Paragraph (i)(2) Q&A–I1 through Q&A–I4 are redesignated Q&A–I2 through Q&A–I5.

17. Paragraph (i)(2) Q&A–I1 and Q&A–I7 through Q&A–I11 are added.

18. Paragraph (j) is revised.

§301.6320–1 Notice and opportunity for hearing upon filing of notice of Federal tax lien.

* * * * *

(c) * * *

(2) * * *

A–C1. (i) The taxpayer must make a request in writing for a CDP hearing. The request for a CDP hearing shall include the information and signature specified in A–C1(ii) of this paragraph (c)(2). See A–D7 and A–D8 of paragraph (d)(2).

(ii) The written request for a CDP hearing must be dated and must include the following:

(A) The taxpayer's name, address, daytime telephone number (if any), and taxpayer identification number (*e.g.*, SSN, ITIN or EIN).

(B) The type of tax involved.

(C) The tax period at issue.

(D) A statement that the taxpayer requests a hearing with Appeals concerning the filing of the NFTL.

(E) The reason or reasons why the taxpayer disagrees with the filing of the NFTL.

(F) The signature of the taxpayer or the taxpayer's authorized representative.

(iii) If the IRS receives a timely written request for CDP hearing that does not satisfy the requirements set forth in A–C1(ii) of this paragraph (c)(2), the IRS will make a reasonable attempt to contact the taxpayer and request that the taxpayer comply with the unsatisfied requirements. The taxpayer must perfect any timely written request for a CDP hearing that does not satisfy the requirements set forth in A–C1(ii) of this paragraph (c)(2) within a reasonable period of time after a request from the IRS.

(iv) Taxpayers are encouraged to use Form 12153, "*Request for a Collection Due Process Hearing*," in requesting a CDP hearing so that the request can be readily identified and forwarded to Appeals. Taxpayers may obtain a copy of Form 12153 by contacting the IRS office that issued the CDP Notice, by downloading a copy from the IRS Internet site, *www.irs.gov/pub/irs-pdf/f12153.pdf*, or by calling, toll-free, 1–800–829–3676.

(v) The taxpayer must affirm any timely written request for a CDP hearing which is signed or alleged to have been signed on the taxpayer's behalf by the taxpayer's spouse or other unauthorized representative by filing, within a reasonable period of time after a request from the IRS, a signed, written affirmation that the request was originally submitted on the taxpayer's behalf. If the affirmation is filed within a reasonable period of time after a request, the timely CDP hearing request will be considered timely with respect to the non-signing taxpayer. If the affirmation is not filed within a reasonable period of time after a request, the CDP hearing request will be denied with respect to the non-signing taxpayer.

* * * * *

Q–C6. Where must the written request for a CDP hearing be sent?

A–C6. The written request for a CDP hearing must be sent, or hand delivered (if permitted), to the IRS office and address as directed on the CDP Notice. If the address of that office does not appear on the CDP Notice, the taxpayer should obtain the address of the office to which the written request should be sent or hand delivered by calling, toll-free, 1–800–829–1040 and providing the taxpayer's identification number (*e.g.*, SSN, ITIN or EIN).

* * * * *

A–C7. If the taxpayer does not request a CDP hearing in writing within the 30-day period that commences on the day after the end of the five-business-day notification period, the taxpayer foregoes the right to a CDP hearing under section 6320 with respect to the unpaid tax and tax periods shown on the CDP Notice. A written request submitted within the 30-day period that does not satisfy the requirements set forth in A–C1(ii)(A), (B), (C), (D) or (F) of this paragraph (c)(2) is considered timely if the request is perfected within a reasonable period of time pursuant to A–C1(iii) of this paragraph (c)(2). If the request for CDP hearing is untimely, either because the request was not submitted within the 30-day period or not perfected within the reasonable period provided, the taxpayer will be notified of the untimeliness of the request and offered an equivalent hearing. In such cases, the taxpayer may obtain an equivalent hearing without submitting an additional request. See paragraph (i) of this section.

* * * * *

(d) * * *

(2) * * *

A–D4. Prior involvement by an Appeals officer or employee includes participation or involvement in a matter (other than a CDP hearing held under either section 6320 or section 6330) that the taxpayer may have had with respect to the tax and tax period shown on the CDP Notice. Prior involvement exists only when the taxpayer, the tax and the tax period at issue in the CDP hearing also were at issue in the prior non-CDP matter, and the Appeals officer or employee actually participated in the prior matter.

* * * * *

A–D7. Except as provided in A–D8 of this paragraph (d)(2), a taxpayer who presents in the CDP hearing request relevant, non-frivolous reasons for disagreement with the NFTL filing will ordinarily be offered an opportunity for a face-to-face conference at the Appeals office closest to taxpayer's residence. A business taxpayer will ordinarily be offered an opportunity for a face-to-face conference at the Appeals office closest to the taxpayer's principal place of business. If that is not satisfactory to the taxpayer, the taxpayer will be given an opportunity for a hearing by telephone or by correspondence. In all cases, the Appeals officer or employee will review the case file, as described in A–F4 of paragraph (f)(2). If no face-to-face or telephonic conference is held, or other oral communication takes place, review of the documents in the case file, as described in A–F4 of paragraph (f)(2), will constitute the CDP hearing for purposes of section 6320(b).

Q–D8. In what circumstances will a face-to-face CDP conference not be granted?

A–D8. A taxpayer is not entitled to a face-to-face CDP conference at a location other than as provided in A–D7 of this paragraph (d)(2) and this A–D8. If all Appeals officers or employees at the location provided for in A–D7 of this paragraph (d)(2) have had prior involvement with the taxpayer as provided in A–D4 of this paragraph (d)(2), the taxpayer will not be offered a face-to-face conference at that location, unless the taxpayer elects to waive the requirement of section 6320(b)(3). The taxpayer will be offered a face-to-face conference at another Appeals office if Appeals would have offered the taxpayer a face-to-face conference at the location provided in A–D7 of this paragraph (d)(2), but for the disqualification of all Appeals officers or employees at that location. A face-to-face CDP conference concerning a taxpayer's underlying liability will not be granted if the request for a hearing or other taxpayer communication indicates that the taxpayer wishes only to raise irrelevant or frivolous issues concerning that liability. A face-to-face CDP conference concerning a collection alternative, such as an installment agreement or an offer to compromise liability, will not be granted unless other taxpayers would be eligible for the alternative in similar circumstances. For example, because the IRS does not consider offers to compromise from taxpayers who have not filed required returns or have not made certain required deposits of tax, as set forth in Form 656, "*Offer in Compromise*," no face-to-face conference will be granted to a taxpayer who wishes to make an offer to compromise but has not fulfilled those obligations. Appeals in its discretion, however, may grant a face-to-face conference if Appeals determines that a face-to-face conference is appropriate to explain to the taxpayer the requirements for becoming eligible for a collection alternative. In all cases, a taxpayer will be given an opportunity to demonstrate eligibility for a collection alternative and to become eligible for a collection alternative, in order to obtain a face-to-face conference. For purposes of determining whether a face-to-face conference will be granted, the determination of a taxpayer's eligibility for a collection alternative is made without regard to the taxpayer's ability to pay the unpaid tax. A face-to-face conference need not be granted if the taxpayer does not provide the required information set forth in A–C1(ii)(E) of paragraph (c)(2). See also A–C1(iii) of paragraph (c)(2).

(3) *Examples*. The following examples illustrate the principles of this paragraph (d):

Example 1. Individual A timely requests a CDP hearing concerning a NFTL filed with respect to the 1998 income tax liability assessed against individual A. Appeals employee B previously conducted a CDP hearing regarding a proposed levy for individual A's 1998 income tax liability. Because employee B's only prior involvement with individual A's 1998 income tax liability was in connection with a section 6330 CDP hearing, employee B may conduct the CDP hearing under section 6320 involving the NFTL filed for the 1998 income tax liability.

Example 2. Individual C timely requests a CDP hearing concerning a NFTL filed with respect to the 1998 income tax liability assessed against individual C. Appeals employee D previously conducted a Collection Appeals Program (CAP) hearing regarding a NFTL filed with respect to individual C's 1998 income tax liability. Because employee D's prior involvement with individual C's 1998 income tax liability was in connection with a non-CDP hearing, employee D may not conduct the CDP hearing under section 6320 unless individual C waives the requirement that the hearing will be conducted by an Appeals officer or employee who has had no prior involvement with respect to individual C's 1998 income tax liability.

Example 3. Same facts as in *Example 2*, except that the prior CAP hearing only involved individual C's 1997 income tax liability and employment tax liabilities for 1998 reported on Form 941, "*Employer's Quarterly Federal Tax Return*." Employee D would not be considered to have prior involvement because the prior CAP hearing in which she participated did not involve individual C's 1998 income tax liability.

Example 4. Appeals employee F is assigned to a CDP hearing concerning a NFTL filed with respect to a trust fund recovery penalty (TFRP) assessed pursuant to section 6672 against individual E. Appeals employee F participated in a prior CAP hearing involving individual E's 1999 income tax liability, and participated in a CAP hearing involving the employment taxes of business entity X, which incurred the employment tax liability to which the TFRP assessed against individual E relates. Appeals employee F would not be considered to have prior involvement because the prior CAP hearings in which he participated did not directly involve the TFRP assessed against individual E.

Example 5. Appeals employee G is assigned to a CDP hearing concerning a NFTL filed with respect to a TFRP assessed pursuant to section 6672 against individual H. In preparing for the CDP hearing, Appeals employee G reviews the Appeals case file concerning the prior CAP hearing involving the TFRP assessed pursuant to section 6672 against individual H. Appeals employee G is not deemed to have participated in the previous CAP hearing involving the TFRP assessed against individual H by such review.

(e) *Matters considered at CDP hearing*—(1) *In general*. Appeals will determine the timeliness of any request for a CDP hearing that is made by a taxpayer. Appeals has the authority to determine the validity, sufficiency, and timeliness of any CDP Notice given by the IRS and of any request for a CDP hearing that is made by a taxpayer. Prior to issuance of a determination, Appeals is required to obtain verification from the IRS office collecting the tax that the requirements of any applicable law or administrative procedure with respect to the filing of the NFTL have been met. The taxpayer may raise any relevant issue relating to the unpaid tax at the hearing, including appropriate spousal defenses, challenges to the appropriateness of the NFTL filing, and offers of collection alternatives. The taxpayer also may raise challenges to the existence or amount of the underlying liability, including a liability reported on a self-filed return, for any tax period specified on the CDP Notice if the taxpayer did not receive a statutory notice of deficiency for that tax liability or did not otherwise have an opportunity to dispute the tax liability. Finally, the taxpayer may not raise an issue that was raised and considered at a previous CDP hearing under section 6330 or in any other previous administrative or judicial proceeding if the taxpayer participated meaningfully in such hearing or proceeding. Taxpayers will be expected to provide all relevant information requested by Appeals, including financial statements, for its consideration of the facts and issues involved in the hearing.

* * * * *

(3) * * *

A–E2. A taxpayer is entitled to challenge the existence or amount of the underlying liability for any tax period specified on the CDP Notice if the taxpayer did not receive a statutory notice of deficiency for such liability or did not otherwise have an opportunity to dispute such liability. Receipt of a statutory notice of deficiency for this purpose means receipt in time to petition the Tax Court for a redetermination of the deficiency determined in the notice of deficiency. An opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability. An opportunity

for a conference with Appeals prior to the assessment of a tax subject to deficiency procedures is not a prior opportunity for this purpose.

* * * * *

A–E6. Collection alternatives include, for example, a proposal to withdraw the NFTL in circumstances that will facilitate the collection of the tax liability, subordination of the NFTL, discharge of the NFTL from specific property, an installment agreement, an offer to compromise, the posting of a bond, or the substitution of other assets. A collection alternative is not available unless the alternative would be available to other taxpayers in similar circumstances. See A–D8 of paragraph (d)(2).

* * * * *

A–E7. The taxpayer may raise appropriate spousal defenses, challenges to the appropriateness of the NFTL filing, and offers of collection alternatives. The existence or amount of the underlying liability for any tax period specified in the CDP Notice may be challenged only if the taxpayer did not have a prior opportunity to dispute the tax liability. If the taxpayer previously received a CDP Notice under section 6330 with respect to the same tax and tax period and did not request a CDP hearing with respect to that earlier CDP Notice, the taxpayer had a prior opportunity to dispute the existence or amount of the underlying tax liability.

* * * * *

A–E11. No. An Appeals officer may consider the existence and amount of the underlying tax liability as a part of the CDP hearing only if the taxpayer did not receive a statutory notice of deficiency for the tax liability in question or otherwise have a prior opportunity to dispute the tax liability. Similarly, an Appeals officer may not consider any other issue if the issue was raised and considered at a previous hearing under section 6330 or in any other previous administrative or judicial proceeding in which the person seeking to raise the issue meaningfully participated. In the Appeals officer's sole discretion, however, the Appeals officer may consider the existence or amount of the underlying tax liability, or such other precluded issues, at the same time as the CDP hearing. Any determination, however, made by the Appeals officer with respect to such a precluded issue shall not be treated as part of the Notice of Determination issued by the Appeals officer and will not be subject to any judicial review. Because any decisions made by the Appeals officer on such precluded issues are not properly a part of the CDP hearing, such decisions are not required to appear in the Notice of Determination issued following the hearing. Even if a decision concerning such precluded issues is referred to in the Notice of Determination, it is not reviewable by the Tax Court because the precluded issue is not properly part of the CDP hearing.

* * * * *

(f) *Judicial review of Notice of Determination*—(1) *In general*. Unless the taxpayer provides the IRS a written withdrawal of the request that Appeals conduct a CDP hearing, Appeals is required to issue a Notice of Determination in all cases where a taxpayer has timely requested a CDP hearing. The taxpayer may appeal such determinations made by Appeals within the 30-day period commencing the day after the date of the Notice of Determination to the Tax Court.

(2) * * *

A–F1. Subject to the jurisdictional limitations described in A–F2 of this paragraph (f)(2), the taxpayer must, within the 30-day period commencing the day after the date of the Notice of Determination, appeal the determination by Appeals to the Tax Court.

* * * * *

Q–F3. What issue or issues may the taxpayer raise before the Tax Court if the taxpayer disagrees with the Notice of Determination?

A–F3. In seeking Tax Court review of a Notice of Determination, the taxpayer can only ask the court to consider an issue, including a challenge to the underlying tax liability, that was properly raised in the taxpayer's CDP hearing. An issue is not properly raised if the taxpayer fails to request consideration of the issue by Appeals, or if consideration is requested but the taxpayer fails to present to Appeals any evidence with respect to that issue after being given a reasonable opportunity to present such evidence.

Q–F4. What is the administrative record for purposes of Tax Court review?

A–F4. The case file, including the taxpayer's request for hearing, any other written communications and information from the taxpayer or the taxpayer's authorized representative submitted in connection with the CDP hearing, notes made by an Appeals officer or employee of any oral communications with the taxpayer or the taxpayer's authorized representative, memoranda created by the Appeals officer or employee in connection with the CDP hearing, and any other documents or materials relied upon by the Appeals officer or employee in making the determination under section 6330(c)(3), will constitute the record in the Tax Court review of the Notice of Determination issued by Appeals.

