Internal Revenue bulletin

Bulletin No. 2006-50
December 11, 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.**

## SPECIAL ANNOUNCEMENT

### Announcement 2006–95, page 1105.

This announcement provides a two-part settlement initiative offered by the IRS under which current and former employees of foreign embassies, foreign consular offices, or international organizations in the United States can (1) resolve income tax matters related to their employment at a foreign embassy, foreign consular office, or international organization and (2) unwind their participation in SEP/IRA plans, which they erroneously established. In addition, the announcement sets forth the eligibility for and terms of the settlement, including procedures to be followed by eligible participants.

## INCOME TAX

### T.D. 9296, page 1078.

Final regulations under section 41 of the Code provide rules for the computation and allocation of the credit for increasing research activities in the case of a controlled group of corporations or a group of trades or businesses under common control. The regulations also provide rules for making and revoking an election to compute the research credit using the alternative incremental research credit rules.

### T.D. 9297, page 1089.

Final regulations under section 937(a) of the Code provide a new alternative under the presence test for determining whether an individual is a *bona fide* resident of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands, referred to as U.S. possessions or territories. Generally, an individual is a *bona fide* resident of a territory if the individual satisfies a presence test, a tax home test and a closer connection test. Under this new alternative, an individual would satisfy the presence test if the individual meets an averaging test for the minimum number of days spent in the relevant territory.

### Announcement 2006–97, page 1108.

This announcement contains a correction to a phone number in Announcement 2006–61, 2006–36 I.R.B. 390, which provides an opportunity for small business/self-employed taxpayers to use Fast Track Settlement (FTS) to expedite case resolution within the IRS's Small Business Self-Employed (SB/SE) organization.

## EMPLOYEE PLANS

### Notice 2006–105, page 1093.

**Minimum funding standards; alternative deficit reduction contribution.** This notice describes how a commercial passenger airline may make an election of an alternative deficit reduction contribution pursuant to section 402(i) of the Pension Protection Act of 2006 and contains background for that election. Announcement 2004–38 modified. Announcement 2004–43 amplified and modified. Notice 2004–59 amplified.

## ADMINISTRATIVE

### Announcement 2006–96, page 1108.

***Per diem* allowances.** This announcement corrects the period for which Martha's Vineyard, Massachusetts, is a high-cost locality under the high-low substantiation method of Rev. Proc. 2006–41, 2006–43 I.R.B. 777.

**(Continued on the next page)**

**Announcements of Disbarments and Suspensions begin on page 1095.**
**Finding Lists begin on page ii.**

Department of the Treasury
Internal Revenue Service

**Announcement 2006–97, page 1108.**
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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 41.—Credit for Increasing Research Activities

*26 CFR 1.41–6: Aggregation of expenditures.*

## T.D. 9296

## DEPARTMENT OF THE TREASURY
## Internal Revenue Service
## 26 CFR Part 1

## Credit for Increasing Research Activities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the computation and allocation of the credit for increasing research activities for members of a controlled group of corporations or a group of trades or businesses under common control. These final regulations reflect changes made to section 41 by the Revenue Reconciliation Act of 1989, which introduced the current computational regime for the credit, and the Small Business Job Protection Act of 1996, which introduced the alternative incremental research credit.

DATES: *Effective Date:* These regulations are effective November 9, 2006.

*Applicability Dates:* For dates of applicability, see §§1.41–6(j) and 1.41–8(b)(5).

FOR FURTHER INFORMATION CONTACT: Nicole R. Cimino (202) 622–3120 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

This document amends 26 CFR part 1 to provide revised rules for the research credit under section 41, specifically section 41(f). On May 24, 2005, the Treasury Department and the IRS published in the **Federal Register** (70 FR 29662) proposed amendments to the regulations under section 41(f) by cross-reference to temporary regulations (REG–134030–04, 2005–1 C.B. 1339) and temporary regulations (70 FR 29596) (T.D. 9205, 2005–1 C.B. 1267) (collectively, the 2005 regulations) relating to the computation and allocation of the credit for increasing research activities (research credit) under section 41 for members of a controlled group of corporations or a group of trades or businesses under common control (controlled groups). The 2005 notice of proposed rulemaking withdrew the proposed regulations published in the **Federal Register** on July 29, 2003 (68 FR 44499) (REG–133791–02, 2003–2 C.B. 493) (the 2003 proposed regulations). A public hearing was held on October 19, 2005. After considering the comments received and the statements made at the public hearing regarding the 2005 regulations, the 2005 regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the 2005 regulations with the modifications discussed below.

**Summary of Comments and Explanation of Provisions**

*Allocation of the Group Credit*

The 2005 regulations required that the group credit that did not exceed the sum of the stand-alone entity credits of all the members of the group be allocated among the members of a controlled group in proportion to the relative amounts of each individual member's stand-alone entity credit, computed for each member using the method that would have yielded the largest stand-alone entity credit for that member. Any excess of the group credit over the sum of the stand-alone entity credits of all the members of the group was allocated among all the members of the group based on the ratio of an individual member's qualified research expenditures (QREs) to the sum of all the members' QREs.

Although commentators generally agreed that the 2005 regulations fixed the anomalous results (for example, none of the group credit would be allocated to the members of the controlled group if no member had stand-alone entity credits) created by the method in the 2003 proposed regulations, some commentators continued to disagree with the stand-alone entity credit method. Commentators again suggested that the members of a controlled group should be permitted to use any reasonable method to allocate the group credit as long as the group's members collectively do not claim more than 100 percent of the group credit, or that if one method must be prescribed for all situations, a method that allocates the group credit based on the relative amounts of each member's total QREs (gross QREs method) is more appropriate than any other method.

The Treasury Department and the IRS continue to believe that the allocation method under section 41(f) should be based on a group member's QREs in excess of a base amount, and that the stand-alone entity credit method reflects the incremental nature of the credit. The Treasury Department and the IRS believe that the stand-alone entity credit method of the 2005 regulations is consistent with the purpose of section 41(f) and its underlying legislative history. Further, a single, prescribed method is necessary to ensure the group's members collectively do not claim more than 100 percent of the group credit. For the reasons stated above and in the preamble to the 2005 regulations, the final regulations do not adopt the changes suggested by the commentators, and retain the allocation method contained in the 2005 regulations.

*Special Allocation Rule for Consolidated Groups*

The 2005 regulations provide that, for purposes of allocating the group credit among the members of a controlled group (first-tier allocation), a consolidated group (whose members are members of the controlled group) is treated as a single member of the controlled group, and a single stand-alone entity credit is computed for the consolidated group. If the consolidated group is the only member of

the controlled group, the stand-alone entity credit computed for the consolidated group is equal to the group credit. The portion of the group credit allocated to a consolidated group must be allocated among the members of the consolidated group (second-tier allocation) in proportion to the stand-alone entity credits of the members of the consolidated group. Under the 2005 regulations, this rule applied only to taxable years ending on or after May 24, 2005.

One commentator argued that the treatment of a consolidated group as a single member of a controlled group is contrary to the statutory language of sections 41(f)(5) and 1563. The Secretary is granted broad authority under section 1502 to provide rules regarding the determination of the tax liability of an affiliated group of corporations filing a consolidated return. The Treasury Department and the IRS believe that the treatment of a consolidated group as a single member of a controlled group of corporations for purposes of section 41(f) is within the broad authority of section 1502. Moreover, this treatment is consistent with the single entity treatment of a consolidated group under certain other provisions of the Code.

One commentator argued that treating a consolidated group as a single member of the controlled group adds unnecessary complexity and is administratively burdensome because it requires additional rounds of allocations of each consolidated group's credit among its members and additional computations of each consolidated group member's stand-alone entity credit. One commentator urged that, if the consolidated group rule is retained, then the final regulations should not provide specific rules for how the second-tier allocation is to be made.

The Treasury Department and the IRS continue to believe that computing a stand-alone entity credit for each member of a consolidated group does not impose a greater burden than computing a stand-alone entity credit for a corporation that is not a member of a consolidated group. The Treasury Department and the IRS also believe that specific allocation rules are necessary with respect to the second-tier allocation in order to prevent distortions and provide certainty concerning each consolidated group member's share of the credit, for example, if a member ceases to be a member of the consolidated group or if a member's share of credits becomes subject to section 383. Accordingly, the final regulations retain the rules contained in the 2005 regulations. The final regulations make clear, however, that the special allocation rule for consolidated groups applies prospectively only. Accordingly, the consolidated group rule contained in these final regulations applies only to taxable years ending on or after the date these final regulations are published in the **Federal Register**. For taxable years ending on or after May 24, 2005, and before the date these final regulations are published in the **Federal Register**, taxpayers must use the special allocation rule for consolidated groups contained in the 2005 regulations. However, taxpayers may choose to apply the rule retroactively to taxable years ending before May 24, 2005, provided that all the members of the controlled group treat the consolidated group as a single member of the controlled group.

One commentator stated that the 2005 regulations are unclear whether, for purposes of the second-tier allocation, each consolidated group member's stand-alone entity credit is to be computed in the same manner as a controlled group member's stand-alone entity credit is computed for purposes of a first-tier allocation (that is, using the method that would have yielded the largest stand-alone entity credit for that consolidated group member). The Treasury Department and the IRS believe that the final regulations are clear that this is the rule, as they provide that "the principles of paragraph (c)" (which contains the rule) apply for purposes of the second-tier allocation. In addition, this rule is illustrated in *Example 3* of §1.41–6(e).

*Start-up Companies*

For purposes of computing the group credit, §1.41–6T(b)(2) of the 2005 regulations treated a controlled group as a start-up company if the first taxable year in which at least one member of the group had gross receipts and at least one member of the group had QREs begins after December 31, 1983; or there were fewer than 3 taxable years beginning after December 31, 1983, and before January 1, 1989, in which at least one member of the group had gross receipts and at least one member of the group had QREs. One commentator suggested that the rule was not clear in a situation in which one member of the group has both gross receipts and QREs in a taxable year beginning before January 1, 1984. Although the Treasury Department and IRS believe that the temporary regulations are clear that the start-up rules do not apply if the group had QREs and gross receipts in a year beginning before January 1, 1984, no matter which member(s) of the group had the QREs and gross receipts, the final regulations clarify the start-up company rule of §1.41–6(b)(2) to make it explicit.

*Alternative Incremental Research Credit*

Section 41(c)(4) provides an election to determine the research credit using the alternative incremental research credit (AIRC) computation. Section 41(c)(4)(B) provides that the election to use the AIRC method applies to all succeeding taxable years unless revoked with the consent of the Secretary. The 2005 regulations generally provide that elections (or revocations) of the AIRC method are made by completing the portion of Form 6765, "*Credit for Increasing Research Activities*," relating to the AIRC method (in the case of an election of the AIRC method) or to the regular method (in the case of a revocation of the AIRC method), and attaching the completed form to the taxpayer's timely filed original Federal income tax return for the year to which the election (or revocation) applies. Once an election (or revocation) is made for a taxable year, the taxpayer may not change the election (or revocation) on an amended return. The 2005 regulations provide that the provisions relating to AIRC elections and revocations apply to taxable years ending on or after May 24, 2005.

The 2005 regulations provide special rules for making (or revoking) an election for controlled groups under section 41(f)(1) (in which one or more of the members do not join in filing a consolidated return). In such cases, the designated member must make (or revoke) the AIRC election on behalf of the group's members. The election (or revocation) by the designated member is binding on all the members of the group for the taxable year to which the election (or revocation) relates. The 2005 regulations provide that the designated member is that member

of the group that is allocated the greatest amount of the group credit. In the event the members of a group compute the group credit using different methods (either the regular method or the AIRC method) and at least two members of the group qualify as the designated member, the designated member is the member that computes the group credit using the method that yields the greater group credit. If all the members of a controlled group are members of a single consolidated group, the AIRC election (or revocation) is made by the agent of the consolidated group, determined pursuant to the rules of §1.1502–77.

One commentator suggested that the language contained in §1.41–8T(b)(4)(i) of the 2005 regulations be clarified to avoid any implication that additional requirements (other than completing the appropriate portion of Form 6765 and attaching the form to a timely filed original Federal income tax return) apply to a designated member seeking to elect (or revoke) the AIRC method. The final regulations clarify that a designated member must follow the same procedures for making (or revoking) an AIRC election that apply to other taxpayers.

A commentator also noted that the regulations do not address whether and how changes to a member's research credit information after the original Federal income tax return is timely filed may affect its status as the designated member. The commentator suggested that the final regulations clarify what happens if the designated member at the time of filing subsequently is determined not to be the designated member. The Treasury Department and the IRS agree that clarification regarding this issue is needed. Accordingly, the final regulations are clarified to provide that the term *designated member* means the member of the group that is allocated the greatest amount of the group credit under paragraph (c) of §1.41–6 based on the amount of credit reported on the original timely filed Federal income tax return.