(g) * * *

(3) * * *

Example 1. The period of limitation under section 6502 with respect to the taxpayer's tax period listed in the NFTL will expire on August 1, 1999. The IRS sent a CDP Notice to the taxpayer on April 30, 1999. The taxpayer timely requested a CDP hearing. The IRS received this request on May 15, 1999. Appeals sends the taxpayer its determination on June 15, 1999. The taxpayer timely seeks judicial review of that determination. The period of limitation under section 6502 would be suspended from May 15, 1999, until the determination resulting from that hearing becomes final by expiration of the time for seeking review or reconsideration before the Tax Court, plus 90 days.

* * * * *

(h) * * *

(2) * * *

Q–H2. Is a decision of Appeals resulting from a retained jurisdiction hearing appealable to the Tax Court?

A–H2. No. As discussed in A–H1, a taxpayer is entitled to only one CDP hearing under section 6320 with respect to the tax and tax period or periods specified in the CDP Notice. Only determinations resulting from CDP hearings are appealable to the Tax Court.

(i) * * *

(2) * * *

Q–I1. What must a taxpayer do to obtain an equivalent hearing?

A–I1. (i) A request for an equivalent hearing must be made in writing. A written request in any form that requests an equivalent hearing will be acceptable if it includes the information and signature required in A–I1(ii) of this paragraph (i)(2).

(ii) The request must be dated and must include the following:

(A) The taxpayer's name, address, daytime telephone number (if any), and taxpayer identification number (*e.g.*, SSN, ITIN or EIN).

(B) The type of tax involved.

(C) The tax period at issue.

(D) A statement that the taxpayer is requesting an equivalent hearing with Appeals concerning the filing of the NFTL.

(E) The reason or reasons why the taxpayer disagrees with the filing of the NFTL.

(F) The signature of the taxpayer or the taxpayer's authorized representative.

(iii) The taxpayer must perfect any timely written request for an equivalent hearing that does not satisfy the requirements set forth in A–I1(ii) of this paragraph (i)(2) within a reasonable period of time after a request from the IRS. If the requirements are not satisfied within a reasonable period of time, the taxpayer's equivalent hearing request will be denied.

(iv) The taxpayer must affirm any timely written request for an equivalent hearing that is signed or alleged to have been signed on the taxpayer's behalf by the taxpayer's spouse or other unauthorized representative, and that otherwise meets the requirements set forth in A–I1(ii) of this paragraph (i)(2), by filing, within a reasonable period of time after a request from the IRS, a signed written affirmation that the request was originally submitted on the taxpayer's behalf. If the affirmation is filed within a reasonable period of time after a request, the timely equivalent hearing request will be considered timely with respect to the non-signing taxpayer. If the affirmation is not filed within a reasonable period of time, the equivalent hearing request will be denied with respect to the non-signing taxpayer.

* * * * *

Q–I6. Will a taxpayer be able to obtain Tax Court review of a decision made by Appeals with respect to an equivalent hearing?

* * * * *

Q–I7. When must a taxpayer request an equivalent hearing with respect to a CDP Notice issued under section 6320?

A–I7. A taxpayer must submit a written request for an equivalent hearing within the one-year period commencing the day after the end of the five-business-day period following the filing of the NFTL. This period is slightly different from the period for submitting a written request for an equivalent hearing with respect to a CDP Notice issued under section 6330. For a CDP Notice issued under section 6330, a taxpayer must submit a written request for an equivalent hearing within the one-year period commencing the day after the date of the CDP Notice issued under section 6330.

Q–I8. How will the timeliness of a taxpayer's written request for an equivalent hearing be determined?

A–I8. The rules and regulations under section 7502 and section 7503 will apply to determine the timeliness of the taxpayer's request for an equivalent hearing, if properly transmitted and addressed as provided in A–I10 of this paragraph (i)(2).

Q–I9. Is the one-year period within which a taxpayer must make a request for an equivalent hearing extended because the taxpayer resides outside the United States?

A–I9. No. All taxpayers who want an equivalent hearing concerning the filing of the NFTL must request the hearing within the one-year period commencing the day after the end of the five-business-day period following the filing of the NFTL.

Q–I10. Where must the written request for an equivalent hearing be sent?

A–I10. The written request for an equivalent hearing must be sent, or hand delivered (if permitted), to the IRS office and address as directed on the CDP Notice. If the address of the issuing office does not appear on the CDP Notice, the taxpayer should obtain the address of the office to which the written request should be sent or hand delivered by calling, toll-free, 1–800–829–1040 and providing the taxpayer's identification number (*e.g.*, SSN, ITIN or EIN).

Q–I11. What will happen if the taxpayer does not request an equivalent hearing in writing within the one-year period commencing the day after the end of the five-business-day period following the filing of the NFTL?

A–I11. If the taxpayer does not request an equivalent hearing with Appeals within the one-year period commencing the day after the end of the five-business-day period following the filing of the NFTL, the taxpayer foregoes the right to an equivalent hearing with respect to the unpaid tax and tax periods shown on the CDP Notice. A written request submitted within the one-year period that does not satisfy the requirements set forth in A–I1(ii) of this paragraph (i)(2) is considered timely if the request is perfected within a reasonable period of time pursuant to A–I1(iii) of this paragraph (i)(2). If a request for equivalent hearing is untimely, either because the request was not submitted within the one-year period or not perfected within the reasonable period provided, the equivalent hearing request will be denied. The taxpayer, however, may seek reconsideration by the IRS office collecting the tax, assistance from the National Taxpayer Advocate, or an administrative hearing before Appeals under its Collection Appeals Program or any successor program.

(j) *Effective date*. This section is applicable on or after November 16, 2006 with respect to requests made for CDP hearings or equivalent hearings on or after November 16, 2006.

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

Approved October 6, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on October 16, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2006, 71 F.R. 60835)

Section 6330.—Notice and Opportunity for Hearing Before Levy

26 CFR 301.6330–1: Notice and opportunity for hearing prior to levy.

T.D. 9291

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Miscellaneous Changes to Collection Due Process Procedures Relating to Notice

and Opportunity for Hearing Prior to Levy

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations amending the regulations relating to a taxpayer's right to a hearing before or, in limited cases, after levy under section 6330 of the Internal Revenue Code of 1986. The final regulations make certain clarifying changes in the way collection due process (CDP) hearings are held and specify the period during which a taxpayer may request an equivalent hearing. The final regulations affect taxpayers against whose property or rights to property the Internal Revenue Service (IRS) intends to levy.

DATES: *Effective Date:* These regulations are effective on November 16, 2006.

Applicability Date: These regulations apply to requests for CDP or equivalent hearings on or after November 16, 2006.

FOR FURTHER INFORMATION CONTACT: Laurence K. Williams, 202–622–3600 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Regulations on Procedure and Administration (26 CFR part 301) relating to the provision of notice under section 6330 of the Internal Revenue Code to taxpayers of a right to a CDP hearing (CDP Notice) before or, in limited cases, after levy. Final regulations (T.D. 8980, 2002–1 C.B. 477) were published on January 18, 2002, in the **Federal Register** (67 FR 2549) (the 2002 final regulations). The 2002 final regulations implemented certain changes made by section 3401 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206, 112 Stat. 685) (RRA 1998), including the addition of section 6330 to the Internal Revenue Code.

Section 3401 of RRA 1998 also added section 6320 to the Internal Revenue Code. That statute provides for notice to taxpayers of a right to a hearing after the filing of a notice of Federal tax lien (NFTL). A number of the provisions in section 6330 concerning the conduct and judicial review of a CDP hearing are incorporated by reference in section 6320. On January 18, 2002, final regulations (T.D. 8979, 2002–1 C.B. 466) under section 6320 were published in the **Federal Register** (67 FR 2558) along with the 2002 final regulations under section 6330.

On September 16, 2005, the IRS and the Treasury Department published in the **Federal Register** (70 FR 54687) a notice of proposed rulemaking and notice of public hearing (REG–150091–02, 2005–43 I.R.B. 774). The IRS received one set of written comments responding to the notice of proposed rulemaking. Because no one requested to speak at the public hearing, the hearing was cancelled. After considering each of the comments, the proposed regulations are adopted as amended by this Treasury decision.

On August 17, 2006, the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780 (the PPA), was enacted. Section 855 of the PPA amended section 6330(d) of the Internal Revenue Code to withdraw judicial review of CDP notices of determination from United States district court jurisdiction, leaving review solely in the United States Tax Court. This amendment to section 6330(d), effective for notices of determination issued on or after October 17, 2006, requires the removal of references to district court review in the 2002 final regulations. This Treasury decision removes those references.

The IRS and the Treasury Department have determined that a notice of proposed rulemaking and solicitation of public comments are not required to amend the regulations to implement the modification to section 6330(d). These amendments are made solely to conform the regulations to a statutory change enacted by Congress. Because the amendments do not involve any exercise of discretion or interpretation, the notice and public comment procedures are unnecessary.

The comments and changes to the proposed regulations, and the amendments required by the Congressional modification to section 6330(d), are discussed below.

Summary of Comments and Explanation of Changes

The comments suggested that the IRS be required to contact taxpayers who timely file an incomplete request for CDP hearing to give them the opportunity to perfect the request within a reasonable time period and further recommended that such contact be in writing and identify the infirmity requiring perfection. The comments also recommended that the final regulations establish a specific time period during which taxpayers may, by right, amend or perfect their previously-filed yet incomplete CDP hearing request. The request, according to the comments, should be considered timely if it is perfected within the applicable time period.

Currently, the practice of the IRS is to contact taxpayers whose hearing requests fail to satisfy the requirements specified by the existing regulations and ask these taxpayers to perfect their requests within a specified period of time. The IRS considers requests perfected within the time specified to be timely. The intention of the IRS and the Treasury Department is to incorporate this administrative procedure into the proposed regulations. The final regulations more clearly state that the IRS will make a reasonable attempt to contact taxpayers to give them a reasonable period of time to perfect incomplete requests. However, the timeframe in which to respond to the request, and the method of delivery of the request (*i.e.*, orally or in writing) are more appropriately addressed in the Internal Revenue Manual. The final regulations make clear that requests perfected within the time period specified by the IRS will be considered timely.

The final regulations do not adopt the suggestion to establish a period of time during which a taxpayer is allowed to perfect an incomplete request, without regard to a perfection request from the IRS. The IRS and Treasury Department believe that the procedure incorporated into the final regulations is sufficient to permit taxpayers to ensure their requests are complete.

The comments recommended that the IRS Office of Appeals (Appeals) be given the discretion to permit a taxpayer to amend an imperfect hearing request after the period for perfecting the request has expired, if the taxpayer can demonstrate that such amendment furthers an alter-

native to collection. This change to the regulations is unnecessary because Appeals is already empowered to exercise this discretion. Neither the current regulations nor the proposed amendments limits Appeals from exercising this discretion. Accordingly, the final regulations do not adopt this recommendation. Further clarification, however, will be provided in the Internal Revenue Manual.

The comments suggested that where a taxpayer fails to perfect a CDP hearing request until after the time period specified by the IRS, the perfected request should be automatically treated as a request for an equivalent hearing. Treating untimely perfected requests as equivalent hearing requests may unduly prolong the process in cases in which a taxpayer does not want an equivalent hearing. Accordingly, the final regulations do not adopt this suggestion. The final regulations, however, provide that Appeals will determine the timeliness of CDP hearing requests. The final regulations also add to the proposed regulations that taxpayers making an untimely request will be provided the opportunity to have the request for CDP hearing treated as a request for equivalent hearing, without submitting an additional request.

The comments requested that the final regulations give taxpayers whose hearing requests might be construed as making a frivolous argument the right to amend their hearing requests to raise relevant, non-frivolous issues. The comments further recommended that all taxpayers be given the right to supplement the hearing request prior to the conference conducted by Appeals.

These comments indicate concern that taxpayers may be unable to articulate reasons for disagreeing with the collection action that are satisfactory to Appeals. The reasons for disagreeing with the collection action need not be detailed. To assist taxpayers in articulating reasons, the IRS is revising Form 12153, "*Request for a Collection Due Process Hearing,*" to add examples of the most common reasons taxpayers give for requesting a hearing, including requests for collection alternatives. In any event, the informal nature of the CDP hearing permits taxpayers and Appeals to discuss collection alternatives and issues not listed in the hearing request if such discussion will help resolve the case. Accordingly, the final regulations do not adopt these recommendations.

The comments urged that the final regulations guarantee a face-to-face conference for each taxpayer who presents a relevant, non-frivolous reason for disagreement with the collection action. If this recommendation is not adopted, the comments suggest that the regulations address and provide examples of when a face-to-face conference will not be granted. The final regulations do not adopt the recommendation to guarantee a face-to-face conference for each taxpayer raising a relevant, non-frivolous issue. The IRS and the Treasury Department agree with the comments that a face-to-face conference can be a useful forum for resolving a taxpayer's issues. The final regulations recognize the importance of a face-to-face meeting by providing that taxpayers will ordinarily be offered an opportunity for a face-to-face conference. There will be instances, however, when a face-to-face conference is not practical. The final regulations identify typical situations in which a face-to-face conference will be neither necessary nor productive. Except for these situations, the IRS and the Treasury Department anticipate that Appeals will afford a face-to-face meeting to taxpayers who request one. Nonetheless, unanticipated circumstances may arise in which granting a face-to-face conference will not be appropriate. The final regulations give Appeals the flexibility needed to respond to unanticipated circumstances.

Adoption of the comment requesting guidance on when a face-to-face conference will not be granted is unnecessary. The final regulations retain descriptions of situations in which a face-to-face conference will not be granted, as illustrated in the proposed regulations. Further guidance on granting face-to-face conferences will be provided in the Internal Revenue Manual.

The comments suggested that a taxpayer who appears to be presenting only frivolous reasons be given an opportunity to provide relevant, non-frivolous reasons in order to obtain a face-to-face conference. Adoption of this recommendation is unnecessary. Correspondence sent by Appeals to taxpayers who make only frivolous arguments invites them to submit relevant, non-frivolous reasons. Appeals offers face-to-face conferences to taxpayers who respond by providing such reasons.

The comments also suggested that the regulations define relevant and frivolous. The IRS and the Treasury Department believe that any attempt to define these terms is unnecessary and could result in underinclusive definitions. For example, the comments suggest that a frivolous issue be defined as an issue that is the same or substantially similar to an issue identified as frivolous by the IRS in published guidance. It is not possible to anticipate or keep pace with the evolution of frivolous arguments through published guidance. Instead, taxpayers are advised to consult the lists of examples of frivolous arguments in IRS Publication 2105, "*Why Do I Have to Pay Taxes*" and on the IRS website in a document entitled "The Truth about Frivolous Tax Arguments." The names and web addresses of these documents, and a toll-free number to order Publication 2105, will be added to the instructions to Form 12153 to help taxpayers avoid making these arguments.