A commentator questioned what happens if the designated member fails to timely file an original Federal income tax return. The Treasury Department and the IRS believe that the designated member must timely file a return in order for the group to elect (or revoke) the AIRC method. Accordingly, if the designated member fails to timely file for the current credit year (and thus, fails to elect (or revoke) the AIRC method for that year), then the method used by the group in the immediately preceding credit year remains the method in effect for the current credit year. The final regulations are amended to clarify this rule.

The commentator also suggested that the final regulations allow the members of a controlled group to decide which member of the group will be the designated member. The Treasury Department and the IRS believe that it is necessary to have a bright-line test, applicable to all controlled groups, to provide certainty as to the identity of the designated member, and that to allow the members of a controlled group to decide which member's election (or revocation) will bind all the members of the group would not provide certainty in all situations. Accordingly, this comment has not been adopted.

Another commentator urged the Treasury Department and the IRS to allow taxpayers to elect the AIRC method on an amended return. Alternatively, the commentator argued that if taxpayers cannot elect the AIRC method on an amended return, the final regulations should provide a special rule under which a taxpayer's research credit, computed by the taxpayer under the regular method, may not be adjusted on audit below the amount that would have been allowable under the AIRC method. The Treasury Department and the IRS believe that requiring an election to be made only on a timely filed original Federal income tax return is consistent with the statute and the doctrine of elections, and that the commentator's suggestion would inappropriately limit the authority of the IRS to conduct examinations. Thus, these final regulations retain the rules as contained in the 2005 regulations.

Finally, a commentator suggested that, with respect to the AIRC provisions, the effective date for the 2005 regulations should not be limited to taxable years ending on or after May 24, 2005, but should apply as well to any taxable year ending before that date, provided that the original Federal income tax return for that year has not yet been filed. The Treasury Department and the IRS believe that making this option available retroactively to taxpayers that have not yet filed their returns would treat similarly situated taxpayers differently. For example, taxpayers that already had filed their returns would have been required to request permission for a revocation, while taxpayers that had not filed their returns would be eligible for the automatic revocation procedures set forth in the 2005 regulations. Thus, the Treasury Department and the IRS believe that it is appropriate to limit the application of this rule to prospective use only. The final regulations are effective for taxable years ending on or after the date these final regulations are published in the **Federal Register**. For taxable years ending on or after May 24, 2005, and before the date these final regulations are published in the **Federal Register**, taxpayers must use the rules contained in the 2005 regulations.

*Other*

Several commentators mentioned that the definition of trade or business in the 2005 regulations was changed from the prior regulations. The change in the 2005 regulations was inadvertent, and the definition has been returned to the language from the regulations existing prior to the issuance of the 2005 regulations. For taxable years prior to the effective date of these final regulations, taxpayers may rely upon the definition of trade or business in these final regulations.

Another commentator requested that the regulations provide guidance as to whether the section 280C(c) election is made member by member or by the entire controlled group. This issue is beyond the scope of these final regulations, as guidance would have to be provided under the authority of section 280C rather than section 41. The Treasury Department and the IRS may consider addressing this issue in separate guidance.

*Effective Date*

The preamble to the 2005 regulations states that because the Treasury Department and the IRS decided to retain the general rules for the computation and allocation of the group credit contained in the 2003 proposed regulations, with certain modifications, the 2005 regulations were effective for taxable years ending on or after May 24, 2005. For taxable years prior to those covered by the 2005 regulations, a taxpayer generally may use any reasonable

method of computing and allocating the group credit. As explained in the preamble to the 2005 regulations, paragraph (b) of the 2005 regulations, relating to the computation of the group credit, and paragraph (c) of the 2005 regulations, relating to the allocation of the group credit, apply to taxable years ending on or after December 29, 1999, if the members of a controlled group, as a whole, claimed more than 100 percent of the amount that would be allowable under paragraph (b). In the case of a controlled group whose members have different taxable years and whose members use inconsistent methods of allocation, the members of the controlled group are deemed to have, as a whole, claimed more than 100 percent of the amount that would be allowable under paragraph (b).

One commentator argued that the 2005 regulations should not be effective until final regulations are published in the **Federal Register**. The Treasury Department and the IRS continue to believe that the general May 24, 2005, effective date is appropriate, because these final regulations are substantially similar to the 2003 proposed regulations.

Another commentator objected to the use of the December 29, 1999, effective date for the portions of the 2005 regulations that are retroactive, because that is the date that the previous proposed regulations (2000 proposed regulations) were sent to the **Federal Register**, and not the date (January 4, 2000) on which they were published. The Treasury Department and the IRS continue to believe that the December 29, 1999, effective date is the appropriate date, because this is the date the 2000 proposed regulations were filed with the **Federal Register** and, thus, were made available to the public. Additionally, section 7805(b)(3) allows any regulation to take effect or apply retroactively to prevent abuse.

Another commentator criticized the retroactive application of the rule requiring that a member's stand-alone entity credit be computed using whichever method results in the greater stand-alone entity credit for that member, without regard to the method used to compute the group credit. The commentator stated that the incentive effect sought can only be achieved prospectively, and that to allow use of the rule retroactively may cause abusive inconsistencies where some members of the group rely on the 2003 proposed regulations, while other members amend to follow the new rule. While the Treasury Department and the IRS do not want to encourage potentially abusive inconsistencies in years that taxpayers believe are settled, the Treasury Department and the IRS believe that one bright line is appropriate and do not want to treat similarly situated taxpayers differently.

Another commentator suggested that the final regulations make clear that the special rule for consolidated groups is to be applied prospectively only. The 2005 regulations required paragraph (b) of those regulations, relating to the computation of the group credit, and paragraph (c) of those regulations, relating to the allocation of the group credit, to be applied retroactively in certain instances of abuse. The 2005 regulations did not require paragraph (d), relating to the special rule for consolidated groups, to be applied retroactively. Thus, the Treasury Department and IRS did not intend that taxpayers be required to apply retroactively the special rule for consolidated groups. Accordingly, the final regulations clarify that the special rule for consolidated groups applies only to taxable years ending on or after the date these final regulations are published in the **Federal Register**. The 2005 regulations apply for taxable years ending on or after May 24, 2005, and before the date these final regulations are published in the **Federal Register**. However, a controlled group may choose to apply the rule in paragraph (d) retroactively if all the members of the group do so, so that the controlled group, as a whole, does not claim more than 100 percent of the group credit.

**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 and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

**Drafting Information**

The principal author of these regulations is Nicole R. Cimino, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, personnel from the IRS and Treasury Department participated in their development.

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**Adoption of Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.41–6T and adding an entry in numerical order to read, in part, as follows:

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

Section 1.41–6 also issued under 26 U.S.C. 1502. * * *

Par. 2. In §1.41–0, the table of contents is amended by removing the entries for §1.41–6T and §1.41–8T and adding entries for §1.41–6 and §1.41–8 to read as follows:

*§1.41–0 Table of contents.*

* * * * *

*§1.41–6 Aggregation of expenditures.*

(a) Controlled groups of corporations; trades or businesses under common control.

(1) In general.

(2) Consolidated groups.

(3) Definitions.

(b) Computation of the group credit.

(1) In general.

(2) Start-up companies.

(c) Allocation of the group credit.

(1) In general.

(2) Stand-alone entity credit.

(d) Special rules for consolidated groups.

(1) In general.

(2) Start-up company status.

(3) Special rule for allocation of group credit among consolidated group members.

(e) Examples.

(f) For taxable years beginning before January 1, 1990.

(g) Tax accounting periods used.

(1) In general.

(2) Special rule when timing of research is manipulated.

(h) Membership during taxable year in more than one group.

(i) Intra-group transactions.

(1) In general.

(2) In-house research expenses.

(3) Contract research expenses.

(4) Lease payments.

(5) Payment for supplies.

(j) Effective date.

* * * * *

*§1.41–8 Special rules for taxable years ending on or after May 24, 2005.*

(a) Alternative incremental credit.

(b) Election.

(1) In general.

(2) Time and manner of election.

(3) Revocation.

(4) Special rules for controlled groups.

(5) Effective date.

Par. 3. Section 1.41–6 is added to read as follows.

*§1.41–6 Aggregation of expenditures.*

(a) *Controlled group of corporations; trades or businesses under common control*—(1) *In general*. To determine the amount of research credit (if any) allowable to a trade or business that at the end of its taxable year is a member of a controlled group, a taxpayer must—

(i) Compute the group credit in the manner described in paragraph (b) of this section; and

(ii) Allocate the group credit among the members of the group in the manner described in paragraph (c) of this section.

(2) *Consolidated groups*. For special rules relating to consolidated groups, see paragraph (d) of this section.

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

(i) *Consolidated group* has the meaning set forth in §1.1502–1(h).

(ii) *Controlled group* and *group* mean a controlled group of corporations, as defined in section 41(f)(5), or a group of trades or businesses under common control. For rules for determining whether trades or businesses are under common control, see §1.52–1 (b) through (g).

(iii) *Credit year* means the taxable year for which the member is computing the credit.

(iv) *Group credit* means the research credit (if any) allowable to a controlled group.

(v) *Trade or business* means a sole proprietorship, a partnership, a trust, an estate, or a corporation that is carrying on a trade or business (within the meaning of section 162). Any corporation that is a member of a commonly controlled group shall be deemed to be carrying on a trade or business if any other member of that group is carrying on any trade or business.

(b) *Computation of the group credit*—(1) *In general*. All members of a controlled group are treated as a single taxpayer for purposes of computing the research credit. The group credit is computed by applying all of the section 41 computational rules on an aggregate basis. All members of a controlled group must use the same method of computation, either the method described in section 41(a) or the alternative incremental research credit (AIRC) method described in section 41(c)(4), in computing the group credit for a credit year.

(2) *Start-up companies*—(i) *In general*. For purposes of computing the group credit, a controlled group is treated as a start-up company for purposes of section 41(c)(3)(B)(i) if—

(A) There was no taxable year beginning before January 1, 1984, in which a member of the group had gross receipts and either the same member or another member also had qualified research expenditures (QREs); or

(B) There were fewer than three taxable years beginning after December 31, 1983, and before January 1, 1989, in which a member of the group had gross receipts and either the same member or another member also had QREs.

(ii) *Example*. The following example illustrates the principles of paragraph (b)(2)(i) of this section:

*Example*. A, B, and C, all of which are calendar year taxpayers, are members of a controlled group. During the 1983 taxable year, A had QREs, but no gross receipts; B had gross receipts, but no QREs; and C had no QREs or gross receipts. The 1984 taxable year was the first taxable year for which each of A, B, and C had both QREs and gross receipts. A, B, and C had both QREs and gross receipts in 1985, 1986, 1987, and 1988. Because the first taxable year for which each of A, B, and C had both QREs and gross receipts began after December 31, 1983, each of A, B, and C is a start-up company under section 41(c)(3)(B)(i) and each is a start-up company for purposes of computing the stand-alone entity credit. During the 1983 taxable year, at least one member of the group, A, had QREs and at least one member of the group, B, had gross receipts, thus, the group had both QREs and gross receipts in 1983. Therefore, the controlled group is not a start-up company because the first taxable year for which the group had both QREs and gross receipts did not begin after December 31, 1983, and there were not fewer than three taxable years beginning after December 31, 1983, and before January 1, 1989, in which a member of the group had gross receipts and QREs.

(iii) *First taxable year after December 31, 1993, for which the controlled group had QREs*. In the case of a controlled group that is treated as a start-up company under section 41(c)(3)(B)(i) and paragraph (b)(2)(i) of this section, for purposes of determining the group's fixed-base percentage under section 41(c)(3)(B)(ii), the first taxable year after December 31, 1993, for which the group has QREs is the first taxable year in which at least one member of the group has QREs.

(iv) *Example*. The following example illustrates the principles of paragraph (b)(2)(iii) of this section:

*Example*. D, E, and F, all of which are calendar year taxpayers, are members of a controlled group. The group is treated as a start-up company under section 41(c)(3)(B)(i) and paragraph (b)(2)(i) of this section. The first taxable year after December 31, 1993, for which D had QREs was 1994. The first taxable year after December 31, 1993, for which E had QREs was 1995. The first taxable year after December 31, 1993, for which F had QREs was 1996. Because the 1994 taxable year was the first taxable year after December 31, 1993, for which at least one member of the group, D, had QREs, for purposes of determining the group's fixed-based percentage under section 41(c)(3)(B)(ii), the 1994 taxable year was the first taxable year after December 31, 1993, for which the group had QREs.

(c) *Allocation of the group credit*—(1) *In general*. (i) To the extent the group credit (if any) computed under paragraph (b) of this section does not exceed the sum of the stand-alone entity credits of all of the members of a controlled group, computed under paragraph (c)(2) of this section, such group credit shall be allocated among the members of the controlled group in proportion to the stand-alone entity credits of the members of the controlled group, computed under paragraph (c)(2) of this section:

| group credit that does not exceed sum of all the members' stand-alone entity credits | × | member's stand-alone entity credit / sum of all the members' stand-alone entity credits. |
|---|---|---|

(ii) To the extent that the group credit (if any) computed under paragraph (b) of this section exceeds the sum of the stand-alone entity credits of all of the members of the controlled group, computed under paragraph (c)(2) of this section, such excess shall be allocated among the members of a controlled group in proportion to the QREs of the members of the controlled group:

| (group credit − sum of all the members' stand-alone entity credits) | × | member's QREs / sum of all the members' QREs. |
|---|---|---|

(2) *Stand-alone entity credit*. The term *stand-alone entity credit* means the research credit (if any) that would be allowable to a member of a controlled group if the credit were computed as if section 41(f)(1) did not apply, except that the member must apply the rules provided in paragraphs (d)(1) (relating to consolidated groups) and (i) (relating to intra-group transactions) of this section. Each member's stand-alone entity credit for any credit year must be computed under whichever method (the method described in section 41(a) or the method described in section 41(c)(4)) results in the greater stand-alone entity credit for that member, without regard to the method used to compute the group credit.

(d) *Special rules for consolidated groups*—(1) *In general*. For purposes of applying paragraph (c) of this section, a consolidated group whose members are members of a controlled group is treated as a single member of the controlled group and a single stand-alone entity credit is computed for the consolidated group.

(2) *Start-up company status*. A consolidated group's status as a start-up company and the first taxable year after December 31, 1993, for which a consolidated group has QREs are determined in accordance with the principles of paragraph (b)(2) of this section.

(3) *Special rule for allocation of group credit among consolidated group members*. The portion of the group credit that is allocated to a consolidated group is allocated to the members of the consolidated group in accordance with the principles of paragraph (c) of this section. However, for this purpose, the stand-alone entity credit of a member of a consolidated group is computed without regard to section 41(f)(1), but with regard to paragraph (i) of this section.

(e) *Examples*. The following examples illustrate the provisions of this section. Unless otherwise stated, no members of a controlled group are members of a consolidated group, no member of the group made any basic research payments or paid or incurred any amounts to an energy research consortium, and except as provided in *Example 6*, the group has not made an AIRC election:

*Example 1. Group credit is less than sum of members' stand-alone entity credits*—(i) *Facts*. A, B, and C, all of which are calendar-year taxpayers, are members of a controlled group. For purposes of computing the group credit for the 2004 taxable year (the credit year), A, B, and C had the following:

| | A | B | C | Group Aggregate |
|---|---|---|---|---|
| Credit Year QREs | $200x | $20x | $110x | $330x |
| 1984–1988 QREs | $40x | $10x | $100x | $150x |
| 1984–1988 Gross Receipts | $1,000x | $350x | $150x | $1,500x |
| Average Annual Gross Receipts for 4 Years Preceding the Credit Year | $1,200x | $200x | $300x | $1,700x |

(ii) *Computation of the group credit*—(A) *In general*. The research credit allowable to the group is computed as if A, B, and C were one taxpayer. The group credit is equal to 20 percent of the excess of the group's aggregate credit year QREs ($330x) over the group's base amount ($170x). The group credit is 0.20 × ($330x − $170x), which equals $32x.

(B) *Group's base amount*—(*1*) *Computation*. The group's base amount equals the greater of: the group's fixed-base percentage (10 percent) multiplied by the group's aggregate average annual gross receipts for the 4 taxable years preceding the credit year ($1,700x), or the group's minimum base amount ($165x). The group's base amount, therefore, is $170x, which is the greater of: 0.10 × $1,700x, which equals $170x, or $165x.

(*2*) *Group's minimum base amount*. The group's minimum base amount is 50 percent of the group's aggregate credit year QREs. The group's minimum base amount is 0.50 × $330x, which equals $165x.

(*3*) *Group's fixed-base percentage*. The group's fixed-base percentage is the lesser of: the ratio that the group's aggregate QREs for the taxable years beginning after December 31, 1983, and before January 1, 1989, bear to the group's aggregate gross receipts for the same period, or 16 percent (the statutory maximum). The group's fixed-base percentage, therefore, is 10 percent, which is the lesser of: $150x/$1,500x, which equals 10 percent, or 16 percent.

(iii) *Allocation of the group credit*. Under paragraph (c)(2) of this section, each member's stand-alone entity credit must be computed using the method that results in the greater stand-alone entity credit for that member. The stand-alone entity credit for each of A, B, and C is greater using the method described in section 41(a). Therefore, the stand-alone entity credit for each of A, B, and C must be computed using the method described in section 41(a). A's stand-alone entity credit is $20x. B's stand-alone entity credit is $2x. C's stand-alone entity credit is $11x. The sum of the members' stand-alone entity credits is $33x. Because the group credit of $32x is less than the sum of the stand-alone entity credits of all the members of the group ($33x), the group credit is allocated among the members of the group based on the ratio that each member's stand-alone entity credit bears to the sum of the stand-alone entity credits of all the members of the group. The $32x group credit is allocated as follows:

| | A | B | C | Total |
|---|---|---|---|---|
| Stand-Alone Entity Credit | $20x | $2x | $11x | $33x |
| Allocation Ratio (Stand-Alone Entity Credit/Sum of Stand-Alone Entity Credits) | 20/33 | 2/33 | 11/33 | |
| Multiplied by: Group Credit | $32x | $32x | $32x | |
| Equals: Credit Allocated to Member | $19.39x | $1.94x | $10.67x | $32x |

*Example 2. Group credit exceeds sum of members' stand-alone entity credits*—(i) *Facts*. D, E, F, and G, all of which are calendar-year taxpayers, are members of a controlled group. For purposes of computing the group credit for the 2004 taxable year (the credit year), D, E, F, and G had the following:

| | D | E | F | G | Group Aggregate |
|---|---|---|---|---|---|
| Credit Year QREs | $580x | $10x | $70x | $15x | $675x |
| 1984–1988 QREs | $500x | $25x | $100x | $25x | $650x |
| 1984–1988 Gross Receipts | $4,000x | $5,000x | $2000x | $10,000x | $21,000x |
| Average Annual Gross Receipts for 4 Years Preceding the Credit Year | $5,000x | $5,000x | $2,000x | $5,000x | $17,000x |

(ii) *Computation of the group credit*—(A) *In general*. The research credit allowable to the group is computed as if D, E, F, and G were one taxpayer. The group credit is equal to 20 percent of the excess of the group's aggregate credit year QREs ($675x) over the group's base amount ($527x). The group credit is 0.20 × ($675x − $527x), which equals $29.76x.

(B) *Group's base amount*—(*1*) *Computation*. The group's base amount equals the greater of: the group's fixed-base percentage (3.10 percent) multiplied by the group's aggregate average annual gross receipts for the 4 taxable years preceding the credit year ($17,000x), or the group's minimum base amount ($337.50x). The group's base amount, therefore, is $527x, which is the greater of: 0.031 × $17,000x, which equals $527x, or $337.50x.

(*2*) *Group's minimum base amount*. The group's minimum base amount is 50 percent of the group's aggregate credit year QREs. The group's minimum base amount is 0.50 × $675x, which equals $337.50x.

(*3*) *Group's fixed-base percentage*. The group's fixed-base percentage is the lesser of: the ratio that the group's aggregate QREs for the taxable years beginning after December 31, 1983, and before January 1, 1989, bear to the group's aggregate gross receipts for the same period, or 16 percent (the statutory maximum). The group's fixed-base percentage, therefore, is 3.10 percent, which is the lesser of: $650x/$21,000x, which equals 3.10 percent, or 16 percent.

(iii) *Allocation of the group credit*. Under paragraph (c)(2) of this section, each member's stand-alone entity credit must be computed using the method that results in the greater stand-alone entity credit for that member. The stand-alone entity credits for D ($19.46x) and F ($1.71x) are greater using the AIRC method. Therefore, the stand-alone entity credits for D and F must be computed using the AIRC method. The stand-alone entity credit for G ($0.50x) is greater using the method described in section 41(a). Therefore, the stand-alone entity credit for G must be computed using the method described in section 41(a). E's stand-alone entity credit computed under either method is zero. The sum of the members' stand-alone entity credits is $21.67x. Because the group credit of $29.76x is greater than the sum of the stand-alone entity credits of all the members of the group ($21.67x), each member of the group is allocated an amount of the group credit equal to that member's stand-alone entity credit. The excess of the group credit over the sum of the members' stand-alone entity credits ($8.09x) is allocated among the members of the group based on the ratio that each member's QREs bear to the sum of the QREs of all the members of the group. The $29.76x group credit is allocated as follows:

| | D | E | F | G | Total |
|---|---|---|---|---|---|
| Group Credit | | | | | $29.76x |
| Minus: Sum of Stand-Alone Entity Credits | $19.46x | $0.00x | $1.71x | $0.50x | $21.67x |
| Equals: Excess Group Credit | | | | | $8.09x |
| | | | | | |
| Excess Group Credit | $8.09x | $8.09x | $8.09x | $8.09x | |
| Multiplied By Allocation Ratio: QREs/Sum of QREs | 580/675 | 10/675 | 70/675 | 15/675 | |
| Excess Group Credit Allocated | $6.95x | $0.12x | $0.84x | $0.18x | |
| Plus: Stand-Alone Entity Credit | $19.46x | $0.00x | $1.71x | $0.50x | |
| Equals: Credit Allocated to Member | $26.41x | $0.12x | $2.55x | $0.68x | $29.76x |

*Example 3. Consolidated group within a controlled group*—(i) *Facts*. The facts are the same as in *Example 2*, except that D and E file a consolidated return.

(ii) *Allocation of the group credit*—(A) *In general*. For purposes of allocating the controlled group's research credit of $29.76x among the members of the controlled group, D and E are treated as a single member of the controlled group.

(B) *Computation of stand-alone entity credits*. The stand-alone entity credit for the consolidated group is computed by treating D and E as a single entity. Under paragraph (c)(2) of this section, the stand-alone entity credit for each member must be computed using the method that results in the greater stand-alone entity credit for that member. The stand-alone entity credit for each of the DE consolidated group ($17.55x) and F ($1.71x) is greater using

the AIRC method. Therefore, the stand-alone entity credit for each of the DE consolidated group and F must be computed using the AIRC method. The stand-alone entity credit for G ($0.50x) is greater using the method described in section 41(a). Therefore, the stand-alone entity credit for G must be computed using the method described in section 41(a). The sum of the members' stand-alone entity credits is $19.76x.

(C) *Allocation of controlled group credit*. Because the group credit of $29.76x is greater than the sum of the stand-alone entity credits of all the members of the group ($19.76x), each member of the group is allocated an amount of the group credit equal to that member's stand-alone entity credit. The excess of the group credit over the sum of the members' stand-alone entity credits ($10.00x) is allocated among the members of the group based on the ratio that each member's QREs bear to the sum of the QREs of all the members of the group. The group credit of $29.76x is allocated as follows:

| | DE | F | G | Total |
|---|---|---|---|---|
| Group Credit | | | | $29.76x |
| Minus: Sum of Stand-Alone Entity Credits | $17.55x | $1.71x | $0.50x | $19.76x |
| Equals: Excess Group Credit | | | | $10.00x |
| | | | | |
| Excess Group Credit | $10.00x | $10.00x | $10.00x | |
| Multiplied By Allocation Ratio: QREs/Sum of QREs | 590/675 | 70/675 | 15/675 | |
| Excess Group Credit Allocated | $8.74x | $1.04x | $0.22x | |
| Plus: Stand-Alone Entity Credit | $17.55x | $1.71x | $0.50x | |
| Equals: Credit Allocated to Member | $26.29x | $2.75x | $0.72x | $29.76x |

(iii) *Allocation of the group credit allocated to consolidated group*—(A) *In general*. The group credit that is allocated to a consolidated group is allocated among the members of the consolidated group in accordance with the principles of paragraph (c) of this section.

(B) *Computation of stand-alone entity credits*. Under paragraph (c)(2) of this section, the stand-alone entity credit for each member of the consolidated group must be computed using the method that results in the greater stand-alone entity credit for that member. The stand-alone entity credit for D ($19.46x) is greater using the AIRC method. Therefore, the stand-alone entity credit for D must be computed using the AIRC method. The stand-alone entity credit for E is zero under either method. The sum of the stand-alone entity credits of the members of the consolidated group is $19.46x.