The comments recommended clarification of the proposed rule that a face-to-face conference concerning a collection alternative will not be granted unless the alternative would be available to other taxpayers in similar circumstances. According to the comments, a taxpayer should not be denied a face-to-face conference because the requested collection alternative cannot be accepted, for example, because it appears from financial information that the taxpayer can pay the liabilities in full. This proposed rule was not intended to deny a face-to-face conference because the requested collection alternative would not be accepted. The intention of this rule is to permit the denial of a face-to-face conference to discuss a collection alternative for which the taxpayer is not eligible. A lack of eligibility under IRS policy is tied to a taxpayer's compliance with the Federal tax laws, not to the taxpayer's financial circumstances or ability to request the most appropriate alternative. For example, if the taxpayer has not filed all required tax returns, the taxpayer is not eligible for an offer to compromise or an installment agreement.

In response to the concerns expressed in the comments, the final regulations amplify the rule that a face-to-face conference to discuss a collection alternative will not

be granted unless other taxpayers would be eligible for the alternative in similar circumstances. The final regulations provide in A–D8 that Appeals in its discretion may grant a face-to-face conference if Appeals determines that a face-to-face conference is appropriate to explain to the taxpayer the requirements for becoming eligible for a collection alternative. The final regulations also provide that taxpayers will be given an opportunity to demonstrate they are eligible for a collection alternative in order to obtain a face-to-face conference to discuss the alternative. Taxpayers will also be given an opportunity to become eligible for a collection alternative in order to obtain a face-to-face conference. For example, under the final regulations, if a taxpayer appears to have failed to file all required returns (and thus appears not to be eligible for an offer to compromise or an installment agreement), the taxpayer will be given an opportunity to demonstrate the inapplicability of the filing requirements or to file delinquent returns, in order to obtain a face-to-face conference. The final regulations further provide that a taxpayer's eligibility for a collection alternative does not include the taxpayer's ability to pay the unpaid tax.

The comments expressed concern that the amendment providing a face-to-face conference at an Appeals office other than an office in which all officers or employees had prior involvement could be construed as giving Appeals the discretion to deny a face-to-face conference even if the taxpayer would have been granted a face-to-face conference at the original location. The relevant sentence in A–D8 in the final regulations has been rewritten to make clear that Appeals does not have discretion to deny a face-to-face conference at an alternate location if the taxpayer would have been granted a face-to-face conference but for the disqualification of the Appeals employees at the original location.

The comments suggested that the regulations permit face-to-face conferences to be held not only at the Appeals office closest to the taxpayer's residence or, for a business taxpayer, the taxpayer's principal place of business, but also at the Appeals office closest to the taxpayer's school or place of employment, the authorized representative's place of business, or some other location convenient to the taxpayer or the taxpayer's representative. The IRS and Treasury Department believe the rules for CDP hearings should be consistent with the treatment of other proceedings in Appeals. The long-standing practice of Appeals in cases not docketed in the Tax Court is to grant face-to-face conferences in the Appeals office closest to the taxpayer's residence or principal place of business. The practice is retained in the final regulations. Appeals will, however, attempt to accommodate reasonable requests to hold the face-to-face conference at an Appeals office more convenient to the taxpayer.

The comments expressed concern that the definition of prior involvement under section 6320(b)(3) or 6330(b)(3) in the proposed regulations could be construed too narrowly in two ways. First, the definition of prior involvement as involvement in a prior hearing or proceeding could be read to exclude involvement in some informal settings, *e.g.*, the Appeals officer's participation in a mediation session. In order to clarify that no such limitation is intended, the final regulations substitute matter for hearing or proceeding in A–D4 of paragraph (d)(2). Second, defining prior involvement to exist when the Appeals officer previously considered the same tax liability could be construed as excluding from the definition instances in which the Appeals officer previously considered questions bearing only on collection issues. The final regulations adopt the suggestion in the comments to remove the word liability in A–D4 in order to eliminate the potential interpretation that there is a distinction between liability and collection issues in determining prior involvement.

The comments also requested that a mediation example be added to paragraph (d)(3). The IRS and the Treasury Department believe that the change made to A–D4 adequately clarifies the definition of prior involvement. This example and others will be added to the Internal Revenue Manual to ensure the proper administration of sections 6320(b)(3) and 6330(b)(3).

The comments recommended that the regulations address the treatment of *ex parte* communications during CDP hearings. The rules applicable to *ex parte* communications during CDP hearings and other Appeals proceedings are provided in Rev. Proc. 2000–43, 2000–2 C.B. 404. Therefore, these rules are not duplicated in the regulations under sections 6320 and 6330.

The comments recommended that the regulations be amended to provide that self-reported tax liabilities may be disputed in a CDP hearing. The final regulations adopt this recommendation. See also *Montgomery v. Commissioner*, 122 T.C. 1 (2004), *acq*. 2005–51 I.R.B. 1152.

The comments also requested changes in the existing regulations' interpretation of preclusive events under section 6330(c)(2)(B). Under section 6330(c)(2)(B), during a CDP hearing, a taxpayer may challenge the existence or amount of the underlying tax liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability. According to the comments, the only opportunity to dispute the tax liability that is sufficient to prevent the taxpayer from challenging the liability in a CDP hearing is the prior opportunity to dispute the liability in a judicial forum. The IRS and the Treasury Department believe that the existing regulations correctly include an opportunity for an Appeals conference as a preclusive prior opportunity. The text of section 6330(c)(2)(B) does not contain language limiting prior opportunities to judicial proceedings. Moreover, it is consistent for a taxpayer who has had an opportunity to obtain a determination of liability by Appeals in one administrative hearing to be precluded from obtaining an Appeals determination in a subsequent CDP administrative hearing with respect to the same liability. This interpretation of section 6330(c)(2)(B) has been upheld by the courts. See, *e.g.*, *Pelliccio v. United States*, 253 F. Supp. 2d 258, 261–62 (D. Conn. 2003). Accordingly, the final regulations do not adopt this suggestion.

Alternatively, the comments recommended that the regulations specify that a pre-CDP Appeals conference is not a prior opportunity to dispute liability under section 6330(c)(2)(B) if the receipt of the conference was conditioned upon the taxpayer's agreement to extend the assessment statute of limitations with respect to the liability and the taxpayer declined to extend the statute. The IRS and Treasury Department believe this addition is unnecessary. For taxes subject

to deficiency procedures, the relevant, pre-assessment "prior opportunity" is the receipt of the notice of deficiency. The offer of an Appeals conference prior to receipt of the notice of deficiency does not constitute an opportunity to dispute the liability under section 6330(c)(2)(B). This interpretation of section 6330(c)(2)(B) has been added to paragraph (e)(3) A–E2 to remove any uncertainty about this matter. For liabilities not subject to deficiency procedures, the offer of an Appeals conference prior to assessment constitutes an opportunity to dispute the liability under section 6330(c)(2)(B). Appeals conferences to consider these types of liabilities are rarely conditioned upon an extension of the assessment statute of limitations. The IRS generally makes conditional offers of a conference only when a taxpayer makes an untimely request for review of a proposed Trust Fund Recovery Penalty pursuant to a Letter 1153 and less than one year remains on the assessment statute of limitations. In this circumstance, however, the opportunity for an Appeals conference offered in the Letter 1153 constitutes the opportunity to dispute the liability under section 6330(c)(2)(B). The conditional offer made after the expiration of the prior opportunity provided in the Letter 1153 is irrelevant. For these reasons, the final regulations do not adopt this comment.

The comments objected to the addition of a definition of administrative record to the regulations as an attempt to overrule the Tax Court's decision in *Robinette v. Commissioner*, 123 T.C. 85 (2004), *rev'd*, 439 F.3d 455 (8th Cir. 2006). The assumption that *Robinette* eliminated any role for an administrative record in CDP court proceedings is not supported by the Court's opinion. While the Tax Court held in *Robinette* that it was not required to limit its abuse-of-discretion review to the administrative record, it did not reject the utility of an administrative record. Subsequent to the submission of the comments, the United States Court of Appeals for the Eighth Circuit reversed the Tax Court and held that abuse-of-discretion review in CDP cases is limited to the administrative record. *Robinette v. Commissioner*, 439 F.3d 455 (8th Cir. 2006). For these reasons, it is important that taxpayers and the IRS have a common understanding of the scope of the administrative record. The definition is retained in the final regulations.

The comments suggested that the proposed definition of the administrative record permits Appeals officers and employees to exclude from the record for judicial review issues, arguments, and evidence presented orally by the taxpayer, and to exclude written communications and documents. The administrative record definition is not intended to suggest that the reviewing court is not permitted to determine the contents of the administrative record or the record's adequacy in an individual case. The reviewing court has the authority to receive evidence concerning what happened during the CDP hearing. The definition is provided to establish for the benefit of the IRS and taxpayers a baseline description of what each administrative record should contain to ensure a record sufficient for judicial review. The final regulations have not been changed in this regard. The final regulations, however, adopt the suggestion that the description of the case file in A–D7 and in the definition of administrative record in A–F6 of the proposed regulations (redesignated as A–F4 in the final regulations) be made consistent.

The comments recommended that the final regulations require each Appeals officer to include in the notice of determination a list of the documents the Appeals officer believes are included in the administrative record. The justification for this proposed requirement is that the list would assist the taxpayer in deciding whether to seek judicial review. The list of documents, according to the comments, will also assist the court and taxpayers seeking review to more efficiently ascertain whether there was an abuse of discretion.

The final regulations do not adopt this recommendation. Requiring Appeals officers to prepare a list of documents constituting the administrative record in each of the thousands of cases handled each year would impose a heavy burden on Appeals without a commensurate benefit to taxpayers. The notice of determination issued in each case describes the facts and reasons supporting the Appeals officer's determination and should provide an adequate basis for the taxpayer's decision whether to seek judicial review.

The IRS and the Treasury Department acknowledge that disputes have arisen with respect to the contents of the administrative record in CDP cases and that there are no special rules in place to resolve these disputes. An appropriate solution could involve the Tax Court's development of rules governing the preparation and submission of the administrative record for abuse-of-discretion review, particularly now that the recently-enacted Pension Protection Act of 2006 requires all CDP cases to be litigated in the Tax Court.

The comments suggested removal of the limitation in the existing regulations that a taxpayer is precluded from obtaining judicial review of an issue not raised with Appeals during the CDP hearing. As an alternative, the comments recommended that a taxpayer only be prevented from raising those issues the taxpayer could have, but failed to raise during the CDP hearing. The limitation in the existing regulations implements a basic principle of administrative law that those seeking review of an issue must first give the agency the opportunity to evaluate and respond to the issue. This limitation has been upheld in the courts. See *Robinette v. Commissioner*, 123 T.C. 85, 101–102 (2004), *rev'd on other grounds*, 439 F.3d 455 (8th Cir. 2006); *Magana v. Commissioner*, 118 T.C. 488, 493 (2002); *Abu-Awad v. United States*, 294 F. Supp. 2d 879, 889 (S.D. Tex. 2003). Accordingly, the final regulations do not adopt either of these recommendations.

The comments recommended that if the limitation on the taxpayer's ability to raise new issues during judicial review is retained, then the amendment to A–F5 (redesignated as A–F3 in the final regulations) should clarify that a taxpayer need not provide the evidence specified by Appeals with respect to an issue in order to present "any evidence" necessary to properly raise the issue. The IRS and the Treasury Department believe this change is unnecessary. The revision to A–F5 (redesignated as A–F3) does not suggest that the "any evidence" needed to avoid preclusion must be the evidence specified by Appeals. The revised language simply requires that the taxpayer submit some evidentiary support. This suggestion is not adopted in the final regulations.

The comments also suggested adding that a taxpayer need not provide any evidence to avoid preclusion if the case file

already contains evidence with respect to that issue. This addition is not necessary. If the case file contains all the information needed for a decision on an issue, an Appeals officer will not request any additional evidence and the revised language in A–F5 (redesignated as A–F3 in the final regulations) will not apply. In the unlikely event that an Appeals officer making a determination on an issue requested information already in the file, a reviewing court should find the taxpayer's failure to provide any evidence does not prevent the issue from being raised. The final regulations do not adopt this recommendation.

The comments urged that the regulations make clear that the authority of Appeals officers to determine the validity, sufficiency and timeliness of a CDP notice does not alter or limit the authority of the reviewing court to make the same determination. The IRS and the Treasury Department believe this clarification is unnecessary. It is well-settled that reviewing courts have the authority to determine the validity, sufficiency and timeliness of a CDP notice. See, *e.g.*, *Kennedy v. Commissioner*, 116 T.C. 255 (2001). This clarification is not adopted in the final regulations.

The comments recommended that administrative rules similar to those developed under section 6015 be added to the regulations. The regulations state that a spousal defense raised under section 66 or 6015 is governed by section 66 or 6015 and the regulations and procedures thereunder. See Treas. Reg. § 301.6330–1(e)(2). To the extent it is determined that further guidance is necessary, such guidance will be in the form of additions to the Internal Revenue Manual. The final regulations do not adopt this recommendation.

The final regulations include amendments to the existing regulations to remove references to judicial review by United States district courts. The Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780, § 855 amended section 6330(d) to eliminate the jurisdiction of the district courts to review notices of determination, leaving the Tax Court with sole jurisdiction. For this reason, Q&A–F3 and Q&A–F4 in the existing regulations are removed by the final regulations and Q&A–F5 and Q&A–F6 in the proposed regulations are redesignated as Q&A–F3 and Q&A–F4 in the final regulations. In addition, only the Tax Court is now mentioned in A–E11, paragraph (f)(1), A–F1, redesignated Q&A–F3 and Q&A–F4, *Example 1* of paragraph (g)(3), Q&A–H2 and redesignated Q–I6.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. In particular, the IRS and the Treasury Department find for good cause that a notice of proposed rulemaking and solicitation of public comments are unnecessary to amend the existing regulations to implement the modification of section 6330(d) by the Pension Protection Act of 2006, Public Law 109–280, 120 Stat. 780. These amendments are made solely to conform the regulations to the statutory change enacted by Congress. The amendments do not involve any exercise of discretion or interpretation by the IRS or Treasury Department and the removal of United States district court jurisdiction would become effective even if the amendments were not made. Accordingly, the notice and public comment procedures do not apply. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations were 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 Laurence K. Williams, Office of Associate Chief Counsel, Procedure and Administration (Collection, Bankruptcy and Summonses Division).

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6330–1 is amended as follows:

1. Paragraph (c)(2) A–C1, Q&A–C6 and A–C7 are revised.

2. Paragraph (d)(2) A–D4 and A–D7 are revised.

3. Paragraph (d)(2) Q&A–D8 is added.

4. Paragraph (d)(3) is added.

5. Paragraph (e)(1) is revised.

6. Paragraph (e)(3) A–E2, A–E6, A–E7 and A–E11 are revised.

7. Paragraph (f)(1) is revised.

8. Paragraph (f)(2) A–F1 is revised.

9. Paragraph (f)(2) Q&A–F3 is removed.

10. Paragraph (f)(2) Q&A–F5 is revised and redesignated Q&A–F3.

11. Paragraph (f)(2) Q&A–F4 is revised.

12. Paragraph (g)(3) *Example 1* is revised.

13. Paragraph (h)(2) Q&A–H2 is revised.

14. Paragraph (i)(2) Q–I5 is revised and redesignated Q–I6.

15. Paragraph (i)(2) A–I5 is redesignated A–I6.

16. Paragraph (i)(2) Q&A–I1 through Q&A–I4 are redesignated Q&A–I2 through Q&A–I5

17. Paragraph (i)(2) Q&A–I1 and Q&A–I7 through Q&A–I11 are added.

18. Paragraph (j) is revised.

§301.6330–1 Notice and opportunity for hearing prior to levy.