(C) *Allocation among members of consolidated group*. Because the amount of the group credit allocated to the consolidated group ($26.29x) is greater than $19.46x, the sum of the stand-alone entity credits of all the members of the consolidated group, each member of the consolidated group is allocated an amount of the group credit allocated to the consolidated group equal to that member's stand-alone entity credit. The excess of the group credit allocated to the consolidated group over the sum of the consolidated group members' stand-alone entity credits ($6.83x) is allocated among the members of the consolidated group based on the ratio that each member's QREs bear to the sum of the QREs of all the members of the consolidated group. The group credit of $26.29x allocated to the DE consolidated group is allocated between D and E as follows:

| | D | E | Total |
|---|---|---|---|
| Group Credit | | | $26.29x |
| Minus: Sum of Stand-Alone Entity Credits | $19.46x | $0.00x | $19.46x |
| Excess Group Credit | | | $6.83x |
| | | | |
| Excess Group Credit | $6.83x | $6.83x | |
| Multiplied By Allocation Ratio: QREs/Sum of QREs | 580/590 | 10/590 | |
| Excess Group Credit Allocated | $6.71x | $0.12x | |
| Plus: Stand-Alone Entity Credit | $19.46x | $0.00x | |
| Equals: Credit Allocated to Member | $26.17x | $0.12x | $26.29x |

*Example 4*. *Member is a start-up company*—(i) *Facts*. H, I, and J, all of which are calendar-year taxpayers, are members of a controlled group. The first taxable year for which J has both QREs and gross receipts begins after December 31, 1983, therefore, J is a start-up company under section 41(c)(3)(B)(i). The first taxable year for which H and I had both QREs and gross receipts began before December 31, 1983, therefore, H and I are not start-up companies under section 41(c)(3)(B)(i). For purposes of computing the group credit for the 2004 taxable year (the credit year), H, I, and J had the following:

| | H | I | J | Group Aggregate |
|---|---|---|---|---|
| Credit Year QREs | $200x | $20x | $50x | $270x |
| 1984–1988 QREs | $55x | $15x | $0x | $70x |
| 1984–1988 Gross Receipts | $1,000x | $400x | $0x | $1,400x |
| Average Annual Gross Receipts for 4 Years Preceding the Credit Year | $1,200x | $200x | $0x | $1,400x |

(ii) *Computation of the group credit*—(A) *In general*. The research credit allowable to the group is computed as if H, I, and J were one taxpayer. The group credit is equal to 20 percent of the excess of the group's aggregate credit year QREs ($270x) over the group's base amount ($135x). The group credit is 0.20 × ($270x − $135x), which equals $27x.

(B) *Group's base amount*—(*1*) *Computation*. The group's base amount equals the greater of: the group's fixed-base percentage (5 percent) multiplied by the group's aggregate average annual gross receipts for the 4 taxable years preceding the credit year ($1,400x), or the group's minimum base amount ($135x). The group's base amount, therefore, is $135x, which is the greater of: 0.05 × $1,400x, which equals $70x, or $135x.

(*2*) *Group's minimum base amount*. The group's minimum base amount is 50 percent of the group's aggregate credit year QREs. The group's minimum base amount is 0.50 × $270x, which equals $135x.

(*3*) *Group's fixed-base percentage*. Because the first taxable year in which at least one member of the group has QREs and at least one member of the group has gross receipts does not begin after December 31, 1983, the group is not a start-up company. Therefore, the group's fixed-base percentage is the lesser of: the ratio that the group's aggregate QREs for the taxable years beginning after December 31, 1983, and before January 1, 1989, bear to the group's aggregate gross receipts for the same period, or 16 percent (the statutory maximum). The group's fixed-base percentage, therefore, is 5 percent, which is the lesser of: $70x/$1,400x, which equals 5 percent, or 16 percent.

(iii) *Allocation of the group credit*. Under paragraph (c)(2) of this section, the stand-alone entity credit for each member of the group must be computed using the method that results in the greater stand-alone entity credit for that member. The stand-alone entity credits for H ($20x), I ($2x), and J ($5x) are greater using the method described in section 41(a). Therefore, the stand-alone entity credits for each of H, I, and J must be computed using the method described in section 41(a). The sum of the stand-alone entity credits of the members of the group is $27x. Because the group credit of $27x is equal to the sum of the stand-alone entity credits of all the members of the group ($27x), the group credit is allocated among the members of the group based on the ratio that each member's stand-alone entity credit bears to the sum of the stand-alone entity credits of all the members of the group. The group credit of $27x is allocated as follows:

| | H | I | J | Total |
|---|---|---|---|---|
| Stand-Alone Entity Credit | $20x | $2x | $5x | $27x |
| Allocation Ratio (Stand-Alone Entity Credit/Sum of Stand-Alone Entity Credits) | 20/27 | 2/27 | 5/27 | |
| Multiplied by: Group Credit | $27x | $27x | $27x | |
| Equals: Credit Allocated to Member | $20x | $2x | $5x | $27x |

*Example 5. Group is a start-up company*—(i) *Facts*. K, L, and M, all of which are calendar-year taxpayers, are members of a controlled group. The taxable year ending on December 31, 1999, is the first taxable year in which a member of the group had QREs and either the same member or another member also had gross receipts. In that year, each of K, L, and M had both QREs and gross receipts. The 2004 taxable year is the fifth taxable year beginning after December 31, 1993, for which at least one member of the group had QREs. For purposes of computing the group credit for the 2004 taxable year (the credit year), K, L, and M had the following:

| | K | L | M | Group Aggregate |
|---|---|---|---|---|
| Credit Year QREs | $255x | $25x | $100x | $380x |
| 1984–1988 QREs | $0x | $0x | $0x | $0x |
| 1984–1988 Gross Receipts | $0x | $0x | $0x | $0x |
| Average Annual Gross Receipts for 4 Years Preceding the Credit Year | $1,600x | $340x | $300x | $2,240x |

(ii) *Computation of the group credit*—(A) *In general*. The research credit allowable to the group is computed as if K, L, and M were one taxpayer. The group credit is equal to 20 percent of the excess of the group's aggregate credit year QREs ($380x) over the group's base amount ($190x). The group credit is 0.20 × ($380x − $190x), which equals $38x.

(B) *Group's base amount*—(*1*) *Computation*. The group's base amount equals the greater of: the group's fixed-base percentage (3 percent) multiplied by the group's aggregate average annual gross receipts for the 4 taxable years preceding the credit year ($2,240x), or the group's minimum base amount ($190x). The group's base amount, therefore, is $190x, which is the greater of: 0.03 × $2,240x, which equals $67.20x, or $190x.

(*2*) *Group's minimum base amount*. The group's minimum base amount is 50 percent of the group's aggregate credit year QREs. The group's minimum base amount is 0.50 × $380x, which equals $190x.

(*3*) *Group's fixed-base percentage*. Because the first taxable year in which at least one member of the group has QREs and at least one member of the group has gross receipts begins after December 31, 1983, the group is treated as a start-up company under section 41(c)(3)(B)(i) and paragraph (b)(2)(i) of this section. Because the 2004 taxable year is the fifth taxable year beginning after December 31, 1993, for which at least one member of the group had

QREs, under section 41(c)(3)(B)(ii)(I), the group's fixed-base percentage is 3 percent.

(iii) *Allocation of the group credit*. Under paragraph (c)(2) of this section, the stand-alone entity credit for each member of the group must be computed using the method that results in the greater stand-alone entity credit for that member. The stand-alone entity credit for each of K ($25.5x), L ($2.5x), and M ($10x) is greater using the method described in section 41(a). Therefore, the stand-alone entity credits for each of K, L, and M must be computed using the method described in section 41(a). The sum of the stand-alone entity credits of all the members of the group is $38x. Because the group credit of $38x is equal to sum of the stand-alone entity credits of all the members of the group ($38x), the group credit is allocated among the members of the group based on the ratio that each member's stand-alone entity credit bears to the sum of the stand-alone entity credits of all the members of the group. The $38x group credit is allocated as follows:

| | K | L | M | Total |
|---|---|---|---|---|
| Stand-Alone Entity Credit | $25.5x | $2.5x | $10x | $38x |
| Allocation Ratio (Stand-Alone Entity Credit/Sum of Stand-Alone Entity Credits) | 25.5/38 | 2.5/38 | 10/38 | |
| Multiplied by: Group Credit | $38x | $38x | $38x | |
| Equals: Credit Allocated to Member | $25.5x | $2.5x | $10x | $38x |

*Example 6*. *Group alternative incremental research credit*—(i) *Facts*. N, O, and P, all of which are calendar-year taxpayers, are members of a controlled group. The research credit under section 41(a) is not allowable to the group for the 2004 taxable year because the group's aggregate QREs for the 2004 taxable year are less than the group's base amount. The group credit is computed using the AIRC rules of section 41(c)(4). For purposes of computing the group credit for the 2004 taxable year (the credit year), N, O, and P had the following:

| | N | O | P | Group Aggregate |
|---|---|---|---|---|
| Credit Year QREs | $0x | $20x | $110x | $130x |
| Average Annual Gross Receipts for 4 Years Preceding the Credit Year | $1,200x | $200x | $300x | $1,700x |

(ii) *Computation of the group credit*. The research credit allowable to the group is computed as if N, O, and P were one taxpayer. The group credit is equal to the sum of: 2.65 percent of so much of the group's aggregate QREs for the taxable year as exceeds 1 percent of the group's aggregate average annual gross receipts for the 4 taxable years preceding the credit year, but does not exceed 1.5 percent of such average; 3.2 percent of so much of the group's aggregate QREs as exceeds 1.5 percent of such average but does not exceed 2 percent of such average; and 3.75 percent of so much of such QREs as exceeds 2 percent of such average. The group credit is [0.0265 × [($1,700x × 0.015) − ($1,700x × 0.01)]] + [0.032 × [($1,700x × 0.02) − ($1,700x × 0.015)]] + [0.0375 × [$130x − ($1,700x × 0.02)]], which equals $4.10x.

(iii) *Allocation of the group credit*. Under paragraph (c)(2) of this section, the stand-alone entity credit for each member of the group must be computed using the method that results in the greater stand-alone entity credit for that member. The stand-alone entity credit for N is zero under either method. The stand-alone entity credit for each of O ($0.66x) and P ($3.99x) is greater using the AIRC method. Therefore, the stand-alone entity credits for each of O and P must be computed using the AIRC method. The sum of the stand-alone entity credits of the members of the group is $4.65x. Because the group credit of $4.10x is less than the sum of the stand-alone entity credits of all the members of the group ($4.65x), the group credit is allocated among the members of the group based on the ratio that each member's stand-alone entity credit bears to the sum of the stand-alone entity credits of all the members of the group. The $4.10x group credit is allocated as follows:

| | N | O | P | Total |
|---|---|---|---|---|
| Stand-Alone Entity Credit | $0.00x | $0.66x | $3.99x | $4.65x |
| Allocation Ratio (Stand-Alone Entity Credit/Sum of Stand-Alone Entity Credits) | 0/4.65 | 0.66/4.65 | 3.99/4.65 | |
| Multiplied by: Group Credit | $4.10x | $4.10x | $4.10x | |
| Equals: Credit Allocated to Member | $0.00x | $0.58x | $3.52x | $4.10x |

(f) *For taxable years beginning before January 1, 1990*. For taxable years beginning before January 1, 1990, see §1.41–6 as contained in 26 CFR part 1, revised April 1, 2005.

(g) *Tax accounting periods used*—(1) *In general*. The credit allowable to a member of a controlled group is that member's share of the group credit computed as of the end of that member's taxable year. In computing the group credit for a group whose members have different taxable years, a member generally should treat the taxable year of another member that ends with or within the credit year of the computing member as the credit year of that other member. For example, Q, R, and S are members of a controlled group of corporations. Both Q and R are calendar year taxpayers. S files a return using a fiscal year ending June 30. For purposes of computing the group credit at the end of Q's and R's taxable year on December 31, S's fiscal year ending June 30, which ends within Q's and R's taxable year, is treated as S's credit year.

(2) *Special rule when timing of research is manipulated*. If the timing of research by members using different tax accounting periods is manipulated to generate a credit

in excess of the amount that would be allowable if all members of the group used the same tax accounting period, then the appropriate Internal Revenue Service official in the operating division that has examination jurisdiction of the return may require each member of the group to calculate the credit in the current taxable year and all future years as if all members of the group had the same taxable year and base period as the computing member.

(h) *Membership during taxable year in more than one group*. A trade or business may be a member of only one group for a taxable year. If, without application of this paragraph, a business would be a member of more than one group at the end of its taxable year, the business shall be treated as a member of the group in which it was included for its preceding taxable year. If the business was not included for its preceding taxable year in any group in which it could be included as of the end of its taxable year, the business shall designate in its timely filed (including extensions) return the group in which it is being included. If the return for a taxable year is due before July 1, 1983, the business may designate its group membership through an amended return for that year filed on or before June 30, 1983. If the business does not so designate, then the appropriate Internal Revenue Service official in the operating division that has examination jurisdiction of the return will determine the group in which the business is to be included.

(i) *Intra-group transactions*—(1) *In general*. Because all members of a group under common control are treated as a single taxpayer for purposes of determining the research credit, transfers between members of the group are generally disregarded.

(2) *In-house research expenses*. If one member of a group performs qualified research on behalf of another member, the member performing the research shall include in its QREs any in-house research expenses for that work and shall not treat any amount received or accrued as funding the research. Conversely, the member for whom the research is performed shall not treat any part of any amount paid or incurred as a contract research expense. For purposes of determining whether the in-house research for that work is qualified research, the member performing the research shall be treated as carrying on any trade or business carried on by the member on whose behalf the research is performed.

(3) *Contract research expenses*. If a member of a group pays or incurs contract research expenses to a person outside the group in carrying on the member's trade or business, that member shall include those expenses as QREs. However, if the expenses are not paid or incurred in carrying on any trade or business of that member, those expenses may be taken into account as contract research expenses by another member of the group provided that the other member—

(i) Reimburses the member paying or incurring the expenses; and

(ii) Carries on a trade or business to which the research relates.

(4) *Lease Payments*. The amount paid or incurred to another member of the group for the lease of personal property owned by a member of the group is not taken into account for purposes of section 41. Amounts paid or incurred to another member of the group for the lease of personal property owned by a person outside the group shall be taken into account as in-house research expenses for purposes of section 41 only to the extent of the lesser of—

(i) The amount paid or incurred to the other member; or

(ii) The amount of the lease expenses paid to the person outside the group.

(5) *Payment for supplies*. Amounts paid or incurred to another member of the group for supplies shall be taken into account as in-house research expenses for purposes of section 41 only to the extent of the lesser of—

(i) The amount paid or incurred to the other member; or

(ii) The amount of the other member's basis in the supplies.

(j) *Effective date*—(1) *In general*. Except for paragraph (d) of this section, these regulations are applicable for taxable years ending on or after May 24, 2005. Generally, a taxpayer may use any reasonable method of computing and allocating the credit (including use of the consolidated group rule contained in paragraph (d) of this section) for taxable years ending before May 24, 2005. However, paragraph (b) of this section, relating to the computation of the group credit, and paragraph (c) of this section, relating to the allocation of the group credit, (applied without regard to paragraph (d) of this section) will apply to taxable years ending on or after December 29, 1999, if the members of a controlled group, as a whole, claimed more than 100 percent of the amount that would be allowable under paragraph (b) of this section. In the case of a controlled group whose members have different taxable years and whose members use inconsistent methods of allocation, the members of the controlled group shall be deemed to have, as a whole, claimed more than 100 percent of the amount that would be allowable under paragraph (b) of this section.

(2) *Consolidated group rule*. Paragraph (d) of this section is applicable for taxable years ending on or after November 9, 2006. For taxable years ending on or after May 24, 2005, and before November 9, 2006, see §1.41–6T(d) as contained in 26 CFR part 1, revised April 1, 2006.

**§1.41–6T [Removed]**

Par. 4. Section 1.41–6T is removed.

Par. 5. Section 1.41–8 is added to read as follows.

*§1.41–8 Special rules for taxable years ending on or after November 9, 2006.*

(a) *Alternative incremental credit*. At the election of the taxpayer, the credit determined under section 41(a)(1) equals the amount determined under section 41(c)(4).

(b) *Election*—(1) *In general*. A taxpayer may elect to apply the provisions of the alternative incremental research credit (AIRC) in section 41(c)(4) for any taxable year of the taxpayer beginning after June 30, 1996. If a taxpayer makes an election under section 41(c)(4), the election applies to the taxable year for which made and all subsequent taxable years unless revoked in the manner prescribed in paragraph (b)(3) of this section.

(2) *Time and manner of election*. An election under section 41(c)(4) is made by completing the portion of Form 6765, "*Credit for Increasing Research Activities*," relating to the election of the AIRC, and attaching the completed form to the taxpayer's timely filed (including extensions) original return for the taxable year to which the election applies. An election under section 41(c)(4) may not be made on an amended return.

(3) *Revocation*. An election under this section may not be revoked except with

the consent of the Commissioner. A taxpayer is deemed to have requested, and to have been granted, the consent of the Commissioner to revoke an election under section 41(c)(4) if the taxpayer completes the portion of Form 6765 relating to the regular credit and attaches the completed form to the taxpayer's timely filed (including extensions) original return for the year to which the revocation applies. An election under section 41(c)(4) may not be revoked on an amended return.

(4) *Special rules for controlled groups*—(i) *In general*. In the case of a controlled group of corporations, all the members of which are not included on a single consolidated return, an election (or revocation) must be made by the designated member by satisfying the requirements of paragraph (b)(2) or (b)(3) of this section (whichever applies), and such election (or revocation) by the designated member shall be binding on all the members of the group for the credit year to which the election (or revocation) relates. If the designated member fails to timely make (or revoke) an election, each member of the group must compute the group credit using the method used to compute the group credit for the immediately preceding credit year.

(ii) *Designated member*. For purposes of this paragraph (b)(4) of this section, for any credit year, the term *designated member* means that member of the group that is allocated the greatest amount of the group credit under paragraph (c) of this section based on the amount of credit reported on the original timely filed Federal income tax return (even if that member subsequently is determined not to be the designated member). If the members of a group compute the group credit using different methods (either the method described in section 41(a) or the AIRC method of section 41(c)(4)) and at least two members of the group qualify as the designated member, then the term *designated member* means that member that computes the group credit using the method that yields the greater group credit. For example, A, B, C, and D are members of a controlled group but are not members of a consolidated group. For the 2005 taxable year, the group credit using the method described in section 41(a) is $10x. Under this method, A would be allocated $5x of the group credit, which would be the largest share of the group credit under this method. For the 2005 taxable year, the group credit using the AIRC method is $15x. Under the AIRC method, C would be allocated $5x of the group credit, which is the largest share of the group credit computed using the AIRC method. Because the group credit is greater using the AIRC method and C is allocated the greatest amount of credit under that method, C is the designated member. Therefore, C's section 41(c)(4) election is binding on all the members of the group for the 2005 taxable year.

(5) *Effective date*. These regulations are applicable for taxable years ending on or after November 9, 2006. For taxable years ending on or after May 24, 2005, and before November 9, 2006, see §1.41–8T(b)(5) as contained in 26 CFR part 1, revised April 1, 2006.

**§1.41–8T [Removed]**

Par. 6. Section 1.41–8T is removed.

Steven T. Miller,
*Acting Deputy Commissioner for Services and Enforcement.*

Approved October 18, 2006.

Eric Solomon,
*Acting Deputy Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on November 8, 2006, 8:45 a.m., and published in the issue of the Federal Register for November 9, 2006, 71 F.R. 65722)

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## Section 937.—Residence and Source Rules Involving Possessions

*26 CFR 1.937–1: Bona fide residency in a possession.*

## T.D. 9297

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Residence Rules Involving U.S. Possessions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide rules for determining *bona fide* residency in the following U.S. territories: American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the United States Virgin Islands under section 937(a) of the Internal Revenue Code.

DATES: *Effective Date:* These regulations are effective November 14, 2006.

*Applicability Dates:* For dates of applicability, see §1.937–1(i).

FOR FURTHER INFORMATION CONTACT: J. David Varley, (202) 435–5262 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

On April 11, 2005, the IRS and Treasury Department published in the **Federal Register** temporary regulations (T.D. 9194, 2005–1 C.B. 1016 [70 FR 18920], as corrected at 70 FR 32589–01), which provided rules to implement section 937 of the Internal Revenue Code (Code) dealing with U.S. possessions or territories specified in that section (territories) and to conform existing regulations to other legislative changes with respect to the territories. A notice of proposed rulemaking (REG–159243–03, 2005–1 C.B. 1075 [70 FR 18949]) cross-referencing the temporary regulations was published in the **Federal Register** on the same day. Written comments were received in response to the notice of proposed rulemaking and a public hearing on the proposed regulations was held on July 21, 2005. After consideration of the comments, the IRS and Treasury Department on January 31, 2006 published in the Federal Register final regulations (T.D. 9248, 2006–9 I.R.B. 524 [71 FR 4996], as corrected at 71 FR 14099) under section 937(a) concerning the determination of residency in a territory and adopting with amendments the proposed regulations (specifically, §§1.937–1 and 1.881–5(f)(4)).

Section 937(a) provides that an individual is a *bona fide* resident of a territory if the individual meets a presence test, a tax home test and a closer connection test. In

order to satisfy the presence test, a person must be present in the territory for at least 183 days during the taxable year (the 183-day rule), unless otherwise provided in regulations. The final section 937(a) regulations provide several alternatives to the 183-day rule in the statute.

Treasury Reg. §1.937–1 provides that an individual who does not satisfy the 183-day rule nevertheless meets the presence test if the individual satisfies one of three alternative tests: (1) the individual spends no more than 90 days in the United States during the taxable year; (2) the individual has no more than $3,000 of earned income from U.S. sources and is present for more days in the territory than in the United States during the taxable year; or (3) the individual has no significant connection to the United States during the tax year. The term "significant connection" is generally defined as a permanent home, voter registration, spouse, or minor child in the United States. The final regulations also provide that certain days count as days of presence in the relevant territory for purposes of the presence test, even if the person was not physically present in the territory. Similarly, certain days that an individual spends in the United States do not count as days of presence in the United States for purposes of the presence test.

Before finalizing the regulations, the IRS and Treasury Department received comments suggesting that days spent outside of a territory for nonmedical family emergencies, charitable pursuits or business travel should count as days spent in the territory and outside the United States. The IRS and Treasury Department were sympathetic to the concern that the realities of life in the territories might require periodic temporary absences from the territories, but found that the particular suggestions would have been very difficult to implement and monitor administratively. Further, the IRS and Treasury Department declined to adopt the commentators' suggestion to import a simple mirroring of the substantial presence test of section 7701(b) to determine *bona fide* residency in a territory on the ground that Congress had considered but rejected this approach for determining residency in a territory. See H.R. Conf. Rep. No. 108–755, at 791–795 (2004). Nonetheless, the IRS and Treasury Department believed that final regulations provided meaningful advantages to taxpayers over the proposed and temporary regulations.

**Explanation of Provisions**

Following publication of the final regulations, additional comments were made requesting that the IRS and Treasury Department revisit the presence test. For example, one commentator requested that up to 30 days of business or personal travel outside the United States and the territory be treated as days of presence in a territory. The IRS and Treasury Department continue to be sympathetic to the concern that the realities of life in the territories might require periodic temporary absences from the territories for business pursuits but have concluded that such a rule would be administratively difficult to implement and monitor. In addition, commentators have not been able to offer meaningful suggestions to alleviate this concern. The IRS and Treasury Department believe that in these situations, the 183-day rule in combination with the alternatives to that rule, as liberalized in these final regulations, provide sufficient flexibility to accommodate absences from the territory to pursue a range of activities.

In addition, a commentator argued that the treatment of major disasters should be liberalized to allow individuals to spend time away from the territories in the event of a natural disaster. This commentator said the final regulations only provide rules for evacuations of territories, which suggests the IRS and Treasury Department do not realize that the territories are typically not evacuated in the event of natural disasters such as a hurricane. This commentator appears to have misunderstood the final regulations. The final regulations already address the commentator's concerns and provide that if an individual leaves, or is unable to return to, a relevant territory during a two-week period within which an officially declared major disaster in the relevant territory occurs, then the individual will not count any day during either period as a day of presence in the United States, even if the individual is physically present in the United States, and will treat such days as days of presence in the relevant territory. In addition, the regulations provide for similar relief in case there ever is a natural disaster that would warrant the evacuation of a territory. The IRS and Treasury Department recognize that it is currently not the custom to evacuate the territories in the event of natural disasters such as a hurricane. However, the IRS and Treasury Department continue to think it best to retain the rules regarding evacuations so that the regulations are flexible enough to allow for such an event should it ever occur. Individuals who remain in the territories during the natural disaster obviously can count those days for the presence test.

Commentators also requested that outpatient care be added to the permitted types of qualifying medical treatment. Under the final regulations, a temporary stay in the United States for certain documented medical treatment of the individual, or a parent, spouse or child whom the individual accompanies to the treatment, will not count as days spent in the United States for purposes of the alternatives to the 183-day rule, irrespective of where the medical condition arose. The final regulations focus on inpatient treatment in a hospital, hospice or residential medical care facility and the formal credentials of the health care provider as an objective proxy for a determination that a medical condition is serious enough to entail periods of treatment that may not be readily covered by other alternatives to the 183-day rule. The IRS and Treasury Department continue to believe that in medical situations not otherwise provided for in the final regulations, the 183-day rule in combination with the alternatives to that rule, as liberalized in these final regulations, provide sufficient flexibility to accommodate absences from the territories.

Finally, these post-publication comments suggested a new alternative to the presence test whereby U.S. citizens and residents should be permitted to satisfy the 183-day rule of section 937(a)(1) by meeting some type of averaging test that would better accommodate the reality that business cycles and life in the territories may require more time away from the territories in some years than in others. The IRS and Treasury Department believe that this final new suggestion is administrable and achieves the additional flexibility the commentators sought for the host of activities commentators discussed above and for which the commentators suggested additional exceptions to the 183-day rule.

As amended by this Treasury decision, the final regulations now incorporate a new alternative to the presence test that requires the individual to be present in the relevant territory for a simple non-weighted three-year average of 183 days per year, provided that a minimum of 60 days of presence is met in each of those three years. Thus, under this alternative, an individual will satisfy the presence test for a taxable year if the individual is present in the relevant territory a minimum of 549 days during the three-year period that includes the current taxable year and the two preceding taxable years, so long as the individual is also present in the relevant territory for a minimum of 60 days in each year during that three-year period. This test is in addition to the existing regulatory alternatives to the statutory test and incorporates the existing rules for counting days.