* * * * *

(c) * * *

(2) * * *

A–C1. (i) The taxpayer must make a request in writing for a CDP hearing. The request for a CDP hearing shall include the information and signature specified in A–C1(ii) of this paragraph (c)(2). See A–D7 and A–D8 of paragraph (d)(2).

(ii) The written request for a CDP hearing must be dated and must include the following:

(A) The taxpayer's name, address, daytime telephone number (if any), and

taxpayer identification number (*e.g.*, SSN, ITIN or EIN).

(B) The type of tax involved.

(C) The tax period at issue.

(D) A statement that the taxpayer requests a hearing with Appeals concerning the proposed levy.

(E) The reason or reasons why the taxpayer disagrees with the proposed levy.

(F) The signature of the taxpayer or the taxpayer's authorized representative.

(iii) If the IRS receives a timely written request for CDP hearing that does not satisfy the requirements set forth in A–C1(ii) of this paragraph (c)(2), the IRS will make a reasonable attempt to contact the taxpayer and request that the taxpayer comply with the unsatisfied requirements. The taxpayer must perfect any timely written request for a CDP hearing that does not satisfy the requirements set forth in A–C1(ii) of this paragraph (c)(2) within a reasonable period of time after a request from the IRS.

(iv) Taxpayers are encouraged to use Form 12153, "*Request for a Collection Due Process Hearing*," in requesting a CDP hearing so that the request can be readily identified and forwarded to Appeals. Taxpayers may obtain a copy of Form 12153 by contacting the IRS office that issued the CDP Notice, by downloading a copy from the IRS Internet site, *www.irs.gov/pub/irs-pdf/f12153.pdf*, or by calling, toll-free, 1–800–829–3676.

(v) The taxpayer must affirm any timely written request for a CDP hearing which is signed or alleged to have been signed on the taxpayer's behalf by the taxpayer's spouse or other unauthorized representative by filing, within a reasonable period of time after a request from the IRS, a signed, written affirmation that the request was originally submitted on the taxpayer's behalf. If the affirmation is filed within a reasonable period of time after a request, the timely CDP hearing request will be considered timely with respect to the non-signing taxpayer. If the affirmation is not filed within a reasonable period of time after a request, the CDP hearing request will be denied with respect to the non-signing taxpayer.

* * * * *

Q–C6. Where must the written request for a CDP hearing be sent?

A–C6. The written request for a CDP hearing must be sent, or hand delivered (if permitted), to the IRS office and address as directed on the CDP Notice. If the address of that office does not appear on the CDP Notice, the taxpayer should obtain the address of the office to which the written request should be sent or hand delivered by calling, toll-free, 1–800–829–1040 and providing the taxpayer's identification number (*e.g.*, SSN, ITIN or EIN).

* * * * *

A–C7. If the taxpayer does not request a CDP hearing in writing within the 30-day period that commences on the day after the date of the CDP Notice, the taxpayer foregoes the right to a CDP hearing under section 6330 with respect to the unpaid tax and tax periods shown on the CDP Notice. A written request submitted within the 30-day period that does not satisfy the requirements set forth in A–C1(ii)(A), (B), (C), (D) or (F) of this paragraph (c)(2) is considered timely if the request is perfected within a reasonable period of time pursuant to A–C1(iii) of this paragraph (c)(2). If the request for CDP hearing is untimely, either because the request was not submitted within the 30-day period or not perfected within the reasonable period provided, the taxpayer will be notified of the untimeliness of the request and offered an equivalent hearing. In such cases, the taxpayer may obtain an equivalent hearing without submitting an additional request. See paragraph (i) of this section.

* * * * *

(d) * * *

(2) * * *

A–D4. Prior involvement by an Appeals officer or employee includes participation or involvement in a matter (other than a CDP hearing held under either section 6320 or section 6330) that the taxpayer may have had with respect to the tax and tax period shown on the CDP Notice. Prior involvement exists only when the taxpayer, the tax and the tax period at issue in the CDP hearing also were at issue in the prior non-CDP matter, and the Appeals officer or employee actually participated in the prior matter.

* * * * *

A–D7. Except as provided in A–D8 of this paragraph (d)(2), a taxpayer who presents in the CDP hearing request relevant, non-frivolous reasons for disagreement with the proposed levy will ordinarily be offered an opportunity for a face-to-face conference at the Appeals office closest to taxpayer's residence. A business taxpayer will ordinarily be offered an opportunity for a face-to-face conference at the Appeals office closest to the taxpayer's principal place of business. If that is not satisfactory to the taxpayer, the taxpayer will be given an opportunity for a hearing by telephone or by correspondence. In all cases, the Appeals officer or employee will review the case file, as described in A–F4 of paragraph (f)(2). If no face-to-face or telephonic conference is held, or other oral communication takes place, review of the documents in the case file, as described in A–F4 of paragraph (f)(2), will constitute the CDP hearing for purposes of section 6330(b).

Q–D8. In what circumstances will a face-to-face CDP conference not be granted?

A–D8. A taxpayer is not entitled to a face-to-face CDP conference at a location other than as provided in A–D7 of this paragraph (d)(2) and this A–D8. If all Appeals officers or employees at the location provided for in A–D7 of this paragraph (d)(2) have had prior involvement with the taxpayer as provided in A–D4 of this paragraph (d)(2), the taxpayer will not be offered a face-to-face conference at that location, unless the taxpayer elects to waive the requirement of section 6330(b)(3). The taxpayer will be offered a face-to-face conference at another Appeals office if Appeals would have offered the taxpayer a face-to-face conference at the location provided in A–D7 of this paragraph (d)(2), but for the disqualification of all Appeals officers or employees at that location. A face-to-face CDP conference concerning a taxpayer's underlying liability will not be granted if the request for a hearing or other taxpayer communication indicates that the taxpayer wishes only to raise irrelevant or frivolous issues concerning that liability. A face-to-face CDP conference concerning a collection alternative, such as an installment agreement or an offer to compromise liability, will not be granted unless other taxpayers would be eligible for the alternative in similar circumstances. For example, because the IRS does not consider offers to compromise from taxpayers who have not filed required returns or have not made certain required deposits of tax, as set forth in Form 656, "*Offer in Compromise*," no face-to-face confer-

ence will be granted to a taxpayer who wishes to make an offer to compromise but has not fulfilled those obligations. Appeals in its discretion, however, may grant a face-to-face conference if Appeals determines that a face-to-face conference is appropriate to explain to the taxpayer the requirements for becoming eligible for a collection alternative. In all cases, a taxpayer will be given an opportunity to demonstrate eligibility for a collection alternative and to become eligible for a collection alternative, in order to obtain a face-to-face conference. For purposes of determining whether a face-to-face conference will be granted, the determination of a taxpayer's eligibility for a collection alternative is made without regard to the taxpayer's ability to pay the unpaid tax. A face-to-face conference need not be granted if the taxpayer does not provide the required information set forth in A–C1(ii)(E) of paragraph (c)(2). See also A–C1(iii) of paragraph (c)(2).

(3) *Examples*. The following examples illustrate the principles of this paragraph (d):

Example 1. Individual A timely requests a CDP hearing concerning a proposed levy for the 1998 income tax liability assessed against individual A. Appeals employee B previously conducted a CDP hearing regarding a NFTL filed with respect to individual A's 1998 income tax liability. Because employee B's only prior involvement with individual A's 1998 income tax liability was in connection with a section 6320 CDP hearing, employee B may conduct the CDP hearing under section 6330 involving the proposed levy for the 1998 income tax liability.

Example 2. Individual C timely requests a CDP hearing concerning a proposed levy for the 1998 income tax liability assessed against individual C. Appeals employee D previously conducted a Collection Appeals Program (CAP) hearing regarding a NFTL filed with respect to individual C's 1998 income tax liability. Because employee D's prior involvement with individual C's 1998 income tax liability was in connection with a non-CDP hearing, employee D may not conduct the CDP hearing under section 6330 unless individual C waives the requirement that the hearing will be conducted by an Appeals officer or employee who has had no prior involvement with respect to individual C's 1998 income tax liability.

Example 3. Same facts as in *Example 2*, except that the prior CAP hearing only involved individual C's 1997 income tax liability and employment tax liabilities for 1998 reported on Form 941, "*Employer's Quarterly Federal Tax Return*." Employee D would not be considered to have prior involvement because the prior CAP hearing in which she participated did not involve individual C's 1998 income tax liability.

Example 4. Appeals employee F is assigned to a CDP hearing concerning a proposed levy for a trust fund recovery penalty (TFRP) assessed pursuant to section 6672 against individual E. Appeals employee F participated in a prior CAP hearing involving individual E's 1999 income tax liability, and participated in a CAP hearing involving the employment taxes of business entity X, which incurred the employment tax liability to which the TFRP assessed against individual E relates. Appeals employee F would not be considered to have prior involvement because the prior CAP hearings in which he participated did not directly involve the TFRP assessed against individual E.

Example 5. Appeals employee G is assigned to a CDP hearing concerning a proposed levy for a TFRP assessed pursuant to section 6672 against individual H. In preparing for the CDP hearing, Appeals employee G reviews the Appeals case file concerning the prior CAP hearing involving the TFRP assessed pursuant to section 6672 against individual H. Appeals employee G is not deemed to have participated in the previous CAP hearing involving the TFRP assessed against individual H by such review.

(e) *Matters considered at CDP hearing*—(1) *In general*. Appeals will determine the timeliness of any request for a CDP hearing that is made by a taxpayer. Appeals has the authority to determine the validity, sufficiency, and timeliness of any CDP Notice given by the IRS and of any request for a CDP hearing that is made by a taxpayer. Prior to issuance of a determination, Appeals is required to obtain verification from the IRS office collecting the tax that the requirements of any applicable law or administrative procedure with respect to the proposed levy have been met. The taxpayer may raise any relevant issue relating to the unpaid tax at the hearing, including appropriate spousal defenses, challenges to the appropriateness of the proposed levy, and offers of collection alternatives. The taxpayer also may raise challenges to the existence or amount of the underlying liability, including a liability reported on a self-filed return, for any tax period specified on the CDP Notice if the taxpayer did not receive a statutory notice of deficiency for that tax liability or did not otherwise have an opportunity to dispute the tax liability. Finally, the taxpayer may not raise an issue that was raised and considered at a previous CDP hearing under section 6320 or in any other previous administrative or judicial proceeding if the taxpayer participated meaningfully in such hearing or proceeding. Taxpayers will be expected to provide all relevant information requested by Appeals, including financial statements, for its consideration of the facts and issues involved in the hearing.

* * * * *

(3) * * *

A–E2. A taxpayer is entitled to challenge the existence or amount of the underlying liability for any tax period specified on the CDP Notice if the taxpayer did not receive a statutory notice of deficiency for such liability or did not otherwise have an opportunity to dispute such liability. Receipt of a statutory notice of deficiency for this purpose means receipt in time to petition the Tax Court for a redetermination of the deficiency determined in the notice of deficiency. An opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability. An opportunity for a conference with Appeals prior to the assessment of a tax subject to deficiency procedures is not a prior opportunity for this purpose.

* * * * *

A–E6. Collection alternatives include, for example, a proposal to withhold the proposed levy or future collection action in circumstances that will facilitate the collection of the tax liability, an installment agreement, an offer to compromise, the posting of a bond, or the substitution of other assets. A collection alternative is not available unless the alternative would be available to other taxpayers in similar circumstances. See A–D8 of paragraph (d)(2).

* * * * *

A–E7. The taxpayer may raise appropriate spousal defenses, challenges to the appropriateness of the proposed collection action, and offers of collection alternatives. The existence or amount of the underlying liability for any tax period specified in the CDP Notice may be challenged only if the taxpayer did not have a prior opportunity to dispute the tax liability. If the taxpayer previously received a CDP Notice under section 6320 with respect to the same tax and tax period and did not request a CDP hearing with respect to that earlier CDP Notice, the taxpayer had a prior opportunity to dispute the existence or amount of the underlying tax liability.

* * * * *

A–E11. No. An Appeals officer may consider the existence and amount of the underlying tax liability as a part of the CDP hearing only if the taxpayer did not receive a statutory notice of deficiency for the tax liability in question or otherwise have a

prior opportunity to dispute the tax liability. Similarly, an Appeals officer may not consider any other issue if the issue was raised and considered at a previous hearing under section 6320 or in any other previous administrative or judicial proceeding in which the person seeking to raise the issue meaningfully participated. In the Appeals officer's sole discretion, however, the Appeals officer may consider the existence or amount of the underlying tax liability, or such other precluded issues, at the same time as the CDP hearing. Any determination, however, made by the Appeals officer with respect to such a precluded issue shall not be treated as part of the Notice of Determination issued by the Appeals officer and will not be subject to any judicial review. Because any decisions made by the Appeals officer on such precluded issues are not properly a part of the CDP hearing, such decisions are not required to appear in the Notice of Determination issued following the hearing. Even if a decision concerning such precluded issues is referred to in the Notice of Determination, it is not reviewable by the Tax Court because the precluded issue is not properly part of the CDP hearing.

* * * * *

(f) *Judicial review of Notice of Determination*—(1) *In general.* Unless the taxpayer provides the IRS a written withdrawal of the request that Appeals conduct a CDP hearing, Appeals is required to issue a Notice of Determination in all cases where a taxpayer has timely requested a CDP hearing. The taxpayer may appeal such determinations made by Appeals within the 30-day period commencing the day after the date of the Notice of Determination to the Tax Court.

(2) * * *

A–F1. Subject to the jurisdictional limitations described in A–F2 of this paragraph (f)(2), the taxpayer must, within the 30-day period commencing the day after the date of the Notice of Determination, appeal the determination by Appeals to the Tax Court.

* * * * *

Q–F3. What issue or issues may the taxpayer raise before the Tax Court if the taxpayer disagrees with the Notice of Determination?

A–F3. In seeking Tax Court review of a Notice of Determination, the taxpayer can only ask the court to consider an issue, including a challenge to the underlying tax liability, that was properly raised in the taxpayer's CDP hearing. An issue is not properly raised if the taxpayer fails to request consideration of the issue by Appeals, or if consideration is requested but the taxpayer fails to present to Appeals any evidence with respect to that issue after being given a reasonable opportunity to present such evidence.

Q–F4. What is the administrative record for purposes of Tax Court review?

A–F4. The case file, including the taxpayer's request for hearing, any other written communications and information from the taxpayer or the taxpayer's authorized representative submitted in connection with the CDP hearing, notes made by an Appeals officer or employee of any oral communications with the taxpayer or the taxpayer's authorized representative, memoranda created by the Appeals officer or employee in connection with the CDP hearing, and any other documents or materials relied upon by the Appeals officer or employee in making the determination under section 6330(c)(3), will constitute the record in the Tax Court review of the Notice of Determination issued by Appeals.