In light of the additional flexibility achieved by the new three-year averaging alternative adopted in this Treasury decision, the IRS and Treasury Department have determined not to adopt the other amendments suggested by commentators. These suggestions were each felt to be either not appropriate or difficult to administer. The new three-year averaging alternative, together with the existing available alternatives, provides individuals with sufficient flexibility in applying the presence test. It is not expected that any further amendments will be made to the *bona fide* residence rules of §1.937–1.

**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. 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 these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal author of these regulations is J. David Varley, Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and 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, in part, as follows:

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

Section 1.937–1 also issued under 26 U.S.C. 937(a). * * *

Par. 2. Section 1.937–1 is amended as follows:

1. Revise paragraph (c)(1) and (c)(5) introductory text.

2. Revise paragraph (g) by redesignating *Examples 1* through *9* as *Examples 2* through *10* respectively, adding new *Example 1*, and revising newly designated *Example 2*, the last sentence; *Example 3*, the ninth sentence; and *Example 6*, the sixth sentence.

The revisions and addition read as follows:

*§1.937–1 Bona fide residency in a possession.*

* * * * *

(c) *Presence test*—(1) *In general*. A United States citizen or resident alien individual (as defined in section 7701(b)(1)(A)) satisfies the requirements of this paragraph (c) for a taxable year if that individual—

(i) Was present in the relevant possession for at least 183 days during the taxable year;

(ii) Was present in the relevant possession for at least 549 days during the three-year period consisting of the taxable year and the two immediately preceding taxable years, provided that the individual was also present in the relevant possession for at least 60 days during each taxable year of the period;

(iii) Was present in the United States for no more than 90 days during the taxable year;

(iv) During the taxable year had earned income (as defined in §1.911–3(b)) in the United States, if any, not exceeding in the aggregate the amount specified in section 861(a)(3)(B) and was present for more days in the relevant possession than in the United States; or

(v) Had no significant connection to the United States during the taxable year. See paragraph (c)(5) of this section.

* * * * *

(5) *Significant connection*. For purposes of paragraph (c)(1)(v) of this section—

* * * * *

(g) Examples. * * *

*Example 1. Presence test.* H, a U.S. citizen, is engaged in a profession that requires frequent travel. H spends 195 days of each of the years 2005 and 2006 in Possession N. In 2007, H spends 160 days in Possession N. Under paragraph (c)(1)(ii), H satisfies the presence test of paragraph (c) of this section with respect to Possession N for taxable year 2007. Assuming that in 2007 H does not have a tax home outside of Possession N and does not have a closer connection to the United States or a foreign country under paragraphs (d) and (e) of this section respectively, then regardless of whether H was a *bona fide* resident of Possession N in 2005 and 2006, H is a *bona fide* resident of Possession N for taxable year 2007.

*Example 2. Presence test.* * * * However, under paragraph (c)(1)(iv) of this section, W still satisfies the presence test of paragraph (c) of this section with respect to Possession P because she has no earned income in the United States and is present for more days in Possession P than in the United States.

*Example 3. Presence test.* * * * Assuming that no other accommodations in the United States constitute a permanent home with respect to T, then under paragraphs (c)(1)(v) and (c)(5) of this section, T has no significant connection to the United States. * * *

* * * * *

*Example 6. Seasonal workers— Tax home and closer connection.* * * * P satisfies the presence test of paragraph (c) of this section with respect to both Possession Q and Possession I, because, among other reasons, under paragraph (c)(1)(iii) of this section she does not spend more than 90 days in the United States during the taxable year. * * *

* * * * *

Linda M. Kroening,
*Acting Deputy Commissioner for Services and Enforcement.*

Approved November 3, 2006.

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

(Filed by the Office of the Federal Register on November 13, 2006, 8:45 a.m., and published in the issue of the Federal Register for November 14, 2006, 71 F.R. 66232)

# Part III. Administrative, Procedural, and Miscellaneous

## Extension of Election of Alternative Deficit Reduction Contribution

## Notice 2006–105

This notice sets forth the procedures for electing an alternative deficit reduction contribution under § 412(l)(12) of the Internal Revenue Code (the Code) (which was added by section 102 of the Pension Funding Equity Act of 2004 (PFEA), Pub. L. No. 108–218), as modified by section 402(i) of the Pension Protection Act of 2006 (PPA), Pub. L. No. 109–280. Except as outlined below, all references to the Code and the Employee Retirement Income Security Act of 1974 (ERISA) are to the Code and ERISA as in effect on August 16, 2006.

**I. Background**

Section 412(l)(12) of the Code permits certain employers who are required to make additional contributions under § 412(l) to elect a reduced amount of those contributions ("alternative deficit reduction contributions") for plan years beginning after December 27, 2003, and before December 28, 2005. Section 412(l)(12) is generally limited to a plan maintained by either (1) a commercial passenger airline or (2) an employer primarily engaged in the production or manufacture of a steel mill product or the processing of iron ore pellets.[1] Section 302(d)(12) of ERISA permits an identical election and provides identical requirements with respect to the minimum funding standard of section 302.

Announcement 2004–38, 2004–1 C.B. 878, provides procedures for electing an alternative deficit reduction contribution including a model election form. Announcement 2004–43, 2004–1 C.B. 955, provides guidance on the types of notices that must be given by an employer to plan participants and their beneficiaries and to the Pension Benefit Guaranty Corporation (the PBGC) if that employer elects to make an alternative deficit reduction contribution described in Announcement 2004–38. In addition, Announcement 2004–43, as corrected by Announcement 2004–51, 2004–1 C.B. 1041, sets forth timing requirements for the election. Notice 2004–59, 2004–2 C.B. 447, provides guidance on the restrictions that are placed on plan amendments following an employer's election of an alternative deficit reduction contribution under § 412(l)(12) of the Code and section 302(d)(12) of ERISA.

Section 402(i) of PPA extended the alternative deficit reduction election for certain employers. The extension under the PPA is limited to an eligible employer that is a commercial passenger airline, can be made for any plan year beginning after December 27, 2003, and before December 28, 2007, and applies without regard to the two plan year limit contained in § 412(l)(12)(D)(ii) of the Code.

Other than as necessary to reflect the statutory narrowing of the class of eligible employers, the elimination of the two-year rule and the extension of time described in the preceding paragraph, all of the guidance described above with respect to the election under PFEA remains applicable to the election under section 402(i) of the PPA with the following exceptions. Notwithstanding the requirement under Announcement 2004–43 that any alternative deficit reduction contribution election be made by the end of the first quarter of the plan year, if, on or before December 21, 2006, an employer makes an alternative deficit reduction contribution election for the first plan year beginning on or after December 28, 2005, that election will be deemed timely. In addition, if an employer issues a PBGC notice for a plan for such a plan year on or before December 21, 2006, the PBGC will treat the PBGC notice as timely issued. The content of the PBGC notice should reflect a reasonable effort to make any appropriate modifications to the projections in order to take into account the enactment of the PPA.

Section III of this notice sets forth the information that must be contained in the election and the address to which the election must be sent. If an employer elects an alternative deficit reduction contribution for any plan year, the employer must provide written notice of the election to the plan's participants and beneficiaries and (except to the extent that an earlier notice is required by the preceding paragraph) to the PBGC within 30 days of filing the election.

**II. Effect on Other Documents**

Announcement 2004–38 is modified, Announcement 2004–43 is amplified and modified, and Notice 2004–59 is amplified.

[1] An eligible employer under PFEA (but not PPA) also included an organization described in § 501(c)(5) of the Code that established a plan on June 30, 1955, to which § 412 now applies.

### III. Election of Alternative Deficit Reduction Contribution for Commercial Passenger Airlines

A. As an officer of the employer maintaining the plan, I hereby elect an alternative deficit reduction contribution under § 412(l)(12) of the Code and section 302(d)(12) of ERISA and include the following information:

1. The name and EIN of the employer: ____________________
2. The name and plan number of the plan: ____________________
3. The plan year to which the election relates: ____________________
4. Specify the plan year beginning in 2000 for which the additional contributions under § 412(l) did not apply: ____________________
5. If any of the information in items 1 or 2 was different for the 2000 plan year than in the plan year for which the election is being made, enter the plan name, plan number, and name and EIN of the employer for the 2000 plan year:

   ____________________

   ____________________

6. Signature of employer ____________________ Date ____________

   The election must be signed by an officer of the employer maintaining the plan. An authorized representative of the employer, plan administrator, or enrolled actuary may not sign this election on behalf of the employer.

B. This election must be filed at the following address:

Internal Revenue Service<br>
Commissioner, Tax Exempt and Government Entities Division<br>
Attention: SE:T:EP:RA:T<br>
Alternative DRC Election<br>
P.O. Box 27063<br>
McPherson Station<br>
Washington, D.C. 20038

**Drafting Information**

The principal author of this notice is Michael Rubin of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans taxpayer assistance telephone service at (877) 829–5500 (a toll-free number) between the hours of 8:30 am and 4:30 pm Eastern Time, Monday through Friday. Mr. Rubin may be reached at (202) 283–9888 (not a toll-free number).

# Part IV. Items of General Interest

# Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

## Announcement 2006-94

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

# Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Tomasulo, Maria V. | Wantagh, NY | CPA | Indefinite from August 7, 2006 |
| Maloy, Jr., Robert J. | Galion, OH | CPA | Indefinite from August 15, 2006 |
| Pate, Janet M. | Broadview, NM | CPA | Indefinite from August 15, 2006 |
| Scott, Howard | Miami, FL | Attorney | Indefinite from August 15, 2006 |
| Adamic, Jonathan E. | San Lorenzo, CA | CPA | Indefinite from August 18, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Becker, Ira S. | Wilmette, IL | CPA | August 22, 2006<br>to<br>August 21, 2008 |
| Snigur, Virginia Iaquinta | Warwick, NY | Attorney | Indefinite<br>from<br>August 31, 2006 |
| Galpern, Joel G. | North Miami, FL | CPA | Indefinite<br>from<br>September 1, 2006 |
| DiSiena, Frank E. | Katonah, NY | CPA | Indefinite<br>from<br>September 4, 2006 |
| Carusona, Thomas M. | Huntington, NY | Attorney | Indefinite<br>from<br>September 15, 2006 |
| Shaikh, Firoz A. | Melville, NY | CPA | Indefinite<br>from<br>September 15, 2006 |
| Wickline, Ella L. | Ronceverte, WV | Enrolled Agent | Indefinite<br>from<br>September 15, 2006 |
| Smith, Daniel B. | Garden City, NY | CPA | Indefinite<br>from<br>September 18, 2006 |
| Carlin, Charles R. | South Bend, IN | CPA | Indefinite<br>from<br>October 1, 2006 |
| Devine, Daniel M. | Boca Raton, FL | CPA | Indefinite<br>from<br>October 1, 2006 |
| Dupont, Hewitt, J. | Daytona Beach, FL | CPA | Indefinite<br>from<br>October 1, 2006 |
| Farrell, Raymond J. | Matawan, NJ | Attorney | Indefinite<br>from<br>October 1, 2006 |
| Kelligrew, John R. | White Plains, NY | Attorney | Indefinite<br>from<br>October 1, 2006 |
| Klein, Robert B. | Bardonia, NY | Enrolled Agent | Indefinite<br>from<br>October 1, 2006 |
| Long, Gregory S. | Hutchinson, KS | Attorney | Indefinite<br>from<br>October 1, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Moore, Ronald L. | Cayce, SC | CPA | Indefinite from October 1, 2006 |
| Schaffer, Robert J. | Calverton, NY | CPA | Indefinite from October 1, 2006 |
| Berlin, Stanley | Erie, PA | Attorney | Indefinite from October 15, 2006 |
| Briscoe, Jack | Drexel Hill, PA | Attorney | Indefinite from October 15, 2006 |
| Buzzeo, Michael V. | New Canaan, CT | CPA | Indefinite from October 15, 2006 |
| Sacco, John M. | Pound Ridge, NY | CPA | Indefinite from October 15, 2006 |
| Sheiman, Alan P. | Sherman Oaks, CA | Enrolled Agent | Indefinite from October 15, 2006 |
| Tourin, Mark | Miami, FL | CPA | Indefinite from October 15, 2006 |
| Burns, William J. | Randolph, MA | Attorney | Indefinite from October 16, 2006 |
| Webb, Norman R. | Daphne, AL | CPA | Indefinite from October 16, 2006 |
| Brown, Guia EP | Hobe Sound, FL | Enrolled Agent | October 20, 2006 to April 19, 2008 |
| Gram, John A. | Gainesville, GA | Attorney | Indefinite from November 1, 2006 |
| Herzog, Samuel A. | Jericho, NY | CPA | Indefinite from November 1, 2006 |
| Kellicker, John F. | Cleveland, OH | CPA | Indefinite from November 1, 2006 |
| Krieger, Robert M. | Hampton, NH | CPA | Indefinite from November 1, 2006 |
| Minsky, Neil J. | Randolph, NJ | CPA | Indefinite from November 1, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| O'Brien, Timothy | Newton Center, MA | Attorney | Indefinite from November 1, 2006 |
| Sukenik, Martin | Kew Gardens, NY | Attorney | Indefinite from November 1, 2006 |
| Savoy, Cassandra | East Orange, NJ | Attorney | Indefinite from November 7, 2006 |
| Bonner, Charles B. | Athens, GA | CPA | Indefinite from November 15, 2006 |
| Levine, Barton P. | New York, NY | Attorney | Indefinite from November 15, 2006 |
| Taves, Joseph G. | Provincetown, MA | CPA | Indefinite from November 15, 2006 |
| Young, Ronald | Fairfield, CT | CPA | Indefinite from November 16, 2006 |
| Brush, Charles, H. | Southbury, CT | CPA | Indefinite from December 1, 2006 |
| Jacob, Robert T. | Tucson, AZ | CPA | Indefinite from December 15, 2006 |

# Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Williams, Donna M. | York, PA | CPA | Indefinite from July 25, 2006 |
| Foushee, Wayne H. | Winston-Salem, NC | Attorney | Indefinite from August 3, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Kronegold, Sheldon H. | Englewood, NJ | Attorney | Indefinite from August 3, 2006 |
| Norman, Clarence | Brooklyn, NY | Attorney | Indefinite from August 3, 2006 |
| Chin, Arnold | San Francisco, CA | Attorney | Indefinite from August 31, 2006 |
| McCann, Thomas | Des Moines, IA | Attorney | Indefinite from August 31, 2006 |
| Whaley, Daniel P. | Hood, CA | Attorney | Indefinite from August 31, 2006 |
| Chukumba, Stephen C. | Montclair, NJ | Attorney | Indefinite from September 12, 2006 |
| Katz, Edward C. | New York, NY | Attorney | Indefinite from September 12, 2006 |
| Kadunce, Darrell L. | Butler, PA | Attorney | Indefinite from September 18, 2006 |
| Allen, Robert W. | Torrance, CA | CPA | Indefinite from September 21, 2006 |
| Brown, Davin W. | Raleigh, NC | CPA | Indefinite from September 21, 2006 |
| Cunningham, R. Scott | Dalton, GA | Attorney | Indefinite from September 21, 2006 |
| Eilers, Tom D. | Raleigh, NC | CPA | Indefinite from September 21, 2006 |
| Gerdes, Roger A. | Carpinteria, CA | Attorney | Indefinite from September 21, 2006 |
| Kurth, Richard Frederick | Danville, IL | Attorney | Indefinite from September 21, 2006 |
| Mitchell, McArthur D. | Charlotte, NC | CPA | Indefinite from September 21, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Ragusa, Patricia A. | Spring, TX | CPA | Indefinite from September 21, 2006 |
| Wulfsberg, David E. | Murrieta, CA | Attorney | Indefinite from September 21, 2006 |
| Cox, Brian J. | Plymouth, MI | CPA | Indefinite from September 25, 2006 |
| Mandelman, Michael D. | Mequon, WI | Attorney | Indefinite from September 25, 2006 |
| Miller, Steven L. | Canal Winchester, OH | Attorney | Indefinite from September 25, 2006 |
| Felli, Jay A. | Mequon, WI | Attorney | Indefinite from October 2, 2006 |
| Schoch V, Arch K. | High Point, NC | Attorney | Indefinite from October 2, 2006 |
| Andre, Patrick F. | Manchester, MO | Attorney | Indefinite from October 12, 2006 |
| Brill, Kevin Michael | Downers Grove, IL | Attorney | Indefinite from October 12, 2006 |
| Day, Richard G. | Largo, FL | Attorney | Indefinite from October 12, 2006 |
| Dull, Kay E. | Miami Shores, FL | Attorney | Indefinite from October 12, 2006 |
| Frank, Arthur J. | Chicago, IL | Attorney | Indefinite from October 12, 2006 |
| Gackle, Thomas E. | Plymouth, MI | Attorney | Indefinite from October 12, 2006 |
| Hamilton, Howard D. | Fort Dodge, IA | Attorney | Indefinite from October 12, 2006 |
| Hodge, Robert M. | Lafayette, LA | Attorney | Indefinite from October 12, 2006 |
| Lesyshen, Donna P. | Waterloo, IA | Attorney | Indefinite from October 12, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Peiss, John H. | Downers Grove, IL | Attorney | Indefinite from October 12, 2006 |
| Petty, James E. | Austin, TX | CPA | Indefinite from October 12, 2006 |
| Ruffin-Hudson, Linda C. | Saint Louis, MO | Attorney | Indefinite from October 12, 2006 |
| Schaefer, James E. | St. Louis Park, MN | Attorney | Indefinite from October 12, 2006 |
| Schmitt, Martha G. | Minneapolis, MN | Attorney | Indefinite from October 12, 2006 |
| Shannon, Terrance J. | Mission Viejo, CA | Attorney | Indefinite from October 12, 2006 |
| Smith, Matthew S. | Denver, CO | Attorney | Indefinite from October 12, 2006 |
| Swanson, Richard | West Chicago, IL | CPA | Indefinite from October 12, 2006 |
| Thomas, Kenneth A. | Farmers Branch, TX | Attorney | Indefinite from October 12, 2006 |
| Tomasa, Ryan H. | Honolulu, HI | Attorney | Indefinite from October 12, 2006 |
| Williams, Jr., Harry D. | San Antonio, TX | Attorney | Indefinite from October 12, 2006 |
| Wilson, Jr., Robert N. | Ayer, MA | Attorney | Indefinite from October 12, 2006 |
| Yum, Chris Chulho | Woodbridge, VA | Attorney | Indefinite from October 12, 2006 |
| Dunham, Richard G. | Irvine, CA | Enrolled Agent | Indefinite from October 15, 2006 |
| Housman, David | Albuquerque, NM | Attorney | Indefinite from October 15, 2006 |
| Malitz, Charles P. | Beachwood, OH | CPA | Indefinite from October 15, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Emig, Robert W. | Houston, TX | CPA | Indefinite from October 24, 2006 |
| Freese, Scott D. | Norfolk, NE | Attorney | Indefinite from October 24, 2006 |
| Rambo, Byron L. | Sanford, FL | EA | Indefinite from October 24, 2006 |
| Ask, Ronald W. | Riverside, CA | Attorney | Indefinite from October 30, 2006 |
| Berry, Richard S. | Tempe, AZ | Attorney | Indefinite from October 30, 2006 |
| Burkhardt, William R. | Canyon Lake, TX | CPA | Indefinite from October 30, 2006 |
| Callaway, Jr., Paul F. | Greensboro, NC | CPA | Indefinite from October 30, 2006 |
| Doyle, David W. | Arvada, CO | Attorney | Indefinite from October 30, 2006 |
| Elmore, III, Virgil | Birmingham, AL | Attorney | Indefinite from October 30, 2006 |
| Grandt, Lawrence E. | Gurnee, IL | CPA | Indefinite from October 30, 2006 |
| Hanson, Steven G. | Lodi, CA | Attorney | Indefinite from October 30, 2006 |
| Omodele, Boluwaji | Houston, TX | CPA | Indefinite from October 30, 2006 |
| Rahden, Horst R. | Fort Wayne, IN | CPA | Indefinite from October 30, 2006 |
| Censoprano, Salvatore | Foster City, CA | CPA | Indefinite from October 31, 2006 |
| Powell, James S. | Lakewood, CO | Attorney | Indefinite from October 31, 2006 |
| Allen, Leonard G. | Mesa, AZ | CPA | Indefinite from November 1, 2006 |

| Name | Address | Designation | Date of Suspension |
|---|---|---|---|
| Parker, Donald A. | Benson, NC | Attorney | Indefinite from November 6, 2006 |
| Rogers, James M. | Tulsa, OK | Attorney | Indefinite from November 6, 2006 |
| Coopet, Michael W. | Saint Paul, MN | Attorney | Indefinite from November 8, 2006 |
| Day, Jr., John Taylor | Hingham, MA | Attorney | Indefinite from November 8, 2006 |
| Grella, Paul J. | Canton, MA | Attorney | Indefinite from November 8, 2006 |
| Meggers, Theodore M. | Des Moines, IA | Attorney | Indefinite from November 8, 2006 |
| Tolbert, James L. | Los Angeles, CA | Attorney | Indefinite from November 8, 2006 |

# Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been placed under suspension from practice before the Internal Revenue Service:

| Name | Address | Designation | Effective Date |
|---|---|---|---|
| Lazaro, Charles | Visalia, CA | Attorney | July 20, 2006 to January 19, 2010 |
| Wasilowski, Ronald | Natrona Heights, PA | CPA | July 21, 2006 to July 20, 2011 |
| Wellbery, William J. | Deerfield Beach, FL | CPA | October 12, 2006 to October 11, 2008 |
| Clapper, Gary L. | La Mesa, CA | Enrolled Agent | November 2, 2006 to November 1, 2008 |

# Consent Disbarments From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her consent to disbarment from such practice. The Director, Office of Professional Responsibility, in his discretion, may disbar an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent disbarment from practice before the Internal Revenue Service:

| Name | Address | Designation | Date of Disbarment |
|---|---|---|---|
| Grossman, Robert S. | Ardmore, PA | Attorney | Indefinite from October 4, 2006 |

# Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

| Name | Address | Designation | Effective Date |
|---|---|---|---|
| Hubbard, Murphy | Springfield, MO | CPA | September 20, 2006 |
| Kardos, Sandra E. | Van Nuys, CA | CPA | October 2, 2006 |
| Jewett, Jerry A. | Fremont, OH | Enrolled Agent | November 2, 2006 |

# Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

| Name | Address | Designation | Date of Censure |
|---|---|---|---|
| Applegate, William F. | Madison, NJ | CPA | September 12, 2006 |
| Vigliotti, Anthony J. | East Haven, CT | Enrolled Agent | September 12, 2006 |
| Bolgiani, Janette A. | Brooklyn, NY | Enrolled Agent | September 14, 2006 |
| Cheney, James E. | Phelps, NY | CPA | September 18, 2006 |
| Dollinger, Douglas | Middletown, NY | Attorney | October 2, 2006 |
| Reeves, Zak E. | Denver, CO | Enrolled Agent | October 2, 2006 |

| Name | Address | Designation | Date of Censure |
|---|---|---|---|
| Castiglione, John | Pittsfield, MA | Attorney | October 4, 2006 |
| Shannon, James P. | Rochester, NH | Attorney | October 4, 2006 |
| Kuller, Mark A. | Bethesda, MD | Attorney | October 6, 2006 |

# Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Internal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

| Name | Address | Date of Resignation |
|---|---|---|
| Schwartz, Judy | Las Vegas, NV | October 13, 2006 |

## Settlement Initiative for Employees of Foreign Embassies, Foreign Consular Offices and International Organizations in the United States

## Announcement 2006–95

Section 1. Overview and Purpose of the Settlement Initiative

This announcement provides a two-part settlement initiative offered by the Internal Revenue Service (IRS) under which current and former employees of foreign embassies, foreign consular offices or international organizations (as defined in I.R.C. § 7701(a)(18)) in the United States (U.S.) can: (1) resolve income tax matters related to their employment at a foreign embassy, foreign consular office or international organization; and (2) unwind their participation in Simplified Employee Pension/Individual Retirement Account (SEP/IRA) plans, which they erroneously established. Section 2 describes eligibility requirements to participate in this settlement initiative. Section 3 describes the settlement terms. Section 4 sets out the settlement procedures and Section 5 states how ineligible and non-participating taxpayers will be treated. Taxpayers have until February 20, 2007, to notify the Service of their intent to participate in this settlement initiative.

The IRS has determined that a significant number of U.S. citizens and lawful permanent residents ("LPRs" also referred to as "green cardholders") employed at foreign embassies, foreign consular offices and international organizations in the U.S. have failed to fulfill their U.S. income tax responsibilities. Some have failed to timely file U.S. tax returns. Others have failed to accurately report the tax due by underreporting income, claiming deductions for unallowable expenses, and/or failing to pay self-employment taxes. See Section 3(a) of this announcement for the settlement terms of the income tax part of the settlement initiative.

U.S. citizens and LPRs who perform services in the United States as common law employees of foreign governments are not considered to be self-employed for purposes of I.R.C. §§ 401 and 408. These individuals are common law employees and, thus, may not contribute to SEP/IRA plans based on their employment with foreign embassies, foreign consular offices and international organizations. Many U.S. citizens and LPRs employed by foreign embassies, foreign consular offices and international organizations have erroneously established SEP/IRA plans, claimed deductions for contributions to the plans and used the plans as part of their retirement planning. See Section 3(b) of this announcement for the terms of the settlement of the SEP/IRA part of the settlement initiative.