(g) * * *

(3) * * *

Example 1. The period of limitation under section 6502 with respect to the taxpayer's tax period listed in the CDP Notice will expire on August 1, 1999. The IRS sent a CDP Notice to the taxpayer on April 30, 1999. The taxpayer timely requested a CDP hearing. The IRS received this request on May 15, 1999. Appeals sends the taxpayer its determination on June 15, 1999. The taxpayer timely seeks judicial review of that determination. The period of limitation under section 6502 would be suspended from May 15, 1999, until the determination resulting from that hearing becomes final by expiration of the time for seeking review or reconsideration before the Tax Court, plus 90 days.

* * * * *

(h) * * *

(2) * * *

Q–H2. Is a decision of Appeals resulting from a retained jurisdiction hearing appealable to the Tax Court?

A–H2. No. As discussed in A–H1, a taxpayer is entitled to only one CDP hearing under section 6330 with respect to the tax and tax period or periods specified in the CDP Notice. Only determinations resulting from CDP hearings are appealable to the Tax Court.

(i) * * *

(2) * * *

Q–I1. What must a taxpayer do to obtain an equivalent hearing?

A–I1. (i) A request for an equivalent hearing must be made in writing. A written request in any form that requests an equivalent hearing will be acceptable if it includes the information and signature required in A–I1(ii) of this paragraph (i)(2).

(ii) The request must be dated and must include the following:

(A) The taxpayer's name, address, daytime telephone number (if any), and taxpayer identification number (*e.g.*, SSN, ITIN or EIN).

(B) The type of tax involved.

(C) The tax period at issue.

(D) A statement that the taxpayer is requesting an equivalent hearing with Appeals concerning the levy.

(E) The reason or reasons why the taxpayer disagrees with the proposed levy.

(F) The signature of the taxpayer or the taxpayer's authorized representative.

(iii) The taxpayer must perfect any timely written request for an equivalent hearing that does not satisfy the requirements set forth in A–I1(ii) of this paragraph (i)(2) within a reasonable period of time after a request from the IRS. If the requirements are not satisfied within a reasonable period of time, the taxpayer's equivalent hearing request will be denied.

(iv) The taxpayer must affirm any timely written request for an equivalent hearing that is signed or alleged to have been signed on the taxpayer's behalf by the taxpayer's spouse or other unauthorized representative, and that otherwise meets the requirements set forth in A–I1(ii) of this paragraph (i)(2), by filing, within a reasonable period of time after a request from the IRS, a signed written affirmation that the request was originally submitted on the taxpayer's behalf. If the affirmation is filed within a reasonable period of time after a request, the timely equivalent hearing request will be considered timely with respect to the non-signing taxpayer. If the affirmation is not filed within a reasonable period of time, the equivalent hearing request will be denied with respect to the non-signing taxpayer.

* * * * *

Q–I6. Will a taxpayer be able to obtain Tax Court review of a decision made by

Appeals with respect to an equivalent hearing?

* * * * *

Q–I7. When must a taxpayer request an equivalent hearing with respect to a CDP Notice issued under section 6330?

A–I7. A taxpayer must submit a written request for an equivalent hearing within the one-year period commencing the day after the date of the CDP Notice issued under section 6330. This period is slightly different from the period for submitting a written request for an equivalent hearing with respect to a CDP Notice issued under section 6320. For a CDP Notice issued under section 6320, a taxpayer must submit a written request for an equivalent hearing within the one-year period commencing the day after the end of the five-business-day period following the filing of the NFTL.

Q–I8. How will the timeliness of a taxpayer's written request for an equivalent hearing be determined?

A–I8. The rules and regulations under section 7502 and section 7503 will apply to determine the timeliness of the taxpayer's request for an equivalent hearing, if properly transmitted and addressed as provided in A–I10 of this paragraph (i)(2).

Q–I9. Is the one-year period within which a taxpayer must make a request for an equivalent hearing extended because the taxpayer resides outside the United States?

A–I9. No. All taxpayers who want an equivalent hearing must request the hearing within the one-year period commencing the day after the date of the CDP Notice issued under section 6330.

Q–I10. Where must the written request for an equivalent hearing be sent?

A–I10. The written request for an equivalent hearing must be sent, or hand delivered (if permitted), to the IRS office and address as directed on the CDP Notice. If the address of the issuing office does not appear on the CDP Notice, the taxpayer should obtain the address of the office to which the written request should be sent or hand delivered by calling, toll-free, 1–800–829–1040 and providing the taxpayer's identification number (*e.g.*, SSN, ITIN or EIN).

Q–I11. What will happen if the taxpayer does not request an equivalent hearing in writing within the one-year period commencing the day after the date of the CDP Notice issued under section 6330?

A–I11. If the taxpayer does not request an equivalent hearing with Appeals within the one-year period commencing the day after the date of the CDP Notice issued under section 6330, the taxpayer foregoes the right to an equivalent hearing with respect to the unpaid tax and tax periods shown on the CDP Notice. A written request submitted within the one-year period that does not satisfy the requirements set forth in A–I1(ii) of this paragraph (i)(2) is considered timely if the request is perfected within a reasonable period of time pursuant to A–I1(iii) of this paragraph (i)(2). If a request for equivalent hearing is untimely, either because the request was not submitted within the one-year period or not perfected within the reasonable period provided, the equivalent hearing request will be denied. The taxpayer, however, may seek reconsideration by the IRS office collecting the tax, assistance from the National Taxpayer Advocate, or an administrative hearing before Appeals under its Collection Appeals Program or any successor program.

(j) *Effective date*. This section is applicable on or after November 16, 2006 with respect to requests made for CDP hearings or equivalent hearings on or after November 16, 2006.

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

Approved October 6, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on October 16, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2006, 71 F.R. 60827)

Section 7702.—Life Insurance Contract Defined

26 CFR 1.7702–2: Attained age of the insured under a life insurance contract.

T.D. 9287

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Attained Age of the Insured Under Section 7702

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations explaining how to determine the attained age of an insured for purposes of testing whether a contract qualifies as a life insurance contract for Federal income tax purposes.

DATES: *Effective Date:* These regulations are effective September 13, 2006.

Applicability Dates: For dates of applicability, see §1.7702–2(f).

FOR FURTHER INFORMATION CONTACT: Ann H. Logan, 202–622–3970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 7702(a) of the Internal Revenue Code (Code) provides that, for a contract to qualify as a life insurance contract for Federal income tax purposes, the contract must be a life insurance contract under the applicable law and must either (1) satisfy the cash value accumulation test of section 7702(b), or (2) both meet the guideline premium requirements of section 7702(c) and fall within the cash value corridor of section 7702(d). To determine whether a contract satisfies the cash value accumulation test, or meets the guideline premium requirements and falls within the cash value corridor, it is necessary to determine the attained age of the insured.

A contract meets the cash value accumulation test of section 7702(b) if, by the

terms of the contract, the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at that time to fund future benefits under the contract. Under section 7702(e)(1)(B), the maturity date of the contract is deemed to be no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100, for purposes of applying the cash value accumulation test.

A contract meets the guideline premium requirements of section 7702(c) if the sum of the premiums paid under the contract does not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums as of such time. The guideline single premium is the premium that is needed at the time the policy is issued to fund the future benefits under the contract based on the following three elements enumerated in section 7702(c)(3)(B):

(i) 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 section 807(d)(5)) as of the time the contract is issued;

(ii) Any reasonable charges (other than mortality charges) that (on the basis of the company's experience, if any, with respect to similar contracts) are reasonably expected to be actually paid; and

(iii) Interest at the greater of an annual effective rate of six percent or the rate or rates guaranteed on issuance of the contract.

The guideline level premium is the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis as the guideline single premium but using a minimum interest rate of four percent, rather than six percent. Like the cash value accumulation test, the guideline premium requirements are applied by deeming the maturity date of the contract to be no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100. The deemed maturity date generally is the determination date set forth in the contract or the end of the mortality table (which, when section 7702 was enacted in 1984, was age 100).

A contract falls within the cash value corridor if the death benefit of the contract at any time is not less than the applicable percentage of the cash surrender value. The applicable percentage is determined based on the attained age of the insured as of the beginning of the contract year, as follows:

APPLICABLE PERCENTAGE			
In the case of an insured with an attained age as of the beginning of the contract year of:		The applicable percentage shall decrease by a ratable portion for each full year:	
More than:	But not more than:	From:	To:
0	40	250	250
40	45	250	215
45	50	215	185
50	55	185	150
55	60	150	130
60	65	130	120
65	70	120	115
70	75	115	105
75	90	105	105
90	95	105	100

The Code does not define the attained age of the insured for purposes of applying the cash value corridor, the guideline premium limitations, or the computational rules of section 7702(e). The Senate Finance Committee explanation of the Deficit Reduction Act of 1984, Public Law 98–369 (98 Stat. 494), however, states that the attained age of the insured means the insured's age determined by reference to contract anniversaries (rather than the individual's actual birthdays), so long as the age assumed under the contract is within 12 months of the actual age. See S. Prt. No. 98–169, Vol. 1, at 576 (1984).

Section 7702A defines a modified endowment contract (MEC) as a contract that meets the requirements of section 7702 (that is, a contract that is a life insurance contract), but that fails to meet the 7-pay test set forth in section 7702A(b). A contract fails to meet the 7-pay test if the accumulated amount paid under the contract at any time during the first 7 contract years exceeds the sum of the net level premiums that would have been paid on or before that time if the contract provided for paid-up future benefits after the payment of 7 level annual premiums. Section 7702A(c)(1)(B) provides that, for purposes of this test, the computational rules of section 7702(e) generally apply, including the contract's deemed maturity no earlier than the day on which the insured attains age 95, and no later than the day on which the insured attains age 100.

In sum, the attained age of an insured under a contract that is a life insurance contract under the applicable law must be determined to test whether the contract complies with the guideline premium require-

ments of section 7702(c), the cash value corridor of section 7702(d), and (by reason of the computational rules of section 7702(e)) the cash value accumulation test of section 7702(b) and the 7-pay test of section 7702A(b), as applicable.

On May 24, 2005, the IRS and Treasury Department published a notice of proposed rulemaking (REG–168892–03, 2005–25 I.R.B. 1293, June 20, 2005) in the **Federal Register** (70 FR 29671) (the proposed regulations). The proposed regulations provide guidance on how to determine the attained age of an individual insured under a contract that is a life insurance contract under the applicable law, for purposes of testing whether the contract qualifies as a life insurance contract under section 7702 and is a modified endowment contract under section 7702A. Under the proposed regulations, the attained age of the insured is either (i) the insured's age determined by reference to the individual's actual birthday as of the date of determination (actual age) or (ii) the insured's age determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract (contract age) is within 12 months of the actual age. The proposed regulations provide that the attained age of the insured under a contract insuring multiple lives on a last-to-die basis is the attained age of the youngest insured, and the attained age of the insured under a contract insuring multiple lives on a first-to-die basis is the attained age of the oldest insured.

The sole party requesting a public hearing timely withdrew its request. One written comment regarding the notice of proposed rulemaking was received.

Explanation of Provisions

After consideration of the written comment received, this Treasury decision adopts the regulations as proposed, with the modifications noted below.

A. *Identity of the Insured Individual*

The proposed regulations provide that, in the case of a last-to-die contract, the attained age of the insured means the age of the youngest individual insured under the contract. The comment letter pointed out that, in the case of such a contract, the death of the youngest insured raises a question whether the attained age under the contract should continue to be determined based on the attained age of the deceased insured, or should instead be based on the attained age of the youngest *surviving* insured. Some last-to-die life insurance contracts undergo a change in both cash value and future mortality charges as a result of the death of an insured. These changes take into account the identity of the surviving insured or insureds. Other last-to-die life insurance contracts treat the death of an insured as a non-event for purposes of measuring cash value and future mortality charges under the contract. The comment letter suggested a rule for last-to-die contracts that would take into account the age of the youngest surviving insured if the contract undergoes modifications to both the cash value and future mortality charges under the contract, so that the attained age assumptions used for Federal income tax purposes are consistent with those used under the terms of the contract. The final regulations include such a rule in §1.7702–2(c)(2).

B. *Changes in Benefits Between Policy Anniversaries*

The proposed regulations provide that the age of an individual insured under a life insurance contract is either (i) the insured's age determined by reference to the individual's actual birthday as of the date of determination (actual age), or (ii) the insured's age determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract (contract age) is within 12 months of the actual age. The proposed regulations do not, however, define the attained age to be used if there is an increase in death benefits between policy anniversary dates. Specifically, should the attained age as of the beginning of the contract year continue to be used at the time of the benefit increase, even if the date of change is closer to the next contract anniversary? The comment letter requests flexibility to use the attained age as of either the previous or subsequent policy anniversary, or any age between those two ages. The final regulations address this issue by clarifying that the attained age of the insured under a contract, once determined, changes annually. This rule is set forth in §1.7702–2(b)(2).

C. *Use of Derived Ages for Multiple Life Contracts*

Under the proposed regulations, the attained age of the insured under a contract insuring multiple lives is either the attained age of the youngest insured (in the case of a last-to-die contract) or the attained age of the oldest insured (in the case of a first-to-die contract). Some issuers, however, determine mortality charges under such contracts using a single, derived age that does not correspond to the attained age of any single insured under the contract. In addition, in some cases issuers currently account for substandard risks by determining mortality charges based on an age that is older than the actual attained age of the insured under the contract. The comment letter requested a rule that would permit the use of the same derived age as the *attained age* of the insured in these circumstances, to avoid whatever administrative complexities could result from the use of different ages for different purposes in the course of testing compliance of the contracts with sections 7702 and 7702A.

The final regulations do not make this change. The manner in which age is used to determine *reasonable mortality charges* under section 7702(c)(3)(B)(i) is independent of the age that is treated as the *attained age* of the insured for purposes of determining the guideline level premium under section 7702(c)(4), or applying the cash value corridor of section 7702(d) or the computational rules of section 7702(e). The final regulations do not, nor are they intended to, endorse or prohibit any methodology for determining reasonable mortality charges under section 7702(c). Reasonable mortality charges were the subject of regulations proposed July 5, 1991, (FI–069–89, 1991–2 C.B. 963) in the **Federal Register** (56 FR 30718), and also were addressed in Notice 88–128, 1988–2 C.B. 540, and Notice 2004–61, 2004–2 C.B. 596. See §601.601(d)(2)(ii). This prior guidance is not modified, clarified, or in any other way affected by these final regulations.

D.. *Contract Anniversary*

The comment letter requested that the regulations include a definition of *contract anniversary* other than the issue date of the contract and subsequent anniversaries

of that date. The final regulations do not include such a definition because the terms *issue date* and *contract year* have broad application, and it would be inappropriate to address the matter for the first time in these final regulations.

E. *Effective Date*

The proposed regulations were proposed to apply to contracts issued on or after the date that is one year after the regulations are published as final regulations in the **Federal Register**. A taxpayer would be permitted, however, to apply these final regulations retroactively for contracts issued before that date provided the taxpayer does not later determine qualification of those contracts in a manner that is inconsistent with these regulations.