Section 2. Eligibility Requirements

(1) This settlement initiative is limited to employees and former employees of foreign embassies, foreign consular offices or international organizations who are either currently employed or were employed as such in the United States. The initiative is limited to taxation issues relating to their employment at a foreign embassy, foreign consular office or international organization for taxable years 2003, 2004, and 2005.

(2) To be eligible to participate, taxpayers who contributed to SEP/IRA plans based on their employment with foreign embassies, foreign consular offices and international organizations, must comply, where applicable, with all requirements of both parts of the settlement initiative (Sections 3(a) and 3(b)).

(3) To be eligible to participate, taxpayers who are LPRs must represent that they have signed and filed a U.S. Citizenship and Immigration Services (USCIS) Form I–508 (*Waiver of Rights, Privileges, Exemptions and Immunities under Section 274(b) of the Immigration and Nationality Act*).

(4) Persons under criminal investigation. A person under tax-related criminal investigation by the IRS or the Department of Justice, or a person that has been notified, before the date on which a Notice of Election is filed pursuant to Section 4 of this announcement, that the IRS or the Department of Justice intends to commence a tax-related criminal investigation of that person is ineligible to participate in this settlement initiative.

(5) Taxpayers agree to cooperate and provide information to the IRS as required in this settlement initiative.

Section 3. Settlement Terms

(a) *Income Tax Part*

(1) Taxpayers will submit correct original returns or amend their previously filed tax returns for 2003, 2004, and 2005 to correctly report their tax liability.

(2) Taxpayers will pay all taxes and applicable statutory interest with respect to their correct tax liabilities for taxable years 2003, 2004, and 2005. Taxpayers will pay penalties and/or additions to tax as described in subsection (7) below. Taxpayers will not claim refunds of any amounts paid under this initiative. Taxpayers will not file claims for interest abatement with respect to taxable years 2003, 2004, and 2005.

(3) Taxpayers will provide an official statement from their employer to verify the correct amount of gross income received for taxable years 2003, 2004, and 2005. Gross income includes, but is not limited to, wages, taxable benefits, contributions to qualified retirement plans made on an after tax basis, pension distributions, and taxes paid by employers.

(4) Taxpayers will provide verification of payment and entitlement for all deductions and foreign tax credits claimed on their original and amended tax returns for taxable years 2003, 2004, and 2005, which are related to their employment at a foreign embassy, foreign consular office or international organization.

(5) Taxpayers must agree to report all income they receive after 2005 related to their employment at a foreign embassy, foreign consular office or international organization. No penalties and/or additions to tax will be waived with respect to any taxable years after 2005 as part of this initiative.

(6) Taxpayers will agree not to claim tax benefits in taxable years after 2005 that are inconsistent with positions taken with respect to prior taxable years. For example, a taxpayer failing to report after tax contributions to a qualified retirement plan as described in I.R.C. § 401(a) for any year cannot treat those contributions as constituting basis in those payments in a subsequent year.

(7) The IRS will assess an applicable accuracy penalty on underpayments under I.R.C. § 6662 and/or applicable additions to tax under I.R.C. § 6651 for failure to file and/or failure to pay *for only one* of the taxable years 2003, 2004, or 2005, the year to be determined by the IRS based on the year with the highest tax deficiency. No other penalties will be assessed for adjustments relating to foreign embassy, foreign consular office or international organization income for the taxable years 2003, 2004, and 2005.

(8) The IRS will assess the taxes, penalties, additions to tax, and statutory interest determined under this initiative for taxable years 2003, 2004, and 2005.

(b) *SEP/IRA Part*

(1) Taxpayers agree to the disallowance of deductions claimed on their 2003, 2004, and 2005 income tax returns for contributions to erroneously established SEP/IRA accounts relating to their employment at a foreign embassy, foreign consular office or international organization and will not claim deductions for such contributions after 2005.

(2) Taxpayers will pay all taxes and applicable statutory interest resulting from the disallowance of erroneous SEP/IRA contribution deductions for taxable years 2003, 2004, and 2005. Taxpayers will not claim refunds of any amounts paid under this initiative. Taxpayers will not file claims for interest abatement with respect to taxable years 2003, 2004, and 2005.

(3) The IRS will allow taxpayers to move funds from their erroneously established SEP/IRA accounts to other tax-favored retirement plans (*i.e.*, I.R.C. § 401(a) plans and IRAs) that would have been available to them for the years in which improper SEP/IRA contributions were made. The amount that may be moved will be limited to the amount of the contributions that could have been made to an allowable tax-favored retirement plan plus the earnings, as determined by the IRS, on the allowable contributions. To the extent the taxpayer would have been able to make pre-tax contributions to an I.R.C. § 401(k) plan or an I.R.C. § 408(a) IRA for the years in which the improper SEP/IRA contributions were made, the amount that is moved, plus the deemed earnings thereon, will not be treated as a taxable distribution from the SEP/IRA. To the extent the amount moved is not described in the preceding sentence, the amount moved will be treated as a taxable distribution from the SEP/IRA in the year the amount is moved and will be treated as investment in the contract for purposes of I.R.C. § 72.

(4) Taxpayers will arrange for distribution of all amounts in their erroneously established SEP/IRA accounts in excess of those allowed to be moved as provided in the preceding paragraph. In accordance with I.R.C. § 408(d)(1), taxpayers will report the amount of the distribution as ordinary income in the year the distribution is received, irrespective of the years in which the amounts were contributed.

(5) The taxpayers will advise the financial institution where the SEP/IRA account is established to withhold 20% of the taxable distribution from the erroneously established SEP/IRA account.

(6) The IRS will not assess the annual 6% excise tax under I.R.C. § 4973(a) on the excess contributions in the erroneously established SEP/IRA account.

(7) The IRS will not assess the 10% excise tax under I.R.C. § 72(t)(l) on the early distribution from the erroneously established SEP/IRA account.

(8) The IRS will not assess the accuracy penalty under I.R.C. § 6662 on underpayments relating to deductions to the erroneously established SEP/IRA account. Notwithstanding, the IRS will assess penalties and/or additions to tax related to income tax as provided in Section 3(a)(7) above.

(9) No penalties and/or additions to tax will be waived with respect to taxable years after 2005 as part of this initiative.

(10) The IRS will assess the taxes, penalties, additions to tax, and statutory interest determined under this initiative for taxable years 2003, 2004, and 2005.

Section 4. Required Procedures for Electing Participants

(a) *Notice of Election*

Taxpayers electing to participate in this initiative must notify the IRS of their election by sending a Notice of Election, as set out below, on or before Tuesday, **February 20, 2007**. The Notice of Election must be sent by certified mail or designated delivery service (within the meaning of I.R.C. § 7502(f)) to:

Internal Revenue Service
1111 Constitution Ave., NW
LE 4423
Washington, DC 20024
Attn: SE:LM:IN:C:FR:ELECTION

The Notice of Election must be signed and must:

(1) State that the taxpayer elects to participate in the Foreign Embassy/Foreign Consular Office/International Organization Employee Settlement Initiative;

(2) Include the taxpayer's name, taxpayer's legal status (U.S. citizen or LPR), taxpayer identification number (TIN), current address, and daytime telephone number. If the taxpayer is under examination, in Appeals, or has filed a petition in Tax Court, the taxpayer must include the name, address, and daytime telephone number of the IRS examiner, IRS Appeals Officer or IRS Attorney. If a tax practitioner represents the taxpayer, the practitioner must provide a completed Form 2848 or other valid power of attorney specifying each taxable year and type of tax covered;

(3) Include copies of all tax returns previously filed with the IRS (with the notation "Copy" written across the top of each return) for the taxable years 2003, 2004, and 2005;

(4) Include an official statement from the foreign embassy, foreign consular office or international organization showing total gross income paid in taxable years 2003, 2004, and 2005; and

(5) Include original delinquent or amended tax returns for taxable years 2003, 2004, and 2005 reporting the correct income and claiming only the proper amount of deductions and foreign tax credits, which are related to their employment at a foreign embassy, foreign consular office or international organization.

A taxpayer who is under examination, in Appeals, or has filed a petition in Tax Court must send a copy of the Notice of Election to the IRS examiner, IRS Appeals Officer, or IRS Attorney assigned to the matter.

(b) *Additional Information and Documentation*

Upon receipt of an election to participate, the IRS may send a request for additional information and documentation. Taxpayer must submit all requested information under penalties of perjury to the IRS within 30 days of the date of mailing of the request by the IRS. The IRS may grant an extension for good cause to a taxpayer who requests additional time within the 30-day period. The IRS will treat a taxpayer who fails to provide the requested information within the applicable time as having withdrawn from the initiative.

(c) *Closing Agreement and Payment*

After receiving the requested information, the IRS will prepare a closing agreement under I.R.C. § 7121 reflecting the terms of the settlement. The closing agreement will provide that: (1) all information provided by the taxpayer as required by the settlement is considered material and providing inaccurate information is a misrepresentation of a material fact within the meaning of I.R.C. § 7121(b); and (2) taxpayer waives all defenses to the assessment and collection of the tax, penalties, additions to tax, and statutory interest determined under this initiative.

The IRS will mail the closing agreement to taxpayer who must sign and return it to the IRS within **30** days of the date of mailing by the IRS. The IRS may grant an extension for good cause to a taxpayer who requests additional time within the **30**-day period.

A taxpayer participating in this initiative must fully pay all taxes, additions to tax, penalties, and statutory interest due when the signed closing agreement is returned to the IRS. Any taxpayer unable to make full payment at that time must submit complete financial statements and agree to financial arrangements acceptable to the IRS before the IRS will execute the closing agreement. The IRS will not execute a closing agreement under this initiative with a taxpayer who is unable to reach acceptable financial arrangements.

Section 5. Ineligible and Non-participating Taxpayers

For taxpayers ineligible or not participating in this initiative, the IRS may: (a) conduct examinations; (b) determine the correct taxes, penalties, additions to tax; and, (c) issue a Notice of Deficiency.

Section 6. Paperwork Reduction Act

The collection of information contained in this announcement has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507(c)) under control number 1545–2045.

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 number.

The collection of information in this announcement is in Section 4 of this announcement, Required Procedures for Electing Participants. The information is required to apply the terms of the settlement and determine the amount of taxes, applicable statutory interest and penalties. Collecting information is required to obtain the benefit described in this announcement. The likely respondents are individuals.

The estimated total annual reporting burden is 11,000 hours. The estimated annual burden per respondent varies from 1 to 3 hours, depending on individual circumstances, with an estimated average of 2 hours. The estimated number of respondents is 5,500. The estimated frequency of responses is one time per respondent.

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

Section 7. Contact Information

Various personnel from the Office of Associate Chief Counsel (International) and Office of Division Counsel (Small Business/Self-Employed) participated in

drafting this announcement. For further information regarding this announcement, contact Brant Meadows with the Office of Deputy Commissioner, International, at (202) 874–1789 (not a toll-free call) or send an e-mail to *embassy@irs.gov*.

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## Correction to High-Low Substantiation Method for Per Diem Allowances in Rev. Proc. 2006–41

### Announcement 2006–96

This announcement makes a correction to Rev. Proc. 2006–41, 2006–43 I.R.B. 777 (October 23, 2006), released September 29, 2006, which provides rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses incurred while traveling away from home are deemed substantiated under § 1.274–5 of the Income Tax Regulations.

Section 5 of Rev. Proc. 2006–41 provides rules for the high-low substantiation method, which may be used in lieu of the *per diem* substantiation method of section 4.01 of Rev. Proc. 2006–41 when a payor (the employer, its agent, or a third party) provides a *per diem* allowance for lodging, meals, and incidental expenses under a reimbursement or other expense allowance arrangement. Section 5.03 of Rev. Proc. 2006–41 identifies localities that are high-cost localities (for all of the calendar year or for a portion of the calendar year) for purposes of the high-low substantiation method. Section 5.03 contains an error in identifying the period for which Martha's Vineyard, Massachusetts, is a high-cost locality. The correct period is June 1, 2007, through August 31, 2007.

DRAFTING INFORMATION

The principal author of this announcement is Jeffrey T. Rodrick of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this announcement, contact Mr. Rodrick at (202) 622–4930 (not a toll-free call).

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## Correction of Announcement 2006–61 Fast Track Settlement For SB/SE Taxpayers

### Announcement 2006–97

CORRECTION OF CONTACT INFORMATION

This announcement provides the correct contact information for further information regarding Announcement 2006–61, 2006–36 I.R.B. 390, Fast Track Settlement for SB/SE Taxpayers. In that announcement, interested persons were instructed to contact either Thomas S. Ryan, SB/SE Program Analyst or Nancy J. Talajkowski, Appeals Program Analyst, Tax Policy & Procedure (Alternative Dispute Resolution). The telephone number published for Thomas S. Ryan was incorrect. The correct telephone number is (757) 213–3810 (not a toll-free number). The remainder of the contact information is correct as originally published.

# Definition of Terms

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

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

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

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

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

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

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

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

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

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

# Abbreviations

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

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

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