The comment letter requested that the final regulations conform more closely to the adoption dates for the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables). These tables are now prevailing within the meaning of section 807(d)(5) and have a mandatory effective date of January 1, 2009. In some States, insurers have the option to use either the 1980 CSO tables or the 2001 CSO tables for contracts issued before January 1, 2009. Either changing from the 1980 CSO mortality tables to the 2001 CSO tables or adopting changes to the determination of the insured's attained age under this regulation (or both) may require filing new contract forms with the relevant state insurance commissioners and may require changes to existing compliance systems. Accordingly, the effective date of this final regulation has been adjusted to take into account the transition period for adoption of the new mortality tables. Specifically, the final regulations apply to life insurance contracts that are either (1) issued after December 31, 2008, or (2) issued on or after October 1, 2007, and based upon the 2001 CSO tables. This modification will enable issuers to make any changes required by this final regulation concurrently with the changes required by the adoption of the 2001 CSO mortality tables. In addition, taxpayers may apply the regulations for contracts issued before October 1, 2007, provided they do not later determine qualification of those contracts under section 7702 in a manner inconsistent with the regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding this Treasury decision 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 final regulations is Ann H. Logan, Office of the Associate Chief Counsel (Financial Institutions and Products), Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the IRS and the Treasury Department participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.7702–2 also issued under 26 U.S.C. 7702(k). * * *

Par. 2. Section 1.7702–0 is added to read as follows:

§1.7702–0 Table of contents.

This section lists the captions that appear in §§1.7702–1, 1.7702–2, and 1.7702–3.

§1.7702–1 Mortality charges.

(a) General rule.
(b) Reasonable mortality charges.
(1) Actually expected to be imposed.
(2) Limit on charges.
(c) Safe harbors.
(1) 1980 C.S.O. Basic Mortality Tables.
(2) Unisex tables and smoker/nonsmoker tables.
(3) Certain contracts based on 1958 C.S.O. table.
(d) Definitions.
(1) Prevailing commissioners' standard tables.
(2) Substandard risk.
(3) Nonparticipating contract.
(4) Charge reduction mechanism.
(5) Plan of insurance.
(e) Effective date.

§1.7702–2 Attained age of the insured under a life insurance contract.

(a) In general.
(b) Contract insuring a single life.
(c) Contract insuring multiple lives on a last-to-die basis.
(1) In general.
(2) Modifications to cash value and future mortality charges upon the death of insured.
(d) Contract insuring multiple lives on a first-to-die basis.
(e) Examples.
(f) Effective dates.
(1) In general.
(2) Contracts issued before the general effective date.

§1.7702–3 Definitions.

(a) In general.
(b) Cash value.
(1) In general.
(2) Amounts excluded from cash value.
(c) Death benefit.
(1) In general.
(2) Qualified accelerated death benefit treated as death benefit.
(d) Qualified accelerated death benefit.
(1) In general.
(2) Determination of present value of the reduction in death benefit.
(3) Examples.
(e) Terminally ill defined.
(f) Certain other additional benefits.
(1) In general.
(2) Examples.
(g) Adjustments under section 7702(f)(7).
(h) Cash surrender value.
(1) In general.
(2) For purposes of section 7702(f)(7).

(i) Net surrender value.

(j) Effective date and special rules.

(1) In general.

(2) Provision of certain benefits before July 1, 1993.

(i) Not treated as cash value.

(ii) No effect on date of issuance.

(iii) Special rule for addition of benefit or loan provision after December 15, 1992.

(3) Addition of qualified accelerated death benefit.

(4) Addition of other additional benefits.

Par. 3. Section 1.7702–2 is added to read as follows:

§1.7702–2 Attained age of the insured under a life insurance contract.

(a) *In general*. This section provides guidance on determining the attained age of an insured under a contract that is a life insurance contract under the applicable law, for purposes of determining the guideline level premium of the contract under section 7702(c)(4), applying the cash value corridor of section 7702(d) or applying the computational rules of section 7702(e), as applicable.

(b) *Contract insuring a single life*. (1) If a contract insures the life of a single individual, either of the following two ages may be treated as the attained age of the insured with respect to that contract—

(i) The insured's age determined by reference to the individual's actual birthday as of the date of determination (actual age); or

(ii) The insured's age determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract (contract age) is within 12 months of the actual age as of that date.

(2) Once determined under paragraph (b)(1) of this section, the attained age with respect to an individual insured under a contract changes annually. Moreover, the same attained age must be used for purposes of applying sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(c) *Contract insuring multiple lives on a last-to-die basis*—(1) *In general*. Except as provided in paragraph (c)(2) of this section, if a contract insures the lives of more than one individual on a last-to-die basis, the attained age of the insured is determined by applying paragraph (b) of this section as if the youngest individual were the only insured under the contract for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(2) *Modifications to cash value and future mortality charges upon the death of insured*. If both the cash value and future mortality charges under a contract change by reason of the death of one or more insureds to no longer take into account the attained age of the deceased insured or insureds, the youngest surviving insured shall thereafter be treated as the only insured under the contract.

(d) *Contract insuring multiple lives on a first-to-die basis*. If a contract insures the lives of more than one individual on a first-to-die basis, the attained age of the insured is determined by applying paragraph (b) of this section as if the oldest individual were the only insured under the contract for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(e) *Examples*. The following examples illustrate the determination of the attained age of the insured for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable. The examples are as follows:

Example 1. (i) X was born on May 1, 1947. X became 60 years old on May 1, 2007. On January 1, 2008, X purchases from IC a contract insuring X's life. January 1 is the contract anniversary date for all future years. IC determines X's annual premiums on an age-last-birthday basis. Based on the method used by IC to determine age, X has an attained age of 60 for the first contract year, 61 for the second contract year, and so on.

(ii) Section 1.7702–2(b)(1) permits the determination of attained age under either of two alternative approaches. Section 1.7702–2(b)(1)(i) provides that, if a contract insures the life of a single insured individual, the attained age may be determined by reference to the individual's actual birthday as of the date of determination. Under this provision, X has an attained age of 60 for the first contract year, 61 for the second contract year, and so on. Alternatively, §1.7702–2(b)(1)(ii) provides that the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract is within 12 months of the actual age as of that date. If IC determines X's attained age under §1.7702–2(b)(1)(ii), X likewise has an attained age of 60 for the first contract year, 61 for the second contract year, and so on. Whichever provision IC uses to determine X's attained age must be used consistently from year to year for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 2. (i) The facts are the same as in *Example 1* except that, under the contract, X's annual premiums are determined on an age-nearest-birthday basis. X's nearest birthday to January 1, 2008, is May 1, 2008, when X will become 61 years old. Based on the method used by IC to determine age, X has an attained age of 61 for the first contract year, 62 for the second contract year, and so on.

(ii) Section 1.7702–2(b)(1) permits the determination of attained age under either of two alternative approaches. Section 1.7702–2(b)(1)(i) provides that, if a contract insures the life of a single insured individual, the attained age may be determined by reference to the individual's actual birthday as of the date of determination. Under this provision, X has an attained age of 60 for the first contract year, 61 for the second contract year, and so on. Alternatively, §1.7702–2(b)(1)(ii) provides that the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract is within 12 months of the actual age as of that date. If IC determines X's attained age under §1.7702–2(b)(1)(ii), X has an attained age of 61 for the first contract year, 62 for the second contract year, and so on. Whichever provision IC uses to determine X's attained age must be used consistently from year to year for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 3. (i) The facts are the same as in *Example 1* except that the face amount of the contract is increased on May 15, 2011. During the contract year beginning January 1, 2011, the age assumed under the contract on an age-last-birthday basis is 63 years. However, X has an actual age of 64 as of the date the face amount of the contract is increased.

(ii) Section 1.7702–2(b)(1)(ii) provides that the insured's age may be determined by reference to contract anniversary (rather than the individual's actual birthday), so long as the age assumed under the contract is within 12 months of the actual age. Section 1.7702–2(b)(2) provides that, once determined under paragraph (b)(1) of this section, the attained age with respect to an individual insured under a contract changes annually. Accordingly, X continues to be 63 years old throughout the contract year beginning January 1, 2011, for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 4. (i) The facts are the same as in *Example 1* except that in addition to X (born in 1947), the insurance contract also insures the life of Y, born on September 1, 1942. The death benefit will be paid when the second of the two insureds dies.

(ii) Section 1.7702–2(c)(1) provides that if a life insurance contract insures the lives of more than one individual on a last-to-die basis, the attained age of the insured is determined by applying §1.7702–2(b) as if the youngest individual were the only insured under the contract. Because X is younger than Y, the attained age of X must be used for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 5. (i) The facts are the same as *Example 4* except that X (the younger of the two insureds) dies in 2012. After X's death, both the cash value and mortality charges of the life insurance contract are adjusted to take into account only the life of Y.

(ii) Section 1.7702–2(c)(1) provides that if a life insurance contract insures the lives of more than one individual on a last-to-die basis, the attained age of the insured is determined by applying §1.7702–2(b) as if the youngest individual were the only insured under the contract. Paragraph (c)(2) of this section provides that if both the cash value and future mortality charges under a contract change by reason of the death of an insured to no longer take into account

the attained age of the deceased insured, the youngest surviving insured is thereafter treated as the only insured under the contract. Because both the cash value and mortality charges are adjusted after X's death to take into account only the life of Y, only the attained age of Y is taken into account after X's death for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

Example 6. (i) The facts are the same as *Example 1* except that in addition to X (born in 1947), the insurance contract also insures the life of Z, born on September 1, 1952. The death benefit will be paid when the first of the two insureds dies.

(ii) Section 1.7702–2(d) provides that if a life insurance contract insures the lives of more than one individual on a first-to-die basis, the attained age of the insured is determined by applying §1.7702–2(b) as if the oldest individual were the only insured under the contract. Because X is older than Z, the attained age of X must be used for purposes of sections 7702(c)(4), 7702(d), and 7702(e), as applicable.

(f) *Effective dates*—(1) *In general*. Except as provided in paragraph (f)(2) of this section, these regulations apply to all life insurance contracts that are either—

(i) Issued after December 31, 2008; or

(ii) Issued on or after October 1, 2007, and based upon the 2001 CSO tables.

(2) *Contracts issued before the general effective date*. Pursuant to section 7805(b)(7), a taxpayer may apply these regulations retroactively for contracts issued before October 1, 2007, provided that the taxpayer does not later determine qualification of those contracts in a manner that is inconsistent with these regulations.

Deborah M. Nolan,
Acting Deputy Commissioner for Services and Enforcement.

Approved September 6, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on September 12, 2006, 8:45 a.m., and published in the issue of the Federal Register for September 13, 2006, 71 F.R. 53967)

Part III. Administrative, Procedural, and Miscellaneous

Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions

Notice 2006–96

SECTION 1. PURPOSE

This notice provides transitional guidance relating to the new definitions of "qualified appraisal" and "qualified appraiser" in § 170(f)(11) of the Internal Revenue Code, and new § 6695A of the Code regarding substantial or gross valuation misstatements, as added by § 1219 of the Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006) (the "PPA").

The Service and the Treasury Department expect to issue regulations under § 170(f)(11). Until those regulations are effective, taxpayers may rely on this notice to comply with the new provisions added by § 1219 of the PPA.

SECTION 2. BACKGROUND

A deduction for charitable contributions is generally permitted under § 170(a), subject to certain limitations depending on the type of taxpayer, the nature of the property contributed, and the type of donee organization. Section 170(f)(11), as added by § 883 of the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418 (2004), contains reporting and substantiation requirements relating to the allowance of deductions for noncash charitable contributions. In particular, under § 170(f)(11)(C), taxpayers are required to obtain a qualified appraisal for donated property for which a deduction of more than $5,000 is claimed. Under § 170(f)(11)(D), in certain cases the qualified appraisal must be attached to the tax return. For appraisals prepared with respect to returns filed on or before August 17, 2006, existing Treasury Regulations provide a definition of the terms "qualified appraisal" and "qualified appraiser" for purposes of § 170(f)(11).

Section 1219 of the PPA amends § 170(f)(11)(E) and provides statutory definitions of a qualified appraisal and qualified appraiser for appraisals prepared with respect to returns filed after August 17, 2006.

Section 170(f)(11)(E)(i) provides that the term "qualified appraisal" means an appraisal that is (1) treated as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and (2) conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Secretary.

Section 170(f)(11)(E)(ii) provides that the term "qualified appraiser" means an individual who (1) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary, (2) regularly performs appraisals for which the individual receives compensation, and (3) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance. Section 170(f)(11)(E)(iii) further provides that an individual will not be treated as a qualified appraiser unless that individual (1) demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and (2) has not been prohibited from practicing before the Internal Revenue Service by the Secretary under § 330(c) of Title 31 of the United States Code at any time during the 3-year period ending on the date of the appraisal.

Section 1219 of the PPA also adds a new penalty provision. If the claimed value of property based on an appraisal results in a substantial or gross valuation misstatement under § 6662, a penalty is imposed by new § 6695A on any person who prepared the appraisal and who knew, or reasonably should have known, the appraisal would be used in connection with a return or claim for refund.

SECTION 3. TRANSITIONAL GUIDANCE

.01 *In general*

The Service and the Treasury Department expect to issue regulations under § 170(f)(11), as amended by the PPA. The terms in section 3 of this notice apply to contributions of property (other than readily valued property within the meaning of § 170(f)(11)(A)(ii)(I)) by individuals, partnerships, or corporations for which a deduction of more than $5,000 is claimed on returns filed after August 17, 2006, and before the effective date of the regulations that the Service and the Treasury Department expect to issue. Until regulations are effective under § 170(f)(11), as amended by the PPA, an appraisal that meets the requirements of this notice shall be treated as a qualified appraisal for purposes of § 170(f)(11). The determination of whether an appraiser is qualified under section 3.03 of this notice must be based on the appraiser's qualifications as of the date the appraisal is made.

.02 *Transitional terms-qualified appraisal*

(1) *Qualified appraisal*. An appraisal will be treated as a qualified appraisal within the meaning of § 170(f)(11)(E) if the appraisal complies with all of the requirements of § 1.170A–13(c) of the existing regulations (except to the extent the regulations are inconsistent with § 170(f)(11)), and is conducted by a qualified appraiser in accordance with generally accepted appraisal standards. See sections 3.02(2) and 3.03 of this notice.

(2) *Generally accepted appraisal standards*. An appraisal will be treated as having been conducted in accordance with generally accepted appraisal standards within the meaning of § 170(f)(11)(E)(i)(II) if, for example, the appraisal is consistent with the substance and principles of the Uniform Standards of Professional Appraisal Practice ("USPAP"), as developed by the Appraisal Standards Board of the Appraisal Foundation. Additional information is available at *http://www.appraisalfoundation.org*.

.03 *Transitional terms-qualified appraiser*

(1) *Appraisal designation*. An appraiser will be treated as having earned an appraisal designation from a recognized professional appraiser organization within the meaning of § 170(f)(11)(E)(ii)(I) if the appraisal designation is awarded on the basis of demonstrated competency in valuing the type of property for which the appraisal is performed.

(2) *Education and experience in valuing the type of property*. An appraiser will be treated as having demonstrated verifiable education and experience in valuing the type of property subject to the appraisal within the meaning of § 170(f)(11)(E)(iii)(I) if the appraiser makes a declaration in the appraisal that, because of the appraiser's background, experience, education, and membership in professional associations, the appraiser is qualified to make appraisals of the type of property being valued. *See also* § 1.170A–13(c)(5).

(3) *Minimum education and experience*. An appraiser will be treated as having met minimum education and experience requirements within the meaning of § 170(f)(11)(E)(ii)(I) if —

(a) *For real property*

(i) For returns filed on or before October 19, 2006, the appraiser is qualified as a "qualified appraiser" within the meaning of § 1.170A–13(c)(5) to make appraisals of the type of property being valued.

(ii) For returns filed after October 19, 2006, the appraiser is licensed or certified for the type of property being appraised in the state in which the appraised real property is located.

(b) *For property other than real property —*

(i) For returns filed on or before February 16, 2007, the appraiser is qualified as a "qualified appraiser" within the meaning of § 1.170A–13(c)(5) to make appraisals of the type of property being valued.

(ii) For returns filed after February 16, 2007, the appraiser has (A) successfully completed college or professional-level coursework that is relevant to the property being valued, (B) obtained at least two years of experience in the trade or business of buying, selling, or valuing the type of property being valued, and (C) fully described in the appraisal the appraiser's education and experience that qualify the appraiser to value the type of property being valued.

.04 *Applicability of reporting and substantiation regulations*

(1) *In general*

The requirements of § 1.170A–13(c) of the existing regulations concerning qualified appraisals and qualified appraisers continue to apply to all taxpayers, including those to whom the transitional guidance in this section may apply, except to the extent the regulations are inconsistent with the provisions of § 170(f)(11). In particular, all taxpayers are required to comply with §§ 1.170A–13(c)(3), (c)(5), (c)(6) and (c)(7).

(2) *Revision to appraiser declaration*

For returns filed after February 16, 2007, the declaration required under § 1.170A–13(c)(5)(i) must include an additional statement that the appraiser understands that a substantial or gross valuation misstatement resulting from an appraisal of the value of property that the appraiser knows, or reasonably should have known, would be used in connection with a return or claim for refund, may subject the appraiser to a civil penalty under § 6695A. *See also* § 1.170A–13(c)(3)(iii).

SECTION 4. REQUEST FOR COMMENTS

The Service and the Treasury Department invite comments containing suggestions for future guidance under § 170(f)(11), including regulations. In particular, comments are requested concerning the definition of the following terms: (1) "generally accepted appraisal standards" in § 170(f)(11)(E)(i)(II); (2) "appraisal designation from a recognized professional appraisal organization" in § 170(f)(11)(E)(ii)(I); (3) "minimum education and experience requirements" in § 170(f)(11)(E)(ii)(I); and (4) "verifiable education and experience in valuing the type of property subject to the appraisal" in § 170(f)(11)(E)(iii)(I). Comments also are requested on the potential impact any guidance under § 170(f)(11) may have on small businesses. Comments should refer to Notice 2006–96 and be submitted by January 17, 2007, to:

Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044
Attn: CC:PA:LPD:PR
Room 5203

Alternatively, comments may be submitted electronically via e-mail to the following address: *Notice.Comments@irscounsel.treas.gov*. All comments will be available for public inspection and copying.

SECTION 5. PAPERWORK REDUCTION ACT

The collections of information in this notice have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1953.

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

The collections of information in this notice are in section 3 of this notice. The collections of information are required from donors to satisfy the substantiation requirements of § 170(f)(11). The collections of information are required from donors to obtain a benefit. The likely respondents are individuals, partnerships, and corporations.

The estimated total annual reporting burden is 161,571 hours.

The estimated annual burden per respondent varies from 5 minutes to 5 hours, with an estimated average of approximately 3.5 hours. The estimated number of respondents is 46,285.

The estimated annual frequency of responses (used for reporting requirements only) is once per year.

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

SECTION 6. DRAFTING INFORMATION

The principal author of this notice is Susan J. Kassell of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Susan J. Kassell at (202) 622–5020 (not a toll-free call).

Taxation and Reporting of Excess Inclusion Income by REITs, RICs, and Other Pass-Through Entities

Notice 2006–97

SECTION 1. PURPOSE

This notice provides interim guidance relating to excess inclusion income of pass-through entities, particularly real estate investment trusts (REITs). A growing number of REITs are generating excess inclusion income by engaging in mortgage securitization transactions that cause the REIT to be a taxable mortgage pool (TMP) or have a qualified REIT subsidiary that is a TMP. The interim guidance applies to excess inclusion income both from REMIC residual interests and from REIT TMPs, whether received directly or allocated from another pass-through entity.

This notice also requests comments and suggestions for further guidance, especially guidance regarding the tax and reporting obligations of regulated investment companies (RICs) and other entities that hold stock of REIT TMPs or that receive excess inclusion income in other ways.

SECTION 2. BACKGROUND

Enacted by the Tax Reform Act of 1986 (the 1986 Act), the real estate mortgage investment conduit (REMIC) provisions of the Internal Revenue Code permit a qualifying entity or arrangement, which finances mortgages by issuing multiple classes of interests, to elect REMIC status. In general, a REMIC is not treated as a taxable entity. Instead, the holders of the residual interests in a REMIC take into account the REMIC's net income or net loss.

A REMIC issues regular interests and a single class of residual interests. Regular interests in a REMIC are treated as debt, and holders of these interests must include interest income from the regular interests under an accrual method. The REMIC deducts interest accruals on the regular interests in computing its net income or net loss. The holders of the residual interests in a REMIC take into account the net income or net loss of the REMIC. A portion of the net income allocated to the residual interest holders may be an excess inclusion within the meaning of section 860E(c). An excess inclusion may not be offset by net operating losses, is treated as unrelated business taxable income (UBTI) by certain tax-exempt organizations, and is not eligible for any reduction in withholding tax (by treaty or otherwise) in the case of a nonresident.

In addition, the REMIC provisions seek to ensure that excess inclusion income does not escape current taxation. Some of these provisions are designed to prevent certain tax-exempt entities (disqualified organizations) from being direct holders of a REMIC residual interest. Others impose tax on certain pass-through entities that have excess inclusion income allocable to a record owner that is a disqualified organization. For this purpose, pass-through entities (as defined in section 860E(e)(6)(B)) include REITs, RICs, and nominees; and disqualified organizations (as defined in section 860E(e)(5)(B)) include tax exempt entities that are not subject to unrelated business income tax under section 511. For example, a REIT that owns REMIC residual interests must pay any tax imposed by section 860E(e)(6) with respect to excess inclusion income allocable to a shareholder that is a disqualified organization. Rev. Rul. 2006–58, 2006–46 I.R.B. 876 (November 13, 2006), illustrates the application of these provisions to a REIT (or a partnership) that has a charitable remainder trust as a shareholder (or a partner).

Section 860E(d) addresses the tax consequences to a REIT's shareholders when the REIT holds a REMIC residual interest. The section provides that, if a REIT holds one or more REMIC residual interests, then, under regulations prescribed by the Secretary, the excess of the aggregate excess inclusions determined with respect to those interests over the REIT's taxable income shall be allocated among the shareholders of the REIT in proportion to the dividends received from the REIT. Any such amounts allocated to a shareholder shall be treated as an excess inclusion with respect to a residual interest held by the shareholder. Section 860E(d) further provides that similar rules apply to RICs, common trust funds, and certain cooperative organizations. Regulations issued under section 860E reserve the portion of the regulations dealing with the application of section 860E(d). *See* § 1.860E–1(b).

Congress intended the REMIC regime to be the exclusive vehicle for securitizations issuing multiple-maturity mortgage-backed debt securities. Accordingly, the 1986 Act also enacted TMP provisions, which require an entity that issues such securities without making the REMIC election to be taxed as a separate corporation.

Section 7701(i) defines a taxable mortgage pool as any entity (other than a REMIC) if—

(i) Substantially all of the assets of the entity consist of debt obligations or interests in debt obligations, and more than 50% of these debt obligations or interests are real estate mortgages or interests in real estate mortgages;

(ii) The entity is the obligor under debt obligations that have two or more maturities; and

(iii) The required payments on the debt obligations that the entity issued bear a relationship to the payments to be received by the entity on the debt obligations that it holds as assets.

A portion of an entity may also be a TMP under this definition.

Section 7701(i)(3) provides a special rule for a REIT that is a TMP. Congress generally intended for equity interests in REIT TMPs to be subject to rules similar to those that apply to residual interests in REMICs. Accordingly, section 7701(i)(3) provides that if a REIT, or a qualified REIT subsidiary, is a TMP, then, under regulations prescribed by the Secretary, adjustments similar to the adjustments provided in section 860E(d) are to apply to the shareholders of the REIT. Regulations under section 7701(i) have been issued, but these regulations specifically reserve on the treatment of REIT TMPs. *See* § 1.7701(i)–4(b).

The Treasury Department and the Service have been advised that a growing number of REITs have recently begun securitizing mortgages by issuing debt obligations that cause the REITs to be TMPs. These securitizations may be effected through a qualified REIT subsidiary or a disregarded entity, such as a securitization trust. In these arrangements, not all of the REIT's income is attributable to a TMP.

The Treasury Department and the Service have also been advised that, in the

absence of regulations or other guidance under section 7701(i)(3), taxpayers are uncertain about how to apply section 7701(i)(3) to REIT TMPs and to shareholders of REIT TMPs. Taxpayers are similarly uncertain about how to apply section 860E(d) to RICs (and other pass-through entities) that receive excess inclusion income (for example, a RIC holding shares of a REIT that is required by sections 7701(i)(3) and 860E(d) to allocate excess inclusion income to its shareholders).

SECTION 3. REQUESTS FOR GUIDANCE AND RELIEF

Representatives of REITs and RICs have requested guidance on the tax treatment of excess inclusion income of a REIT that either is a TMP or has a qualified REIT subsidiary that is a TMP. Some of the questions and issues they have raised are:

- The proper computation of excess inclusion income of a REIT (or qualified REIT subsidiary) that is a TMP under section 7701(i)(3);
- The proper method for allocating excess inclusion income among the dividends paid by REITs and RICs during the taxable year;
- The reporting obligations of REITs, RICs, and their shareholders with respect to excess inclusion income;
- If excess inclusion income is allocated to, or otherwise recognized by, an organization that is subject to tax under section 511, whether the $1,000 deduction provided by section 512(b)(12) is available;
- Whether there is or will be, a *de minimis* exception that applies to REITs, RICs, and other pass-through entities that have only small amounts of excess inclusion income.

Taxpayers have requested the Treasury Department and the Service to issue an announcement providing that sections 860E(d) and 7701(i)(3) do not apply before the issuance of the regulations authorized by those sections. Taxpayers have also requested that any such regulations apply only to REIT distributions made some period after the issuance of regulations or other guidance.

SECTION 4. REQUEST FOR COMMENTS

The Treasury Department and the Service are concerned that the purposes of the REMIC excess inclusion provisions may be avoided through the use of REIT TMPs if the resulting excess inclusion income is not properly reported to, and accounted for by, direct and indirect shareholders of the REITs that create TMPs. At the same time, the Treasury Department and the Service are mindful that many RICs and other investors hold stock in REITs that do not own REMIC residual interests or create TMPs.

Accordingly, in developing further guidance dealing with the excess inclusion income of pass-through entities (especially that of REIT TMPs), it is appropriate to weigh the potential administrative burden and complexity for all direct and indirect investors in these entities. The Treasury Department and the Service invite comments and suggestions on the issues summarized in Section 3 above and on any other matters that may be relevant in achieving the purposes of the REMIC provisions without imposing undesirable administrative burdens on investors.

SECTION 5. INTERIM GUIDANCE

The Treasury Department and the Service have concluded that, although the issuance of regulations may be appropriate to provide detailed guidance on certain issues identified by concerned parties, sections 860E(d) and 7701(i)(3) establish basic principles that are applicable even in the absence of regulations. Pending the issuance of further guidance, in administering sections 860E(d), 860E(e)(6), and 7701(i), the IRS will apply the following principles, which are applicable to all excess inclusion income, whether from TMPs or from REMIC residual interests:

- A REIT must—
  - Determine whether it or its qualified REIT subsidiary (or a portion of either) is a TMP, and if so, calculate the excess inclusion income of the TMP under a reasonable method.
  - Allocate its excess inclusion income to its shareholders in proportion to dividends paid (determined without regard to any special allocation of the expense for any tax paid under section 860E(e)(6)) and inform the shareholders that are not disqualified organizations of the amount and character of the excess inclusion income allocated to them.
  - Pay the tax imposed by section 860E(e)(6) on the excess inclusion income that is allocable to its shareholders that are disqualified organizations.
  - As provided by section 860G(b)(2), apply the withholding tax provisions with respect to the excess inclusion portion of dividends paid to foreign persons without regard to any treaty exception or reduction in tax rate.
- With respect to its excess inclusion income, a pass-through entity, other than a REIT, RIC, or nominee, must—
  - Allocate its excess inclusion income to its partners, participants, beneficiaries, or patrons (collectively, "owners") in accordance with applicable provisions (section 702, section 584, subchapter J, or part I of subchapter T) and inform any owners that are not disqualified organizations of the amount and character of the excess inclusion income that has been allocated to them.
  - Pay the tax imposed by section 860E(e)(6) on excess inclusion income that is allocable to disqualified organizations.
  - As provided by section 860G(b)(2), apply the withholding tax provisions with respect to the excess inclusion portion of the payments made to foreign persons without regard to any treaty exception or reduction in tax rate.
- With respect to excess inclusion income, a nominee must—

- Inform the beneficial owners that are not disqualified organizations of the amount and character of their excess inclusion income.

- Pay the tax imposed by section 860E(e)(6) on the excess inclusion income of beneficial owners that are disqualified organizations.

- As provided by section 860G(b)(2), apply the withholding tax provisions to the excess inclusion portion of the payments made to foreign persons without regard to any treaty exemption or reduction in tax rate.

- With respect to its excess inclusion income, a RIC must—

  - Allocate its excess inclusion income to its shareholders in proportion to dividends paid (determined without regard to any special allocation of the expense for any tax paid under section 860E(e)(6)).

  - Inform shareholders who are nominees of the amount and character of the excess inclusion income that has been allocated to them.

  - Pay the tax imposed by section 860E(e)(6) on excess inclusion income that is allocable to record shareholders that are disqualified organizations.

  - As provided by section 860G(b)(2), apply the withholding tax provisions to the excess inclusion portion of dividends paid to foreign shareholders without regard to any exemption or reduction in tax rate.

- Pending the issuance of further guidance, except as provided in this paragraph, a RIC is not required to report the amount and character of the excess inclusion income allocated to its shareholders who are not nominees. For RIC taxable years beginning on or after January 1, 2007—

  - A RIC must inform all of its shareholders that are not nominees regarding the amount and character of the excess inclusion income allocated to those shareholders if the excess inclusion income received by the RIC from all sources (including investments in REMIC residual interests) exceeds one percent of the gross income of the RIC.

  - A RIC that is not subject to the reporting requirement in the preceding bullet must inform all of its shareholders that are not nominees regarding the amount and character of excess inclusion income allocated to those shareholders, taking into account only excess inclusion income allocated to the RIC from REITs described in the following sentence. A REIT is described in this sentence if it reported to its shareholders for the most recent REIT taxable year ending not later than nine months before the first day of the RIC's taxable year that—

    1. A portion of the REIT's dividends for the year was excess inclusion income, and

    2. This excess inclusion income exceeded three percent of the REIT's total dividends for the year.

  As an example, the reporting obligation described in this bullet applies to a fiscal year RIC for its taxable year beginning February 1, 2007, with respect to excess inclusion income allocated to the RIC by that REIT for the REIT's taxable year ending December 31, 2007, if the REIT had reported for its taxable year ending December 31, 2005, that its excess inclusion income exceeded three percent of its total dividends for that year.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–2036.

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

The collection of information in this notice is in sections 860E(d) and 7701(i)(3). This information is required to allow the recipients of the information to properly report and pay taxes on excess inclusion income allocable to them. The collection of information is mandatory. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is two hours. The estimated annual burden per respondent/recordkeeper varies from one to three hours, depending on individual circumstances, with an estimated average of two hours. The estimated number of respondents and/or recordkeepers is 50.

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

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 author of this revenue ruling is Anna Kim of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Anna Kim at (202) 622–3735.

2007 Limitations Adjusted As Provided in Section 415(d), etc.[1]

Notice 2006–98

Section 415 of the Internal Revenue Code (the Code) provides for dollar limitations on benefits and contributions under qualified retirement plans. Section 415 also requires that the Commissioner annu-

[1] Based on News Release IR–2006–162 dated October 18, 2006.

ally adjust these limits for cost-of-living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments. Many of the limitations will change for 2007. For most of the limitations, the increase in the cost-of-living index met the statutory thresholds that trigger their adjustment. For example, the limitation under § 402(g)(1) on the exclusion for elective deferrals described in § 402(g)(3) is increased from $15,000 to $15,500. This limitation affects elective deferrals to section 401(k) plans and to the Federal Government's Thrift Savings Plan, among other plans.

Cost-of-Living limits for 2007

Effective January 1, 2007, the limitation on the annual benefit under a defined benefit plan under § 415(b)(1)(A) is increased from $175,000 to $180,000. For participants who separated from service before January 1, 2007, the limitation for defined benefit plans under § 415(b)(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 2006, by 1.0334.

The limitation for defined contribution plans under § 415(c)(1)(A) is increased from $44,000 to $45,000.

The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of § 415(b)(1)(A). These dollar amounts and the adjusted amounts are as follows:

The limitation under § 402(g)(1) on the exclusion for elective deferrals described in § 402(g)(3) is increased from $15,000 to $15,500.

The annual compensation limit under §§ 401(a)(17), 404(l), 408(k)(3)(C), and 408(k)(6)(D)(ii) is increased from $220,000 to $225,000.

The dollar limitation under § 416(i)(1)(A)(i) concerning the definition of key employee in a top-heavy plan is increased from $140,000 to $145,000.

The dollar amount under § 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5-year distribution period is increased from $885,000 to $915,000, while the dollar amount used to determine the lengthening of the 5-year distribution period is increased from $175,000 to $180,000.

The limitation used in the definition of highly compensated employee under § 414(q)(1)(B) remains unchanged at $100,000.

The dollar limitation under § 414(v)(2)(B)(i) for catch-up contributions to an applicable employer plan other than a plan described in § 401(k)(11) or 408(p) for individuals aged 50 or over remains unchanged at $5,000. The dollar limitation under § 414(v)(2)(B)(ii) for catch-up contributions to an applicable employer plan described in § 401(k)(11) or 408(p) for individuals aged 50 or over remains unchanged at $2,500.

The annual compensation limitation under § 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limitation under the plan under § 401(a)(17) to be taken into account, is increased from $325,000 to $335,000.

The compensation amount under § 408(k)(2)(C) regarding simplified employee pensions (SEPs) is increased from $450 to $500.

The limitation on deferrals under § 457(e)(15) concerning deferred compensation plans of state and local governments and tax-exempt organizations is increased from $15,000 to $15,500.

The compensation amounts under § 1.61–21(f)(5)(i) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes is increased from $85,000 to $90,000. The compensation amount under § 1.61–21(f)(5)(iii) is increased from $175,000 to $180,000.

The limitation under § 408(p)(2)(E) regarding SIMPLE retirement accounts is increased from $10,000 to $10,500.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.

Drafting Information

The principal author of this notice is John Heil of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding the data in this notice, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free call) between the hours of 8:30 a.m. and 4:30 p.m. Eastern time Monday through Friday. For information regarding the methodology used in arriving at the data in this notice, please contact Mr. Heil at 1–202–283–9888 (not a toll-free call).

Guidance on Withholding and Information Reporting on Foreign Persons, Including Guidance on Certain Book-Entry Systems

Notice 2006–99

SECTION 1. PURPOSE

This notice provides guidance on withholding and information reporting on foreign persons and includes guidance on certain book-entry systems in foreign countries.

This notice provides clarification on whether bonds held through certain book-entry systems are treated as in registered or in bearer form under Treas. Reg. §§ 5f.103–1(c) and 1.871–14. It concludes that a dematerialized bond that can be held and transferred only through a book-entry system is in registered form, when a holder may only obtain a physical certificate in bearer form if the clearing organization that maintains the book-entry system goes out of business without a successor. Notwithstanding the clarification set forth in this notice, obligations that are outstanding prior to January 1, 2007, and that were issued in compliance Treas. Reg. § 1.163–5(c)(2)(i)(D) (TEFRA D)

may continue to be treated as obligations in bearer form until the obligations mature.

Further, this notice announces that the IRS and Treasury intend to issue regulations providing that section 1.871–14(e) of the regulations, dealing with foreign targeted registered obligations, will not apply to obligations issued after December 31, 2006, except in limited circumstances. The regulations will provide that the rules of section 1.871–14(e) will apply to obligations issued after December 31, 2006, and before January 1, 2009, but only if those obligations have a stated maturity of no more than 10 years from the date of issuance. Obligations issued under the rules of Treas. Reg. § 1.871–14(e) prior to January 1, 2009, will continue to be subject to those rules until those obligations mature.

Finally, this notice announces that the IRS and Treasury intend to issue regulations retroactively removing the rule in Treas. Reg. § 1.1441–1(b)(7)(iii) that would impose interest under section 6601 when no underlying tax liability has in fact been imposed. These regulations would also clarify that, like interest, penalties that are computed based on underpayments of tax will not be imposed when no tax has in fact been imposed.

SECTION 2. BACKGROUND

.01 Development of dematerialized book-entry systems

IRS and Treasury are aware of the development of dematerialized book-entry systems for holding and transferring bonds. In such systems, bonds are required to be represented only by book entries, and no physical certificates are issued or transferred. Such dematerialized book-entry systems offer significant efficiencies for securities markets, and in order to capture those efficiencies, markets in certain foreign countries have adopted such systems.

For example, Foreign Country law requires that, beginning on a certain date, bonds issued in that country must be held through the book-entry system operated by Foreign Country Clearing Organization. Foreign Country Clearing Organization is an entity which is in the business of holding obligations for member organizations and transferring obligations among such members by credit or debit to the account of a member without the necessity of physical delivery of the obligation. Within the book-entry system, bonds are not represented by any physical certificates, but are represented only by book entries. Holders do not have the ability to withdraw bonds from the book-entry system and obtain physical certificates representing the bonds. Holders may obtain physical certificates in bearer form only if Foreign Country Clearing Organization goes out of business without a successor that will continue to operate the book-entry system. Bonds that were issued before the book-entry system became mandatory must be transferred into the system by a specified date.

.02 Obligations in registered form

Section 5f.103–1(c)(1) provides that an obligation is in registered form if the obligation is registered as to both principal and interest and the obligation may be transferred only by surrender and re-issuance of the physical certificate or through a book-entry system. Section 5f.103–1(c)(2) provides that an obligation is considered transferable through a book-entry system if the ownership of an interest in the obligation is required to be reflected in a book entry that identifies the owner of an interest in the obligation. Section 5f.103–1(e) provides that an obligation that is not in registered form is considered to be in bearer form. An obligation in registered form that is convertible into bearer form is considered to be in bearer form. Treas. Reg. § 1.871–14(c) provides that for purposes of determining the application of the portfolio interest exception, the conditions for an obligation to be in registered form are identical to the conditions described in Treas. Reg. § 5f.103–1.

SECTION 3. TREATMENT OF OBLIGATIONS HELD THROUGH A DEMATERIALIZED BOOK-ENTRY SYSTEM

.01 Obligations subject to a book-entry requirement described in section 2.01

An obligation subject to a book-entry requirement described in section 2.01 of this notice, and held through the book-entry system operated by Foreign Country Clearing Organization, is an obligation in registered form because, within the book-entry system, it may be transferred only by book entries and the holder of the obligation does not have the ability to withdraw the obligation from the book-entry system and obtain a physical certificate in bearer form.

The cessation of operation of the book-entry system would be an extraordinary event. Holding through the book-entry system is mandatory for obligations in Foreign Country's market while the book-entry system is in existence and while Foreign Country's legal requirements remain in place. The provision for the issuance of physical certificates in bearer form in the event that the book entry system goes out of existence is not the equivalent of a provision conferring on the holder the ability to convert an obligation from registered form into bearer form in the ordinary course of business.

Notwithstanding that such obligations are in registered form, section 3.02 of this notice, below, provides a transition rule for certain obligations issued prior to January 1, 2007.

.02 Obligations issued before January 1, 2007

An obligation in bearer form that was issued before January 1, 2007, and that was issued in compliance with section 1.163–5(c)(2)(i)(D) (TEFRA D) may continue to be treated as an obligation in bearer form until its maturity, whether or not it is held within Foreign Country Clearing Organization's book-entry system described in section 2.01 of this notice.

SECTION 4. SUNSET OF FOREIGN TARGETED REGISTERED RULES

The IRS and Treasury intend to issue regulations providing that the rules of section 1.871–14(e) of the regulations, dealing with foreign targeted registered obligations, will not apply to obligations issued after December 31, 2006, except in the limited circumstances described in the next sentence. The regulations will provide that the rules of section 1.871–14(e) will apply to obligations issued after December 31, 2006, and before January 1, 2009, but only if those obligations have a stated maturity of no more than 10 years from the date of issuance. Obligations issued under the rules of Treas. Reg. § 1.871–14(e) prior to January 1, 2009, will continue to be subject to those rules until those obligations mature.

SECTION 5. INTEREST IMPOSED WHEN NO TAX DUE

Treas. Reg. § 1.1441–1(b)(7)(iii) provides that a withholding agent that has failed to withhold tax other than based on reliance on the appropriate presumptions is not relieved from liability for interest under section 6601. It further provides that such liability exists even when there is no underlying tax that is ultimately shown to be due. That is, the regulation imposes an interest charge under section 6601 on a withholding agent for an amount of tax that has not in fact been imposed. Treas. Reg. § 1.1441–1(b)(7)(v) sets forth two examples that illustrate the operation of this rule.

The IRS and Treasury intend to issue regulations retroactive to January 1, 2001, removing the rule in Treas. Reg. § 1.1441–1(b)(7)(iii), and the accompanying examples illustrating the rule in Treas. Reg. § 1.1441–1(b)(7)(v), that imposes interest under section 6601 when no underlying tax liability is imposed. Further, the IRS and Treasury intend, in the new regulations, to clarify also that, like interest, penalties that are computed based on underpayments of tax will not be imposed when no tax has in fact been imposed. Taxpayers may rely on this notice until the regulations removing the rule are finalized.

SECTION 6. COMMENTS

Comments are requested regarding the regulations to be issued under Section 4 of this notice. Specifically, comments are requested on the transition period to be provided for such rules.

SECTION 7. CONTACT INFORMATION

The principal author of this notice is Kay Holman of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Kay Holman at (202) 622–3840 (not a toll-free call).

Social Security Contribution and Benefit Base for 2007

Notice 2006–102

Under authority contained in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (71 F.R. 62636, dated October 26, 2006) that the contribution and benefit base for remuneration paid in 2007, and self-employment income earned in taxable years beginning in 2007 is $97,500.

"Old-Law" Contribution and Benefit Base

General

The "old-law" contribution and benefit base for 2007 is $72,600. This is the base that would have been effective under the Act without the enactment of the 1977 amendments.

The "old-law" contribution and benefit base is used by:

(a) The Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(b) the Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Social Security Act),

(c) Social Security to determine a year of coverage in computing the special minimum benefit, as described earlier, and

(d) Social Security to determine a year of coverage (acquired whenever earnings equal or exceed 25 percent of the "old-law" base for this purpose only) in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

Domestic Employee Coverage Threshold

General

The minimum amount a domestic worker must earn so that such earnings are covered under Social Security or Medicare is the domestic employee coverage threshold. For 2007, this threshold is $1,500. Section 3121(x) of the Internal Revenue Code provides the formula for increasing the threshold.

Computation

Under the formula, the domestic employee coverage threshold amount for 2007 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 2005 to that for 1993. If the resulting amount is not a multiple of $100, it shall be rounded to the next lower multiple of $100.

Domestic Employee Coverage Threshold Amount

Multiplying the 1995 domestic employee coverage threshold amount ($1,000) by the ratio of the national average wage index for 2005 ($36,952.94) to that for 1993 ($23,132.67) produces the amount of $1,597.44. We then round this amount to $1,500. Accordingly, the domestic employee coverage threshold amount is $1,500 for 2007.

(Filed by the Office of the Federal Register on October 25, 2006, 8:45 a.m., and published in the issue of the Federal Register for October 26, 2006, 71 F.R. 62636)

Part IV. Items of General Interest

Standards for Calculating Energy Savings for the New Energy Efficient Home Credit; Internal Revenue Code 45L

Announcement 2006–88

This announcement informs taxpayers that either Residential Services Network (RESNET) Publication No. 05–001 or RESNET Publication No. 06–001 may be used in determining whether a dwelling unit qualifies for the New Energy Efficient Home Credit. Thus, a taxpayer may calculate heating and cooling energy and cost savings using the procedures contained in either RESNET publication. Similarly, an application to have a software program included on the public list of software programs that may be used to calculate energy consumption may be based on a declaration by the developer that the program satisfies the tests required to conform to the software accreditation process prescribed in either RESNET publication. This change is effective for new energy efficient homes acquired after December 31, 2005.

Notice 2006–27, 2006–11 I.R.B. 626, February 21, 2006, and Notice 2006–28, 2006–11 I.R.B. 628, February 21, 2006, provided guidance regarding the calculation of heating and cooling energy and cost savings for purposes of determining the eligibility of dwelling units for the New Energy Efficient Home Credit under Internal Revenue Code § 45L. Those notices provided that calculations of heating and cooling energy and cost savings be done in accordance with the procedures contained in RESNET Publication No. 05–001. The notices also provided that software would be included on the public list of software programs that may be used to calculate energy consumption only if the software developer certified that the program satisfied all tests required to conform to the software accreditation process prescribed in RESNET Publication No. 05–001. Shortly after the publication of the notices, RESNET updated Publication No. 05–001 by issuing Publication No. 06–001. Publication No. 06–001 is intended to provide more appropriate regional standards for calculating energy and cost savings. This announcement modifies the guidance in the previously issued notices by permitting taxpayers to use either the prior RESNET standards in Publication No. 05–001 or the current RESNET standards in Publication No. 06–001.

The principal author of this announcement is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this announcement, contact Jennifer C. Bernardini at (202) 622–3120 (not a toll-free call).

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.
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